

Prospectus

Federal National Mortgage Association



Guaranteed Mortgage Pass-Through Certificates

(Residential Mortgage Loans)

Principal and Interest payable on the 25th day of each month

THE OBLIGATIONS OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION UNDER ITS GUARANTY ARE OBLIGATIONS SOLELY OF THE CORPORATION AND ARE NOT BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES. THE CERTIFICATES ARE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OF 1933 AND ARE "EXEMPTED SECURITIES" WITHIN THE MEANING OF THE SECURITIES EXCHANGE ACT OF 1934.

The Guaranteed Mortgage Pass-Through Certificates ("Certificates") are issued and guaranteed by the Federal National Mortgage Association (the "Corporation" or "Fannie Mae"), a corporation organized and existing under the laws of the United States, under the authority contained in Section 304(d) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 *et seq.*).

Each Certificate offered hereby and by the Supplement related hereto will represent an undivided interest in a pool of mortgage loans (a "Pool") to be formed by the Corporation. Each Pool will consist of either first lien or (if the related Prospectus Supplement so provides) second lien residential mortgage loans or participation interests therein ("Mortgage Loans") either previously owned by the Corporation or purchased by it in connection with the formation of the Pool. Each Pool will consist entirely of one of the following: (i) fixed-rate level installment Mortgage Loans and/or fixed-rate graduated payment Mortgage Loans having deferred interest features that have expired prior to the issuance of the Certificates and/or fixed-rate growing equity Mortgage Loans (as described below) where no further increases to the payment amount will occur after the Issue Date set forth in the related Prospectus Supplement, (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal, (iii) fixed-rate graduated payment Mortgage Loans having deferred interest features that have not expired for some or all of such Mortgage Loans prior to the issuance of the Certificates, (iv) fixed-rate Mortgage Loans that provide for balloon payments at maturity or other unique features, (v) conventional variable-rate California Mortgage Loans, (vi) other adjustable-rate Mortgage Loans, some of which may have deferred interest features, (vii) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which may have balloon payments or other unique features and (viii) adjustable-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which may have balloon payments, deferred interest or other unique features.

Interests in each Pool will be evidenced by a separate issue of Certificates. Information regarding the aggregate principal amount and characteristics of the related Pool (including the type of Mortgage Loans in the Pool) will be furnished in the related Prospectus Supplement at the time of the identification of the Pool.

Unless the related Prospectus Supplement provides otherwise, Certificates will be available in book-entry form only.

The Corporation will have certain contractual servicing responsibilities with respect to each Pool. In addition, each month the Corporation will be obligated to distribute scheduled installments of principal and to distribute interest (at a rate calculated as described herein) to Certificateholders, whether or not received. The Corporation also will be obligated to distribute to Certificateholders the full principal balance of any foreclosed Mortgage Loan, whether or not such principal balance is actually recovered.

The date of this Prospectus is September 1, 1991

Retain this Prospectus for future reference. This Prospectus may not be used to consummate sales of Certificates unless accompanied by a Prospectus Supplement.

This Prospectus should be read only in conjunction with the Information Statement dated September 1, 1991 (the "Information Statement") attached hereto and which is incorporated herein by this reference. The Information Statement contains financial information about Fannie Mae as of June 30, 1991 and other information about the Corporation as of September 1, 1991.

No salesman, dealer, bank or other person has been authorized to give any information or to make any representation other than those contained in this Prospectus or the Information Statement, and, if given or made, such information or representation must not be relied upon as having been authorized by the Corporation. This Prospectus and the Information Statement do not constitute an offer to sell or a solicitation of an offer to buy any securities other than the Certificates offered hereby and by the related Supplement nor an offer of the Certificates to any person in any state or other jurisdiction in which such offer would be unlawful.

The Certificates have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Commission or any state securities commission passed upon the accuracy or adequacy of this Prospectus or the Information Statement. Any representation to the contrary is a criminal offense.

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SUMMARY OF PROSPECTUS

The following summary of certain pertinent information is qualified in its entirety by reference to the detailed information appearing elsewhere in this Prospectus and by reference to the information with respect to each pool of either first lien or second lien residential mortgage loans or participation interests therein ("Mortgage Loans") contained in the supplement to this Prospectus (a "Prospectus Supplement") to be prepared in connection with the issue of Guaranteed Mortgage Pass-Through Certificates (the "Certificates") evidencing undivided interests in such pool of Mortgage Loans ("Pool").

Title of Security	Guaranteed Mortgage Pass-Through Certificates.
Issuer and Guarantor	Federal National Mortgage Association (the "Corporation"), a corporation organized and existing under the laws of the United States. See "Federal National Mortgage Association" in the Information Statement and the remainder of the Information Statement following that section. The obligations of the Corporation under its guaranty are obligations solely of the Corporation and are not backed by, nor entitled to, the full faith and credit of the United States.
Description of Security	Each Certificate will represent a fractional undivided interest in a Pool of Mortgage Loans to be formed by the Corporation. A Certificate in book-entry form will initially represent at least \$1,000 unpaid principal amount of Mortgage Loans. Unless the related Prospectus Supplement provides otherwise, Certificates will be available in book-entry form only and will not be convertible to definitive form.
Interest	Interest on each Mortgage Loan will be passed through monthly to Certificateholders, commencing on the 25th day of the month following the month of initial issuance of the related Certificates (or, if such 25th day is not a business day, on the first business day next succeeding such 25th day). For all Pools containing fixed-rate Mortgage Loans, interest will be passed through at a uniform Pass-Through Rate which will be specified in the Prospectus Supplement and will not be greater than the lowest annual interest rate borne by any Mortgage Loan in the related Pool, less a specified minimum annual percentage representing compensation for servicing and the Corporation's guaranty and less, in the case of Pools containing graduated payment Mortgage Loans with deferred interest features that have not expired, deferred interest, which is added to the principal balances of the underlying Mortgage Loans. For Pools containing variable-rate Mortgage Loans ("VRM Pools"), interest will be passed through on the basis of a Weighted Average Pass-Through Rate, which is equal at any time to the then-current weighted average of the Mortgage Interest Rates of all Mortgage Loans in the related VRM Pool, less a specified fixed annual percentage representing compensation for servicing and the Corporation's guaranty. For Pools containing adjustable-rate Mortgage Loans ("ARM Pools"), interest will be passed through on each Mortgage Loan at the interest rate at the time applicable thereto less (i) the Corporation's servicing fee and guaranty fee applicable to such Mortgage Loan and (ii) any deferred interest that is added to the principal balance of such Mortgage Loan pursuant to its terms. See "Yield Considerations."

Principal (including prepayments)	Passed through monthly, commencing on the 25th day of the month following the month of initial issuance of the related Certificates (or, if such 25th day is not a business day, on the first business day next succeeding such 25th day). See "Maturity and Prepayment Assumptions" and "Description of Certificates."
Guaranty	On each Distribution Date, the Corporation is obligated to distribute scheduled installments of principal and to distribute interest at a rate calculated as described herein on the Mortgage Loans in a Pool, whether or not received. The Corporation is also obligated to distribute to Certificateholders the full principal balance of any foreclosed Mortgage Loan, whether or not such principal balance is actually recovered. If the Corporation were unable to perform these guaranty obligations, distributions to Certificateholders would consist solely of payments and other recoveries on Mortgage Loans and, accordingly, delinquencies and defaults would affect monthly distributions to Certificateholders. See "Description of Certificates—The Corporation's Guaranty."
Servicing	The Corporation will be responsible for servicing the Mortgage Loans and will, in most cases, contract with mortgage lenders to perform certain servicing functions on its behalf. See "Description of Certificates—Servicing Through Lenders."
The Mortgage Pools	Each Pool will consist entirely of Mortgage Loans of only one of the following types: (i) fixed-rate level installment Mortgage Loans and/or fixed-rate graduated payment Mortgage Loans having deferred interest features that have expired prior to the issuance of the Certificates and/or fixed-rate growing equity Mortgage Loans (as described below) where no further increases to the payment amount will occur after the Issue Date set forth in the related Prospectus Supplement, (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal, (iii) fixed-rate graduated payment Mortgage Loans with deferred interest features that have not expired for some or all of the Mortgage Loans prior to the issuance of the Certificates, (iv) fixed-rate Mortgage Loans that provide for balloon payments at maturity or other unique features, (v) conventional variable-rate California Mortgage Loans, (vi) other adjustable-rate Mortgage Loans, some of which may have deferred interest features, (vii) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which may have balloon payments or other unique features and (viii) adjustable-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which may have balloon payments, deferred interest or other unique features. Unless the related Prospectus Supplement provides otherwise, the Mortgage Loans in each Pool will have unpaid principal balances aggregating not less than \$1,000,000. Each Mortgage Loan will meet the applicable standards set forth under "Purchase Program" and, unless the related Prospectus Supplement provides otherwise, will be secured by a first lien on a residential property. Pool information as to the type of Mortgage Loans (including whether such Mortgage Loans have payments due every 14 days and including whether such Mortgage Loans are conventional Mortgage Loans or are insured by the Federal

Housing Administration or guaranteed by the Department of Veterans Affairs), the aggregate principal balance of the Mortgage Loans as of the Issue Date, the Pass-Through Rate for Certificates evidencing interests in fixed-rate Mortgage Loans (other than fixed-rate graduated payment Mortgage Loans with deferred interest features that have not expired for some or all of the Mortgage Loans prior to the issuance of the Certificates), the Pool Accrual Rate for Certificates evidencing interests in pools of graduated payment Mortgage Loans with deferred interest features that have not expired for some or all of the Mortgage Loans prior to the issuance of the Certificates, the then-current Weighted Average Pass-Through Rate for Certificates evidencing interests in VRM Pools, the then-current Pool Accrual Rate for Certificates evidencing interests in ARM Pools, and the latest maturity date of any Mortgage Loan will be contained in the related Prospectus Supplement. For a VRM Pool or an ARM Pool, the related Prospectus Supplement will also contain information respecting the index upon which adjustments are based, the frequency of interest rate and payment adjustments and any maximum or minimum limitations thereon, the Corporation's fixed or weighted average servicing and guaranty fee, and, in the case of an ARM Pool, whether the underlying Mortgage Loans contain provisions for the deferral of interest.

