Information Statement

Federal National Mortgage Association

This Information Statement describes the business and operations of the Federal National Mortgage Association ("Fannie Mae" or the "Corporation") as of the date hereof and its financial condition as of December 31, 1994. In conjunction with its securities offerings, the Corporation may incorporate this Information Statement by reference in one or more other documents describing the securities offered thereby, the selling arrangements therefor, and other relevant information. Such other documents may be called an Offering Circular, Prospectus, Guide to Debt Securities or otherwise. This Information Statement does not itself constitute an offer of such securities. Any incorporation of this Information Statement by reference shall be deemed to include all supplements hereto. Copies of the Corporation's current Information Statement, any supplements thereto, and other available information can be obtained as provided under "Documents Incorporated by Reference" and "Available Information."

This Information Statement contains audited financial statements with respect to the Corporation for the year ended December 31, 1994. Fannie Mae updates its Information Statement quarterly.

Fannie Mae is a federally chartered corporation. Its principal office is located at 3900 Wisconsin Avenue, NW, Washington, DC 20016 (202/752-7000). Its Internal Revenue Service employer identification number is 52-0883107.

The Corporation's securities are not required to be registered under the Securities Act of 1933. At the close of business on February 28, 1995, 272,655,000 shares of the Corporation's common stock (without par value) were outstanding.

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

March 31, 1995

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DOCUMENTS INCORPORATED BY REFERENCE

The Corporation's Proxy Statement for the 1994 Annual Meeting of Shareholders is incorporated by reference herein under "Management—Additional Information." Any later proxy statement published by the Corporation prior to the Corporation's publication of a new Information Statement is incorporated herein by this reference. This Information Statement will be supplemented to reflect quarterly financial results of the Corporation and as the Corporation otherwise determines. This Information Statement, together with any documents incorporated herein by reference and any applicable amendments or supplements hereto, are referred to herein collectively as the "Information Statement."

AVAILABLE INFORMATION

The Corporation periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about the Corporation. Copies of this Information Statement, any supplements relating hereto, as well as the Corporation's annual and quarterly reports to shareholders, the Federal National Mortgage Association Charter Act, the Corporation's bylaws, and other information regarding the Corporation can be obtained without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone (202) 752-7115). Reports and other information concerning the Corporation also may be inspected at the offices of the New York Stock Exchange, the Chicago Stock Exchange, and the Pacific Stock Exchange. The Corporation is not subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

BUSINESS

General

The Federal National Mortgage Association (the "Corporation" or "Fannie Mae") is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 *et seq*. (the "Charter Act"). See "Government Regulation and Charter Act." It is the largest investor in home mortgage loans in the United States. The Corporation was originally established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market and was transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

The Corporation provides funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. The Corporation acquires funds to purchase loans from many capital market investors that ordinarily may not invest in mortgage loans, thereby expanding the total amount of funds available for housing. Operating nationwide, the Corporation helps to redistribute mortgage funds from capital-surplus to capital-short areas.

The Corporation also issues mortgage-backed securities ("MBS"), primarily in exchange for pools of mortgage loans from lenders, which enables the Corporation to further its statutory purpose of increasing the liquidity of residential mortgage loans. The Corporation receives guaranty fees for its guarantee of timely payment of principal and interest on MBS.

In this document, both whole loans and participation interests in loans are referred to as "loans," "mortgage loans," and "mortgages." (The Corporation purchases participation interests that range from 50 to 99 percent.) The term "mortgage" also is used to refer to the security instrument securing a loan rather than the loan itself, and when so used also refers to a deed of trust. Mortgage loans secured by four or fewer dwelling units are referred to as "single-family" mortgage loans, and mortgage loans secured by more than four dwelling units are referred to as "multifamily" mortgage loans.

Mortgage Loan Portfolio

Mortgage Loans Purchased

The Corporation purchases primarily single-family, conventional, fixed- or adjustable-rate, first mortgage loans, but it also purchases other types of residential mortgage loans for its loan portfolio, including mortgage loans insured by the Federal Housing Administration ("FHA"), mortgage loans guaranteed by the Department of Veterans Affairs ("VA"), mortgage loans guaranteed by the Farmers Home Administration, multifamily mortgage loans and second mortgage loans (*i.e.,* loans secured by second liens). The Corporation's purchases have a variety of maturities. The Corporation's purchases of adjustable-rate mortgage loans ("ARMs"), fixed-rate loans with intermediate terms of 20 years or less, and second mortgage loans are designed to assist in mitigating the risks associated with rising interest rates, to match more closely the generally shorter maturities of its borrowings, and to provide a secondary market for a variety of loans that may be attractive to potential homeowners.

The composition of the Corporation's loan portfolio during the last five years is shown in the table in "Portfolio Composition." The composition of its purchases during the last three years is shown in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Mortgage Portfolio." Of the total single-family and multifamily mortgage loans that the Corporation purchased in 1994, including through purchases of mortgage-backed securities, approximately 40 percent were from investment banking companies, 34 percent were from mortgage banking companies, 7 percent were from savings and loan associations, 10 percent were from commercial and mutual savings banks, and 9 percent were from other institutions. All of the Corporation's mortgage loan purchases from investment banking companies were through purchases of mortgage-backed securities.

Principal Balance Limits. Maximum principal balance limits apply to the Corporation's mortgage loan purchases. The Corporation may not purchase conventional mortgage loans on one-family dwellings if the loan's original principal balance exceeded $203,150, except for loans secured by properties in Alaska, Hawaii and the Virgin Islands. Higher principal balance limits apply to loans secured by properties in those areas or secured by two- to four-family dwelling units. The maximum principal balance limits applicable to such conventional mortgage loans secured by one- to four-family dwellings can be adjusted by the Corporation annually based on the national average price of a one-family dwelling as surveyed by the Federal Housing Finance Board.

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

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

Fixed-Rate/Adjustable-Rate. Substantially all fixed-rate mortgage loans purchased by the Corporation provide for level monthly installments of principal and interest. Some of these loans (two percent of the single-family portfolio at December 31, 1994) have balloon payments due after 5, 7 or 10 years, but with monthly payments based on longer (in many cases 30-year) amortization schedules. Many of the 7-year balloon single-family mortgage loans permit the borrower to refinance the balloon payment at maturity with a 23-year fixed-rate mortgage loan if certain requirements are satisfied. Many of the multifamily mortgage loans have balloon payments due after 5, 7, 10, or 15 years, but with payments based on 25- or 30-year amortization schedules.

The interest rates on ARMs are determined by formulas providing for automatic adjustment, up or down, at specified intervals in accordance with changes in a specified index. Substantially all ARMs provide for adjustments (up or down) in the amount of monthly installments after the interest rate on the loan is adjusted because of changes in the applicable index. The Corporation currently purchases ARMs only if the ARMs have a cap on the amount the interest rate may change over the life of the loan. A substantial number of the ARMs purchased by the Corporation provide the mortgagor with the option, at specified times or during specified periods of time, to convert the ARM to a fixed-rate mortgage loan with payment of a small fee.

The Corporation also purchases single-family conventional mortgage loans that have one interest rate for the first 5 or 7 years and then adjust automatically to another interest rate for the next 25 or 23 years, respectively. Such loans, in the aggregate, represented approximately one percent of its portfolio loan purchases in 1994.

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

Repayments

The majority of the single-family mortgage loans in the Corporation's portfolio are prepayable by the borrower (in some cases with a small penalty). Therefore, the Corporation bears the risk that prepayments may increase when interest rates decline significantly or as a result of other factors. The Corporation manages this risk as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Interest-Rate-Risk Management." Most multifamily loans in the Corporation's portfolio provide for a prepayment penalty that is calculated

under a formula that is intended to protect the Corporation from loss of yield on its investment in the mortgage loan being prepaid.

Portfolio Composition

The following table shows the composition of the Corporation's mortgage loan portfolio and the weighted-average yield (net of servicing) on the mortgage loan portfolio. The table includes mortgage loans that back MBS held in the Corporation's mortgage loan portfolio.

Mortgage Loan Portfolio Composition
(Dollars in millions)

	December 31,				
	1994	1993	1992	1991	1990
Unpaid Principal Balances ("UPB")					
Single-family:					
Government insured or guaranteed	$ 11,659	$ 8,525	$ 9,025	$ 9,900	$ 11,204
Conventional:					
Long-term, fixed-rate	109,079	82,170	66,949	57,643	50,846
Intermediate-term, fixed-rate	68,166	64,623	43,943	26,534	21,409
Adjustable-rate	16,718	19,439	23,278	20,941	20,737
Second	536	772	1,356	2,069	1,885
Multifamily	15,899	15,332	13,568	11,896	10,547
Total UPB	$222,057	$190,861	$158,119	$128,983	$116,628
Average yield	7.80%	7.79%	8.68%	9.54%	9.94%

Underwriting Guidelines

The Corporation has established certain underwriting guidelines for purchases of conventional mortgage loans in an effort to reduce the risk of loss from mortgagor defaults. These guidelines are designed to assess the creditworthiness of the mortgagor as well as the value of the mortgaged property relative to the amount of the mortgage loan. The Corporation, in its discretion, accepts deviations from the guidelines, and also changes its guidelines from time to time. As part of an affordable housing initiative announced by the Corporation in March 1994, the Corporation indicated that it will commit $5 billion by the end of the decade to probe and test new underwriting criteria that could make the mortgage finance system more accessible to minorities, low- and moderate-income families, central city and rural residents, and people with special housing needs. During 1994, the Corporation announced its first national pilot, consisting of a new 3 percent down payment mortgage loan. In addition, the Corporation commenced a number of community-based experiments involving alternative methods of assessing the creditworthiness of potential borrowers and the acceptability of different property types, among other factors. The Corporation intends to revalidate systematically the components of its underwriting guidelines. See "Mortgage Loan Portfolio—Affordable Housing Initiatives and Goals."

The Corporation generally relies on lender representations to ensure that the mortgage loans it purchases conform to its underwriting guidelines. However, the Corporation also performs post-purchase reviews of selected loans to monitor compliance with the guidelines. In the event that a lender is found to have breached its representations with respect to a loan's compliance with the guidelines, the Corporation can demand that the lender repurchase the loan.

The Corporation generally has required that the unpaid principal balance ("UPB") of each conventional single-family first mortgage loan it purchases not be greater than 80 percent of the value of the mortgaged property unless the excess over 75 percent is insured by a mortgage insurance company acceptable to the Corporation. The resulting rule for calculating required insurance coverage levels (expressed as a percentage of UPB) has been replaced by a system that classifies loans into groups by their loan-to-value ("LTV") ratio and specifies a coverage percentage for each such group. The change increased the coverage percentages for all loans except for fully amortizing fixed-rate loans with terms of 20 years or less and with LTV ratios of 90 percent or less, for which coverage

percentages decreased. Under a phase-in plan that affects most loans originated after February 1995: (i) fully amortizing fixed-rate loans with terms of 20 years or less must have 25 percent coverage if the LTV ratio is above 90 percent, 12 percent coverage if the LTV ratio is above 85 percent but not above 90 percent, and six percent coverage if the LTV ratio is above 80 percent but not above 85 percent; and (ii) all other loans must have 30 percent coverage if the LTV ratio is above 90 percent, 25 percent coverage if the LTV ratio is above 85 percent but not above 90 percent, and 12 percent coverage if the LTV ratio is above 80 percent but not above 85 percent. Earlier, under a phase-in plan that affected most loans originated after June 1994, the coverage percentage was increased to 25 percent for fixed-rate loans with LTV ratios above 90 percent. There has been no change to the Corporation's rule that if mortgage insurance is required initially, it must be maintained for so long as the UPB is greater than 80 percent of the original value (or of the appraised value as determined by a subsequent appraisal). The Corporation does not require mortgage insurance on such loans with LTV ratios greater than 80 percent if the mortgage loan seller provides other acceptable credit enhancement. The Corporation bears the risk that in some cases parties assuming credit enhancement obligations may be unable to satisfy their obligations fully. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management."

Commitments

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

The Corporation purchases most of its mortgage loans pursuant to mandatory delivery commitments. Under such commitments, lenders are obligated to sell loans to the Corporation at the commitment yield. Mandatory delivery commitments are available for standard product and negotiated transactions. If a lender is not able to deliver the mortgage loans required under a mandatory delivery commitment during its term, the lender may buy back the commitment at any time during the commitment term for a fee.

The Corporation issues master commitments to lenders to facilitate the delivery of mortgages into MBS pools or portfolio. In order to deliver under a master commitment, a lender must either deliver mortgages in exchange for MBS or enter into a mandatory delivery portfolio commitment with the yield established upon execution of the portfolio commitment.

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

Affordable Housing Initiatives and Goals

In March 1994, the Chairman of the Corporation announced that for the seven years from 1994 through the year 2000 the Corporation will commit $1 trillion to help finance over 10 million homes for families and communities most in need. This targeted housing finance will serve families with incomes below the median for their area, minorities, new immigrants, families who live in central cities and distressed communities, and people with special housing needs. Fannie Mae's commitment, called Showing America a New Way Home®, consists of the following initiatives: (i) a national consumer outreach campaign designed to provide renters with the information they need to buy a home; (ii) the Corporation's commitment to seek to make the elimination of discrimination the number one priority of every participant in the mortgage finance system; (iii) a campaign to provide immigrants with

home-buying information, often in their native language; (iv) an effort to eliminate any final "no" in the mortgage application process by encouraging second and third reviews of rejected applications, coupled with high quality home buyer counseling offered by local counseling agencies and the Corporation so prospective buyers whose applications are not approved are put on a path that can lead to approval; (v) efforts to ensure that the Corporation's underwriting guidelines for lenders are clear, flexible, and applied equally to all applicants; (vi) the opening of 25 "Fannie Mae Partnership Offices" around the country that will work with cities, rural areas, and other underserved communities; (vii) $5 billion in new underwriting experiments to probe and test new underwriting criteria; (viii) an initiative to develop at least ten new financing tools to serve the full range of housing needs; (ix) a $50 billion commitment to multifamily housing finance; (x) an initiative to develop and make available new technologies that will reduce the cost, complexity, paperwork, and time involved in obtaining mortgage credit; and (xi) a major increase in the size of the Fannie Mae Foundation, which will make more than $30 million in grants over the three-year period ending December 31, 1996 to support housing and community development.

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the Corporation has certain goals to promote affordable housing for low- and very low-income families and to serve the housing needs of those in underserved areas such as central cities. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Housing Goals."

Servicing

The Corporation does not service mortgage loans held in the portfolio, except for government-insured multifamily loans. The Corporation also generally manages and markets properties acquired through foreclosure. Fannie Mae mortgage loans can be serviced only by a servicer approved by the Corporation. Lenders who sell single-family mortgage loans and conventional multifamily loans to the Corporation often retain the responsibility for servicing the mortgage loans sold, subject to the Corporation's guidelines. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, collection of insurance claims, and, if necessary, processing of foreclosures. The Corporation compensates servicers by permitting them to retain a specified portion of each interest payment on a serviced mortgage loan. The Corporation reserves the right to remove servicing responsibility from a lender.

Mortgage-Backed Securities

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

MBS are backed by loans from one of three sources: a single lender, multiple lenders, or the Corporation's portfolio. Single-lender MBS generally are issued through lender swap transactions in which a lender exchanges pools of mortgage loans for MBS. Multiple-lender MBS allow several lenders to pool mortgage loans together and, in return, receive MBS (called Fannie Majors®) representing a proportionate share of a larger pool. MBS may back other securities, including Fannie Megas® ("Megas"), Stripped MBS ("SMBS"), and real estate mortgage investment conduit securities ("REMICs").

MBS are not assets of the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities. The Corporation, however, is liable under its guaranty to make timely payments to investors of principal and interest on the mortgage loans in the pools, even if the Corporation has not received payments of principal or interest on the mortgage loans in the underlying pools. MBS enable the Corporation to further its statutory purpose of increasing the liquidity of residential mortgage loans and create a source of guaranty fee income to the Corporation without assuming any debt refinancing risk on the underlying pooled mortgages. Because of the Corporation's guarantees, it assumes the ultimate credit risk of borrowers' defaults on all mortgage

loans underlying MBS, as it does for portfolio mortgage loans. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management."

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

The Corporation issues and guarantees several forms of MBS, including Fannie Majors, that involve only a single class of certificates with each investor receiving a portion of the payments of principal and interest on the underlying mortgage loans equal to its undivided interest in the pool. With a standard MBS, an investor has an undivided interest in a pool of underlying mortgage loans that generally are provided either by one lender or by the Corporation out of the Corporation's mortgage loan portfolio. Megas represent undivided interests in a pool of MBS or pass-through certificates guaranteed by the Government National Mortgage Association ("Ginnie Mae certificates") of the same type.

The Corporation also issues and guarantees MBS that involve more than one class of certificates and, therefore, require special allocations of cash flows. SMBS are issued in series, with one or more classes that are each entitled to different cash flows and may represent (a) an undivided interest solely in the principal payments, (b) an undivided interest solely in the interest payments, or (c) different percentage interests in principal and interest payments, to be made on a pool of mortgage loans, MBS, REMICs, other SMBS, and/or Ginnie Mae certificates. REMICs represent beneficial interests in a trust having multiple classes of certificates entitled to different cash flows from the underlying mortgage loans, MBS, SMBS, Ginnie Mae certificates and/or certificates from other REMICs. Pursuant to its guarantee of REMICs and SMBS, the Corporation is obligated to make timely distribution of required installments of principal and/or interest and, in the case of REMICs, to distribute the principal balance in full by a specified date, whether or not sufficient funds are available in the related REMIC trust.

The Corporation receives guaranty fees for its standard MBS and Fannie Majors. Such fees are paid monthly until the underlying mortgage loans have been repaid or otherwise liquidated from the pool (generally as a result of delinquency). The aggregate amount of guaranty fees received by the Corporation depends upon the amount of MBS outstanding and on the guaranty fee rate. The amount of MBS outstanding is influenced by the repayment rates on the underlying mortgage loans and by the rate at which the Corporation issues new MBS. In general, when the level of interest rates declines significantly below the interest rates on loans underlying MBS, the rate of prepayments is likely to increase; conversely, when interest rates rise, as they did during 1994, above the interest rates on loans underlying MBS, the rate of prepayments is likely to slow. In addition to interest rate changes, the rate of principal payments is influenced by a variety of economic, demographic and other factors. The Corporation also generally receives one-time fees for swapping SMBS, REMICs and Megas for MBS, mortgage loans, Ginnie Mae certificates, SMBS, or REMIC certificates.