Financial Results

Fannie Mae earned net income of \$1,173 million in 1990, compared with \$807 million in 1989 and \$507 million in 1988. Net income for the first six months of 1991 was \$652 million, compared with \$566 million in the first six months of 1991.

The increase in net income in the first half of 1991 compared with the first half of 1990 was primarily due to higher net interest income and continued growth in guaranty fee income. The 1991 first half results included the recognition of \$239 million of interest income as a result of the resolution of a tax case, a pre-tax loss of \$59 million on the sale of low coupon mortgages, and a pre-tax loss of \$130 million due to the repurchase of high coupon debt at a premium. In addition, the provision for losses was increased by \$50 million in the second quarter of 1991, as compared with the preceding three quarters. The net impact of these transactions did not materially affect first half earnings.

The growth in net income in 1990 was attributable mainly to increases in net interest income, guaranty fee income and miscellaneous income. The higher net interest income resulted from an increase in both the net interest margin and the average investment balance. The increase in the net interest margin was attributable primarily to a rise in the average investment spread and a higher interest-free return. Guaranty fee income increased due to the growth in the amount of MBS outstanding. The increase in miscellaneous income was primarily the result of increased fee income for issuing REMIC securities.

Net income in 1989 surpassed 1988 net income mainly because of higher net interest income. Increased guaranty fee income and a reduction in the provision for losses also contributed to the higher net income in 1989.

The Corporation's net mortgage portfolio totaled \$120.1 billion at June 30, 1991, compared with \$110.0 billion at June 30, 1990. Mortgage-backed securities outstanding at June 30, 1991 totaled \$331.1 billion, compared with \$263.3 billion at June 30, 1990.

THE MORTGAGE POOLS

The Federal National Mortgage Association (the "Corporation" or "Fannie Mae") has implemented a program for (a) the setting aside of residential mortgage loans or participation interests therein (the "Mortgage Loans") into separate pools (the "Pools") bearing distinctive identification and (b) the issuance and sale of trust certificates of beneficial interest evidencing pro rata undivided ownership interests in the Mortgage Loans comprising each separate Pool (the "Guaranteed Pass-Through Certificates" or "Certificates"). If so specified in the related Prospectus Supplement, each Pool will consist of participation interests representing a specified undivided percentage interest in residential mortgage loans, rather than whole residential mortgage loans. The Mortgage Loans may be purchased by the Corporation expressly for the Pools or may be Mortgage Loans that have been held by the Corporation in its own portfolio. Each Pool will consist of Mortgage Loans evidenced by promissory notes (the "Mortgage Notes") secured by first (or second, if the related Prospectus Supplement so provides) mortgages or deeds of trust (the "Mortgages") on either one- to four-family (also referred to as "single-family") residential properties or multifamily projects consisting of five or more dwelling units (the "Mortgaged Properties"). A Pool will contain Mortgage Loans of only one of the following types: (i) fixed-rate level payment Mortgage Loans ("Level Payment Mortgage Loans") and/or GPMs (as defined below) with deferred interest features that have expired prior to the issuance of the Certificates ("Fully Graduated GPMs") and/or fixed-rate GEMs (as defined below) where no further increases to the payment amount will occur after the Issue Date set forth in the related Prospectus Supplement (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal ("GEMs"), some or all of which scheduled increases have not occurred prior to issuance of the Certificates, (iii) fixed-rate graduated payment Mortgage Loans with deferred interest features ("GPMs") that have not expired for some or all of the Mortgage Loans prior to the issuance of the Certificates ("Graduating GPMs"), (iv) fixed-rate Mortgage Loans that provide for balloon payments at maturity or other unique features ("Balloon Mortgages"), (v) conventional variable-rate California Mortgage Loans ("VRMs"), (vi) other adjustable-rate Mortgage Loans ("ARMs"), some of which may have deferred interest features, (vii) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units ("Multifamily Mortgage Loans"), some of which may have balloon payments or other unique features and (viii) adjustable-rate Multifamily Mortgage Loans, some of which may have balloon payments, deferred interest or other unique features. The Mortgage Loans may be either conventional Mortgage Loans (i.e., not insured or guaranteed by any United States government agency) or Mortgage Loans that are either insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs ("Conventional Mortgage Loans" and "FHA/VA Mortgage Loans," respectively). If so specified in the related Prospectus Supplement, each Mortgage Loan in the Pool is a Level Payment Mortgage Loan that has payments due every 14 days ("Biweekly Mortgage Loans"). The Mortgage Loans purchased expressly for the Pools will be sold to the Corporation by eligible institutions that meet certain requirements set forth under "Purchase Program" and are referred to herein as "Lenders." Unless the related Prospectus Supplement provides otherwise, no Pool will consist of Mortgage Loans having an aggregate unpaid principal balance of less than \$1,000,000 on the first day of the month of issuance of the related Certificates. See "Purchase Program—Mortgage Loan Eligibility" for a description of certain criteria applicable to the eligibility of Mortgage Loans for inclusion in Pools.

Interests in each Pool will be evidenced by a separate series of Certificates (an "Issue"). The Corporation will acquire the Mortgage Loans that it has purchased expressly for Pools under purchase contracts. By entering into such contracts, the Corporation will obligate itself to issue Certificates to, or to the order of, the Lenders named in the contracts, upon delivery to the Corporation of the required Mortgage Loans conforming to the Corporation's standards. **The**

Corporation will not insure or guarantee the performance by any Lender of its obligation to deliver Mortgage Loans and, correspondingly, does not insure or guarantee the performance by any person of any obligation to deliver Certificates.

The Mortgage Loans in each Pool of Level Payment Mortgage Loans, Fully Graduated GPMs, GEMs, Balloon Mortgages or fixed-rate Multifamily Mortgage Loans (collectively, the "Fixed-Rate Mortgage Loans"), will be held for the benefit of the holders of Certificates ("Certificateholders" or "Holders") pursuant to the combined terms of a trust indenture, as amended, executed by the Corporation in its corporate capacity and in its capacity as Trustee (the Trust Indenture dated as of November 1, 1981, as modified and amended by a First Supplemental Indenture dated as of February 15, 1982, a Second Supplemental Indenture dated as of October 1, 1982, a Third Supplemental Indenture dated as of August 1, 1983, a Fourth Supplemental Indenture dated as of May 1, 1984, a Fifth Supplemental Indenture dated as of July 1, 1984, a Sixth Supplemental Indenture dated as of May 1, 1985, a Seventh Supplemental Indenture dated as of August 1, 1986, and an Eighth Supplemental Indenture dated as of January 1, 1987, being herein called the "Fixed-Rate Trust Indenture"), and a supplement thereto for the related Issue (the "Issue Supplement"). The Mortgage Loans in each Pool of VRMs will be held for the benefit of Certificateholders pursuant to the combined terms of an Issue Supplement and a Trust Indenture dated as of July 1, 1982, as modified and amended by a First Supplemental Indenture dated as of December 1, 1983, a Second Supplemental Indenture dated as of September 1, 1984, a Third Supplemental Indenture dated as of February 1, 1985, a Fourth Supplemental Indenture dated as of August 1, 1985, and a Fifth Supplemental Indenture dated as of January 1, 1987, each executed by the Corporation in its corporate capacity and in its capacity as Trustee (such Trust Indenture, as amended, being hereinafter called the "VRM Trust Indenture"). The Mortgage Loans in each Pool of Graduating GPMs and ARMs will be held for the benefit of the Certificateholders pursuant to the combined terms of an Issue Supplement and a Trust Indenture dated as of July 1, 1984, as modified and amended by a First Supplemental Indenture dated as of January 1, 1987 (the "GPM Trust Indenture") and a Trust Indenture dated as of July 1, 1984, as modified and amended by a First Supplemental Indenture dated as of May 1, 1985, and a Second Supplemental Indenture dated as of January 1, 1987 (the "ARM Trust Indenture"), respectively, each executed by the Corporation in its corporate capacity and in its capacity as Trustee. The Fixed-Rate Trust Indenture, the VRM Trust Indenture, the GPM Trust Indenture, and the ARM Trust Indenture are herein, collectively, referred to as the "Trust Indenture" or "TI" where common terms and provisions are being referred to or described. Certain capitalized words or series of words in this Prospectus refer to and are further defined in the Trust Indenture. The Corporation will be responsible for the administration and servicing of the Mortgage Loans in the Pool, including the supervision of the servicing activities of Lenders, if appropriate, the collection and receipt of payments from Lenders, and the remittance of distributions and certain reports to Certificateholders. The Corporation will be entitled to receive a fee for its guaranty obligations and its services pursuant to the Trust Indenture. The fee to the Corporation for any Mortgage Loan (out of which it will compensate Lenders for servicing the Mortgage Loans) will, as to any Pool containing Fixed-Rate Mortgage Loans other than Biweekly Mortgage Loans (a "Fixed-Rate Pool") or any Pool containing Biweekly Mortgage Loans (a "Biweekly Mortgage Pool"), be equal to the difference between the annual interest rate borne by the Mortgage Loan and the annual rate of interest paid to Certificateholders at the Pass-Through Rate for the related Fixed-Rate Pool or the Accrual Rate for Pools containing Graduating GPMs (a "GPM Pool"). For any Pool containing ARMs or VRMs (an "ARM Pool" or "VRM Pool"), the Corporation will similarly compensate itself from interest payments on the underlying ARMs or VRMs as to each ARM or VRM Pool. The Corporation will reserve 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 Certificateholders. In such event, the Corporation will meet its obligation to provide servicing either by directly servicing the Mortgage Loans itself or by finding a replacement Lender.

The Corporation's obligations with respect to the Mortgage Loans will be limited to the servicing responsibilities under the Trust Indenture, and, in the event of any delinquency in payment or loss on any Mortgage Loan, its obligation to make supplemental payments in amounts described herein under "Description of Certificates—The Corporation's Guaranty."

Because the principal amount of the Mortgage Loans in a Pool will decline (with the exception of GPM Pools and certain ARM Pools that contain ARMs providing for deferred interest) monthly as principal payments, including prepayments, are received, each Certificate Principal Balance (defined as to any Certificate to be the principal amount of Mortgage Loans in the related Pool evidenced thereby) will also decline over time. See "Maturity and Prepayment Assumptions."

YIELD CONSIDERATIONS

Effect of Delay

The effective yield to Certificateholders in all Pools will be reduced slightly below the yield otherwise produced by the applicable Pass-Through Rate, Pool Accrual Rate or Weighted Average Pass-Through Rate because the distribution of interest that accrues from the first day of each month will not be made until the 25th day of the month following the month of accrual.

Fixed-Rate Pools

Each Fixed-Rate Pool will consist of Mortgage Loans other than Biweekly Mortgage Loans that provide for monthly payments and bear interest at annual rates ("Mortgage Interest Rates") that are fixed (and may include Fully Graduated GPMs). Such a Fixed-Rate Pool may include Mortgage Loans that bear different Mortgage Interest Rates. The Pass-Through Rate of interest payable to Certificateholders of each such Issue will be equal to the lowest Mortgage Interest Rate borne by any Mortgage Loan in the related Pool, less a specified minimum annual percentage representing compensation for servicing and the Corporation's guaranty. Because the Pass-Through Rate payable with respect to each Mortgage Loan in a Pool will be the same, any disproportionate principal prepayments among Mortgage Loans bearing different Mortgage Interest Rates will not affect the return to Certificateholders.

When a Mortgage Loan is prepaid or otherwise liquidated, the proceeds of such prepayment or liquidation will, unless the Corporation elects in its discretion to make any distribution thereof in the following month, be passed through to Certificateholders in the second month following the month of such prepayment or other liquidation. Because the Corporation agrees to distribute on each Distribution Date to each Certificateholder an amount as to interest representing one month's interest at the Pass-Through Rate on the Certificate Principal Balance, any prepayment or other liquidation of a Mortgage Loan and the timing of the distribution of the proceeds thereof will have no effect on the interest return to Certificateholders.

Assuming performance by the Corporation of its obligations under its guaranty, the net effect of each distribution respecting interest will be the pass-through to each Certificateholder of an amount that is equal to one month's interest at the Pass-Through Rate on the Certificate Principal Balance of such Holder's Certificate. See "Description of Certificates—Payments on Mortgage Loans; Distributions on Certificates."

Biweekly Mortgage Pools

A Biweekly Mortgage Pool will contain fixed-rate, level payment, fully amortizing Mortgage Loans that have payments due every 14 days. The biweekly payment amount is calculated by dividing the monthly payment amount (normally for a mortgage loan with an original term of 30 years) by two. Because payments are due every 14 days there will be 26 payments (some years 27 payments) in a year. The combination of a larger payment amount relative to the payment schedule (*i.e.*, one-half of the monthly payment amount is due 26 or 27 times a year, not twice a month or 24

times a year) and more frequent payments causes a reduction of the term of the loan. For example, a \$100,000 Mortgage Loan with a 9% interest rate would mature in 21.7 years (or 567 biweekly payments) using a biweekly payment schedule. In addition to the reduction of the term of the Mortgage Loan, the biweekly payment schedule also causes more rapid amortization in the early years. The illustration below compares the amortization of a monthly payment schedule (based on a 30-year term) and a biweekly payment schedule for two \$100,000 loans with 9% and 10% interest rates, respectively.

	<u>Monthly—9%</u>	<u>Monthly—10%</u>
Beginning Principal Balance—	\$100,000	\$100,000
Balance at end of: Year 1	99,317	99,444
Year 5	95,880	96,574
Year 10	89,430	90,938
Year 15	79,331	81,665
Year 20	63,520	66,408
	<u>Biweekly—9%</u>	<u>Biweekly—10%</u>
Beginning Principal Balance—	\$100,000	\$100,000
Balance at end of: Year 1	98,449	98,493
Year 5	90,651	90,714
Year 10	76,018	75,440
Year 15	52,896	50,070
Year 20	16,925	8,585
Term—	21.7 yrs.	20.75 yrs.

As this example indicates, the interest rate of a Biweekly Mortgage Loan affects its term. The actual range of the interest rates of the Biweekly Mortgage Loans in a Pool, as well as the weighted average coupon, will be set forth in the related Prospectus Supplement. The weighted average term to maturity of the Biweekly Mortgage Loans in a Pool will also be set forth in the related Prospectus Supplement. Updated weighted average coupon and weighted average maturity information will not be published for Biweekly Mortgage Pools.

The amount of interest passed through and guaranteed by the Corporation on any Distribution Date will be equal to one month's interest at the Pass-Through Rate on the Certificate balance and, accordingly, will be identical to the amount for a comparable pool of monthly payment mortgage loans. Each distribution will also include principal prepayments as well as the principal portion of scheduled biweekly payments (See "Description of Certificates—Payments on Mortgage Loans; Distribution on Certificates"). Ten calendar months a year the Biweekly Mortgage Loans will have two scheduled biweekly payments and two calendar months a year the Biweekly Mortgage Loans will have three scheduled biweekly payments, except in years that 27 biweekly payments are due in which case it will be nine months and three months, respectively. However, the months in which there are three scheduled biweekly payments could vary among the Biweekly Mortgage Loans in a Pool.

GPM Pools

A GPM Pool will consist of fixed-rate fully amortizing Mortgage Loans providing for monthly payments that increase annually for a period of years (generally between three to seven) and are level thereafter. During all or part of the period in which monthly payments are increasing, those payments will not be sufficient to cover the full amount of interest on the Graduating GPM at the Mortgage Interest Rate borne thereby. The amount of each such interest insufficiency will be added to the principal balance of the Graduating GPM, which will accrue interest thereafter on this new increased amount.

GPM Pools will have characteristics similar to Fixed-Rate Pools described above commencing with the time at which payments are sufficient to cover interest on the principal balances of the underlying Graduating GPMs. Prior to that time, the Certificates evidencing interests in GPM Pools will provide for the monthly distribution of the scheduled interest payment on each Mortgage Loan in the Pool less the Corporation's servicing and guaranty fee attributable thereto, the amount of any such fee being equal to the difference between the fixed Mortgage Interest Rate at which interest accrues on the Graduating GPM and the Pool Accrual Rate borne by the related Certificates.

The Prospectus Supplement relating to a GPM Pool will set forth the period over which payments on the Graduating GPMs increase.

The Corporation's guaranty of Certificates evidencing interests in GPM Pools will cover the principal amount of each underlying Graduating GPM, including any portion thereof representing deferred interest. The Corporation will, following the period (the "Deferred Interest Period") during which such payments are insufficient to cover interest at the Mortgage Interest Rate on their then-outstanding principal balances, including deferred interest that has been added thereto, also be obligated to distribute on each Distribution Date one month's interest at the Pool Accrual Rate on the then-outstanding principal balances of the underlying Graduating GPMs. During the Deferred Interest Period, the Corporation's guaranty will cover, as to each underlying Graduating GPM, the amount of each scheduled payment less the Corporation's servicing and guaranty fee applicable thereto.

VRM Pools

A VRM Pool will be composed of California home Mortgage Loans bearing interest at rates that will vary in response to a cost of funds index published by the Federal Home Loan Bank of San Francisco as described in the Prospectus Supplement. The interest rates will be adjusted periodically at uniform specified intervals. The Prospectus Supplement to be prepared with respect to each Issue will specify the fixed annual percentage servicing fee or "Spread" (out of which the Corporation will compensate Lenders) that the Corporation will retain from interest payments on Mortgage Loans in the related Pool. The resultant interest rate, equal as to each Mortgage Loan to the related Mortgage Interest Rate less this fixed percentage servicing fee, is the "Pass-Through Rate" for that Mortgage Loan. The Corporation has agreed in the VRM Trust Indenture to pass through payments of interest on the Mortgage Loans in a Pool, whether or not received, in an amount equal to one month's interest at the then-current weighted average of the Pass-Through Rates of all Mortgage Loans in that Pool (the "Weighted Average Pass-Through Rate") multiplied by the Certificate Principal Balance as of the preceding Distribution Date (or, respecting the initial distribution, as of the Issue Date). The Weighted Average Pass-Through Rate as of the Issue Date as well as information regarding the original indexes, the initial Mortgage Interest Rates and the then-current Mortgage Interest Rates of all Mortgage Loans in a VRM Pool will be set forth in the Prospectus Supplement. This Weighted Average Pass-Through Rate will change with any changes in the underlying Mortgage Interest Rates and as disproportionate payments of principal are made on Mortgage Loans bearing different Mortgage Interest Rates.

When a Mortgage Loan is prepaid or otherwise liquidated, the proceeds of such prepayment or liquidation will, unless the Corporation elects in its discretion to make any distribution thereof in the following month, be passed through to Certificateholders in the second month after such prepayment or other liquidation. Since the Corporation will agree in each Certificate to distribute on each Distribution Date to the Holder thereof an amount as to interest representing one month's interest at the then-current Weighted Average Pass-Through Rate on the related Certificate Principal Balance, any prepayment or other liquidation of a Mortgage Loan and the timing of the distribution of the proceeds thereof will have no effect on the interest return to Certificateholders.

Assuming performance by the Corporation of its obligations under its guaranty, the net effect of each distribution respecting interest will be the pass-through to each Certificateholder of an

amount which is equal to one month's interest at the then-current Weighted Average Pass-Through Rate on the Certificate Principal Balance of such Holder's Certificate. See "Description of Certificates—Payments on Mortgage Loans; Distributions on Certificates."

ARM Pools

General Characteristics

An ARM Pool will contain Mortgage Loans that bear interest at rates that will vary in response to a single specified index (such as, but not limited to, the indexes described below) and will adjust periodically at certain intervals specified in the related Prospectus Supplement. The actual Mortgage Interest Rate at any time borne by an ARM after any initial fixed-rate period of the ARM will, subject to any applicable adjustment caps, be equal to the sum, rounded to the extent specified in the related Prospectus Supplement, of a specified percentage, or "Mortgage Margin," and the index value then applicable thereto. ARMs may or may not contain provisions limiting the amount by which rates may be adjusted upward or downward and may or may not limit the amount by which monthly payments may be increased or decreased to accommodate upward or downward adjustments in the Mortgage Interest Rate. Certain ARMs may provide for periodic adjustments of scheduled payments in order to fully amortize the Mortgage Loan by its stated maturity while other ARMs may permit substantial balloon payments at maturity or permit that maturity to be extended or shortened in accordance with the portion of each payment that is applied to interest in accordance with the periodic interest rate adjustments. Unless a Prospectus Supplement specifies otherwise, each ARM in the related Pool will provide for payment adjustments in the month following any interest rate change, each such adjusted payment being in the amount necessary to pay interest at the Mortgage Interest Rate in effect during the month immediately prior to the month in which the first payment in the new amount is due and to fully amortize the outstanding principal balance of the ARM on a level debt service basis over the remainder of its term.