In most instances, the lender or lenders that originated the loans in an MBS pool created from the Corporation's portfolio or the lender or lenders that exchanged the loans for the MBS (in the case of a "swap" transaction) initially service the loans. The Corporation, however, reserves the right to remove the servicing responsibility from a lender at any time if it considers such removal to be in the best interest of MBS certificate holders. In such event, the Corporation finds a replacement lender that will service the loans. The Corporation ultimately is responsible for the administration and servicing of mortgage loans underlying MBS, including the supervision of the servicing activities of

lenders, the collection and receipt of payments from lenders, and the remittance of distributions and certain reports to holders of MBS certificates.

Delinquencies and REO

When a mortgage loan for which Fannie Mae bears the default risk is liquidated by foreclosure, the Corporation generally acquires the underlying property (such real estate owned is called "REO") and holds it for sale. The level of delinquencies and number of REO are affected by economic conditions, loss mitigation efforts (which include contacting delinquent borrowers to offer the options of a preforeclosure sale or modification), and a variety of other factors. The Corporation manages the risk of delinquencies and REO as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management."

Competition

The Corporation competes, within the limits prescribed by its Charter Act, for the purchase of mortgage loans for portfolio and the issuance of mortgage-backed securities in the secondary mortgage market. For single-family products, the Corporation competes primarily with the Federal Home Loan Mortgage Corporation ("Freddie Mac"), another government-sponsored enterprise regulated by the Department of Housing and Urban Development ("HUD") and the Office of Federal Housing Enterprise Oversight with a mission and authority that is virtually identical to that of Fannie Mae. Fannie Mae competes to a lesser extent with savings and loan associations, savings banks, commercial banks, government-sponsored entities, and companies that purchase for their own portfolio or pool single-family mortgage loans for sale to investors as whole loans or mortgage-backed securities. In the case of multifamily products, the Corporation generally competes with the same kinds of entities as in the case of single-family products, but Freddie Mac is just one among many competitors that vigorously compete in this market.

The Corporation's market share of loans purchased for cash or swapped for MBS is affected by the volume of mortgage loans offered for sale in the secondary market by loan originators and other market participants and the amount purchased by other market participants that compete with the Corporation.

The Corporation competes primarily on the basis of price, products, and services offered. Competition based on advances in technology-related services continues to increase as do the types and nature of the products offered by the Corporation and Freddie Mac and other market participants.

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

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, the Secretary of HUD must approve any new Fannie Mae or Freddie Mac program that is significantly different from those approved or engaged in prior to that Act's enactment. The ability of Fannie Mae and Freddie Mac to compete with other competitors possibly could be affected by this requirement. See "Government Regulation and Charter Act."

Facilities

The Corporation owns its principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, an office at 3939 Wisconsin Avenue, NW, Washington, DC, and a facility in Herndon, Virginia. In addition, the Corporation leases approximately 389,000 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to the Corporation's principal office, and approximately 87,000 square feet of office space at 2115 Wisconsin Avenue, NW. The present lease for 4000 Wisconsin Avenue expires in 2001, but the Corporation has options to extend the lease for up to 15 additional years, in 5-year increments. The lease for 2115 Wisconsin expires in 1998. The Corporation also maintains regional offices in leased premises in Pasadena, California; Atlanta, Georgia; Chicago, Illinois; Philadelphia, Pennsylvania; and Dallas, Texas. The regional offices negotiate mortgage loan and MBS business with lenders, assist in supervising the servicing of the Corporation's mortgage loan portfolio by lenders, assist in supervising or managing the handling and disposition of REO, and provide training to the staffs of lenders. In addition to the regional offices, the Corporation, as part of the Showing America a New Way Home initiative, has opened 12 "Fannie Mae Partnership Offices" in leased premises around the country, and expects to establish a total of 25 such offices, which will work with cities, rural areas, and other underserved communities. There currently are Fannie Mae Partnership Offices in Baltimore, Maryland; Boston, Massachusetts; Washington, D.C.; Miami, Florida; St. Paul, Minnesota; San Antonio/Colonias, Texas; New Orleans, Louisiana; Los Angeles, California; Portland, Oregon; Cleveland, Ohio; Chicago, Illinois; and Hartford, Connecticut.

Employees

At December 31, 1994, the Corporation employed approximately 3,500 full-time personnel.

GOVERNMENT REGULATION AND CHARTER ACT

The Corporation is a federally chartered and stockholder-owned corporation organized and existing under the Charter Act (12 U.S.C. § 1716 *et seq.*) whose purpose is to (1) provide stability in the secondary market for residential mortgages, (2) respond appropriately to the private capital market by developing new finance and mortgage products, (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) and (4) promote access to mortgage credit throughout the nation (including central cities, rural areas and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

The Federal National Mortgage Association originally was incorporated in 1938 pursuant to Title III of the National Housing Act as a wholly owned government corporation and in 1954, under a revised Title III called the Federal National Mortgage Association Charter Act, became a mixed-ownership corporate instrumentality of the United States. From 1950 to 1968, it operated in the Housing and Home Finance Agency, which was succeeded by the Department of Housing and Urban Development ("HUD"). Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the "1968 Act"), the then Federal National Mortgage Association was divided into two separate institutions, the present Corporation and the Government National Mortgage Association, a wholly owned corporate instrumentality of the United States within HUD, which carried on certain special financing assistance and management and liquidation functions. Under the 1968 Act, the Corporation was constituted as a federally chartered corporation and the entire equity interest in the Corporation became stockholder-owned.

Although the 1968 Act eliminated all federal ownership interest in the Corporation, it did not terminate government regulation of the Corporation. Under the Charter Act, approval of the Secretary of the Treasury is required for the Corporation's issuance of its debt obligations and MBS.

In addition, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act") established an independent Office of Federal Housing Enterprise Oversight ("OFHEO") within HUD under the management of a Director (the "Director") who is responsible for ensuring that the Corporation is adequately capitalized and operating safely in accordance with the 1992 Act. The 1992 Act established risk-based capital, minimum capital and critical capital levels for the Corporation. If the Corporation fails to meet one or more of these capital standards, the Director is required to take certain remedial measures and may take others, depending on the standards the Corporation fails to meet. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements." The Director is given enforcement powers that include the power to impose temporary and final cease-and-desist orders and civil penalties on the Corporation and on a director or executive officer of the Corporation. Prior approval of the Director is required for the Corporation to pay a dividend if the dividend would decrease the Corporation's capital below risk-based capital or minimum capital levels established under the 1992 Act. See "Common Stock." The Director is authorized to levy, pursuant to annual Congressional appropriations, annual assessments on Fannie Mae and Freddie Mac to cover reasonable expenses of the OFHEO.

The 1992 Act also gives the Director the authority to conduct annually an on-site examination of the Corporation for purposes of ensuring the Corporation's financial safety and soundness. The Director also has the discretion to conduct more frequent examinations if deemed necessary for safety and soundness. In addition, the Corporation is required to submit annual and quarterly reports of the financial condition and operations of the Corporation to the Director. Moreover, the Charter Act, as amended by the 1992 Act, authorizes the General Accounting Office ("GAO") to audit the programs, activities, receipts, expenditures and financial transactions of the Corporation. The Corporation also is required to submit an annual report to the House and Senate Banking Committees and the Secretary of HUD regarding the Corporation's performance in meeting housing goals relating to the purchase of mortgages on housing for low- and moderate-income families, mortgages on rental and owner-occupied housing for low-income families in low-income areas or for very-low-income families, and mortgages on housing located in central cities, rural areas and other underserved areas.

Under the 1992 Act, the Secretary of HUD retains general regulatory authority to promulgate rules and regulations to carry out the purposes of the Charter Act, excluding authority over matters granted exclusively to the Director in the 1992 Act. The Secretary of HUD also must approve any new conventional mortgage program that is significantly different from those approved or engaged in prior to the 1992 Act. The Secretary is required to approve any new program unless it is not authorized by the Charter Act of the Corporation or the Secretary finds that it is not in the public interest. However, until one year after the final regulations establishing the risk-based capital test are in effect, the Secretary must disapprove a new program if the Director determines that the program would risk significant deterioration of the financial condition of the Corporation. The Secretary has proposed regulations related to the program approval requirement.

Thirteen members of the Corporation's eighteen-member Board of Directors are elected by the holders of the Corporation's common stock, and the remaining five members are appointed by the President of the United States. The appointed directors must include one person from the home building industry, one person from the mortgage lending industry, and one person from the real estate industry. Under the 1992 Act, one appointed director also must be from an organization that has represented consumer or community interests for not less than two years or a person who has demonstrated a career commitment to the provision of housing for low-income households. Any member of the Board of Directors that is appointed by the President of the United States may be removed by the President for good cause.

In addition to placing the Corporation under federal regulation, the Charter Act also grants to the Corporation certain privileges. For instance, securities issued by the Corporation are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission ("SEC") to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the

United States. (However, in issuing such securities, the Corporation must clearly indicate that the securities, and the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States.) Registration statements with respect to the Corporation's securities are not filed with the SEC. The Corporation also is not required to file periodic reports with the SEC.

The Secretary of the Treasury of the United States has discretionary authority to purchase obligations of the Corporation up to a maximum of $2.25 billion outstanding at any one time. This facility has not been used since the Corporation's transition from government ownership in 1968. Neither the United States nor any agency thereof is obligated to finance the Corporation's operations or to assist the Corporation in any other manner.

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

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

The 1992 Act requires studies by the Comptroller General of the United States, the Secretary of HUD, the Secretary of the Treasury and the Director of Congressional Budget Office of the effect of fully privatizing Fannie Mae and Freddie Mac. The statutory deadline for the privatization studies was October 1994 but they have not yet been completed. Management cannot predict the impact, if any, of such studies on the Corporation. Privatization of the Corporation would require legislation.

Management expects that the Director will adopt new regulations to implement certain provisions of the 1992 Act, including regulations establishing a risk-based capital standard for the Corporation. The Secretary of HUD has proposed regulations establishing final housing goals for the Corporation. See "Balance Sheet Analysis—Regulatory Capital Requirements" and "Housing Goals" in "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Secretary of HUD also has proposed regulations to ensure that the Corporation's policies and practices are consistent with fair housing requirements and that would require the Corporation to provide certain information to HUD and other agencies upon request.

LEGAL PROCEEDINGS

In the ordinary course of business, the Corporation is involved in legal proceedings that arise in connection with properties acquired by the Corporation, either through foreclosure on properties securing delinquent mortgage loans owned by the Corporation or by receiving deeds to such properties in lieu of foreclosure. For example, claims related to possible tort liability and compliance with applicable environmental requirements arise from time to time, primarily in the case of single-family REO.

The Corporation is a party to legal proceedings from time to time arising from its relationships with its seller/servicers. Disputes with lenders concerning their loan origination or servicing obligations to the Corporation, or disputes concerning termination by the Corporation (for any of a variety of reasons) of a lender's authority to do business with the Corporation as a seller and/or servicer, can result in litigation.

The Corporation also is a party to legal proceedings arising from time to time in connection with other aspects of its business.

Claims and proceedings of all types are subject to many uncertain factors that generally cannot be predicted with assurance. However, in the case of the legal proceedings and claims that are currently

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

COMMON STOCK

Section 303(a) of the Charter Act provides that the Corporation shall have common stock, without par value. The common stock is vested with all voting rights. Each share of common stock is entitled to one vote at all elections of directors and on all other matters presented for common stockholder vote. The holders of the common stock elect thirteen directors, and the President of the United States appoints the remaining five directors. Any member of the Board of Directors that is appointed by the President of the United States may be removed by the President for good cause. The Charter Act, the Corporation's governing instrument, cannot be amended by the stockholders, but only by an Act of Congress.

The Corporation also is authorized by the Charter Act to have preferred stock on such terms and conditions as the Board of Directors of the Corporation may prescribe. No common stockholder approval is required to issue preferred stock. As of the date of this Information Statement, no preferred stock is issued or outstanding.

The Charter Act contains no limitation on the amount of stock that may be issued, except that if the Corporation fails to meet certain minimum capital standards, the Director of the Federal Housing Enterprise Oversight Office (the "Director") could require that the Director approve the Corporation's issuance of stock or securities convertible into stock. At February 28, 1995, there were outstanding approximately 273 million shares of common stock, which were held by approximately 11,000 stockholders of record. Based on the number of requests for proxies and quarterly reports, the Corporation estimates that on February 28, 1995 there were approximately 170,000 additional stockholders who held shares through banks, brokers, and nominees.

Holders of the common stock are entitled to receive cash dividends if, as and when declared by the Board of Directors. However, if the Corporation meets both the risk-based capital and minimum capital levels established under the 1992 Act, a dividend may be paid without the prior approval of the Director only if the dividend payment would not decrease the Corporation's total capital below the risk-based capital level or its core capital below the minimum capital level. If the Corporation meets either the risk-based capital standard or the minimum capital standard, it may make a dividend payment without obtaining the approval of the Director only if the dividend payment would not cause the Corporation to fail to meet another capital standard. At any time when the Corporation does not meet the risk-based capital standard but meets the minimum capital standard, the Corporation is prohibited from making a dividend payment that would cause the Corporation to fail to meet the minimum capital standard. If the Corporation meets neither the risk-based capital standard nor the minimum capital standard but does meet the critical capital standard established under the 1992 Act, it may make a dividend payment only if the Corporation would not fail to meet the critical capital standard as a result of such payment and the Director approves the payment after finding that it satisfies certain statutory conditions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements" regarding the capital standards applicable to the Corporation. The Director has the authority to require the Corporation to submit a report to the Director regarding any capital distribution (including any dividend) declared by the Corporation before the Corporation makes the distribution.

If the Director determines that the Corporation is engaging in conduct not approved by the Director that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by the Corporation has decreased significantly, the Director is authorized to treat the Corporation as not meeting one of the capital standards that it otherwise meets. In addition, the Corporation is required to submit a capital restoration plan if it fails to meet any of the capital standards. If the Director does not approve the plan or determines that the Corporation has failed to make reasonable efforts to comply with the plan, then the Director may treat

the Corporation as not meeting one of the capital standards that it otherwise meets. Also, if the Corporation fails to meet or is treated by the Director as not meeting one of the capital standards and the Director has reasonable cause to believe that the Corporation or any executive officer or director of the Corporation is engaging in or about to engage in any conduct that threatens to result in a significant depletion of the Corporation's core capital, then the Director is authorized to commence proceedings pursuant to which, after a hearing, the Director could issue a cease and desist order prohibiting such conduct. The Director could issue such an order without a hearing, which would be effective until completion of the cease-and-desist proceedings, if the Director determined that the conduct in question was likely to cause a significant depletion of core capital.

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

Dividends have been declared and paid for each quarter during the Corporation's two most recent fiscal years. See "Quarterly Results of Operations" on page 63 for quarterly dividends paid during 1994 and 1993.

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

The common stock has no conversion or pre-emptive rights or redemption or sinking fund provisions. The outstanding shares of common stock are fully paid and nonassessable. There is no prohibition against the purchase by the Corporation of its own common stock, holding such common stock in its treasury, and reselling such stock.

This description is summarized from the Charter Act, the 1992 Act, the bylaws, and certain resolutions of the Board of Directors and stockholders of the Corporation. This description does not purport to be complete and is qualified in its entirety by reference to the Charter Act, the 1992 Act, bylaws of the Corporation, and such resolutions. Copies of the Charter Act, bylaws of the Corporation and any applicable resolutions may be obtained from the Corporation.

The Corporation's common stock is publicly traded on the New York, Pacific, and Chicago stock exchanges and is identified by the ticker symbol "FNM". The transfer agent and registrar for the common stock is Chemical Bank, 450 West 33rd Street, New York, New York 10001.

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

	1994		**1993**	
Quarter	**High**	**Low**	**High**	**Low**
1st	$89.50	$76.25	$84.63	$74.63
2nd	88.25	75.63	85.38	73.50
3rd	90.38	77.25	86.13	74.63
4th	79.88	68.13	83.00	72.88

The closing price of the Corporation's common stock on March 30, 1995, as so reported, was $82.50.

SELECTED FINANCIAL INFORMATION

The following selected financial data for the years 1990 through 1994 (which data are not covered by the independent auditors' report) have been summarized or derived from the audited financial statements and other financial information. These data should be read in conjunction with the audited financial statements and notes to the financial statements.

(Dollars in millions, except per share amounts)

	Year Ended December 31,				
Income Statement Data:	**1994**	**1993**	**1992**	**1991**	**1990**
Interest income	$ 17,347	$ 14,833	$ 13,534	$ 12,593	$ 12,069
Interest expense	14,524	12,300	11,476	10,815	10,476
Net interest income	2,823	2,533	2,058	1,778	1,593
Guaranty fees	1,083	961	834	675	536
Gain (loss) on sales of mortgages, net	(2)	(1)	23	(28)	7
Miscellaneous income, net	145	260	168	106	107
Income from tax settlement	—	—	—	239	—
Provision for losses	(155)	(175)	(320)	(370)	(310)
Foreclosed property expenses	(223)	(130)	—	—	—
Administrative expenses	(525)	(443)	(381)	(319)	(286)
Income before federal income taxes and extraordinary item	3,146	3,005	2,382	2,081	1,647
Provision for federal income taxes	(1,005)	(963)	(733)	(626)	(474)
Income before extraordinary item	2,141	2,042	1,649	1,455	1,173
Extraordinary loss: early extinguishment of debt, net of tax effect	(9)	(169)	(26)	(92)	—
Net income	$ 2,132	$ 1,873	$ 1,623	$ 1,363	$ 1,173
Per common share:					
Earnings before extraordinary item	$ 7.80	$ 7.44	$ 6.00	$ 5.31	$ 4.49
Net earnings	7.77	6.82	5.91	4.98	4.49
Cash dividends	2.40	1.84	1.38	1.04	0.72

	Year Ended December 31,				
Balance Sheet Data:	**1994**	**1993**	**1992**	**1991**	**1990**
Mortgage portfolio, net	$220,525	$189,892	$156,021	$126,486	$113,875
Total assets	272,508	216,979	180,978	147,072	133,113
Borrowings:					
Due within one year	112,602	71,950	56,404	34,608	38,453
Due after one year	144,628	129,162	109,896	99,329	84,950
Total liabilities	262,967	208,927	174,204	141,525	129,172
Stockholders' equity	9,541	8,052	6,774	5,547	3,941

	Year Ended December 31,				
Other Data:	**1994**	**1993**	**1992**	**1991**	**1990**
Net interest margin	1.24%	1.38%	1.37%	1.42%	1.39%
Return on average equity	24.3	25.3	26.5	27.7	33.7
Return on average assets	1.0	1.0	1.0	1.0	.9
Ratio of earnings to fixed charges(1)	1.22:1	1.22:1	1.20:1	1.19:1	1.15:1
Dividend payout ratio	30.8%	26.9%	23.2%	20.7%	14.7%
Equity to assets ratio	3.6	3.8	3.8	3.6	2.7
Mortgage purchases	$ 62,389	$ 92,037	$ 75,905	$ 37,202	$ 23,959
MBS issued	130,622	221,444	194,037	112,903	96,695
MBS outstanding at year-end(2)	530,343	495,525	444,979	371,984	299,833
Capital(3)	10,367	8,893	7,554	6,251	4,480

(1) For the purpose of calculating the ratio of earnings to fixed charges, "earnings" consists of income before federal taxes and fixed charges. "Fixed charges" consists of interest expense and, for periods prior to 1993, interest capitalized on real estate owned.