For ARMs with provisions limiting the amount by which rates may be adjusted, the Mortgage Interest Rate for each ARM, when adjusted on each interest rate change date, typically may not be more than a specified percentage amount greater or less than the initial Mortgage Interest Rate, in the case of the first change date, and, in the case of any subsequent change date, the Mortgage Interest Rate that was in effect immediately preceding such change date. Such periodic adjustment caps will be specified in the related Prospectus Supplement. In addition, the Mortgage Interest Rate for an ARM is generally also subject to lifetime maximum and minimum caps, as specified in the related Mortgage Note. Whenever an ARM is limited by a maximum interest rate cap, the Mortgage Interest Rate shall be less than the sum of the applicable index value and the Mortgage Margin; whenever an ARM is limited by a minimum interest rate cap, the Mortgage Interest Rate shall be greater than the sum of the applicable index value and the Mortgage Margin.

If an ARM provides for limitations on the amount by which monthly payments may be increased or if changes to the Mortgage Interest Rate of the ARM are made more frequently than payment changes, it is possible that interest due on scheduled payment dates at an increased rate of interest will not be covered by the amount of the scheduled payment. In that case, the uncollected portion of interest will be deferred and added to the principal balance of the Mortgage Loan.

Certain ARMs may be converted to fixed-rate mortgage loans at the option of their borrowers at the times and in accordance with the procedures specified in the Mortgage Loan documents. These "convertible" ARMs will not be included in the same Pool with "non-convertible" ARMs. If a Pool consists of "convertible" ARMs (a "Convertible ARM Pool"), the times at which converted ARMs may begin to accrue interest at a fixed rate will be specified in the related Prospectus

Supplement. The method of calculating the new fixed rate of interest borne by the converted ARM will be specified in the Mortgage Note and generally will be based on a spread of at least .375% above either the Corporation's or the Federal Home Loan Mortgage Corporation's required net yield for the purchase of 30-year (15-year if the original term of the ARM was 15 years or less) fixed-rate mortgage loans covered by short-term mandatory delivery commitments generally contemporaneous with the conversion date. During the month prior to the month in which a converted ARM begins to accrue interest at the new fixed rate, the Corporation will repurchase the converted ARM from the Pool at a price equal to its unpaid principal amount, together with one month's interest at its then-current Accrual Rate (as defined below). As a result, the weighted average life of the Certificates evidencing interests in a Convertible ARM Pool may be significantly shorter than for similar Pools where no such option to convert and obligation to repurchase exist.

The Corporation's guaranty of Certificates evidencing interests in ARM Pools will cover the principal of each underlying Mortgage Loan, including any portion thereof representing deferred interest. Its guaranty of interest will cover all interest due and payable by the mortgagor (net of the Corporation's servicing and guaranty fee). The Corporation also will add to the amount of interest accompanying the prepayment of an underlying Mortgage Loan any amount by which such interest is less than one month's interest at the rate that accrues to Certificateholders on the Mortgage Loan on the prepaid principal balance thereof. As a consequence, the timing of the prepayment of a Mortgage Loan will have no effect on the interest return to Certificateholders.

Pool Accrual Rate

Because the interest rates borne by Mortgage Loans in an ARM Pool will, following an initial fixed-rate period, adjust from time to time, and because a portion of the interest accrued thereon may be deferred and payable at a future time, Certificates evidencing interests in such Pools will not provide for the distribution of interest at a fixed Pass-Through Rate. Rather, interest on each ARM in an ARM Pool will accrue to Certificateholders during any period at a monthly rate (the "Accrual Rate") that is always equal to the corresponding Mortgage Interest Rate at which interest accrued on such ARM during such period net of the Corporation's percentage servicing and guaranty fee. This percentage servicing and guaranty fee may either (i) vary among the ARMs in a Pool for which the Mortgage Margins vary in order to produce a uniform margin (the "MBS Margin") specified in the related Prospectus Supplement that will be used to determine the rate over the applicable index value at which interest accrues to Certificateholders (a "Uniform MBS Margin Pool") or (ii) be uniform as to all ARMs in a Pool (a "Uniform Fee Pool"), resulting, if the Mortgage Margins vary, in varying MBS Margins among the ARMs in that Pool. For example, if the MBS Margin is fixed at a uniform 1.75% among the ARMs in a Uniform MBS Margin Pool, an ARM in that Pool that has a Mortgage Margin of 275 basis points would be assigned a servicing and guaranty fee of 100 basis points and another ARM in that Pool having a Mortgage Margin of 250 basis points would be assigned a servicing and guaranty fee of 75 basis points. Conversely, if the servicing and guaranty fee is fixed at 1.00% for all ARMs in a Uniform Fee Pool, an ARM in that Pool that has a Mortgage Margin of 275 basis points would be assigned an MBS Margin of 1.75%, and another ARM in that Pool having a Mortgage Margin of 250 basis points would have an MBS Margin of 1.50%. To the extent no interest rate cap is applicable and the Mortgage Interest Rate of an ARM is freely floating, the Accrual Rate of that ARM will always be equal, before giving effect to any rounding, to the sum of the applicable Index value and the ARM's MBS Margin.

At any time, interest for any month will accrue to Certificateholders at a rate that equals the weighted average of the individual Accrual Rates of the ARMs (the "Pool Accrual Rate"). If the Mortgage Interest Rates for all ARMs in a Pool are freely floating and not affected by an interest rate cap, the Pool Accrual Rate will at any such time be equal, before giving effect to any rounding,

to the sum of the then applicable index value (or the weighted average of the applicable index values if the ARMs in the Pool have different interest rate change dates as described under *Maturity, Interest Rate Change Dates* below) and, in the case of a Uniform MBS Margin Pool, the uniform MBS Margin or, in the case of a Uniform Fee Pool, the weighted average of the individual MBS Margins. The Pool Accrual Rate for a Pool cannot, however, be determined solely on the basis of applicable index values and MBS Margins if the Mortgage Interest Rate of any ARM in that Pool is in its initial fixed-rate period or is restricted by a periodic or lifetime adjustment cap. In any case, the Pool Accrual Rate for a Pool will always be equal to the weighted average of the Mortgage Interest Rates of the ARMs in the Pool net of, in the case of a Uniform Fee Pool, the uniform fixed servicing and guaranty fee or, in the case of a Uniform MBS Margin Pool, net of the weighted average of the individual fixed servicing and guaranty fees.

The range of Mortgage Margins for the ARMs in a Pool will be set forth in the related Prospectus Supplement. The Prospectus Supplement for a Uniform MBS Margin Pool will also set forth the fixed MBS Margin for that Pool. For Uniform Fee Pools, the initial weighted average MBS Margin at the Issue Date will be specified in the Prospectus Supplement. Because differences in the amortization or prepayment of ARMs with differing Mortgage Margins will cause any such initial weighted average MBS Margin to change, Fannie Mae will publish each month for each Uniform Fee Pool an updated weighted average MBS Margin in the Fannie Mae *Monthly ARMs Report* supplement to the Fannie Mae *Monthly Factor Report* published by The Bond Buyer (the "*Monthly ARMs Report*") that will be applicable to the distribution to be made in the month of the publication of such *Monthly ARMs Report* (which distribution reflects the Accrual Rates of the ARMs in the month preceding the month of publication), subject to any deferral of interest. Although changes in the weighted average of the Mortgage Margins of ARMs in a Uniform MBS Margin Pool will affect the weighted average of the fixed servicing and guaranty fees applicable to the ARMs included therein (with a corresponding effect on the Pool Accrual Rate during any initial fixed-rate period or whenever Mortgage Interest Rate caps may be applicable), no such updated information will be published for Pools of this type.

Information as to the approximate maximum and minimum (if applicable) Pool Accrual Rates of a Pool (*i.e.*, the weighted averages of the maximum and minimum Accrual Rates of the ARMs in the Pool) will be included in the Prospectus Supplement. These rates will be computed using the maximum and minimum Accrual Rates of the ARMs in a Pool weighted on the basis of their Issue Date Principal Balances. Differences in the amortization, prepayment, or maturity dates of ARMs with differing maximum and minimum Mortgage Interest Rates, and, in the case of Uniform MBS Margin Pools, fixed servicing and guaranty fees, are likely to cause the initial maximum and minimum Pool Accrual Rates for a Pool to change over the life of that Pool. In addition, if a Prospectus Supplement discloses that any assumption of an ARM in the related Pool by a new mortgagor may result in a change in the maximum and/or minimum Mortgage Interest Rates applicable thereto, any such assumption may also affect the maximum and minimum Pool Accrual Rates.

Maturity, Interest Rate Change Dates

The weighted average remaining term to maturity of the ARMs in a Pool will be set forth in the related Prospectus Supplement. The Prospectus Supplement also will specify whether or not the ARMs in a Pool all have the same interest rate change dates on and after the Issue Date. If the interest rate change dates for ARMs in a Pool are uniform, the Accrual Rates for all ARMs in a Pool will, subsequent to the first interest rate change date on or after the Issue Date of the Pool, be based on Mortgage Interest Rates that have been calculated using the same index value. If the Prospectus Supplement indicates that the ARMs in a Pool have varying interest rate change dates, the Pool Accrual Rate for any month will be calculated based on Mortgage Interest Rates that,

after the initial fixed-rate period of each of the ARMs, have been determined based on varying index values. For instance, with respect to a Pool that contains ARMs with both March 1 and August 1 annual interest rate change dates and a 45-day “look-back” period, interest will accrue to Certificateholders during the month of August with respect to the March 1 interest rate change date ARMs on the basis of the index value most recently available 45 days prior to March 1, and with respect to the August 1 interest rate change date ARMs on the basis of the index value most recently available 45 days prior to August 1. This results in the likelihood of a Pool Accrual Rate that, even in the case of a Uniform MBS Margin Pool, represents a weighted average of the different Accrual Rates of the ARMs included therein. The uniform or varying interest rate change dates of the ARMs in a Pool will be specified in the related Prospectus Supplement. In addition, the Prospectus Supplement will specify a “Weighted Average Months to Roll” that represents the weighted average amount of time from the Issue Date of the related Pool to the next interest rate change dates of all ARMs in the Pool.