(2) Includes $44.0 billion, $24.2 billion, $20.5 billion, $16.7 billion, and $11.8 billion of MBS in portfolio at December 31, 1994, 1993, 1992, 1991, and 1990, respectively.

(3) Stockholders' equity plus allowance for losses at year end.

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

Overview

In 1994, Fannie Mae generated another solid financial performance during a year of extreme volatility in the mortgage markets produced by rising interest rates. Net income increased to $2.132 billion, 14 percent higher than the $1.873 billion earned in 1993, while earnings per share increased to $7.77 in 1994 from $6.82 in 1993.

Continued portfolio growth and effective matching of assets and liabilities were primary factors in producing higher earnings in 1994, in spite of a rise in mortgage rates of more than 200 basis points since October 1993 when the industry experienced its lowest rates in 25 years. This rise in rates resulted in a substantial decrease in origination volumes from the record 1993 levels. Despite these obstacles, Fannie Mae grew its mortgage portfolio, the Corporation's major source of earnings, by 16 percent. The net mortgage portfolio was $220.5 billion at December 31, 1994, up $30.6 billion from the 1993 year-end level. Mortgage-Backed Securities ("MBS") outstanding, net of MBS held in portfolio, also grew during the year to $486.3 billion at year-end 1994, or 3 percent higher than the $471.3 billion outstanding at year-end 1993.

Credit risk management continued to be a major focus during 1994. The single-family serious delinquency rate rose slightly to 57 basis points at the end of 1994, compared with 56 basis points at year-end 1993, while the multifamily serious delinquency rate declined significantly to 1.21 percent at December 31, 1994 from 2.34 percent at December 31, 1993. Due primarily to the weak economy in California and the Northeast, single-family foreclosed property acquisitions rose from approximately 11,600 in 1993 to 13,200 in 1994. The higher level of acquired properties, along with a $15 million loss from the California earthquake in the first quarter of the year, contributed to a $146 million increase in single-family net credit losses (charge-offs and foreclosed property expenses) to $373 million in 1994. Multifamily net credit losses rose slightly to $19 million in 1994, which included a $10 million loss from the California earthquake, compared with $17 million in 1993. The lower serious delinquency rates and stable credit losses in the multifamily portfolio were due, in part, to active management of delinquent assets and stronger rental and sales markets.

The Corporation's capital base (stockholders' equity plus allowance for losses) reached $10.4 billion at December 31, 1994, 17 percent higher than the amount of capital at December 31, 1993. Fannie Mae met the applicable regulatory capital standards at December 31, 1994 and expects that continued growth in retained earnings will ensure compliance with these standards in the future.

The remainder of Management's Discussion and Analysis presents detailed information on the Corporation's results of operations, risk management, balance sheet analysis, MBS activity, and housing goals.

Results of Operations

Net Interest Income

Net interest income increased $290 million to $2.823 billion in 1994 due primarily to a $36.6 billion increase in the average mortgage portfolio balance outstanding during 1994, which offset the impact of compression in the net interest margin.

The average net interest margin decreased 14 basis points to 1.24 percent in 1994 from 1.38 percent in 1993 due to a number of factors that each had a small adverse effect. These factors included lower MBS float balances due to a reduction in MBS prepayments, a higher proportion of the investment portfolio in shorter term investments with lower yields than those earned on the mortgage portfolio, debt costs increasing at a faster pace than mortgage yields, and lengthening of debt maturities during the second half of 1994. As discussed under "Risk Management," the Corporation extended the average maturity of its debt during 1994 to mitigate the effect of higher interest rates and

lower liquidations which lengthened the duration of the mortgage portfolio. For 1995, management believes the net interest margin will average somewhat above the fourth quarter 1994 net interest margin of 117 basis points.

Net interest income increased $475 million to $2.533 billion in 1993 compared with 1992, due to a $30.4 billion increase in the average mortgage portfolio balance outstanding during 1993 and higher MBS float income, which together offset the impact of high portfolio liquidations.

Net interest income does not include interest receivable on nonperforming loans. Conventional (nongovernment insured or guaranteed) single-family and multifamily loans are classified as nonperforming and previously accrued interest is removed from income when a payment is 90 days or more past due. Nonperforming loans outstanding totaled $2.1 billion at the end of 1994, compared with $1.3 billion at December 31, 1993 and $1.2 billion at December 31, 1992. Average nonperforming loans increased in 1994 from 1993 due primarily to efforts in 1994 to accelerate the purchase of seriously delinquent loans from MBS pools. Once a delinquent loan has been removed from the MBS, the Corporation no longer advances uncollected interest to investors and is able to proceed with loss mitigation efforts. If nonperforming assets had been fully performing, they would have contributed an additional $133 million to net interest income in 1994, $115 million in 1993, and $88 million in 1992.

Guaranty Fee Income

As a result of growth in MBS outstanding, guaranty fee income continued to increase. These fees compensate the Corporation for its guarantee of timely payment of principal and interest to MBS investors and its assumption of credit risk on the loans underlying MBS.

The following table shows guaranty fee income as a percentage of the average balance of MBS outstanding in 1994, 1993, and 1992.

Guaranty Fee Income

(Dollars in millions)

	1994	1993	1992
Guaranty fee income	$ 1,083	$ 961	$ 834
Average balance of MBS outstanding(1)	481,987	450,412	394,126
Effective guaranty fee rate	.225%	.213%	.212%

(1) Excludes $33.6 billion, $20.2 billion, and $18.7 billion in 1994, 1993, and 1992, respectively, which represented the average balances of MBS held in the mortgage portfolio.

The effective guaranty fee rate on MBS rose slightly in 1994 and 1993, due primarily to the Corporation implementing faster amortization of deferred guaranty fees in response to the high level of prepayments in 1993. Deferred guaranty fees result when a lender chooses to make an upfront payment at securitization in exchange for a lower guaranty fee over the life of the MBS.

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

Gain (Loss) on Sales of Mortgages

Loss on sales of mortgages was $2 million in 1994, compared with a loss of $1 million in 1993 and a gain of $23 million in 1992. These gains and losses generally relate to buy/sell transactions. Buy/sell activity is described under "Balance Sheet Analysis."

Miscellaneous Income

Miscellaneous income decreased $115 million, or 44 percent, during 1994, primarily as a result of a 37 percent decline in REMIC fee income, lower MBS transaction fees, and lower prepayment fee income from multifamily refinancing transactions. The decrease in REMIC fees was attributable to lower REMIC issuances as a result of a decline in the volume of fixed-rate MBS issued in a higher interest rate environment. In addition, higher interest rates caused a substantial amount of outstanding REMICs to become available for sale and reduced opportunities for dealers to create profitable new REMIC structures, which reduced demand for new REMIC issuances.

Miscellaneous income increased during 1993 compared with 1992, primarily due to a 45 percent increase in REMIC fee income resulting from the growth in the volume of REMIC securities issued, as well as increased REMIC fee rates. The Corporation also recorded $33 million of prepayment fee income related to the refinancing of certain multifamily loans in 1993.

The following table presents REMIC issuances and fees for 1994, 1993, and 1992.

REMIC Issuances and Fees

				Change	
	1994	**1993**	**1992**	**1994 vs. 1993**	**1993 vs. 1992**
Issuances (in billions)	$56	$168	$155	(67)%	8%
Net fee income (in millions)	80	126	87	(37)	45

A portion of the REMIC fees are deferred and amortized over the life of the REMIC to match expected future administrative costs. Additional information on REMIC activity is presented under "Mortgage-Backed Securities."

Credit-Related Expenses

Credit-related expenses, which include foreclosed property expenses and the provision for losses, were $378 million in 1994, compared with $305 million and $320 million, in 1993 and 1992, respectively. The increase in credit-related expenses in 1994 was primarily due to the higher level of acquisitions of foreclosed properties that resulted from the weak economies in the Northeast and California. Management provides an allowance to cover expected foreclosure losses.

Administrative Expenses

Administrative expenses totaled $525 million in 1994, compared with $443 million and $381 million in 1993 and 1992, respectively. Compensation expense was $293 million or 56 percent of administrative expenses in 1994, compared with $251 million (57 percent) in 1993 and $209 million (55 percent) in 1992. Technology-related expenses and increased staffing for affordable housing initiatives were the primary reasons for administrative expense increases in both years. The ratio of administrative expenses to the average mortgage portfolio plus average MBS outstanding was .076 percent in 1994 compared with .072 percent in 1993 and 1992. The ratio of administrative expenses to revenues (net interest income, guaranty fees, and miscellaneous income) was 13.0 percent in 1994, 11.8 percent in 1993, and 12.5 percent in 1992.

Income Taxes

The total provision for federal income taxes, net of the tax benefit from extraordinary losses, was $999 million in 1994, compared with $872 million and $719 million in 1993 and 1992, respectively. The effective federal income tax rate in 1994 and 1993 was 32 percent, an increase from 31 percent in

1992. The increase from 1992 primarily reflects the change in the statutory federal income tax rate from 34 percent to 35 percent, effective January 1, 1993.

As discussed in the Notes to Financial Statements, ''Income Taxes,'' during 1993 the U.S. Tax Court ruled in the Corporation's favor regarding the tax treatment of certain hedging transactions.

Extraordinary Loss

Both the repurchase and call of high-coupon debt and the call of certain interest rate swaps are part of the Corporation's interest rate risk management strategy and favorably affect the Corporation's cost of funds in future periods. Debt call and repurchase activity and swap call activity during 1994 and 1993 are presented in the following table.

	1994				1993			
Dollars in millions	Amount	Weighted-average Cost	Extraordinary Loss	After-tax Loss	Amount	Weighted-average Cost	Extraordinary Loss	After-tax Loss
Long-term debt called	$12,521	8.45%	$—	$—	$13,635	7.77%	$147	$ 96
Long-term debt repurchased	1,004	8.00	15	9	1,819	7.19	113	73
Interest rate swaps called	600	8.62	—	—	—	—	—	—
Total	$14,125	8.42%	$15	$ 9	$15,454	7.70%	$260	$169

For 1995, management believes that repurchases of debt will not have a significant impact on earnings.

Risk Management

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

Interest-Rate-Risk Management

During the last few years, the Corporation has operated in a period of substantial interest rate volatility. From early 1992 through the end of 1993, the housing finance system experienced the largest surge of mortgage prepayments in history, which slowed significantly in 1994 as a result of the rise in interest rates.

Fannie Mae's approach to managing interest rate exposure is to acquire and maintain a portfolio of assets and liabilities that have similar expected durations. Duration measures the weighted-average life of a financial instrument's discounted future cash flows, as well as the sensitivity of the market price of the instrument to changes in interest rates. The strategy of matching the expected durations of assets and liabilities has allowed the Corporation to minimize the sensitivity of its long-term earnings to interest rate movements, while providing high levels of current earnings. As a result, the dramatic changes in interest rates and prepayments in 1994 had relatively small effects on the Corporation's earnings.

To monitor the portfolio's sensitivity to interest rate changes, the Corporation frequently projects the effect of rising and falling interest rate scenarios on the income statement and balance sheet of the portfolio. In addition, the Corporation performs frequent ''stress testing'' of the existing portfolio's behavior under extreme interest rate environments to analyze its interest rate exposure, and to evaluate the level of capital needed to support the portfolio. In assessing its interest-rate risk profile, the Corporation also analyzes the degree to which the durations of assets and liabilities fluctuate as interest rates change, often referred to as convexity. When the convexity of a portfolio's assets is

different from that of its liabilities, the Corporation's duration gap—the difference between its asset and liability durations—will change as interest rates change.

A principal element of duration gap management relates to the maturity profile and call features of long-term debt. Callable debt has enabled the Corporation to shorten the duration of its debt when interest rates fall, while the duration of that same debt lengthens when interest rates rise. When interest rates fall, as they did for most of 1992 and 1993, mortgages prepay at faster rates. By issuing debt that is callable, the Corporation has been able to adjust the duration of its debt to better match the duration of its mortgages.

The increase in interest rates during 1994 caused the duration of the Corporation's mortgage assets to lengthen, as prepayments slowed significantly. In such a rate environment, the Corporation generally would not expect to exercise the call feature of callable debt, which has the effect of lengthening the duration of its debt to better match that of its mortgages. The increase in the issuance of noncallable long-term debt also helped lengthen the duration of liabilities funding the mortgage portfolio in 1994.

At December 31, 1994, callable instruments, including the effect of interest rate swaps, represented 55 percent of total effective long-term, fixed-rate debt outstanding, down slightly from 58 percent at the end of 1993 and up from 49 percent at the end of 1992. In 1994, 45 percent of long-term debt issued during the year was callable, compared with 80 percent in 1993 and 83 percent in 1992.

At December 31, 1994, the Corporation had a positive duration gap of nine months, compared with a negative gap of two months at December 31, 1993. A positive duration gap indicates the Corporation has more interest rate exposure in a rising rate environment. Assuming no management action, net interest income would be adversely affected by a significant rise in interest rates and positively affected by a decrease in interest rates.

The following table quantifies the Corporation's mortgage portfolio duration gap at December 31, 1994 and 1993. It does not, however, capture the dynamics of balance sheet, rate or spread movements, or actions that may be taken to manage this position.

Duration Gap
(in months)

	Portfolio Duration (1) at December 31	
	1994	**1993**
Mortgage Portfolio:		
Single-family:		
Long-term, fixed-rate	29	18
Intermediate-term, fixed-rate	14	12
Adjustable-rate	2	2
Other	3	1
Multifamily	3	2
Total	51	35
Debt (2):		
Short-term	1	1
Long-term:		
Noncallable	20	17
Callable	21	19
	41	36
Total	42	37
Net duration gap	9	(2)

(1) Reflects the weighted effect of the individual items on the overall portfolio duration.

(2) Represents the portion of debt outstanding that funded mortgage portfolio assets and includes the effect of interest rate swaps.

In addition to analyzing on a regular basis the duration and convexity of assets and liabilities as a whole, the Corporation evaluates potential asset purchases to determine the optimal funding mix, given the asset's sensitivity to interest rate movements. To accomplish this, a model is used to simulate the performance of a leveraged mortgage investment, in which a mixture of debt and equity is used to purchase mortgages, under a wide range of interest rate scenarios.

The Corporation also manages interest rate risk through corporate operating hedges, which are sources of income that increase or decrease in certain operating environments. For example, in the declining interest rate environment in 1993, there was a substantial increase in MBS float income due to increased funds from prepayments that the Corporation could reinvest until they were required to be passed to investors. REMIC and other fee income, and portfolio growth, also increased as a result of higher mortgage originations in that environment.

Additional information on portfolio activity and callable debt is presented under "Balance Sheet Analysis."

Credit Risk Management

The primary exposure to credit risk results from the possibility that the Corporation will not recover amounts due from borrowers, lenders, or mortgage insurers on loans in its mortgage portfolio or on loans backing MBS it guarantees.

Management measures its success in managing credit risk by evaluating actual foreclosure activity and expected future credit losses. Two key statistics used to evaluate future credit performance are the risk profile of portfolio and MBS loans and delinquency rates. The discussion that follows addresses separately the major performance measures of credit quality as they pertain to the conventional single-family and multifamily businesses.

Single-Family

Charge-offs and foreclosed property expenses result when the Corporation acquires foreclosed properties or does preforeclosure sales. The following table summarizes net credit losses and the ratio of net credit losses to average principal balances outstanding for single-family loans in portfolio and backing MBS.

Single-Family Credit Losses

(Dollars in millions)

	Year Ended December 31,		
	1994	**1993**	**1992**
Charge-offs:			
Acquired properties	$104	$ 64	$192
Preforeclosure sales	41	23	10
	145	87	202
Foreclosed property expenses	228	140	—
Net credit losses	$373	$227	$202
Net credit loss ratio	.06%	.04%	.04%

The number of conventional single-family properties acquired during the year and owned at year-end, including their carrying value, and the number of preforeclosure sales during the year are summarized below.

Single-Family Real Estate Owned (“REO”)

(Dollars in thousands)

Number of Properties	**1994**	**1993**	**1992**
Acquired:			
Northeast	3,490	3,353	2,526
Southeast	1,739	2,034	2,366
Midwest	670	709	815
Southwest	1,579	1,840	2,450
West	5,738	3,621	1,489
Total	13,216	11,557	9,646
In inventory at year-end	6,162	5,323	4,413
Aggregate carrying value, net	$485,000	$379,000	$295,000
Average carrying value per case	$ 79	$ 71	$ 67
Preforeclosure sales	3,417	2,323	1,557

A major reason for the increase in net credit losses and the number of properties acquired through foreclosure in 1994 was continued weakness in the economies of California and the Northeast. In addition, net credit losses included a $15 million loss related to the California earthquake during the first quarter of 1994. Despite the increased volume of loans and MBS outstanding, management does not anticipate a significant increase in net credit losses or the number of acquired properties in 1995 because management expects stable or improving economic conditions in California and the Northeast and the Corporation will undertake increased loss mitigation efforts. The increase in single-family net credit losses in 1993, compared with 1992, was attributable to the increase in acquisitions of foreclosed properties. This was offset, in part, by a reduction in charge-offs resulting from a new accounting standard, which was implemented at December 31, 1992.

In evaluating expected future credit performance, management analyzes the risk profile of the Corporation's conventional single-family portfolio and MBS outstanding. The loan-to-value ("LTV") ratio is an important factor in credit performance because the amount of equity a borrower has in a home has proven to be a key determinant of the incidence and loss severity of default. During the period from 1992 through the first quarter of 1994, the mortgage industry experienced high volumes of refinances due to declining interest rates. In this environment, the Corporation's business volumes reflected a higher concentration of lower LTV and intermediate-term loans. As a result, the amount of the Corporation's conventional portfolio and MBS outstanding that consisted of intermediate-term, fixed-rate product increased from 19 percent at the end of 1991 to 31 percent at year-end 1994 (32 percent at year-end 1993). Intermediate-term products generally have lower LTV ratios and better credit performance than long-term mortgages.

Beginning in the spring of 1994, as interest rates rose, there was a shift in the market toward mortgages needed to purchase homes. These mortgages generally have higher LTV ratios compared with those used to refinance existing mortgages. For loans with LTV ratios over 80 percent the Corporation requires private mortgage insurance or its equivalent, which reduces the amount of potential loss to Fannie Mae. In response to an increase in LTV ratios on new business during 1994, commencing in March 1995 the Corporation generally will require higher levels of private mortgage insurance for long-term, higher LTV (greater than 85 percent) loans.