Assumptions

The ARMs in each Pool are assumable by a new mortgagor and the Corporation’s general policy, described herein under “Description of Certificates—Collection and Other Servicing Procedures,” to require acceleration in the event of certain transfers of the underlying property is inapplicable.

The Indexes

The index for each ARM Pool will be identified in the related Prospectus Supplement. Two commonly used indexes are the weekly average yield on United States Treasury Securities adjusted to a constant maturity of one year or three years as published by the Board of Governors of the Federal Reserve System in the Federal Reserve Statistical Release: Selected Interest Rates H.15 (519) (the “One Year Treasury Index” and the “Three Year Treasury Index”). Another frequently used index is currently published by the Federal Home Loan Bank of San Francisco (the “FHLB of San Francisco”) on or about the last working day of each month and is designed to represent the monthly weighted average cost of funds for savings institutions in Arizona, California, and Nevada that are member institutions of the Eleventh Federal Home Loan Bank District (the “Eleventh District”) for the month prior to publication (the “COFI Index”). The COFI Index for a particular month reflects the interest costs paid on all types of funds held by Eleventh District member institutions and is calculated by dividing the cost of funds by the average of the total amount of those funds outstanding at the end of that month and of the prior month and annualizing and adjusting the result to reflect the actual number of days in the particular month. If necessary, before these calculations are made, the component figures are adjusted by the FHLB of San Francisco to neutralize the effect of events such as member institutions leaving the Eleventh District or acquiring institutions outside the Eleventh District. The COFI Index is weighted to reflect the relative amount of each type of funds held at the end of the relevant month. There are four major components of funds of Eleventh District member institutions: (i) savings deposits, (ii) time deposits, (iii) FHLB of San Francisco advances, and (iv) all other borrowings. Unlike most other interest rate measures, the COFI Index does not necessarily reflect current market rates because the component funds represent a variety of maturities whose costs may react in different ways to changing conditions.

A number of factors affect the performance of the COFI Index that may cause it to move in a manner different from indexes tied to specific interest rates, such as the One Year Treasury Index and the Three Year Treasury Index. Because of the various maturities of the liabilities upon which the COFI Index is based, the COFI Index may not necessarily reflect the average prevailing market interest rates on new liabilities of similar maturities. Additionally, the COFI Index may not necessarily move in the same direction as market interest rates at all times, because as longer term deposits or borrowings mature and are renewed at prevailing market interest rates, the COFI Index

is influenced by the differential between the prior and the new rates on those deposits or borrowings. In addition, such movement of the COFI Index, as compared with other indexes tied to specific interest rates, may be affected by changes instituted by the FHLB of San Francisco in the method used to calculate the Index. The FHLB of San Francisco publishes the COFI Index in its monthly *Federal Home Loan Bank of San Francisco Information Bulletin* and such bulletins may be obtained from its Office of Public Information.

Listed below are some historical values for the above-mentioned indexes which are provided for selected months from June 1982 to December 1990 and monthly from January 1991 to July 1991. The values for the One Year Treasury Index and the Three Year Treasury Index are the first weekly values published in a given month. The values for the COFI Index represent the weighted average cost of funds for the given month, as published the month thereafter.

<u>Year-Month</u>	<u>One Year Treasury Index</u>	<u>Three Year Treasury Index</u>	<u>COFI Index</u>
1982-June	13.000%	13.710%	12.673%
-December	9.070	9.920	11.093
1983-June	9.230	9.950	9.824
-December	10.010	10.980	10.192
1984-June	12.100	13.250	10.434
-December	9.550	10.670	10.520
1985-June	8.090	9.360	9.565
-December	7.870	8.750	8.867
1986-June	6.790	7.470	8.374
-December	5.770	6.390	7.509
1987-June	6.950	8.010	7.274
-December	7.020	8.050	7.645
1988-June	7.580	8.400	7.618
-December	8.750	8.980	8.022
1989-June	8.800	8.710	8.923
-December	7.730	7.760	8.476
1990-June	8.180	8.500	8.086
-December	7.300	7.680	7.963
1991-January	6.780	7.340	7.858
-February	6.510	7.290	7.848
-March	6.400	7.270	7.654
-April	6.340	7.360	7.501
-May	6.110	7.160	7.329
-June	6.130	7.070	7.155
-July	6.360	7.420	6.998

Unless otherwise specified in the Prospectus Supplement, the index value for each ARM's interest rate change date is that value that is most recently available 45 days prior to such interest rate change date. For a particular Distribution Date, the applicable index value is the value (which will be a weighted average value if the ARMs in a Pool have varying interest rate change dates) that was used to determine the interest rates of the ARMs in a Pool for the prior month.

MATURITY AND PREPAYMENT ASSUMPTIONS

The original maturities of substantially all of the Conventional Level Payment Mortgage Loans are expected to be either up to 15 years or 20 to 30 years. The maturities of substantially all of the FHA/VA Level Payment Mortgage Loans at origination are expected to be 30 years. Each Level Payment Mortgage Loan (other than a Biweekly Mortgage) with an original maturity of 30 years will provide for amortization of principal according to a schedule that, in the absence of prepayments, would result in repayment of one-half of the original principal amount of such Mortgage Loan by approximately the 23rd to 27th year, with higher Mortgage Interest Rates resulting in slower amortization of principal. (The amortization of principal of Biweekly Mortgages is described in greater detail under "Yield Considerations—Biweekly Mortgage Pools.") A 15-year fully amortizing Level Payment Mortgage Loan (other than a Biweekly Mortgage) would, in the absence of prepayments, result in repayment of one-half of the original principal amount by approximately the 10th to 12th year, with higher Mortgage Interest Rates resulting in slower amortization of principal. The original maturities of the Mortgage Loans in an ARM Pool may range from 15 to 30 years. The original maturities of Balloon Mortgages may range from 7 to 10 years. Each Balloon Mortgage provides for monthly payments based upon a 30-year amortization schedule with a lump sum payment equal to the unpaid principal balance of the Balloon Mortgage on its maturity date.

A significant number of the Conventional Mortgage Loans may provide by their terms that in the event of the sale of all or some of the underlying property the full unpaid principal balance of the Mortgage Loan is due and payable at the option of the holder. FHA/VA Mortgage Loans contain no such "due-on-sale" provisions. As set forth under "Description of Certificates—Collection and Other Servicing Procedures," the Trust Indenture or related Issue Supplement requires the Corporation to exercise its right to accelerate the maturity of a Conventional Mortgage Loan other than a VRM or ARM in such an event so long as acceleration is permitted under applicable law unless it elects to repurchase such Mortgage Loan. Further, the Corporation will not enforce "due-on-sale" provisions in the event that a property is transferred from one co-borrower to an unrelated co-borrower under the circumstances specified in the published guidelines of Fannie Mae governing assumability of the related Conventional Mortgage Loan.

The ability of mortgage lenders and their assignees and transferees to enforce "due-on-sale" clauses was addressed by the "Garn-St Germain Depository Institutions Act of 1982," which was passed by Congress and signed into law on October 15, 1982. This legislation, subject to certain exceptions, pre-empts state statutory and case law that prohibits the enforcement of "due-on-sale" clauses. Exempted from this pre-emption are mortgage loans (originated other than by federally chartered lenders) that were made or assumed during the period beginning on the date a state, by statute or statewide court decision, prohibited the exercise of "due-on-sale" clauses and ending on October 15, 1982 (the "window period"). Mortgage lenders, however, may require any successor or transferee of the borrower to meet customary credit standards. The exemption for such loans ended on October 15, 1985 unless the state acted to otherwise regulate these loans by that date. Several states passed legislation extending the assumability of the mortgage loans that were made or assumed during the window period. In the case of those states, the enforceability of "due-on-sale" clauses in loans made or assumed during the window period is limited by the provisions of the applicable state legislation. The federal legislation also enumerates nine circumstances under which a lender may not enforce "due-on-sale" clauses, *e.g.*, the creation of a subordinate encumbrance that does not relate to a transfer of rights of occupancy in the property, a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety, and the granting of a leasehold interest of three years or less not containing an option to purchase.

Conventional Mortgage Loans purchased by the Corporation from November 10, 1980, to October 15, 1982, in jurisdictions where, on the date of origination, the law substantially restricted lenders from enforcing "due-on-sale" provisions may provide that they are due and payable at the holder's option at the end of seven years. As described in "Description of Certificates—Collection

and Other Servicing Procedures,” the Trust Indenture provides that the Corporation will exercise or refrain from exercising any such “call option rider” in a manner that is consistent with then-current policies or practices employed by the Corporation respecting comparable mortgage loans held in its own portfolio.

The Corporation’s rate of prepayments on its entire portfolio of 30-year single-family loans (which contains fixed-rate loans with widely varying interest rates as well as ARMs with greatly different terms) has been relatively constant in recent years. The table under “Business—Mortgage Loan Portfolio—Repayments and Sales” in the Information Statement shows that changes in repayments (including foreclosures) during 1990 compared with 1989, and during 1989 compared with 1988, were relatively small, whereas repayments during 1988 were 29 percent less than in 1987. The decrease in repayments experienced in 1988 when compared with 1987 were a result of increases in mortgage interest rates. The slight changes experienced in repayments in 1989 and 1990 were primarily due to greater stability of interest rates. In 1988, 1989 and 1990, there were \$10.7 billion, \$11.0 billion and \$11.6 billion, respectively, in mortgage repayments (exclusive of foreclosures) that the Corporation received, which included approximately \$8.4 billion, \$8.5 billion and \$8.8 billion, respectively, for mortgages that were prepaid.

In an environment of declining interest rates, lenders servicing mortgage loans often are asked by mortgagors to refinance the mortgage loans through issuance of new loans secured by mortgages on the same properties. The resultant prepayments, if they involve Mortgage Loans in Pools, result in the distribution to Certificateholders of the principal balances of the prepaid Mortgage Loans and their removal from the Pools. Under the Corporation’s current policy, Lenders servicing Mortgage Loans are permitted to advertise in a general manner their availability to handle refinancings, although they may not specifically target mortgagors whose Mortgage Loans are in Pools. The Corporation does not, however, permit Lenders to remove Mortgage Loans from Pools for the purpose of Mortgage Loan modifications.