The table below presents certain risk characteristics of the Corporation's conventional loan purchases and MBS issuances in the years 1992—1994 and conventional product outstanding at December 31, 1994 and 1993.

Risk Characteristics of Conventional Single-Family Purchases and MBS Issuances

	Percentage of Business Volumes			Outstanding at December 31,	
	1994	1993	1992	1994	1993
Product:					
Long-term, fixed-rate	65%	57%	55%	58%	57%
Intermediate-term, fixed-rate(1)	26	38	37	31	32
Adjustable-rate	9	5	8	11	11
Total	100%	100%	100%	100%	100%
Occupancy:					
Owner-occupied	94%	96%	97%	95%	96%
Investor	4	3	2	3	3
Other	2	1	1	2	1
Total	100%	100%	100%	100%	100%
Number of units:					
1 unit	96%	97%	98%	96%	96%
2 to 4 units	4	3	2	4	4
Total	100%	100%	100%	100%	100%
Loan-to-value ratio(2)					
Greater than 90%	14%	7%	6%	9%	7%
81% to 90%	18	16	14	17	16
71% to 80%	36	37	38	37	39
61% to 70%	14	17	17	16	16
Less than 61%	18	23	25	21	22
Total	100%	100%	100%	100%	100%
Average loan-to-value ratio	75%	71%	70%	73%	72%
Average loan amount (Maximum $203,150 in 1994)	$95,100	$98,100	$95,800	$81,000	$79,800

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

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

The table also highlights other factors that limit credit risk, such as the low percentage of investor loans and loans on two- to four-unit properties, both of which are considered riskier products.

A second indicator of future credit losses is the rate of serious delinquencies (90 or more days delinquent). Throughout 1994, the serious delinquency rate remained relatively stable in the range of .56 percent to .59 percent, and at year-end 1994 serious delinquencies were .57 percent of all conventional single-family loans.

The following table summarizes conventional single-family serious delinquencies by property region as of December 31, 1994, 1993, and 1992. Single-family serious delinquency rates are based on

the number of loans in portfolio and underlying MBS for which the Corporation has primary risk of loss and that are delinquent 90 days or more, in foreclosure, bankruptcy, or in relief.

Single-Family Serious Delinquencies

	December 31,		
	1994	**1993**	**1992**
Northeast	.86%	.92%	1.04%
Southeast	.43	.44	.56
Midwest	.27	.29	.35
Southwest	.37	.42	.55
West	.82	.67	.57
Total	.57%	.56%	.63%

While the weak economies and depressed housing markets in California and the Northeast over the past few years have had a negative impact on the Corporation's serious delinquency rate, both of these regions showed improvement during the course of 1994. Serious delinquencies in the Northeast reached their highest level in early 1993, and have since continued to decline as home prices stabilized. During 1994, the serious delinquency rate in California reached its highest level of 1.09 percent in the second quarter, and had dropped to 1.05 percent at year-end.

Management began an initiative in 1993 to mitigate future credit losses. A key element of the new initiative is the reduction of losses through early intervention in a delinquency. Experience has shown that once a borrower has missed two or more payments, it is less likely the loan will become current. To reduce the costs that are incurred when a loan goes through the foreclosure process, more borrowers are contacted early in a delinquency to offer the options of a preforeclosure sale or modification.

The benefits of preforeclosure sales include a significant reduction in the amount of time the Corporation retains a nonearning asset, avoidance of the costs of foreclosure, and a tendency to sell at a better price because the home is occupied and not in foreclosure during the selling period.

In 1994, the Corporation executed preforeclosure sales on over 3,400 properties with an average per case loss of $12,100. This compares with a per case loss of $24,100 for loans that went through the foreclosure process and were disposed of in 1994.

Another loss mitigation technique the Corporation utilizes is the modification of the rate, term, or rate and term of a loan to allow a borrower to make lower payments in lieu of foreclosing on the property and incurring foreclosure costs. In 1994, the Corporation modified over 4,300 loans, compared with approximately 2,500 and 1,200 loans in 1993 and 1992, respectively. Management expects to expand its loss mitigation efforts further during 1995.

Multifamily

For the majority of multifamily loans, either held in portfolio or backing MBS, the Corporation has full or partial recourse to the lender or third parties (which may be secured by letter of credit or pledged collateral), or has FHA insurance. Such recourse frequently is through the Delegated Underwriting and Servicing ("DUS") program under which the lender is responsible for the first 5 percent of losses, with any remaining losses shared by the lender and Fannie Mae. The percentages of multifamily loans and MBS for which Fannie Mae has the primary risk of default (with no risk sharing) and for shared risk under DUS as of December 31, 1994 were 16 percent and 39 percent, respectively. The comparable percentages were 17 percent and 36 percent, respectively, at December 31, 1993 and 19 percent and 30 percent, respectively, at December 31, 1992. While the Corporation's Western Region had 39 percent of the conventional multifamily portfolio and MBS at

December 31, 1994, the majority of those loans and MBS involve collateralized recourse or shared risk.

Multifamily serious delinquencies at December 31, 1994, 1993, and 1992 were 1.21 percent, 2.34 percent, and 2.65 percent, respectively. Multifamily serious delinquencies are those loans for which the Corporation has primary risk of loss (including those with shared risk) that are two months or more delinquent. Delinquency percentages are based on the dollar amount of such loans in portfolio and underlying MBS.

The level of serious delinquencies for multifamily loans has declined significantly in recent years, primarily as a result of better underwriting, improvements in the multifamily rental market, continued emphasis on early loss mitigation efforts, and the foreclosure and disposition of problem loans.

Multifamily foreclosed property acquisitions totaled 31 properties, 36 properties, and 26 properties during 1994, 1993, and 1992, respectively. At December 31, 1994 and 1993, the Corporation held 26 properties with an aggregate carrying value of $66 million and 46 properties with an aggregate carrying value of $115 million, respectively.

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

Multifamily Credit Losses
(Dollars in millions)

	Year Ended December 31,		
	1994	**1993**	**1992**
Charge-offs	$24	$27	$42
Foreclosed property income	(5)	(10)	—
Net credit losses	$19	$17	$42
Net credit loss ratio	.08%	.08%	.19%

Multifamily net credit losses have remained relatively stable, despite increased business volumes and a $10 million charge-off related to the California earthquake, due primarily to active management of delinquent multifamily assets and an improvement in the multifamily market. As a result of improved market conditions, net operating income on foreclosed properties, and gains recorded at the disposition of certain properties, the Corporation recorded net foreclosed property income in both 1994 and 1993.

Allowance for Losses

In evaluating the risk of loss on portfolio loans and MBS outstanding, management considers current delinquency levels, historical loss experience, current economic conditions, geographic concen-

trations, estimates of future loan losses, and other pertinent factors. The allowance for losses is established by recording an expense for the provision for losses and is reduced through charge-offs.

Allowance for Losses
(Dollars in millions)

	Total
Balance, January 1, 1990	$ 463
Provision for losses	310
Charge-offs:	
Conventional:	
Single-family	(175)
Multifamily	(44)
Government	(15)
Balance, December 31, 1990	539
Provision for losses	370
Charge-offs:	
Conventional:	
Single-family	(138)
Multifamily	(61)
Government	(6)
Balance, December 31, 1991	704
Provision for losses	320
Charge-offs:	
Conventional:	
Single-family	(200)
Multifamily	(42)
Government	(2)
Balance, December 31, 1992	780
Provision for losses	175
Charge-offs:	
Conventional:	
Single-family	(87)
Multifamily	(27)
Government	(—)
Balance, December 31, 1993	841
Provision for losses	155
Charge-offs:	
Conventional:	
Single-family	(144)
Multifamily	(24)
Government	(1)
Balance, December 31, 1994	$ 827

Balance Sheet Analysis

This section discusses the Corporation's mortgage portfolio and the financing activities that fund mortgage purchases. Also included is a discussion of regulatory capital requirements.

Mortgage Portfolio

As of December 31, 1994, the net mortgage portfolio totaled $220.5 billion. In comparison, the portfolio totaled $189.9 billion and $156.0 billion at December 31, 1993 and 1992, respectively. The yield on the net mortgage portfolio was 7.80 percent as of December 31, 1994, compared with 7.79 percent as of December 31, 1993 and 8.68 percent as of December 31, 1992. The decrease in yield in 1993 from the year-end 1992 level was due primarily to increased prepayments of higher coupon mortgages, lower yields on mortgage purchases, an increase in the proportion of intermediate-term, fixed-rate mortgages in portfolio, and adjustable-rate mortgage ("ARM") rate adjustments as interest rates declined in 1993. Management expects the yield on the net mortgage portfolio to increase during 1995 as a result of new loan purchases at higher yields and ARMs adjusting upward in the higher interest rate environment.

The following table summarizes mortgage purchases, sales, and repayments for the years 1992 through 1994.

Mortgage Purchases, Sales, and Repayments
(Dollars in millions)

	Purchases			Sales			Repayments (1)		
	1994	1993	1992	1994	1993	1992	1994	1993	1992
Mortgage type:									
Single-family:									
Government insured or guaranteed	$ 4,751	$ 1,590	$ 951	$ —	$ —	$ —	$ 1,617	$ 2,084	$ 1,825
Conventional:									
Long-term, fixed-rate	39,426	45,705	32,846	1,048	6,209	5,828	11,868	24,853	18,897
Intermediate-term, fixed-rate	15,378	38,940	30,775	726	684	2,978	11,110	17,712	10,389
Adjustable-rate	1,223	2,597	9,091	—	—	—	3,541	5,727	5,573
Second	8	29	136	—	—	—	248	617	849
Total single-family	60,786	88,861	73,799	1,774	6,893	8,806	28,384	50,993	37,533
Multifamily	1,603	3,176	2,106	28	42	1	1,008	1,372	434
Total	$62,389	$92,037	$75,905	$1,802	$6,935	$8,807	$29,392	$52,365	$37,967
Average net yield	7.75%	6.89%	7.77%				8.11%	8.56%	9.22%
Repayments as a percentage of average mortgage portfolio							14.2%	30.5%	26.8%

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

The decrease in mortgage purchases in 1994 as compared with 1993 was primarily due to a decrease in the number of mortgages offered for sale in the secondary market, resulting in large part from the substantial slowdown in refinancing activity because of rising mortgage rates. The rising interest rate environment also prompted the origination of more adjustable-rate loans, which lenders are more likely to retain or purchase for their portfolios. The Corporation increased its purchases of mortgage securities from $6.3 billion in 1993 to $24.6 billion in 1994, which helped support portfolio growth.

The increase in mortgage purchases in 1993 compared with 1992 was due principally to the high level of refinancing activity resulting from the substantial decline in mortgage interest rates. This, in

turn, resulted in a large increase in both the number of mortgage originations and the number of new mortgages offered for sale in the secondary market.

The lower sales level in 1994, compared with 1993 and 1992, primarily reflected the reduced volume of loan originations during the period. Mortgage sales in connection with buy/sell activities were $1.8 billion, $6.6 billion, and $7.5 billion in 1994, 1993, and 1992, respectively. Buy/sell refers to the Corporation's practice of committing to purchase mortgages and, upon delivery, immediately selling the mortgages as MBS. This activity generally occurs during periods characterized by narrow spreads between mortgage yields and the Corporation's debt cost, when management does not consider it desirable to invest in mortgages. Buy/sell activity does not materially affect net interest margin, nor does it generate significant gains or losses.

Financing Activities

Debt Issued and Outstanding

The average cost of debt outstanding at December 31, 1994 was 6.78 percent, compared with 6.53 percent and 7.21 percent at December 31, 1993 and 1992, respectively. The increase in the average cost during 1994 was primarily the result of higher interest rates and the lengthening of debt to match the extension in the duration of mortgage assets. The decrease in 1993 compared with 1992 was the result of achieving a cost of funds on net new debt (debt issued less debt repaid) that was lower than the average cost of debt outstanding. The average maturity of effective long-term, fixed-rate debt outstanding at December 31, 1994 and 1993 was 69 months and 67 months, respectively.

The following table sets forth the amount and average cost of debt issued and repaid during the last three years, and of debt outstanding at the end of each of those years.

Debt Issued, Repaid, and Outstanding
(Dollars in millions)

	1994	1993	1992
Issued during the year:			
Short-term(1):			
Amount	$564,014	$289,904	$203,230
Average cost	4.58%	2.96%	3.43%
Long-term(1):			
Amount	$ 39,238	$ 46,425	$ 30,599
Average cost	6.19%	5.19%	6.24%
Total debt:			
Amount	$603,252	$336,329	$233,829
Average cost(2)	4.76%	3.39%	3.81%
Repaid during the year:			
Short-term(1):			
Amount	$523,656	$275,992	$179,254
Average cost	4.21%	2.99%	3.60%
Long-term(1):			
Amount	$ 23,595	$ 24,938	$ 21,508
Average cost	8.19%	7.79%	8.53%
Total debt:			
Amount	$547,251	$300,930	$200,762
Average cost(2)	4.39%	3.39%	4.13%
Outstanding at year-end:			
Due within one year:			
Net amount	$112,602	$ 71,950	$ 56,404
Average cost	6.05%	4.20%	4.56%
Due after one year:			
Net amount	$144,628	$129,162	$109,896
Average cost	6.97%	7.06%	8.06%
Total debt:			
Net amount	$257,230	$201,112	$166,300
Average cost(2)	6.78%	6.53%	7.21%

(1) Short-term refers to the face amount of debt issued with an original term of one year or less. Long-term is the face amount of debt issued with an original term greater than one year.

(2) Average cost includes the amortization of issuance costs and hedging results, and the effect of currency, debt, and interest rate swaps.

The following table presents the amount of callable debt and the notional amount of callable swaps issued and outstanding for each year.

Callable Debt and Swaps
(Dollars in billions)

	1994	1993	1992
Issued during the year	$ 22.2	$43.9	$30.7
Percentage of total long-term debt issued(1)	45%	80%	83%
Outstanding at year-end	$101.9	$93.5	$63.2
Percentage of total long-term debt outstanding(1)	55%	58%	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 during 1994 from callable to noncallable debt primarily reflected the need to lengthen the duration of the funding mix in response to the lengthening of the portfolio duration.

Off-Balance-Sheet Financial Instruments

The Corporation uses a variety of off-balance-sheet financial instruments, including risk management derivatives, to mitigate interest rate risk on its mortgage portfolio and to reduce its debt costs. Examples of Fannie Mae's use of these instruments include interest rate swaps, callable swaps to synthetically create callable funding, and short sales of Treasury securities to hedge daily interest rate fluctuations. Fannie Mae does not speculate using derivatives and is not a derivatives trader or dealer.

Interest rate swaps provide the specific cash flows or characteristics the portfolio requires but that might not be as readily available or cost effective if obtained in the standard debt market. They also allow the Corporation to issue a wider range of debt instruments giving it greater access to a broad array of investors and low-cost alternatives to standard funding structures. Callable swaps provide the Corporation with an additional tool to match-fund mortgages effectively and to increase flexibility among its funding alternatives. Short sales enable the Corporation to maintain an orderly and cost effective debt issuance schedule so that it can make daily loan purchase commitments without increasing its interest rate exposure.

At December 31, 1994 and 1993, the Corporation had total notional principal outstanding of $87.9 billion and $49.8 billion, respectively, of interest rate swaps. Notional amounts, however, do not represent the market or credit risk of interest rate swaps. The Corporation's swaps had a weighted-average term of 79 months at year-end 1994 and 78 months at year-end 1993. Long-term debt outstanding, including the effect of swaps and excluding effective variable-rate debt (*i.e.*, long-term debt that reprices within one year), totaled $186.7 billion at December 31, 1994 and $160.8 billion at December 31, 1993. Interest rate swaps lengthened the final maturity of the Corporation's liabilities by 15 months and 11 months at December 31, 1994 and 1993, respectively.

The risks posed by off-balance-sheet financial instruments are mainly credit-related. Credit risk for a swap is the risk that the counterparty fails to meet its contractual obligations on that swap transaction, causing the Corporation to have to replace the swap at market prices. Fannie Mae manages credit risk by dealing only with experienced swap counterparties with high credit quality, diversifying its swaps across many counterparties, ensuring that swaps generally are executed under master agreements which provide for netting of certain amounts payable by each party, and requiring the use of collateral agreements.

Collateral agreements require counterparties to post collateral if the Corporation is exposed to credit loss on the related swaps exceeding an agreed-upon threshold. The amount of required

collateral is based on credit ratings and the level of credit exposure. The Corporation generally requires overcollateralization from counterparties whose credit ratings have dropped below predetermined levels. Fannie Mae regularly monitors the exposures on its interest-rate swaps book by marking the positions to market via option pricing models and dealer quotes. At December 31, 1994, over 99 percent of the notional principal of outstanding swaps was with counterparties rated A or better (38 percent with counterparties rated AA or better), and 96 percent of the notional principal of outstanding swaps had collateral arrangements.

The gross maximum credit risk for interest rate swaps, were all counterparties to default simultaneously on their obligations to Fannie Mae and were Fannie Mae unable to offset amounts owed to counterparties against such obligations, was $3.6 billion at December 31, 1994 and $0.4 billion at December 31, 1993. However, including the effect of netting provisions in the related swap agreements, the net exposures were $3.0 billion and $0.2 billion, respectively.

Additional information on off-balance-sheet financial instruments is presented in the Notes to Financial Statements, "Financial Instruments with Off-Balance-Sheet Risk" and "Disclosures of Fair Value of Financial Instruments."

Liquidity and Capital Resources

Fannie Mae's statutory mission requires that it provide ongoing assistance to the secondary market for mortgage loans. The Corporation, therefore, must raise funds continually to support its mortgage purchase activity. The capital markets traditionally have treated the Corporation's obligations as "federal agency" debt. As a result, even though its debt is not guaranteed by the U.S. government, the Corporation has had ready access to sufficient funds at relatively favorable rates.

Fannie Mae's primary sources of cash are issuances of debt obligations, mortgage loan repayments, interest income, MBS guaranty fees, and the sale of mortgages. In addition, at December 31, 1994, Fannie Mae had cash and a portfolio of cash equivalents and shorter term investments totaling $46.6 billion. Primary uses of cash include the purchase of mortgages, repayment of debt, payment of interest and administrative expenses, and payment of taxes.

At December 31, 1994, the Corporation had mandatory delivery commitments and lender-option commitments outstanding to purchase $1.4 billion and $1.6 billion of mortgage loans, respectively, compared with $7.0 billion and $7.4 billion, respectively, outstanding at December 31, 1993.

At December 31, 1994, the Corporation's capital base (stockholders' equity plus allowance for losses) had grown to $10.4 billion, compared with $8.9 billion and $7.6 billion at the end of 1993 and 1992, respectively. At December 31, 1994, there were 273 million shares of common stock outstanding. In 1994, the Board of Directors began increasing the quarterly dividend once per year, in January. In January 1995, the Board approved a quarterly dividend rate of 68 cents per share for 1995; in 1994, the quarterly dividend rate was 60 cents per share.

During 1994 and 1993, the Corporation repurchased 0.9 million and 1.9 million shares of common stock, respectively. The shares were purchased to offset the dilutive effect of shares previously issued or anticipated to be issued under employee stock-related benefit plans.

Regulatory Capital Requirements

The Corporation is subject to capital adequacy standards established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("1992 Act"). The capital standards apply equally to Fannie Mae and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Three separate capital standards apply: a critical capital standard, a minimum capital standard, and a risk-based capital standard. To meet the critical capital standard Fannie Mae's core capital must equal the sum of (1) 1.25 percent of on-balance-sheet assets; (2) 0.25 percent of outstanding MBS; and (3) 0.25 percent of other off-balance-sheet obligations, except as adjusted by the Director of the Office of Federal Housing Enterprise Oversight (the "Director"), the regulator charged with seeing that the

Corporation is adequately capitalized. Core capital is defined as the sum of: (a) the par value of outstanding common stock, (b) the par value of outstanding perpetual noncumulative preferred stock, (c) paid-in capital, and (d) retained earnings. The Corporation also is subject to a minimum capital standard. Beginning in April 1994, to meet the minimum capital standard, Fannie Mae's core capital was required to equal the sum of (1) 2.50 percent of on-balance-sheet assets; (2) 0.45 percent of outstanding MBS; and (3) 0.45 percent of other off-balance-sheet obligations, except as adjusted by the Director.

The Corporation met the applicable minimum and critical capital standards as of December 31, 1994. Stockholders' equity as of that date was $9.5 billion, compared with required minimum capital of $9.4 billion and required critical capital of $4.9 billion.

The Director is currently developing, consistent with parameters specified in the 1992 Act, a risk-based capital standard. The risk-based standard includes credit and interest rate risk components along with an additional amount of capital for management and operations risk. To meet the standard, the Corporation must hold total capital equal to (1) the level of capital necessary to meet the combined occurrence of highly stressful credit and interest rate conditions for a ten-year period, and (2) 30 percent of such level of capital for management and operations risk. Total capital is defined as the sum of core capital and a general loss allowance. The new regulations implementing the risk-based standard are expected to be finalized in 1996. The 1992 Act provides that these regulations will be enforceable one year after issuance.

Mortgage-Backed Securities

At December 31, 1994, there were $530.3 billion of MBS outstanding, compared with $495.5 billion at December 31, 1993, and $445.0 billion at December 31, 1992. MBS are backed by loans from a single lender, multiple lenders, or from the Corporation's mortgage portfolio. Single-lender MBS are issued through lender swap transactions in which a lender exchanges pools of mortgage loans for MBS. Multiple-lender MBS allow several lenders to pool mortgage loans together and, in return, receive MBS (called Fannie Majors®) representing a proportionate share of a larger pool. Loans acquired by the Corporation to support buy/sell activity are designated as available for sale and sold from the portfolio as MBS.

MBS frequently are used to back other securities, including Fannie Megas®, Stripped MBS ("SMBS"), and REMICs. In 1994 and 1993, Fannie Mae also issued REMIC securities and SMBS backed by REMICs, SMBS, and mixed mortgage securities. Fannie Megas allow investors to consolidate small or partially paid down pools of MBS of the same type and pass-through rate. In return, the investor receives a certificate representing an undivided interest in the consolidated pool. SMBS and REMICs represent interests in a trust having multiple classes that entitle investors to cash flows structured differently from the payments on the underlying mortgage loans.

MBS are not assets of the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities. However, the Corporation is liable under its guarantee to make timely payment of principal and interest to investors. The issuance of MBS creates guaranty fee income for Fannie Mae. Sellers of pools of mortgage loans may retain or transfer to one or more third parties the primary default risk on loans comprising the MBS pools, or they may elect to transfer this credit risk to Fannie Mae. The guaranty fee paid by the lender varies depending upon the risk profile of the loans securitized as well as the level of credit risk assumed by Fannie Mae. The Corporation, however, assumes the ultimate risk of loss on all MBS.

The following table summarizes MBS issued and outstanding for the years ended December 31, 1994, 1993, and 1992.

MBS Issued and Outstanding
(Dollars in millions)

	Issued				Outstanding (1)		
	Lender Originated (1)						
	Lender Risk	Fannie Mae Risk	Fannie Mae Originated	Total	Lender Risk (2)	Fannie Mae Risk (3)	Total (4)
1994	$11,698	$114,526	$ 4,398	$130,622	$58,565	$471,778	$530,343
1993	6,837	201,561	13,046	221,444	61,183	434,342	495,525
1992	12,344	168,396	13,297	194,037	79,809	365,170	444,979

(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 $30.5 billion, $33.8 billion, and $39.7 billion at December 31, 1994, 1993, and 1992, 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 $5.2 billion at December 31, 1994, $6.4 billion at December 31, 1993 and $8.0 billion at December 31, 1992 that are backed by government insured or guaranteed mortgages.

(4) Included are $44.0 billion, $24.2 billion, and $20.5 billion at December 31, 1994, 1993, and 1992, respectively, of MBS in portfolio.

Fannie Mae issued a smaller amount of MBS in 1994 than it issued during its record 1993 year or in 1992. This was primarily due to a reduction in refinance activity in a higher interest rate environment and, in part, to higher interest rates prompting a greater percentage of adjustable-rate mortgages to be originated, which many lenders desire to hold in their portfolio. The increase in MBS issued in 1993 compared with 1992 was principally due to an increase in the volume of fixed-rate mortgages originated and available in the secondary market to create MBS, as a result of the high level of refinancings brought about by substantially lower interest rates during 1993.

In 1994, REMIC issuances totaled $56.3 billion, compared with $168.0 billion in 1993, and $154.8 billion in 1992. The decrease in REMIC issuances in 1994 reflected the decline in volume of fixed-rate MBS in a higher interest rate environment. In addition, higher interest rates caused a substantial amount of already outstanding REMICs to become available for sale and reduced opportunities for dealers to create profitable new REMIC structures, which reduced demand for new REMICs. The increase in REMIC issuances in 1993 compared with 1992 resulted from the greater availability of underlying MBS, as well as a demand for investments with a variety of average life and prepayment characteristics.

Fannie Mae has issued REMICs backed by both Fannie Mae and Government National Mortgage Association ("Ginnie Mae") mortgage-backed securities. REMICs provide an additional source of fee income that does not subject the Corporation to added credit risk. The outstanding balance of REMICs as of December 31, 1994 was $315.0 billion, compared with $323.4 billion and $276.9 billion as of December 31, 1993 and 1992, respectively. Management expects REMIC volume and fees to decline in 1995 due to lower projected average MBS volumes, an expectation of reduced demand due to recent adverse publicity about certain types of REMICs and derivative securities, and because of the recent rise in interest rates and flatter yield curve.

Housing Goals

For 1994, the Secretary of Housing and Urban Development ("HUD") established housing goals for the Corporation. These included a goal that 30 percent of the Corporation's conventional mortgage business, measured by dwelling units, serve families with incomes at or below the median income in the area in which they live, and a goal that 30 percent of such business, again measured by dwelling units, finance housing in central cities. Units meeting both tests count against both goals. During the combined two-year transition period of 1993 and 1994, HUD had an additional Special Affordable Housing goal for the Corporation to purchase conventional mortgages financing housing for low- and very-low-income families in an amount that exceeded its 1992 purchases of such mortgages by $2 billion. Half the increase, by dollars, had to relate to multifamily housing and half to one- to four-family properties. For 1995, HUD has temporarily extended the 1994 goals relating to housing for low- and moderate-income families and housing in central cities. HUD also has set a temporary 1995 goal for special affordable housing in the amount of $4.6 billion. HUD has announced that it plans to adopt adjusted housing goals, which will supersede the temporary goals for the remainder of 1995.

In 1994, the Corporation exceeded the low- and moderate-income housing goal with 45.7 percent of its conventional business serving families whose income was at or below the median for the areas where they live. In addition, 31.5 percent of the conventional business in 1994 served families in central cities. The comparable percentages for low- and moderate-income and central cities business in 1993 were 35.6 percent and 26.3 percent, respectively. In 1994, 59 percent of all units financed by the Corporation met at least one of these two goals. Additionally, the Corporation exceeded its two-year (1993-1994) Special Affordable Housing target by $4.8 billion.

Fannie Mae has built a solid foundation in affordable housing through significant consumer outreach efforts, product initiatives directed at certain disadvantaged groups and the implementation of programs with targeted underwriting flexibilities, including an initiative to purchase loans with lower down payments to aid low-income households in affording homes.

During 1994, the Corporation introduced an initiative called "Showing America a New Way Home" to provide $1 trillion between 1994 and the end of the year 2000 to finance homes for families and communities most in need. This targeted housing finance will serve families with incomes below the median for their area, minorities and new immigrants, families who live in central cities and distressed communities, and people with special housing needs.

New Accounting Standards

During 1994, the Financial Accounting Standards Board issued Financial Accounting Standard No. 118, "Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures" ("FAS 118"), and Financial Accounting Standard No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments" ("FAS 119").

FAS 118 is an amendment of Financial Accounting Standard No. 114, "Accounting by Creditors for Impairment of a Loan" ("FAS 114"), and allows a creditor to use existing methods for recognizing interest income on an impaired loan. FAS 114 requires loans that will not be repaid in accordance with their contractual terms to be measured using a discounted cash flow methodology or the fair value of the collateral. With limited exceptions, smaller balance loans, including single-family residential mortgages, are excluded from the scope of the statement. Implementation of FAS 114 and FAS 118 is required beginning in 1995.

FAS 119 requires disclosures about the amounts, nature, and terms of derivative financial instruments. It also requires that a distinction be made between financial instruments held or issued for trading purposes and those issued for purposes other than trading. Implementation was required for the year ended December 31, 1994.

In management's opinion, neither standard is expected to have a material impact on the Corporation.

FANNIE MAE

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Fannie Mae:

We have audited the accompanying balance sheets of Fannie Mae (Federal National Mortgage Association) as of December 31, 1994 and 1993, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1994. These financial statements are the responsibility of Fannie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fannie Mae as of December 31, 1994 and 1993, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1994, in conformity with generally accepted accounting principles.

We also have audited in accordance with generally accepted auditing standards the supplemental fair value balance sheets of Fannie Mae as of December 31, 1994 and 1993 included in Note 10 to the financial statements. The supplemental fair value balance sheets have been prepared by management to present relevant financial information that is not provided by the financial statements and is not intended to be a presentation in conformity with generally accepted accounting principles. In addition, the supplemental fair value balance sheets do not purport to present the net realizable, liquidation, or market value of Fannie Mae as a whole. Furthermore, amounts ultimately realized by Fannie Mae from the disposal of assets may vary from the fair values presented. In our opinion, the supplemental fair value balance sheets included in Note 10 present fairly, in all material respects, the information set forth therein on the basis of accounting described in Note 10.

KPMG Peat Marwick LLP

Washington, DC
January 11, 1995

FANNIE MAE

STATEMENTS OF INCOME

	Year Ended December 31,		
	1994	1993	1992
	(Dollars in millions, except per share amounts)		
Interest income:			
Mortgage portfolio	$15,851	$13,957	$12,650
Investments and cash equivalents	1,496	876	884
Total interest income	17,347	14,833	13,534
Interest expense:			
Short-term debt	2,315	1,345	1,326
Long-term debt	12,209	10,955	10,150
Total interest expense	14,524	12,300	11,476
Net interest income	2,823	2,533	2,058
Other income:			
Guaranty fees	1,083	961	834
Gain (loss) on sales of mortgages, net	(2)	(1)	23
Miscellaneous, net	145	260	168
Total other income	1,226	1,220	1,025
Other expenses:			
Provision for losses	155	175	320
Foreclosed property	223	130	—
Administrative	525	443	381
Total other expenses	903	748	701
Income before federal income taxes and extraordinary item	3,146	3,005	2,382
Provision for federal income taxes	1,005	963	733
Income before extraordinary item	2,141	2,042	1,649
Extraordinary loss: early extinguishment of debt (net of tax effect of $6 million, $91 million, and $14 million in 1994, 1993, and 1992, respectively)	9	169	26
Net income	$ 2,132	$ 1,873	$ 1,623
Per common share:			
Earnings before extraordinary item	$ 7.80	$ 7.44	$ 6.00
Net earnings	7.77	6.82	5.91
Cash dividends	2.40	1.84	1.38
Average shares outstanding used to compute earnings per share (in millions)	274	274	275

See Notes to Financial Statements

FANNIE MAE

BALANCE SHEETS

Assets

	December 31,	
	1994	1993
	(Dollars in millions)	
Mortgage portfolio, net	$220,525	$189,892
Investments	46,335	21,396
Cash and cash equivalents	231	977
Accrued interest receivable	1,688	1,257
Acquired property and foreclosure claims, net	636	679
Other	3,093	2,778
Total assets	$272,508	$216,979

Liabilities and Stockholders' Equity

	1994	1993
Liabilities:		
Debentures, notes, and bonds, net:		
Due within one year	$112,602	$ 71,950
Due after one year	144,628	129,162
Total	257,230	201,112
Accrued interest payable	3,138	2,921
Other	2,599	4,894
Total liabilities	262,967	208,927
Stockholders' Equity:		
Common stock, $2.10 stated value, no maximum authorization, issued 282,193,291 shares (1994) and 282,180,295 shares (1993)	593	593
Additional paid-in capital	1,365	1,308
Retained earnings	7,933	6,470
	9,891	8,371
Less: treasury stock, at cost, 9,391,093 shares (1994) and 9,730,105 shares (1993)	350	319
Total stockholders' equity	9,541	8,052
Total liabilities and stockholders' equity	$272,508	$216,979

See Notes to Financial Statements

FANNIE MAE

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Number of Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
	(Dollars and shares in millions)					
Balance, January 1, 1992	273	$593	$1,245	$3,853	$(144)	$5,547
Net income	—	—	—	1,623	—	1,623
Dividends	—	—	—	(377)	—	(377)
Shares repurchased	(1)	—	—	—	(76)	(76)
Treasury stock issued for stock options and benefit plans	1	—	32	—	25	57
Balance, December 31, 1992	273	593	1,277	5,099	(195)	6,774
Net income	—	—	—	1,873	—	1,873
Dividends	—	—	—	(502)	—	(502)
Shares repurchased	(2)	—	—	—	(145)	(145)
Treasury stock issued for stock options and benefit plans	1	—	31	—	21	52
Balance, December 31, 1993	272	593	1,308	6,470	(319)	8,052
Net income	—	—	—	2,132	—	2,132
Dividends	—	—	—	(656)	—	(656)
Shares repurchased	(1)	—	—	—	(67)	(67)
Treasury stock issued for stock options and benefit plans	2	—	57	—	36	93
Securities available for sale, market value adjustment, net of tax effect	—	—	—	(13)	—	(13)
Balance, December 31, 1994	273	$593	$1,365	$7,933	$(350)	$9,541

See Notes to Financial Statements

FANNIE MAE

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1994	1993	1992
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	$ 2,132	$ 1,873	$ 1,623
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for losses	155	175	320
Loss on early extinguishment of debt	15	260	40
Other increases (decreases), net	(543)	197	1,507
Net cash provided by operating activities	1,759	2,505	3,490
Cash flows from investing activities:			
Purchases of mortgages	(61,491)	(92,938)	(75,995)
Proceeds from sales of mortgages	1,819	7,024	8,866
Mortgage principal repayments	27,902	51,370	37,195
Net proceeds from disposition of foreclosed properties	2,001	1,424	673
Net increase in investments	(24,939)	(1,822)	(6,528)
Net cash used in investing activities	(54,708)	(34,942)	(35,789)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	39,181	46,382	30,643
Payments to redeem long-term debt	(23,605)	(25,105)	(21,534)
Proceeds from issuance of short-term debt	567,026	293,567	202,105
Payments to redeem short-term debt	(529,746)	(281,241)	(179,254)
Net payments from stock activities	(653)	(594)	(403)
Net cash provided by financing activities	52,203	33,009	31,557
Net increase (decrease) in cash and cash equivalents	(746)	572	(742)
Cash and cash equivalents at beginning of year	977	405	1,147
Cash and cash equivalents at end of year	$ 231	$ 977	$ 405
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 13,940	$ 12,220	$ 11,231
Income taxes	1,007	1,059	927

See Notes to Financial Statements

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Fannie Mae is a federally chartered and stockholder-owned corporation operating in the residential mortgage finance industry. The accounting and reporting policies of the Corporation conform with generally accepted accounting principles. Certain amounts in prior years' financial statements have been reclassified to conform with the current presentation.

Mortgage Portfolio and Investments

On January 1, 1994, the Corporation adopted Financial Accounting Standard No. 115, "Accounting for Investments in Certain Debt and Equity Securities" ("FAS 115"), which requires that debt securities be classified as either held-to-maturity, available-for-sale, or trading securities. Mortgages and mortgage-backed securities that the Corporation has the ability and positive intent to hold to maturity are classified as held to maturity and are carried at their unpaid principal balances adjusted for unamortized purchase discount or premium and deferred loan fees. Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in gain/loss on sales of mortgages. Mortgage-backed securities that the Corporation intends to hold for an undetermined period of time, but not necessarily to maturity, are classified as available for sale and are carried at fair value, with any valuation adjustments reported in retained earnings, net of deferred taxes.

The Corporation uses actual principal prepayment experience and estimates of future principal prepayments in calculating the constant effective yield necessary to apply the interest method in the amortization of loan fees and purchase discount or premium. In evaluating prepayments, loans are aggregated by similar characteristics (*e.g.*, loan type, acquisition date, and maturity). Factors used in determining estimates of future prepayments include historical prepayment data and expected prepayment performance under varying interest rate scenarios.

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

Nonmortgage investments are carried at their historical cost adjusted for unamortized discount or premium. The Corporation has the ability and positive intent to hold nonmortgage investments until their maturity.

Guaranteed Mortgage-Backed Securities

The Corporation guarantees the timely payment of principal and interest on Fannie Mae Mortgage-Backed Securities ("MBS"). These securities represent beneficial interests in pools of mortgages or other mortgage-backed securities held in trust by the Corporation. The pools of mortgages or mortgage-backed securities are not assets of the Corporation, except when acquired for investment purposes, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets. The Corporation receives monthly guaranty fees for each MBS mortgage pool based on a percentage of the pool's outstanding balance. Adjustments to the guaranty fee rate effected through an upfront payment at securitization are deferred and amortized into guaranty fee income over the estimated life of the underlying loans using the interest method. For MBS pools held in the Corporation's portfolio, the guaranty fee is reflected as interest income.