In general, when the level of interest rates declines significantly below the interest rates on mortgage loans, the rate of prepayment is likely to increase, although the prepayment rate is influenced by a number of other factors, including general economic conditions and homeowner mobility. In addition, certain Mortgage Loans may have provisions for prepayment penalties in varying amounts that may or may not influence prepayment rates. Accordingly, the Corporation cannot estimate what the prepayment experience of the Mortgage Loans in Pools will be. See also “Description of Certificates—Termination” for a description of the Corporation’s option to repurchase the Mortgage Loans in any Pool when the aggregate principal balance thereof becomes less than 10 percent of the aggregate principal balance of the Mortgage Loans in the Pool on the Issue Date.

A GEM provides for scheduled annual increases in the mortgagor’s monthly payments. Because the additional scheduled portion of the monthly payments is applied to reduce the unpaid principal balance of a GEM, the scheduled maturity of a GEM will be significantly shorter than the 25- or 30-year term used as the basis for calculating the initial level installment of principal and interest applicable until the first adjustment. The latest maturity date and weighted average remaining term set forth in the Prospectus Supplement for a Fixed-Rate Pool containing GEMs are calculated without regard to the original term used for purposes of calculating the initial monthly payment amount, but are based on the term required to amortize the Issue Date Principal Balance of each GEM, based on its interest rate and current monthly installment assuming only scheduled increases in monthly payments and no prepayments of principal. No GEM that matures by its terms more than 15 years subsequent to the Issue Date of the related Certificates will be eligible for inclusion in a Pool.

As set forth above under “Yield Considerations,” GPMs provide for payments that increase annually for a period of years (generally between three and seven) and then amortize on a level payment basis to their stated maturity. Because the principal amount of a GPM will increase during its Deferred Interest Period, the time at which one-half of the principal amount of a GPM will be paid in accordance with its amortization schedule will be longer than for a Level Payment Mortgage Loan bearing a similar Mortgage Interest Rate. The maturities of substantially all VRMs at origination are expected to be 30 years, but the maturity of each Mortgage Loan may at the option of the mortgagor be increased to a term not in excess of 40 years in the event of certain increases in the Mortgage Interest Rate. ARMs vary substantially as to their terms and it is impossible to generalize as to the speed at which they will amortize in the absence of prepayments.

Second Lien Mortgage Loans

The original maturities of second lien Mortgage Loans are expected to be between 8 and 15 years. All of the Mortgage Loans may be prepaid in whole or in part at any time without penalty. The Corporation is not aware of any reliable studies or statistics on the rate of prepayment of second lien Mortgage Loans. Generally, second lien Mortgage Loans are not viewed by mortgagors as permanent financing because in most instances the term is shorter and the interest rate is higher than on first lien Mortgage Loans placed under similar circumstances. Accordingly, they may prepay at a higher rate than traditional fixed-rate first lien Mortgage Loans with substantially similar coupons. In addition, any future limitation on the right of borrowers to deduct interest payments on second lien Mortgage Loans for federal income tax purposes also may contribute to a higher rate of prepayments of such Mortgage Loans. Prepayment experience may also be affected by a wide variety of additional factors, including general economic conditions, interest rates, the availability of alternative financing and homeowner mobility. The Corporation will enforce the “due-on-sale” provisions of such Mortgage Loans (other than an ARM) or, in the alternative, will repurchase such Mortgage Loans subject to the same conditions as its general obligation with respect to fixed-rate first lien Conventional Mortgage Loans described above.

PURCHASE PROGRAM

Set forth below is a description of certain aspects of the Corporation’s purchase program for mortgage loans eligible for inclusion in a Pool (the “Program”). The Prospectus Supplement to be prepared with respect to each Issue will contain information on the Mortgage Loans in the Pool, including information as to the type of Mortgage Loans, the aggregate principal balance of the Mortgage Loans as of the Issue Date, for Fixed-Rate Pools and Biweekly Mortgage Pools the Pass-Through Rate, for GPM Pools the Pool Accrual Rate, for ARM Pools the initial Pool Accrual Rate, for VRM Pools the initial Weighted Average Pass-Through Rate, and the latest maturity date of any Mortgage Loan.

Lender Eligibility

The Corporation will purchase Mortgage Loans from eligible federally and state-chartered savings and loan associations, mutual savings banks, commercial banks, credit unions, and similar financial institutions, the deposits or accounts of which are insured by a fund administered by the Federal Deposit Insurance Corporation (“FDIC”) or the National Credit Union Administration (“NCUA”), from certain other state-insured financial institutions and from certain institutions, principally mortgage bankers, that are mortgage sellers approved by the Corporation. The Corporation, on an individual institution basis, will determine whether such institutions will be approved as Lenders for the Program by applying certain criteria, which may include depth of mortgage origination experience, servicing experience, and financial capacity. Approved Lenders will be party with the Corporation to a Mortgage Selling and Servicing Contract.

Mortgage Loan Eligibility

General

The Mortgage Loans to be included in each Pool will be Mortgage Loans on residential properties. Each Mortgage Loan purchased for inclusion in a Pool will be subject to and must comply with the terms of the current Selling Guide (and the Multifamily Guide, if applicable) unless Fannie Mae grants an exception with respect to certain requirements. These Mortgage Loans are permanent loans (as opposed to construction and land development loans) secured by Mortgages on properties comprised of (i) single-family dwelling units, including units in condominium projects and planned unit developments or (ii) multifamily projects consisting of five or more dwelling units. The Prospectus Supplement to be prepared with respect to each Issue backed by Multifamily Mortgage Loans will describe the eligibility criteria for such loans, which will differ in certain respects from the criteria described below. Each Mortgage Loan will be documented by the appropriate FNMA/FHLMC Uniform Instrument in effect at the time of origination, or an FHA or VA mortgage instrument or other instrument acceptable to the Corporation, and will comply with all applicable federal and local laws, including laws relating to usury, equal credit opportunity, and disclosure.

There is no requirement that Mortgage Loans be payable on the first day of the month in order to be eligible for inclusion in a Pool. The Mortgage Loans generally must have had maturities of not more than 30 years from their date of origination, although VRMs can be extended to 40 years at the option of the mortgagor in the event of certain increases in the Mortgage Interest Rates.

Conventional Mortgage Loans

Pursuant to the requirements of the Selling Guide, first lien Conventional Mortgage Loans must be real estate loans secured by first Mortgages on residential properties, with original principal balances that (when combined with the original principal balance of any second lien Mortgage Loan in which the Corporation has an interest) did not exceed certain federally imposed maximum principal balance limitations applicable to the Corporation. In 1991, the maximum dollar purchase limitations for Conventional Mortgage Loans are as follows: \$191,250 for mortgages secured by one-family residences (\$286,875 in Alaska and Hawaii); \$244,650 for mortgages secured by two-family residences (\$366,975 in Alaska and Hawaii); \$295,650 for mortgages secured by three-family residences (\$443,475 in Alaska and Hawaii); and \$367,500 for mortgages secured by four-family residences (\$551,250 in Alaska and Hawaii). The maximum mortgage amount for a second lien Mortgage Loan is 50 percent of the Corporation's conventional first mortgage limit for a single-family dwelling. Additionally, the Corporation will acquire the second lien Mortgage Loan only if the combined original balance of both the first lien Mortgage Loan and the second lien Mortgage Loan do not exceed \$191,250 (\$286,875 in Alaska and Hawaii).

First lien Conventional Mortgage Loans (other than Multifamily Mortgage Loans) with loan-to-value ratios exceeding 80 percent must have the principal amount of the indebtedness in excess of 75 percent of the appraised value of the Mortgaged Property insured by a policy of primary mortgage guaranty insurance. Second lien Conventional Mortgage Loans (other than Multifamily Mortgage Loans) where the combined loan-to-value ratio of the first lien and the second lien exceeds 70 percent must be insured by a policy of primary mortgage guaranty insurance in an amount equal to 25 percent of the unpaid principal balance of such second lien Conventional Mortgage Loan. Each mortgage insurer must be licensed to transact a mortgage guaranty insurance business in the state where the Mortgaged Property is located and be acceptable to the Corporation as a mortgage insurer. As an alternative to the requirement to obtain mortgage insurance for such Conventional Mortgage Loans, Lenders may contract with the Corporation to repurchase such Conventional Mortgage Loans for such period and under such circumstances as the Corporation may require in the event the Conventional Mortgage Loans are in default.

The maximum loan-to-value ratio at the time of purchase for a Conventional Mortgage Loan secured by a first Mortgage on an owner-occupied one-family property (other than second homes) that does not secure any subordinate financing is 95 percent (90 percent in the case of ARMs or Balloon Mortgages). Where such a property also secures subordinate financing, the maximum loan-to-value ratio of the sum of the Conventional Mortgage Loan and the subordinate financing is 90 percent. In the case of a Conventional Mortgage Loan secured by a first Mortgage on an owner-occupied one-family second home that does not secure any subordinate financing, the maximum loan-to-value ratio is 80 percent. In addition, if such a property also secures subordinate financing, the maximum loan-to-value ratio of the sum of the Conventional Mortgage Loan and the subordinate financing is 90 percent.

The maximum loan-to-value ratio (including the unpaid principal balance of all subordinate financing) at the time of purchase for a Conventional Mortgage Loan secured by an owner-occupied two-family property is generally 90 percent. The maximum loan-to-value ratio (including the unpaid principal balance of all subordinate financing) at the time of purchase for a Conventional Mortgage Loan secured by an owner-occupied three- to four-family property is 80 percent. In the case of a first lien Conventional Mortgage Loan secured by an investment property, the maximum loan-to-value ratio (including the unpaid principal balance of all subordinate financing) at the time of purchase is 70 percent. The maximum combined loan-to-value ratio of a second lien Conventional Mortgage Loan and the first lien financing is 80 percent.

Pursuant to the requirements of the Selling Guide, each Lender that sells a Conventional Mortgage Loan to the Corporation for the purposes of the Program must assume responsibility for underwriting such Conventional Mortgage Loan using the same underwriting criteria, as from time to time in effect, that must be met by mortgage loans eligible for Fannie Mae portfolio purchases. As provided above, exceptions to these underwriting criteria (including the maximum loan-to-value ratio limitations) may be granted by the Corporation from time-to-time. After delivery of the Conventional Mortgage Loans, the Corporation will conduct reviews of the quality of credit and property underwriting used in the origination of certain randomly selected Conventional Mortgage Loans.