Allowance for Losses

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

Acquired Property

At December 31, 1992, the Corporation implemented Statement of Position No. 92-3, "Accounting for Foreclosed Assets" ("SOP 92-3"). In accordance with SOP 92-3, foreclosed assets are recorded at the lower of cost or fair value less estimated costs to sell. Cost is defined as fair value at foreclosure and represents the amount that a willing seller could reasonably expect from a willing buyer in an arm's-length transaction. The difference between fair value at foreclosure and the principal owed is recorded as a charge-off. Foreclosure, holding, and disposition costs are charged directly against earnings as incurred.

Prior to adoption of SOP 92-3, the difference between estimated net realizable value, which took into consideration foreclosure, holding, disposition, and interest carrying costs, and the principal owed was recorded as a charge-off.

Gain/Loss on Sales of Mortgages

When the Corporation places mortgages in MBS pools and sells them as securities, a gain or loss is recognized to the extent the sale proceeds differ from the recorded value of the mortgages sold. An adjustment to the gain or loss is recognized in an amount equal to the present value, after considering estimated prepayments, of the difference between the effective mortgage interest rate received by the Corporation and the sum of the pass-through rate paid to the investor and a normal guaranty fee.

Interest Expense and Risk Management Activities

Classification of interest expense as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of interest rate swaps.

The difference between the interest rates paid and received on interest rate swaps is recognized as an adjustment to interest income or expense on the related assets or liabilities over their expected lives.

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

Foreign Currency Translation

The Corporation issues debt securities in which principal, interest, or both are payable in a foreign currency or are determined by reference to an index that includes one or more foreign currencies. Concurrently, the Corporation enters into currency swaps that convert the proceeds of certain borrowings into dollars or provide for scheduled future exchanges of the currencies to insulate the Corporation against foreign exchange risk.

Foreign currency borrowings and the related net receivables and payables from currency swaps are translated at the market rates of exchange as of the balance sheet date.

Cash and Cash Equivalents

The Corporation considers highly liquid investment instruments, generally with an original maturity of three months or less, to be cash equivalents. Cash equivalents are carried at cost, which approximates market value.

Income Taxes

Deferred income tax assets and liabilities are established for temporary differences between financial and taxable income. Investment and other tax credits are deferred and amortized over the lives of the related assets.

On January 1, 1993, the Corporation adopted Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("FAS 109"). FAS 109 requires that deferred tax assets and liabilities arising from temporary differences between tax and financial income be measured using the current marginal statutory tax rate. Under FAS 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period enacted.

Earnings Per Share

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

2. Mortgage Portfolio, Net

The mortgage portfolio consisted of the following at December 31, 1994 and 1993.

	1994	1993
	(Dollars in millions)	
Single-family mortgages:		
Government insured or guaranteed	$ 11,659	$ 8,525
Conventional:		
Long-term, fixed-rate	109,079	82,170
Intermediate-term, fixed-rate(1)	68,166	64,623
Adjustable-rate	16,718	19,439
Second	536	772
	206,158	175,529
Multifamily mortgages:		
Government insured	3,722	3,807
Conventional	12,177	11,525
	15,899	15,332
Total unpaid principal balance	222,057	190,861
Less:		
Unamortized discount and deferred loan fees, net	1,242	692
Allowance for losses	290	277
Net mortgage portfolio	$220,525	$189,892

(1) Intermediate-term consists of portfolio loans with contractual maturities at purchase equal to or less than 20 years, and MBS held in portfolio with maturities of 15 years or less at issue date.

Included in the mortgage portfolio are $50.5 billion and $27.7 billion of MBS and other mortgage-related securities at December 31, 1994 and 1993 with fair values of $48.3 billion and $28.8 billion, respectively. Mortgage assets available for sale were $0.1 billion and $0.3 billion at December 31, 1994 and 1993, respectively.

MBS held in portfolio at December 31, 1994 and 1993 included $12.4 billion and $2.0 billion, respectively, of Real Estate Mortgage Investment Conduits ("REMICs") and Stripped MBS ("SMBS"). REMICs and SMBS have the same type of credit risks as whole loans and MBS but generally have different interest rate risks. At December 31, 1994, these securities had aggregate gross unrealized losses of $535 million and gross unrealized gains of $31 million. At December 31, 1993, aggregate gross unrealized losses and gains were $31 million and $25 million, respectively.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

3. Allowance for Losses

Changes in the allowance for the years 1992 to 1994 are summarized below.

	Total
	(Dollars in millions)
Balance, January 1, 1992	$ 704
Provision	320
Net foreclosure losses charged off	(244)
Balance, December 31, 1992	780
Provision	175
Net foreclosure losses charged off	(114)
Balance, December 31, 1993	841
Provision	155
Net foreclosure losses charged off	(169)
Balance, December 31, 1994	$ 827

At December 31, 1994, $290 million of the allowance for losses is included in the Balance Sheet under "Mortgage portfolio, net," which represents the allocation for portfolio loan losses; $532 million is included under "Other liabilities" for estimated losses on MBS; and the remainder, or $5 million, which relates to unrecoverable losses on FHA loans, is included in "Acquired property and foreclosure claims, net." The corresponding amounts at December 31, 1993 were $277 million, $558 million, and $6 million, respectively.

4. Investments

Presented below are the amortized cost and fair value of nonmortgage investments at December 31, 1994 and 1993.

	1994				1993			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Federal funds	$13,298	$—	$ —	$13,298	$ 5,825	$—	$—	$ 5,825
Repurchase agreements	9,006	—	—	9,006	4,684	3	—	4,687
Commercial paper	7,719	5	—	7,724	1,023	1	—	1,024
Eurodollar time deposits	4,295	—	—	4,295	2,663	—	—	2,663
Asset-backed securities	3,796	—	66	3,730	3,557	51	3	3,605
Other	8,221	—	103	8,118	3,644	20	—	3,664
Total	$46,335	$ 5	$169	$46,171	$21,396	$75	$ 3	$21,468

The following table shows nonmortgage investments at December 31, 1994 and 1993 by remaining maturity with the amortized cost, fair value, and yield.

	1994			1993		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in millions)					
Due within one year	$41,044	$40,991	6.00%	$17,236	$17,242	3.60%
Due after one year through five years	1,495	1,450	6.45	603	621	4.39
	42,539	42,441	6.01	17,839	17,863	3.63
Asset-backed securities(1)	3,796	3,730	5.60	3,557	3,605	5.46
Total	$46,335	$46,171	5.98%	$21,396	$21,468	3.93%

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

5. Debentures, Notes, and Bonds, Net

Borrowings Due Within One Year

Borrowings due within one year at December 31, 1994 and 1993 are summarized below. Amounts are net of unamortized discount and premium.

	1994					1993				
	Outstanding at December 31		Average Outstanding During Year		Maximum Outstanding At Any Month End	Outstanding at December 31		Average Outstanding During Year		Maximum Outstanding At Any Month End
	Amount	Cost(1)	Amount	Cost(1)		Amount	Cost(1)	Amount	Cost(1)	
	(Dollars in millions)									
Short-term notes	$ 92,603	5.86%	$68,567	4.33%	$92,603	$52,508	3.37%	$40,688	3.33%	$52,508
Other short-term debt	6,592	5.43	5,436	4.16	7,853	5,969	3.05	3,980	3.27	6,256
Current portion of borrowings due after one year(2):										
Debentures	6,477	9.81				10,896	8.36			
Other	6,930	5.68				2,577	6.09			
Total due within one year	$112,602	6.05%				$71,950	4.20%			

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

(2) Information on average amount and cost of debt outstanding during the year and maximum amount outstanding at any month end is not applicable. See "Borrowings Due After One Year" for additional information.

Borrowings Due After One Year

Borrowings due after one year consisted of the following at December 31, 1994 and 1993.

		1994		1993	
	Maturity Date	Amount Outstanding	Average Cost (1)	Amount Outstanding	Average Cost (1)
		(Dollars in millions)			
Debentures, net of $192 million of discount for 1994 ($274 million for 1993)	1995-2022	$ 77,773	7.61%	$ 82,293	7.93%
Medium-term notes, net of $34 million of discount for 1994 ($33 million for 1993) (2)	1995-2024	64,547	6.10	43,514	5.32
Zero coupon securities and subordinated capital debentures, net of $11,507 million of discount for 1994 ($11,634 million for 1993)	1995-2019	1,262	10.67	1,137	10.65
Long-term other, net of $56 million of discount for 1994 ($60 million for 1993)	1995-2018	965	8.71	2,167	6.85
		144,547	6.97%	129,111	7.06%
Adjustment for foreign currency translation	—	81		51	
Total due after one year		$144,628		$129,162	

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

(2) Medium-term notes may be fixed-rate, floating-rate, or zero coupon with maturities ranging from one day to thirty years. Interest and principal may be payable in U.S. dollars or a foreign currency and may be indexed to foreign exchange rates or other indices.

Debentures, notes, and bonds at December 31, 1994 included $74.0 billion of callable debt, which generally is redeemable in whole or in part (and, in certain cases, at a specified premium), at the option of the Corporation any time on or after a specified date, and $0.5 billion of other debt instruments that are subject to mandatory redemptions tied to certain indices or rates after an initial nonredemption period.

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

Call Date	Year of Maturity	Amount Outstanding	Average Cost
		(Dollars in millions)	
Callable Debt and Callable Swaps (notional amount):			
Currently callable	1996-2019	$ 5,401	5.90%
1995	1996-2020	27,253	6.64
1996	1998-2021	32,570	6.23
1997	1999-2021	18,199	7.26
1998	2001-2022	12,405	6.48
1999	2003-2024	5,177	7.96
2000 and over	2003-2004	169	6.53
		101,174	6.63
Other redeemable debt and swaps	1995-2000	699	8.06
Total		$101,873	6.64%

Principal amounts at December 31, 1994 of total debt payable in the years 1996-2000 assuming callable debt is paid at maturity and assuming callable debt is redeemed at the initial call date are as follows:

	Total Debt by Year of Maturity	Assuming Callable Debt Redeemed at Initial Call Date
	(Dollars in millions)	
1996	$23,126	$46,011
1997	21,792	27,364
1998	31,006	14,778
1999	18,428	13,951
2000	6,647	4,209

In 1994 and 1993, the Corporation repurchased or called $14.1 billion of debt with an average cost of 8.42 percent and $15.5 billion with an average cost of 7.70 percent, respectively. The Corporation recorded extraordinary losses of $15 million ($9 million after tax) in 1994 and $260 million ($169 million after tax) in 1993 on the early extinguishment of debt.

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

6. Income Taxes

Components of the provision for federal income taxes for the years ended December 31, 1994, 1993, and 1992 were as follows:

	1994	1993	1992
	(Dollars in millions)		
Current	$1,083	$1,119	$ 852
Deferred	(78)	(156)	(119)
	1,005	963	733
Tax benefit of extraordinary loss	(6)	(91)	(14)
Net federal income tax provision	$ 999	$ 872	$ 719

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1994 and 1993 consisted of the following:

	1994	1993
	(Dollars in millions)	
Deferred tax assets:		
MBS guaranty and REMIC fees	$385	$359
Provision for losses	316	326
Purchase discount and deferred fees	50	50
Other items, net	41	37
Deferred tax assets	792	772
Deferred tax liabilities:		
Benefits from tax-advantaged investments	250	198
Hedging transactions	21	61
Other items, net	31	46
Deferred tax liabilities	302	305
Net deferred tax assets	$490	$467

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

Deferred federal income tax benefit relating to timing differences consisted of the following for the year ended December 31, 1992:

	1992
	(Dollars in millions)
Deferred commitment fees	$ (86)
Amortization of purchase discount	(46)
Loss on disposition of mortgages	11
Provision for losses	(26)
Benefits from tax-advantaged investments	29
Other items, net	(1)
Total deferred federal income tax benefit	$(119)

The Corporation's effective tax rates differed from statutory federal rates for the years ended December 31, 1994, 1993, and 1992 as follows:

	1994	1993	1992
Statutory corporate rate	35%	35%	34%
Tax exempt interest and dividends received deductions	(3)	(3)	(3)
Effective rate	32%	32%	31%

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

IRS Examinations

In June 1993, the U.S. Tax Court ruled in the Corporation's favor on an issue relating to the proper tax treatment of certain hedging gains and losses resulting from 1984 and 1985 transactions. The Corporation had claimed ordinary net losses on its tax returns, but the IRS asserted that the losses were capital. The IRS did not appeal the decision.

7. Employee Benefits

Stock Compensation Plans

The Federal National Mortgage Association Stock Compensation Plans authorize certain officers to receive performance awards, generally issued within an award period that can range from three to five years. The performance awards become actual awards only if the Corporation attains the goals set for the award period. At the end of such time, the awards generally are payable in common stock. The outstanding contingent grants made for the 1995-1997, 1994-1996, and 1993-1995 award periods were 128,190; 92,720; and 66,215 performance shares, respectively.

Stock options also may be granted to key employees and nonmanagement members of the Board of Directors under the plans. The options generally do not become exercisable until at least one year after the grant date and generally expire ten years from the grant date. The purchase price of the

common stock covered by each option is equal to the fair value of the stock on the date the option is granted. The following table summarizes stock option activity for the years 1992 to 1994.

	1994		1993		1992	
	Number of Options	Option Price	Number of Options	Option Price	Number of Options	Option Price
Balance, January 1	3,977,560	$ 5.38-$82.50	2,705,238	$ 5.38-$73.44	2,263,487	$ 5.38-$59.25
Granted	1,874,290	68.88- 86.94	1,519,170	73.44- 82.50	853,740	64.25- 73.44
Exercised	(221,621)	5.38- 79.88	(140,032)	5.38- 78.63	(362,681)	5.38- 55.75
Terminated	(106,584)	32.00- 78.63	(106,816)	15.75- 75.94	(49,308)	15.75- 55.75
Balance, December 31	5,523,645	$ 7.98-$86.94	3,977,560	$ 5.38-$82.50	2,705,238	$ 5.38-$73.44

At December 31, 1994 and 1993, stock options on 1,718,780 shares and 1,168,444 shares, respectively, were exercisable.

In 1994, 11,274 shares of restricted stock (56,825 shares in 1993) were awarded, issued, and placed in escrow under the Stock Compensation Plans and the Restricted Stock Plan for Directors; and 38,207 shares (29,777 shares in 1993) were released as vesting of participants occurred. Compensation expense is being recorded over the vesting period of the stock as services are performed.

Employee Stock Purchase Plan

The Corporation has an Employee Stock Purchase Plan that allows the issuance of up to nine million shares of common stock to qualified employees at a price equal to 85 percent of its fair market value on the first day of the period in which employees can elect to purchase the stock. In 1994, the Corporation granted each qualified employee, excluding certain officers, the right to purchase in January 1995 up to 284 shares of stock. Under the 1994 offering, 2,880 shares were purchased at $74.64 per share, compared with 856,900 shares purchased in 1994 at $68.58 per share under the plan's 1993 offering. The Board of Directors has approved a 1995 offering under the plan, granting each qualified employee the right to purchase 300 shares.

Employee Stock Ownership Plan

The Corporation has an Employee Stock Ownership Plan (ESOP) for qualified employees. The Corporation may contribute to the ESOP an amount based on defined earnings goals, not to exceed 4 percent of the aggregate base salary for all participants. The contribution is made in the subsequent year either in shares of Fannie Mae common stock or cash that is used to purchase such stock. The expense to the Corporation related to the ESOP was $3 million in both 1994 and 1993 and $2 million in 1992.

Retirement Savings Plan

All regular, full-time employees of the Corporation are eligible to participate in the Corporation's Retirement Savings Plan, which includes a 401(k) option. Employees may contribute up to the lesser of 12 percent of their base salary or the current annual dollar cap established and revised annually by the IRS, with the Corporation matching such contributions up to 3 percent of base salary. The Corporation contributed $5 million in 1994, $4 million in 1993, and $3 million in 1992.

Postretirement Benefit Plans

All regular, full-time employees of the Corporation are covered by a noncontributory retirement plan or by the contributory Civil Service Retirement Law. Benefits payable under the corporate plan are based on years of service and compensation using the average pay during the three consecutive highest paid years of employment. The Corporation's policy is to fund the pension expense accrued each year, up to the contribution that would be tax deductible for the year. Contributions to the plan reflect benefits attributed to employees' service to date as well as services expected to be rendered in the future. Plan assets consist primarily of listed stocks, fixed-income securities, and other liquid assets. No contributions were made to the retirement plan in recent years because the plan has been overfunded.

The following table sets forth the corporate retirement plan's funded status and amounts recognized in the Corporation's financial statements at December 31, 1994 and 1993.

	1994	1993
	(Dollars in millions)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $54.8 million ($55.8 million in 1993)	$(59.0)	$ (60.2)
Projected benefit obligation for services rendered to date	$(95.8)	$(102.1)
Plan assets at fair value	92.5	94.4
Projected benefit obligation in excess of plan assets	(3.3)	(7.7)
Unrecognized net gain (loss) from past experience different from that assumed and effects of changes in assumptions	(8.9)	2.6
Unrecognized prior service costs	0.2	1.6
Unrecognized net transition asset recognized over 18.25 years	(11.1)	(12.3)
Pension liability included in other liabilities	$(23.1)	$ (15.8)
Net pension cost included the following components:		
Service cost—benefits earned during the period	$ 9.0	$ 6.5
Interest cost on projected benefit obligation	8.3	6.9
Actual return on plan assets	0.2	(7.8)
Net amortization and deferral	(10.3)	(1.9)
Net periodic pension cost	$ 7.2	$ 3.7

For 1994 and 1993, the weighted-average discount rate used in determining the actuarial present value of the projected benefit obligation was 8.5 percent and 7.5 percent, respectively; the average rate of increase in future compensation levels used in the calculation was 6.0 percent, and the expected long-term rate of return on assets was 9.5 percent. The Corporation uses the straight-line method of amortization for prior service costs.

The Corporation also has an Executive Pension Plan and a Supplemental Pension Plan, which supplement for key senior officers the benefits payable under the retirement plan. Estimated benefits under the supplementary plans are accrued as an expense over the period of employment. Accrued benefits for the Executive Pension Plan are funded through a trust.

Fannie Mae sponsors a postretirement health care plan that covers substantially all full-time employees. The plan pays stated percentages of most necessary medical expenses incurred by retirees, after subtracting payments by Medicare or other providers and after a stated deductible has been met. Participants become eligible for the benefits if they retire from the Corporation after reaching age 55 with 5 or more years of service. The plan is contributory, with retiree contributions adjusted annually. The expected cost of these postretirement benefits is charged to expense during the years that employees render service. Cost-sharing percentages are based upon length of service with the Corporation. Fannie Mae does not fund this plan.

The following table presents the component's of the Corporation's accrued postretirement health care cost liability and net postretirement health care cost as reflected in the financial statements at December 31, 1994 and 1993.

	1994	1993
	(Dollars in millions)	
Accumulated postretirement benefit obligation:		
Retirees	$(19.4)	$(20.0)
Other fully eligible participants	(3.7)	(3.0)
Other active participants	(15.6)	(17.0)
	(38.7)	(40.0)
Unrecognized actuarial gain	(7.8)	(2.0)
Unrecognized transition obligation	34.6	36.5
Accrued postretirement health care cost liability	$(11.9)	$ (5.5)
Net postretirement health care cost included the following components:		
Service cost—benefits attributed to service during the period	$ 2.7	$ 2.0
Interest cost on accumulated postretirement benefit obligation	3.2	3.4
Amortization of transition obligation over 20 years	1.9	1.9
Net postretirement health care cost	$ 7.8	$ 7.3

In determining the net postretirement health care cost for 1994 and the year-end accrued liability, an 11 percent annual rate of increase in the per capita cost of covered health care claims was assumed for 1994; the rate was assumed to decrease gradually to 5.5 percent over 9 years and remain at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1994 by $7 million and the aggregate of the service and interest cost components of net postretirement health care cost for the year then ended by $2 million. The weighted-average discount rates used in determining the health care cost and the year-end accumulated postretirement benefit obligation were 7.5 percent and 8.5 percent, respectively, in 1994 and 8.5 percent and 7.5 percent, respectively, in 1993.

8. Financial Instruments with Off-Balance-Sheet Risk

The Corporation is a party to transactions involving financial instruments with off-balance-sheet risk. The Corporation uses these instruments to fulfill its statutory purpose of meeting the financing

needs of the secondary mortgage market and to reduce its own exposure to fluctuations in interest rates. These financial instruments include MBS, commitments to purchase mortgages or to issue and guarantee MBS, credit enhancements, and certain hedge instruments. These instruments involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the balance sheet.

Guaranteed Mortgage-Backed Securities

As issuer and guarantor of MBS, the Corporation is obligated to disburse scheduled monthly installments of principal and interest (at the certificate rate) and the full unpaid principal balance of any foreclosed mortgage to MBS investors, whether or not any such amounts have been received. The Corporation also is obligated to disburse unscheduled principal payments received from borrowers.

The Corporation's credit risk is mitigated to the extent sellers of pools of mortgages elect to remain at risk on the loans sold to the Corporation. Lenders have the option to retain the primary default risk, in whole or in part, in exchange for a lower guaranty fee. Fannie Mae, however, bears the ultimate risk of default.

Commitments

The Corporation enters into master delivery commitments with lenders on either a mandatory or optional basis. Under a mandatory master commitment, a lender must either deliver loans under an MBS contract at a specified guaranty fee rate or enter into a mandatory portfolio commitment with the yield established upon executing the portfolio commitment.

The Corporation also will accept mandatory or lender option delivery commitments not issued pursuant to a master commitment. These commitments may be for portfolio or MBS. The guaranty fee rate on MBS lender option commitments is specified in the contract while the yield for portfolio lender option commitments is set at the date of conversion to a mandatory commitment.

The cost of funding future portfolio purchases generally is hedged upon issuance of, or conversion to, a mandatory commitment. Therefore, the interest rate risk relating to loans purchased pursuant to those commitments is largely mitigated.

Hedge Instruments

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

Short sales of Treasury securities, which are used to hedge interest rate risk on planned debt issuances, are obligations for the delivery of securities on a specified future date at a specified price. Gains and losses that result from the hedge position are deferred and recognized as an adjustment to the debt cost over the life of the hedged debt issuance. Credit risk arises from the possible inability or unwillingness of the counterparty to pay any difference between the agreed-upon price and the current securities price at settlement. This risk is reduced through evaluation of the creditworthiness of counterparties and continuous monitoring of hedge positions. The amounts of deferrable unrealized

gains and losses on open hedge positions were $3 million and $1 million at December 31, 1994, respectively, compared with $5 million and $1 million, respectively, at December 31, 1993. Total deferred gains and losses on closed positions were $247 million and $276 million, respectively, at December 31, 1994, compared with $152 million and $286 million, respectively, at December 31, 1993.

Interest rate swaps are contractual agreements between two parties for the exchange of periodic payments, generally based on a notional principal amount and agreed-upon fixed and variable rates. The Corporation has long-term interest rate swap agreements with various parties to extend the effective maturity of certain short-term debt obligations and to adjust the effective maturity of certain long-term debt obligations.

The Corporation also has interest rate swap agreements that are linked to specific debt issues (debt swaps) or specific investments (asset swaps). These swaps achieve a specific financing or investment objective at a desired cost or yield. The costs and terms of the specific debt issues and yield of the specific investments, as presented in the financial statements, include the effects of the swaps.

The Corporation reduces counterparty risk on interest rate swaps by dealing only with experienced swap counterparties with high credit quality, diversifying its swaps across many counterparties, ensuring that swaps generally are executed under master agreements which provide for netting of certain amounts payable by each party, and requiring the use of collateral agreements. At December 31, 1994, three counterparties, each with a credit rating of A or better, represented 58 percent of the notional amount of outstanding interest rate swaps.

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

Credit Enhancements

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

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Credit Exposure for Off-Balance-Sheet Financial Instruments

The following table presents the contract or notional amount of off-balance-sheet financial instruments at December 31, 1994 and 1993.

	1994	1993
	(Dollars in billions)	
MBS outstanding(1)	$485.8	$470.8
MBS outstanding with lender or third party recourse	(58.6)	(61.2)
Net MBS outstanding with Fannie Mae risk(1)	427.2	409.6
Master commitments:		
Mandatory	74.4	74.6
Optional	33.6	38.9
Portfolio commitments:		
Mandatory	1.4	7.0
Optional	0.9	0.7
MBS commitments:		
Mandatory	0.3	4.1
Optional	2.1	24.9
Short sales of Treasury securities	1.5	1.4
Interest rate swaps(2)	54.3	31.6
Debt swaps(3)	32.1	17.2
Asset swaps(4)	1.5	1.0
Credit enhancements	2.3	1.8

(1) Net of $44.0 billion and $24.2 billion of MBS held in portfolio at December 31, 1994 and 1993, respectively, and allowance for losses.

(2) The weighted-average interest rate being received under these swaps was 5.84 percent and the weighted-average interest rate being paid was 6.92 percent at December 31, 1994, compared with 3.55 percent and 6.64 percent, respectively, at December 31, 1993.

(3) The weighted-average interest rate being received under these swaps was 5.73 percent and the weighted-average interest rate being paid was 5.78 percent at December 31, 1994, compared with 4.45 percent and 3.79 percent, respectively, at December 31, 1993.

(4) The weighted-average interest rate being received under these swaps was 6.37 percent and the weighted-average interest rate being paid was 5.96 percent at December 31, 1994, compared with 3.63 percent and 6.03 percent, respectively, at December 31, 1993.

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

The Corporation's exposure to credit loss for off-balance-sheet financial instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all those off-balance-sheet financial instruments outstanding for which the Corporation was in a gain position. The Corporation's net exposure (taking into account master netting agreements) was $3.0 billion at December 31, 1994 and $246 million at December 31, 1993. At December 31, 1994, the Corporation had collateral with a market value of $1.2 billion pledged from counterparties to offset credit risk. No collateral was pledged from counterparties at December 31, 1993.

9. Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (borrowers, lenders, and mortgage insurers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations.

The following table presents unpaid principal balances ("UPB") by primary default risk and the general geographic distribution of properties underlying mortgages in the portfolio and MBS outstanding as of December 31, 1994 and 1993.

		Geographic Distribution					
1994	**Gross UPB**	**Northeast**	**Southeast**	**Midwest**	**Southwest**	**West**	**Total**
	(Dollars in millions)						
Fannie Mae risk	$636,339	21%	20%	17%	14%	28%	100%
Lender risk	72,062	29	16	12	11	32	100
Total	$708,401	22%	20%	16%	14%	28%	100%

		Geographic Distribution					
1993	**Gross UPB**	**Northeast**	**Southeast**	**Midwest**	**Southwest**	**West**	**Total**
	(Dollars in millions)						
Fannie Mae risk	$592,044	21%	20%	16%	14%	29%	100%
Lender risk	70,123	33	17	13	9	28	100
Total	$662,167	22%	20%	16%	13%	29%	100%

No significant concentration exists at the state level except for California, where, at December 31, 1994, 21 percent of total mortgages in portfolio and backing MBS were located, compared with 22 percent at December 31, 1993.

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

The Corporation uses more than 20 mortgage insurance ("MI") companies. Of these, nine private MI companies are the most active. Three mortgage insurers, all rated AAA, cover approximately 68 percent of the $166.9 billion of unpaid principal balance of portfolio and MBS outstanding at December 31, 1994, for which Fannie Mae requires insurance. The Corporation monitors on a regular basis the performance and financial strength of its mortgage insurers.

The following table presents the LTV ratio distribution of conventional single-family mortgages in portfolio and backing MBS at December 31, 1994 and 1993.

1994	Gross UPB	Loan-to-Value Ratio (1)						
		60% and Less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$612,620	21%	16%	15%	22%	17%	9%	100%
Lender risk	53,368	16	13	16	27	21	7	100
Total	$665,988	21%	16%	15%	22%	17%	9%	100%

1993	Gross UPB	Loan-to-Value Ratio (1)						
		60% and Less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$564,863	23%	16%	16%	22%	16%	7%	100%
Lender risk	57,539	17	13	16	27	21	6	100
Total	$622,402	22%	16%	16%	23%	16%	7%	100%

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

The rate at which mortgage loans prepay tends to be sensitive to the level and direction of prevailing market interest rates. In a declining interest rate environment, higher rate mortgage loans will pay off at a faster rate; conversely, in an increasing interest rate environment, lower interest rate mortgages will prepay at a slower rate. The following table presents the distribution by note rate of fixed-rate loans in the mortgage portfolio at December 31, 1994 and 1993.

Gross UPB at December 31,	Fixed-rate Portfolio by Note Rate (1)						
	Under 7.00%	7.00% to 7.99%	8.00% to 8.99%	9.00% to 9.99%	10.00% to 10.99%	11.00% and over	Total
	(Dollars in billions)						
1994	$20.2	$68.1	$37.4	$17.8	$7.8	$2.7	$154.0
Percent of total	13.1%	44.2%	24.3%	11.6%	5.1%	1.7%	100.0%
1993	$16.8	$60.5	$34.0	$18.8	$9.9	$3.7	$143.7
Percent of total	11.7%	42.1%	23.6%	13.1%	6.9%	2.6%	100.0%

(1) Excludes MBS and other mortgage securities held in portfolio.

10. Disclosures of Fair Value of Financial Instruments

The basic assumptions used and the estimates disclosed in the Fair Value Balance Sheets represent management's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to management as of December 31, 1994 and 1993. In certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors, and management's evaluation of those factors, change.

Although management uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. Therefore, these fair value estimates are not necessarily indicative of the amounts that the Corporation would realize in a market transaction. The accompanying Fair Value Balance Sheets do not represent an estimate of the overall market value of the Corporation as a going concern, which would take into account future business opportunities.

Fair Value Balance Sheets

Assets

	December 31, 1994		December 31, 1993	
	Cost	Fair Value	Cost	Fair Value
	(Dollars in millions)			
Mortgage portfolio, net	$220,525	$211,958	$189,892	$198,459
Investments	46,335	46,171	21,396	21,468
Cash and cash equivalents	231	231	977	977
Other assets	5,417	3,902	4,714	4,004
	272,508	262,262	216,979	224,908
Off-balance-sheet items:				
Guaranty fee income, net	—	2,654	—	1,788
Swap obligations in gain position, net	—	2,848	—	246
Other	—	10	—	59
Total assets	$272,508	$267,774	$216,979	$227,001

Liabilities and Net Equity

	December 31, 1994		December 31, 1993	
	Cost	Fair Value	Cost	Fair Value
Liabilities				
Noncallable debt:				
Due within one year	$112,077	$111,804	$ 69,613	$ 69,796
Due after one year	69,151	69,106	64,607	71,184
Callable debt:				
Due within one year	525	526	2,337	2,412
Due after one year	75,477	71,011	64,555	66,469
	257,230	252,447	201,112	209,861
Other liabilities	5,737	4,260	7,815	7,189
Off-balance-sheet item:				
Swap obligations in loss position, net	—	143	—	825
Total liabilities	262,967	256,850	208,927	217,875
Equity, net of tax effect	9,541	10,924	8,052	9,126
Total liabilities and net equity	$272,508	$267,774	$216,979	$227,001

See accompanying Notes to Fair Value Balance Sheets.

Notes to Fair Value Balance Sheets

The following discussion summarizes the significant methodologies and assumptions used in estimating the fair values presented in the accompanying Fair Value Balance Sheets.

Mortgage Portfolio, Net

The fair value calculations of the Corporation's mortgage portfolio take into consideration such variables as interest rates, credit quality, and loan collateral. Because an active market does not exist for a large portion of mortgage loans in the portfolio, the portfolio's unsecuritized mortgages were aggregated into pools by product type, coupon, and maturity. These pools then were converted into notional MBS by subtracting from the weighted-average interest rate less servicing fees the normal guaranty fee that Fannie Mae's securitization business would charge for a pool of loans with similar characteristics. The method for estimating this guaranty fee and the credit risk associated with the mortgage portfolio is described under "Guaranty Fee Income, Net."

The Corporation then employed an option-adjusted spread ("OAS") approach to estimate fair values for both notional MBS (the mortgage loan portfolio) and for MBS held in portfolio. The OAS represents the risk premium or incremental interest spread over Treasury rates that is included in a security's yield to compensate an investor for the uncertain effects of embedded prepayment options on mortgages. The OAS is calculated using quoted market values for selected benchmark securities and provides a generally applicable return measure that considers the effect of prepayment risk and interest rate volatility.

Investments

Fair values of the Corporation's investment portfolio were based on actual quoted prices or prices quoted for similar financial instruments.

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents was used as a reasonable estimate of their fair value.

Other Assets

Other assets include accrued interest receivable, net currency swap receivables, and several other smaller asset categories. The fair value of other assets, excluding certain deferred items that have no fair value, approximates their carrying amount. Net currency swap receivables, which are included in other assets at cost, are reclassified as a component of the fair value of the related foreign-denominated debt.

Guaranty Fee Income, Net

MBS are not assets owned by the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities of the Corporation. On MBS outstanding, the Corporation receives a guaranty fee equal to the spread between the net yield remitted to Fannie Mae and the pass-through rate paid to the owner of the securities. The guaranty fee represents a future income stream for the Corporation. Under generally accepted accounting principles, this guaranty fee is recognized as income over the life of the securities. The Fair Value Balance Sheets reflect the present value of guaranty fees, net of estimated future administrative costs and credit losses, and taking into account estimated prepayments.

The Corporation estimates the credit loss exposure attached to the notional MBS, MBS held in portfolio, and off-balance-sheet MBS where Fannie Mae has the primary risk of default. The Corporation deducts credit risk premiums from the contractual (or estimated contractual) guaranty fee to arrive at the net guaranty fee. The credit risk premiums are calculated using an internal forecasting model that estimates future credit losses based on actual historical loss experience for the Corporation. The net guaranty fee cash flows are then valued using an OAS method similar to that described under "Mortgage Portfolio, Net."

Swap Obligations, Net

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

Other Off-Balance-Sheet Items

The Corporation issues mandatory delivery commitments to purchase mortgages or issue MBS. Under mandatory delivery portfolio commitments, lenders are obligated to sell mortgages to the Corporation at the commitment yield. In certain instances, the Corporation enters into MBS sales commitments related to the commitments to purchase mortgages. Mandatory commitments to purchase mortgages have been valued based on the yield differential between required mortgage yields at the balance sheet date and actual commitment yields, discounted over the estimated life of the assets to be delivered, plus the estimated value of the expected guaranty fee, calculated as described under "Mortgage Portfolio, Net." MBS sales commitments have been valued based on the differential between MBS market prices at the balance sheet date and the prices on MBS sales commitments. Mandatory commitments to issue MBS have been valued based on the expected guaranty fee stream, as described above.

Noncallable and Callable Debt

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

Other Liabilities

Other liabilities include accrued interest payable, amounts payable to MBS holders, estimated losses on MBS, net currency swap payables, and several other smaller liability categories. The fair value of other liabilities, excluding certain deferred items that have no fair value, approximates their carrying amount, except for net currency swap payables, which are included as a component of the fair value of the related foreign-denominated debt, and credit loss exposure for MBS, which is included as a component of the net MBS guaranty fee.

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

FANNIE MAE

QUARTERLY RESULTS OF OPERATIONS (Unaudited)

The following unaudited results of operations include, in the opinion of management, all adjustments necessary for a fair presentation of the results of operations for such periods.

	1994 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per share amounts)			
Interest income	$4,743	$4,435	$4,196	$3,973
Interest expense	4,032	3,707	3,476	3,309
Net interest income	711	728	720	664
Guaranty fees	269	272	272	270
Gain (loss) on sales of mortgages, net	—	—	(4)	2
Miscellaneous income, net	26	28	32	59
Provision for losses	(35)	(40)	(40)	(40)
Foreclosed property expenses	(52)	(53)	(58)	(60)
Administrative expenses	(139)	(132)	(130)	(124)
Income before income taxes and extraordinary item	780	803	792	771
Provision for federal income taxes	(235)	(260)	(257)	(253)
Income before extraordinary item	545	543	535	518
Extraordinary gain (loss): early extinguishment of debt (net of tax effect)	8	—	(9)	(8)
Net income	$ 553	$ 543	$ 526	$ 510
Per share:				
Earnings before extraordinary item (1)	$ 1.99	$ 1.98	$ 1.95	$ 1.89
Net earnings	2.02	1.98	1.91	1.86
Cash dividends	0.60	0.60	0.60	0.60

	1993 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per share amounts)			
Interest income	$3,878	$3,759	$3,614	$3,582
Interest expense	3,243	3,097	2,982	2,978
Net interest income	635	662	632	604
Guaranty fees	253	243	235	230
Gain (loss) on sales of mortgages, net	(7)	3	(1)	4
Miscellaneous income, net	98	66	49	47
Provision for losses	(40)	(45)	(45)	(45)
Foreclosed property expenses	(30)	(31)	(36)	(33)
Administrative expenses	(123)	(110)	(107)	(103)
Income before income taxes and extraordinary item	786	788	727	704
Provision for federal income taxes	(254)	(260)	(229)	(220)
Income before extraordinary item	532	528	498	484
Extraordinary loss: early extinguishment of debt (net of tax effect)	(39)	(50)	(40)	(40)
Net income	$ 493	$ 478	$ 458	$ 444
Per share:				
Earnings before extraordinary item	$ 1.94	$ 1.93	$ 1.81	$ 1.76
Net earnings	1.80	1.74	1.67	1.61
Cash dividends	0.52	0.46	0.46	0.40

(1) The total of the four quarters does not equal the amount for the year because the amount for each period is calculated independently based on the weighted-average number of shares outstanding during that period.