FHA/VA Mortgage Loans

Pursuant to the requirements of the Selling Guide, FHA/VA Mortgage Loans must be real estate loans with stated constant annual rates of interest, secured by first mortgages on residential properties. The principal balance and loan-to-value ratio of each FHA Mortgage Loan must comply with the standards established by the FHA. In the case of VA Mortgage Loans, the Corporation has imposed a maximum principal balance limitation of \$184,000. In addition, the unguaranteed portion of the VA Mortgage Loan amount cannot be greater than 75 percent of the lesser of (i) the purchase price of the property or (ii) the VA's estimate of reasonable value. Each FHA/VA Mortgage Loan must be insured or guaranteed by a valid and subsisting policy or guaranty in full force and effect.

DESCRIPTION OF CERTIFICATES

Each Issue of Certificates will be issued pursuant to the applicable Trust Indenture described above. The applicable Trust Indenture will, as to each Issue, be supplemented by an Issue Supplement, which will be prepared at the time of the creation of such Issue. The Issue Supplement will set forth the specific terms of the Issue, such as the Pass-Through Rate applicable thereto in the case of Fixed-Rate Pools and the Issue Date. The Issue Supplement will also contain any variation from the basic Trust Indenture applicable to a particular Issue, any such variation also being described in the Prospectus Supplement relating to such Issue. As set forth under "Legal

Opinion,” the validity of each Issue of Certificates, the Trust Indenture, and the applicable Issue Supplement will be passed upon by the General Counsel of the Corporation upon the request of any Holder of Certificates of such Issue.

Mortgage Loans not previously held in the Corporation’s portfolio will be purchased pursuant to a Pool Purchase Contract for cash or in exchange for Certificates in the related Pool. Such Mortgage Loans will be serviced by one of the Corporation-approved Lenders, normally the same entity as the loan originator, pursuant to the terms of the Pool Purchase Contract, as supplemented by the Selling Guide, the Servicing Guide and the Multifamily Guide, if applicable (collectively, the “Guides”), which are incorporated therein by reference. Copies of the Trust Indenture may be obtained from the Corporation’s Washington, D.C. office, or from any of the Corporation’s regional offices in Philadelphia, Atlanta, Chicago, Dallas, and Pasadena.

The following summaries describe certain provisions of the Trust Indenture. These summaries do not purport to be complete and are subject to, and qualified in their entirety by reference to, the more complete provisions of the Trust Indenture.

General

The Certificates will represent Fractional Undivided Interests in the Trust Fund created pursuant to the Trust Indenture and Issue Supplement for each Issue. The Fractional Undivided Interest represented by a particular Certificate will be equal to the initial principal denomination of such Certificate entered on the books of a Federal Reserve Bank divided by the aggregate Stated Principal Balance⁽¹⁾ of the Mortgage Loans in the Pool (the “Pool Principal Balance”) as of the Issue Date. The Trust Fund for an Issue consists of (i) such Mortgage Loans as from time to time are subject to the Trust Indenture and Issue Supplement, (ii) such payments or other recoveries on Mortgage Loans as from time to time may be considered to be held by the Corporation for Certificateholders, (iii) property acquired by foreclosure of Mortgage Loans or by deed in lieu of foreclosure, and (iv) the interest of Certificateholders in the obligation of the Corporation to supplement payments and other recoveries on Mortgage Loans to the extent necessary to make required distributions to Certificateholders.

Unless the related Prospectus Supplement provides otherwise, Certificates will be available in book-entry form only and will not be convertible to definitive form. A Fiscal Agency Agreement between the Corporation and the Federal Reserve Bank of New York makes generally applicable to Certificates in book-entry form (i) regulations governing the Corporation’s use of the book-entry system, contained in 24 C.F.R. Part 81, Subpart E, (ii) such procedures, insofar as applicable, as may from time to time be established by regulations of the United States Department of the Treasury governing United States securities, as now set forth in Treasury Department Circular Number 300, 31 C.F.R. Part 306 (other than Subpart O), and (iii) the Federal Reserve Bank’s operating circulars and letters. Certificates can be accommodated on the Federal Reserve Bank’s book-entry system in a minimum denomination of \$1,000 and in additional increments of one dollar and will be freely transferable on the records of a Federal Reserve Bank.

(1) All references herein to the Stated Principal Balance of a Mortgage Loan or to the aggregate Stated Principal Balance of all Mortgage Loans in a Pool are to the principal balance or aggregate principal balance, as the case may be, utilized by the Corporation in calculating the then-outstanding principal balances of Certificates. Such Stated Principal Balances may differ from actual principal balances for a number of reasons, including supplemental payments by the Corporation on delinquent Mortgage Loans pursuant to its guaranty obligations and delays in the distribution of certain Mortgage Loan receipts.

Certificates will be maintained on the book-entry system of a Federal Reserve Bank in a manner that permits separate trading and ownership. The Federal Reserve Bank of New York will make payments on the Certificates on behalf of Fannie Mae on the applicable Distribution Dates by crediting accounts on its records or on the records of other Federal Reserve Banks. Certificates may be held of record only by entities eligible to maintain book-entry accounts with a Federal Reserve Bank. Such entities are not necessarily the beneficial owners of the Certificates. Beneficial owners will ordinarily hold Certificates through one or more financial intermediaries, such as banks, brokerage firms and securities clearing organizations. A Certificateholder that is not the beneficial owner of a Certificate, and each other financial intermediary in the chain to the beneficial owner, will have the responsibility of establishing and maintaining accounts for its respective customers. The rights of the beneficial owner of a Certificate with respect to Fannie Mae and the Federal Reserve Bank may be exercised only through the financial intermediaries thereof. Fannie Mae and the Federal Reserve Bank will have no direct obligation to a beneficial owner of a Certificate that is not also the owner of record according to the account maintained by the Federal Reserve Bank. The Federal Reserve Bank will act only upon the instructions of the record owner in recording transfers of a Certificate.

Distributions of principal and interest on each Issue of Certificates will be made by the Corporation on the 25th day of each month (the "Distribution Date") to the persons in whose names the Certificates are entered on the books of a Federal Reserve Bank as of the close of business on the last day of the preceding month (the "Record Date"). The first distribution for each Issue of Certificates will be in the month following the month in which the Issue Date occurs. Distributions for each Issue will be made by wire to Certificateholders of record not later than the 25th day of each month.

As described under "Rights Upon Event of Default," Holders of Certificates will have the right under certain circumstances to appoint a successor Trustee.

Transfer of Mortgage Loans to Pools

Each Mortgage Loan transferred to a Pool will be identified in a Mortgage Loan Schedule appearing as an exhibit to the Issue Supplement for the related Issue of Certificates. In addition, in the case of whole Mortgage Loans, the Corporation, as Trustee of the Mortgage Loans, will hold on behalf of Certificateholders the original Mortgage Note, endorsed in blank, and an assignment to the Corporation of the mortgage instrument. Usually assignments are in a form suitable for recording but they are not recorded. However, a blanket assignment may be used for the transfer of a large number of Mortgage Loans, even if the properties are not located in the same recording jurisdiction, depending on the Lender's servicing experience and its financial condition. At its option, the Corporation may choose to maintain such documents with a custodian institution (the Lender or another institution) supervised and regulated by the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the FDIC or the NCUA. The Corporation will review the Mortgage Loan Schedule prior to the issuance of the Certificates and will conduct random spot checks to confirm the sufficiency of the documents after issuance of the Certificates.

Although the above procedures are intended to protect the interests of the Holders of Certificates in the Mortgage Loans in the related Pool, the law applicable to a liquidation, reorganization, or similar proceeding involving the assets of a Lender or of the Corporation is unclear and as a result no opinion can be rendered as to the status of Certificateholders' interests in the event of any such proceeding. The Corporation's guaranty would, however, by its terms be available in the event of any such proceeding involving the assets of a Lender.

Servicing Through Lenders

Pursuant to the Trust Indenture, the Corporation is responsible for servicing and administering the Mortgage Loans but, in its discretion, is permitted to contract with the originator of each Mortgage Loan, or another eligible servicing institution, to perform such functions under the supervision of the Corporation as more fully described herein. Any servicing contract or arrangement by the Corporation with a Lender for the direct servicing of Mortgage Loans is a contract solely between the Corporation and that Lender, and the Certificateholders are not deemed to be parties thereto and have no claims, rights, obligations, duties, or liabilities with respect to such Lender. (TI Section 5.01)

Lenders will be obligated pursuant to the applicable Guide to perform diligently all services and duties customary to the servicing of mortgages, as well as those specifically prescribed by the applicable Guide. The Corporation will monitor the Lender's performance and has the right to remove any Lender for cause at any time it considers such removal to be in the best interest of Certificateholders. The duties performed by Lenders include general loan servicing responsibilities, collection and remittance of principal and interest payments, administration of mortgage escrow accounts, collection of insurance claims, and, if necessary, foreclosure.

The Corporation retains as to each Fixed-Rate Mortgage Loan (other than Biweekly Mortgage Loans) the difference in interest between the annual Mortgage Interest Rate borne by the Mortgage Loan and the Pass-Through Rate on the Certificates. For example, if a Mortgage Loan with a 12.25 percent Mortgage Interest Rate is included in a Pool against which a Certificate with an 11.25 percent Pass-Through Rate is issued, the Corporation would be entitled to receive total compensation of one percent per annum on the Mortgage Loan. For Biweekly Mortgage Loans, the Corporation will retain the difference in interest between the scheduled interest borne by the Mortgage Loan and the interest paid on account of such Mortgage Loan at the Pass-Through Rate. For VRMs, the Corporation will retain from interest payments a fixed annual servicing fee, or "Spread," as described under "VRM Pools" above. For ARMs and Graduating GPMs, the Corporation will retain an amount equal to the percentage spread applicable thereto applied to the outstanding principal balance as increased by any deferred interest that has been included therein. See "Yield Considerations." The Corporation is also entitled to retain prepayment fees, late charges, assumption fees, and similar charges to the extent they are collected from borrowers. The Corporation will compensate Lenders in an amount up to, but never exceeding, the amount of interest retention described above, less a prescribed minimum amount to be retained by the Corporation for itself in consideration of its guaranty obligations and servicing responsibilities.