FANNIE MAE

NET INTEREST INCOME AND AVERAGE BALANCES (Unaudited)

	1994	1993	1992
	(Dollars in millions)		
Interest income:			
Mortgage portfolio	$ 15,851	$ 13,957	$ 12,650
Investments and cash equivalents	1,496	876	884
Total interest income	17,347	14,833	13,534
Interest expense(1):			
Short-term debt	2,315	1,345	1,326
Long-term debt	12,209	10,955	10,150
Total interest expense	14,524	12,300	11,476
Net interest income	2,823	2,533	2,058
Tax equivalent adjustment(2)	134	119	118
Net interest income tax equivalent basis	$ 2,957	$ 2,652	$ 2,176
Average balances:			
Interest-earning assets(3):			
Mortgage portfolio, net	$205,998	$169,440	$139,004
Investments and cash equivalents	32,431	23,184	20,153
Total interest-earning assets	$238,429	$192,624	$159,157
Interest-bearing liabilities(1):			
Short-term debt	$ 53,856	$ 35,837	$ 27,877
Long-term debt	170,911	141,161	118,410
Total interest-bearing liabilities	224,767	176,998	146,287
Interest-free funds	13,662	15,626	12,870
Total interest-bearing liabilities and interest-free funds	$238,429	$192,624	$159,157
Average interest rates(2):			
Interest earning assets:			
Mortgage portfolio, net	7.71%	8.27%	9.13%
Investments and cash equivalents	4.70	3.84	4.44
Total interest-earning assets	7.30	7.74	8.54
Interest-bearing liabilities(1):			
Short-term debt	4.35	3.47	4.35
Long-term debt	7.14	7.76	8.57
Total interest-bearing liabilities	6.47	6.89	7.77
Investment spread(4)	.83	.85	.77
Interest-free return(5)	.41	.53	.60
Net interest margin(6)	1.24%	1.38%	1.37%

(1) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of interest rate swaps.

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

(3) Includes average balance of nonperforming loans of $1.6 billion, $1.3 billion, and $1.1 billion in 1994, 1993, and 1992, respectively.

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

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

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

FANNIE MAE

RATE / VOLUME ANALYSIS (Unaudited)

	Increase (Decrease)	Attributable to changes in (1)	
		Volume	Rate
	(Dollars in millions)		
1994 vs. 1993			
Interest income:			
Mortgage portfolio	$1,894	$2,859	$ (965)
Investments and cash equivalents	620	399	221
Total interest income	2,514	3,258	(744)
Interest expense (2):			
Short-term debt	970	753	217
Long-term debt	1,254	2,175	(921)
Total interest expense	2,224	2,928	(704)
Net interest income	$ 290	$ 330	$ (40)
1993 vs. 1992			
Interest income:			
Mortgage portfolio	$1,307	$2,587	$(1,280)
Investments and cash equivalents	(8)	123	(131)
Total interest income	1,299	2,710	(1,411)
Interest expense (2):			
Short-term debt	19	333	(314)
Long-term debt	805	1,826	(1,021)
Total interest expense	824	2,159	(1,335)
Net interest income	$ 475	$ 551	$ (76)

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

(2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on the effective maturity or repricing date, taking into consideration the effect of interest rate swaps.

MANAGEMENT

Directors

The age and background, as of March 1, 1995, of each of the members of the Board of Directors of the Corporation are as follows:

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships(1)
Felix M. Beck, 68	Chairman Emeritus, Chemical Residential Mortgage Corporation, a mortgage banking company, January 1995 to present; Chairman of the Board and Chief Executive Officer, Margaretten & Company, Inc., a mortgage banking company, 1969 to July 1994; Chairman of the Board, Margaretten Financial Corporation, January 1992 to July 1994; Livingston, New Jersey	1985	
Roger E. Birk, 64	President and Chief Operating Officer of the Corporation, November 1987 until his retirement in January 1992; Tequesta, Florida	1985	Mutual of America Capital Corp.; New Jersey Resources Corporation; Penske Transportation; WellPoint Health Networks Inc.
Eli Broad, 61	Chairman of the Board, 1961 to present, Chief Executive Officer, 1976 to present, and President, May 1990 to present, SunAmerica Inc. (formerly Broad Inc. and Kaufman and Broad, Inc.), a financial services corporation; Chairman of the Board, Kaufman and Broad Home Corporation; Los Angeles, California	1984	
William M. Daley(2), 46	Partner, Mayer, Brown & Platt, a law firm, May 1993 to present; Special Counsellor to the President of the United States for North American Free Trade Agreement, September 1993 to December 1993; President and Chief Operating Officer, October 1990 to May 1993, and Vice Chairman, October 1989 to October 1990, Amalgamated Bank of Chicago, a financial institution; Partner, Mayer, Brown & Platt, 1985 to October 1989; Chicago, Illinois	1993	
Thomas P. Gerrity, 53	Dean of The Wharton School of the University of Pennsylvania, an educational institution, July 1990 to present; President of CSC Consulting, a subsidiary of Computer Sciences Corporation, and Vice President of Computer Sciences Corporation, May 1989 to June 1990; Chairman and Chief Executive Officer, Index Group, a technology-oriented consulting company, 1969 to April 1989; Haverford, Pennsylvania	1991	Digital Equipment Corporation; Reliance Group Holdings, Inc.; Sun Company, Inc.
James A. Johnson, 51	Chairman of the Board of Directors and Chief Executive Officer of the Corporation, February 1991 to present; Vice Chairman of the Board of the Corporation, January 1990 to January 1991; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, April 1985 to December 1989; Washington, D.C.	1990	Kaufman and Broad Home Corporation; United HealthCare Corporation
Thomas A. Leonard(2), 48	Partner, Obermayer, Rebmann, Maxwell & Hippel, a law firm, January 1992 to present; Partner, Dilworth, Paxson, Kalish & Kauffman, a law firm, January 1983 to December 1991; Philadelphia, Pennsylvania	1993	
Vincent A. Mai, 54	President and Chief Executive Officer, AEA Investors Inc., a private investment company, April 1989 to present; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, 1974 to April 1989; Port Washington, New York	1991	

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships(1)
Ann McLaughlin, 53	President, Federal City Council, a nonprofit organization, May 1990 to present; President and Chief Executive Officer, New American Schools Development Corporation, June 1992 to April 1993; Visiting Fellow, Urban Institute, January 1989 to June 1992; Chairman, President's Commission on Aviation Security and Terrorism, September 1989 to May 1990; U.S. Secretary of Labor, December 1987 to December 1989; Washington, D.C.	1994	AMR Corporation (and its subsidiary, American Airlines); General Motors Corporation; Host Marriott Corporation; Kellogg Company; Nordstrom Inc.; Potomac Electric Power Company; Union Camp Corporation; Vulcan Materials Company
Richard D. Parsons, 46	President, Time Warner, Inc., a media and entertainment corporation, January 1995 to present; Chairman of the Board and Chief Executive Officer, January 1991 to January 1995, President and Chief Executive Officer, July 1990 to January 1991, and President and Chief Operating Officer, July 1988 to June 1990, The Dime Savings Bank of New York, FSB, a financial institution; Pocantico Hills, New York	1989	Dime Bankcorp, Inc.; Philip Morris Companies, Inc.; Time Warner, Inc.
Franklin D. Raines, 46	Vice Chairman of the Board of the Corporation, September 1991 to present; Vice Chairman-Designate of the Corporation, July 1991 to September 1991; General Partner, January 1985 to December 1990, and Limited Partner, January 1991 to June 1991, Lazard Freres and Co., an investment banking firm; Washington, D.C.	1991	Pfizer, Inc.
John R. Sasso(2), 47	President, Advanced Strategies, Inc., a corporate communications and public affairs consulting firm, January 1990 to present; Senior Vice President, Hill, Holiday, Connors and Cosmopulos, Inc., January 1988 to December 1989; Wayland, Massachusetts	1993	
Antonia Shusta, 45	Group Executive, Household International, a financial services company, April 1988 to January 1995; Chairman, President and Chief Executive Officer, Household Bank, F.S.B., a wholly-owned subsidiary of Household International, 1990 to January 1995; Wilmette, Illinois	1994	
Lawrence M. Small, 53	President and Chief Operating Officer of the Corporation, February 1992 to present; President and Chief Operating Officer-Designate of the Corporation, September 1991 to January 1992; Vice Chairman and Chairman of the Executive Committee, January 1990 to July 1991, Sector Executive, January 1985 to December 1989, Citicorp/Citibank, a financial institution; Washington, D.C.	1991	The Chubb Corporation; Marriott International, Inc.
Christopher J. Sumner, 49	President and Chief Executive Officer, CrossLand Mortgage Corporation, a mortgage banking corporation, May 1988 to present; Vice Chairman, April 1990 to August 1991, and President and Director, March 1987 to April 1990, CrossLand Savings, FSB (Utah) (formerly Western Savings and Loan Company), a financial institution; Salt Lake City, Utah	1985	

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships(1)
José H. Villarreal(2), 41	Partner, Akin, Gump, Strauss, Hanes & Feld, L.L.P., a law firm, August 1994 to present; Partner, McGinnis, Lochridge & Kilgore, L.L.P., a law firm, July 1993 to August 1994; White House Office of Presidential Personnel, April 1993 to June 1993; Presidential Transition Team, November 1992 to March 1993; Deputy Campaign Manager, Clinton Campaign, June 1992 to November 1992; Associate, McGinnis, Lochridge & Kilgore, February 1991 to May 1992; Assistant Attorney General for Public Finance, State of Texas, November 1988 to January 1991; San Antonio, Texas	1993	
Karen Hastie Williams, 50	Partner, Crowell & Moring, a law firm practicing in the District of Columbia, 1982 to present; Washington, D.C.	1988	Continental Airlines, Inc.; Crestar Financial Corporation; SunAmerica Inc.; Washington Gas Company

(1) Companies with a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or subject to the requirements of Section 15(d) of that Act or any company registered as an investment company under the Investment Company Act of 1940. Certain directorships of other companies are also noted in the occupation column.

(2) Appointed by the President of the United States, who has authority to appoint five directors.

The term of each director will end on the date of the May 1995 annual meeting of stockholders, except that the President of the United States may remove any director that the President appointed for good cause.

Executive Officers

The age and business experience, as of March 1, 1995, of each of the executive officers of the Corporation, are as follows:

James A. Johnson, 51, has been Chairman of the Board of Directors and Chief Executive Officer since February 1991. Mr. Johnson was Vice Chairman of the Board of Directors from January 1990 to January 1991. Mr. Johnson was a Managing Director in Corporate Finance at Shearson Lehman Brothers, Inc. from April 1985 to December 1989.

Lawrence M. Small, 53, has been President and Chief Operating Officer since February 1992. Mr. Small was President and Chief Operating Officer-Designate of the Corporation from September 1991 to January 1992. Prior to his employment with the Corporation, Mr. Small was with Citicorp/Citibank, where he was Vice Chairman and Chairman of the Executive Committee from January 1990 to July 1991.

Franklin D. Raines, 46, has been Vice Chairman of the Board of Directors since September 1991. Mr. Raines was Vice Chairman-Designate from July 1991 to September 1991. Prior to his employment with the Corporation, Mr. Raines was a General Partner with Lazard Freres and Company from January 1985 to December 1990 and a Limited Partner with that firm from January 1991 to June 1991.

J. Timothy Howard, 46, has been Executive Vice President and Chief Financial Officer since February 1990. Mr. Howard was Executive Vice President—Asset Management from December 1987 to February 1990.

William E. Kelvie, 47, has been Executive Vice President and Chief Information Officer since November 1992. Mr. Kelvie was Senior Vice President and Chief Information Officer from November 1990 to November 1992. Prior to his employment with the Corporation, Mr. Kelvie was a managing

partner of Nolan, Norton & Company, a management consulting firm specializing in information technology, from March 1987 to November 1990.

Robert J. Levin, 39, has been Executive Vice President—Marketing since June 1990. Mr. Levin was Senior Vice President—Marketing and MBS from June 1989 to June 1990.

Ann D. Logan, 40, has been Executive Vice President and Chief Credit Officer since May 1993. Ms. Logan has been an Executive Vice President since January 1993 and was Senior Vice President—Northeastern Regional Office from June 1989 to January 1993.

Robert B. Zoellick, 41, has been Executive Vice President, General Counsel and Secretary of the Corporation since July 1993. Mr. Zoellick was Executive Vice President, General Counsel and Corporate Secretary-Designate from May 1993 until June 1993. He was Assistant to the President and Deputy Chief of Staff of the White House from August 1992 to January 1993. From March 1989 to August 1992 he was Counselor of the State Department, and from March 1991 to August 1992 he also served as Under Secretary of State for Economics and Agricultural Affairs.

Glenn T. Austin, Jr., 46, has been Senior Vice President—Southeastern Regional Office since May 1985.

Kenneth J. Bacon, 40, has been Senior Vice President—Northeastern Regional Office since April 1993. Mr. Bacon was Director of the Office of Securitization at the Resolution Trust Corporation (''RTC'') from February 1991 to April 1993. He also served as Director of Policy and Deputy Director of Policy of the RTC Oversight Board from August 1990 to February 1991 and May 1990 to July 1990, respectively. From June 1987 to May 1990 he was Vice President, Mortgage Products Group, at Morgan Stanley & Co.

Douglas M. Bibby, 48, has been Senior Vice President—Administration since October 1988.

John Buckley, 38, has been Senior Vice President—Communications since November 1991. Prior to his employment with the Corporation, Mr. Buckley was a Senior Vice President with Robinson, Lake, Lerer & Montgomery, a strategic communications firm, from October 1989 to November 1991.

Donna Callejon, 32, has been Senior Vice President—Single-Family Marketing since November 1991. Ms. Callejon was Vice President for Product Acquisition from November 1990 to November 1991, and Co-Head of Mortgage-Backed Securities Transactions from June 1989 to November 1990.

Larry H. Dale, 49, has been Executive Director, National Housing Impact Division since October 1991. Mr. Dale was Senior Vice President—Marketing and Mortgage-Backed Securities from June 1990 to October 1991, and Senior Vice President—Multifamily Finance and Housing Initiatives from May 1989 to June 1990.

Judith Dedmon, 44, has been Senior Vice President—Southwestern Regional Office since July 1987.

William G. Ehrhorn, 46, has been Senior Vice President—Mortgage Operations since May 1993. Mr. Ehrhorn is a former executive vice president and division manager for operations, automation management, securities lending, and the Trust Company with Nomura Securities International, which he joined in May 1985. Mr. Ehrhorn also was a member of the firm's management committee.

John H. Fulford, III, 45, has been Senior Vice President—Western Regional Office since November 1985.

John R. Hayes, 56, has been Senior Vice President—Midwestern Regional Office since November 1985.

Lynda C. Horvath, 42, has been Senior Vice President—Corporate Development since May 1993. Ms. Horvath was Senior Vice President—Mortgage Operations from February 1991 to May 1993,

Acting Senior Vice President—Mortgage Operations from November 1990 to February 1991, and Vice President for Product Acquisition and Development from January 1989 to November 1990.

Linda K. Knight, 45, has been Senior Vice President and Treasurer since February 1993. Ms. Knight was Vice President and Assistant Treasurer from November 1986 to February 1993.

Thomas A. Lawler, 41, has been Senior Vice President—Portfolio Management since November 1989.

William R. Maloni, 50, has been Senior Vice President—Policy and Public Affairs since March 1989.

Michael A. Quinn, 40, has been Senior Vice President—Credit Loss Management since April 1994. Mr. Quinn was Senior Vice President and Controller from March 1991 to April 1994. Prior to his employment with the Corporation, Mr. Quinn was Vice President and Assistant Controller of Chemical Bank, a New York commercial bank, from September 1987 to March 1991.

Sampath Rajappa, 49, has been Senior Vice President and Controller since April 1994. Mr. Rajappa joined the Corporation in March 1994 as Corporate Controller. Prior thereto, Mr. Rajappa was Senior Vice President and Controller for ITT Residential Capital Corporation, a mortgage banking company, from August 1993 to February 1994; Chief Financial Officer of ITT Consumer Financial Corporation, a financial services company, from September 1992 to August 1993; and Senior Vice President, Finance and Operations for the Treasurer's Group for Citicorp Mortgage Inc., a mortgage banking company, from 1988 to August 1992.

Jayne J. Shontell, 40, has been Senior Vice President—Financial and Information Services since November 1992. Ms. Shontell was Vice President for Financial Services and Information Group from August 1992 to November 1992, Vice President for Business Development from September 1991 to August 1992, and Vice President for Critical Issues from January 1991 to September 1991. Ms. Shontell was Vice President for Business and Product Development from August 1990 to January 1991, and Vice President for Financial Institution Restructuring from October 1989 to August 1990

Elizabeth A. Snyder, 41, has been Senior Vice President—Investor Relations since April 1994. Ms. Snyder was Vice President and Assistant to the Chairman of the Corporation from July 1992 to April 1994, Vice President for Regulatory Policy from January 1992 to July 1992, and Vice President and Deputy General Counsel from November 1987 to January 1992.

Additional Information

For information concerning executive compensation, stock ownership of management and directors, certain transactions of executive officers, and any person or group owning more than five percent of the voting stock of the Corporation, reference is made to the Corporation's proxy statement, dated March 28, 1994 for the Corporation's 1994 annual meeting of stockholders and any later proxy statement published prior to the Corporation's publication of a new Information Statement, which are incorporated herein by this reference. The proxy statement for the Corporation's 1995 annual meeting of stockholders will be available in April 1995.

The Corporation will provide without charge a copy of the Corporation's most recent proxy statement to each person to whom this Information Statement has been delivered, upon the written or oral request of such person. Requests for such copies should be directed to the individual specified on page 2 of this Information Statement.

ACCOUNTANTS

The financial statements of the Corporation as of December 31, 1994 and 1993 and for each of the years in the three-year period ended December 31, 1994, included herein, have been included in reliance upon the report of KPMG Peat Marwick LLP, independent certified public accountants, and upon the authority of that firm as experts in accounting and auditing.

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