Payments on Mortgage Loans; Distributions on Certificates

On the 25th day of each month (beginning with the month following the month of the Issue Date), or, if such 25th day is not a business day, on the first business day next succeeding such 25th day, the Corporation will, respecting each Issue, distribute to Certificateholders an amount equal to the total of (i) the principal due on the Mortgage Loans in the related Pool during the period beginning on the second day of the month prior to the month of such distribution and ending on the first day of such month of distribution (the "Due Period"), (ii) the Stated Principal Balance of any such Mortgage Loan that was prepaid in full during the second month next preceding the month of such distribution (including as prepaid for this purpose any Mortgage Loan repurchased by the Corporation as described herein because of the Corporation's election to repurchase the Mortgage Loan after it is delinquent, in whole or in part, with respect to four consecutive installments of principal and interest (eight consecutive installments of principal and interest with respect to Biweekly Mortgage Loans), because of the Corporation's election to repurchase such Mortgage Loan under the circumstances described under "Collection and Other Servicing Procedures" below, or, as provided in the related Issue Supplement, because of the Corporation's repurchase of converted ARMs under the circumstances described under "ARM Pools—*General Characteristics*" above), (iii) the amount of any partial prepayment of a Mortgage Loan received in the second month next preceding the month of distribution, and (iv) in respect of all Fixed-Rate

Mortgage Loans, one month's interest at the Pass-Through Rate on the Certificate Principal Balance as reported to Certificateholders in connection with the previous distribution (or, respecting the first distribution, the Certificate Principal Balance on the Issue Date). For purposes of distributions, a Mortgage Loan will be considered to have been prepaid in full if, in the Corporation's reasonable judgment, the full amount finally recoverable on account of such Mortgage Loan has been received, whether or not such full amount is equal to the Stated Principal Balance of the Mortgage Loan. The Corporation may, in its discretion, include with any distribution principal prepayments, both full and partial, received during the month prior to the month of distribution but is under no obligation to do so.

For each Graduating GPM during its Deferred Interest Period and each ARM, the Corporation will, on each monthly Distribution Date, distribute an amount as to interest equal to the amount of interest payable on such Mortgage Loan during the applicable Due Period (which will, in the case of Graduating GPMs during their Deferred Interest Period, and may, in the case of ARMs having deferred interest features, be less than one month's interest at the Mortgage Interest Rate) less the amount retained by the Corporation as described under "Servicing Through Lenders" above. For each VRM Pool, the Corporation will, on each Distribution Date, distribute an amount as to interest equal to one month's interest at the then-current Weighted Average Pass-Through Rate on the Certificate Principal Balance of each Certificate.

Distributions on any Distribution Date will be made to Certificateholders of record on the prior Record Date (the close of business on the last day of the immediately preceding month). Each Certificateholder will be entitled to receive an amount equal to the total amount distributed multiplied by the Fractional Undivided Interest evidenced by such Holder's Certificate.

The Corporation's Guaranty

The Corporation's obligation described above to distribute amounts representing scheduled principal and interest, whether or not received, and its obligation to distribute the full principal amount of any foreclosed or otherwise finally liquidated Mortgage Loan, whether or not such principal amount is actually recovered, constitute the Corporation's guaranty obligations in respect of the Certificates. If the Corporation were unable to perform such obligations, distributions to Certificateholders would consist solely of payments and other recoveries on Mortgage Loans and, accordingly, delinquencies and defaults would affect monthly distributions to Certificateholders.

Reports to Certificateholders

With respect to each distribution, the Corporation will cause to be forwarded to each Certificateholder with respect to all Certificates held by such Certificateholder in each Pool, a statement setting forth, to the extent applicable, the following information:

- (i) the amount, if any, due on such Certificates on the related Distribution Date on account of total scheduled and unscheduled principal (including any Deferred Interest);
- (ii) the amount due on such Certificates on the related Distribution Date on account of interest;
- (iii) the total of the cash distribution on such Certificates on the related Distribution Date;
- (iv) the Certificate Principal Balances of such Certificates on the related Distribution Date after giving effect to any distribution of principal made on such date and to any Deferred Interest added to the principal balances of the underlying Mortgage Loans during the preceding Due Period;
- (v) the total amount of any Deferred Interest that was added to the principal balances of the underlying Mortgage Loans during the preceding Due Period;

- (vi) the amount, if any, of (i) above that is allocable to Deferred Interest;
- (vii) the amount, if any, of (iv) above that is allocable to Deferred Interest;
- (viii) for VRM Pools, the Weighted Average Pass-Through Rate applicable to such Distribution Date; and
- (ix) for ARM Pools, the Pool Accrual Rate applicable to such Distribution Date.

Within a reasonable period of time after the end of each calendar year, the Corporation will furnish to each Person who at any time during the calendar year was a Certificateholder a statement containing the information set forth in items (i), (ii), (v), and (vi) above, in summary form for such calendar year, or for any portion thereof during which such Person was a Certificateholder.

Servicing Compensation and Payment of Certain Expenses by the Corporation

As compensation for its activities and obligations under the Trust Indenture, the Corporation will be entitled to retain the amounts applicable to interest that are not required to be distributed to Certificateholders as described above. In addition, the Corporation is entitled to retain any amounts by which the proceeds of the liquidation of a Mortgage Loan exceed (i) the Stated Principal Balance of that Mortgage Loan and (ii) interest thereon at the Pass-Through Rate in the case of a Fixed-Rate Mortgage Loan or a VRM or interest thereon at the Accrual Rate in the case of a Graduating GPM or an ARM. The Corporation will pay all expenses incurred by it in connection with its servicing activities, including, without limitation, the fees to Lenders, and is not entitled to reimbursement therefor out of the Trust Fund.

Additional servicing compensation in the form of prepayment charges, assumption fees, late payment charges, or otherwise will be retained by the Corporation.

Collection and Other Servicing Procedures

The Corporation is responsible for servicing the Mortgage Loans in each Pool and may, as set forth above, conduct such servicing through Lenders or through other Corporation-approved mortgage servicers. In connection with its servicing activities, the Corporation has full power and authority to do or cause to be done any and all things as it may deem necessary or appropriate in its sole discretion, including the foreclosure or comparable conversion of a defaulted Mortgage Loan. In lieu of undertaking any such foreclosure, the Corporation may, in its discretion and without obligation, repurchase from the Trust Fund any Mortgage Loan that is delinquent, in whole or in part, as to four consecutive installments of principal and interest (eight consecutive installments of principal interest with respect to Biweekly Mortgage Loans). The purchase price will be equal to the Stated Principal Balance of the delinquent Mortgage Loan together with accrued interest at the Pass-Through Rate (or the Accrual Rate in the case of a Graduating GPM or an ARM) and will be distributed to Certificateholders in the same manner as full prepayments of Mortgage Loans. See "Description of Certificates—Payments on Mortgage Loans; Distributions on Certificates." (TI Sections 5.01 and 5.03)

With respect to each Mortgage Loan in a Pool, the Lender makes certain warranties to the Corporation concerning such matters as the recordation of the original Mortgage, the validity of the Mortgage Loan as a first or second lien (as the case may be) on the Mortgaged Property, and compliance by such Mortgage Loan with applicable state and federal laws. In the event of a material breach of any such warranty or a material defect in the Mortgage Loan documentation, the Corporation may withdraw such Mortgage Loan from the Trust Fund at a price equal to its Stated Principal Balance together with interest thereon at the Pass-Through Rate (or the Accrual Rate in the case of a Graduating GPM or an ARM). Alternatively, the Corporation may, at its option, for all Pools other than Pools containing Multifamily Mortgage Loans, substitute a new Mortgage Loan for a defective Mortgage Loan; provided, however, that no such substitution may

take place more than two years subsequent to the date of the original issue of the related Certificates, and any such substitute Mortgage Loan must satisfy certain eligibility criteria designed to assure that the nature of the Pool will not be altered by any such substitution. Any amount by which the Stated Principal Balance of the defective Mortgage Loan exceeds the principal balance of the substitute Mortgage Loan (the substitute Mortgage Loan may not be larger than the Mortgage Loan it is replacing) will be passed through to Certificateholders.

Subject to the following paragraphs and to the extent consistent with then-current policies of the Corporation respecting mortgage loans held in its own portfolio, the Corporation in its discretion may enforce or waive enforcement of any of the terms of any Mortgage Loan or enter into an agreement for the modification of any of the terms of any Mortgage Loan, or take any action or refrain from taking any action in servicing any Mortgage Loan. (However, certain modifications are prohibited by the Trust Indenture, *e.g.*, reducing the Mortgage Interest Rate, except as may be required by the terms of the Mortgage Note.) In such connection, the Corporation may waive any prepayment charge, assumption fee, or late payment charge or may exercise or refrain from exercising any "call option rider"; provided, however, that any decision to exercise or refrain from exercising any "call option rider" must be consistent with then-current policies or practices employed by the Corporation respecting comparable mortgage loans held in its own portfolio and must be without consideration of the ownership status of the related Mortgage Loan.

In the VRM Trust Indenture, the Corporation agrees that any decision as to whether or not (i) to increase a Mortgage Interest Rate (where any such increase is permitted by the terms of such Mortgage Loan and by applicable law) or (ii) to shorten the maturity of any Mortgage Note, will be made in accordance with the then-current practice of the related Lender respecting similar Mortgage Notes and without consideration of the ownership status of the related Mortgage Note. If the Corporation is then directly servicing a VRM, it will increase the related Mortgage Interest Rate and shorten the maturity whenever any such change is permitted by the terms of such Mortgage Loan and by applicable law. Any adjustment downward by reason of a decrease in the applicable index is mandatory. See the Prospectus Supplement for criteria and procedures governing changes in Mortgage Interest Rates.

In connection with the transfer or prospective transfer of title to a Mortgaged Property (other than a Mortgaged Property securing a VRM), the Corporation is obligated to accelerate the maturity of the related Mortgage Loan where that Mortgage Loan contains a "due-on-sale" clause permitting acceleration under those conditions unless the Corporation is restricted by law from enforcing the "due-on-sale" clause, the transfer is from one co-borrower to another co-borrower under the circumstances specified in the Corporation's published guidelines or the Corporation elects to withdraw such Mortgage Loan from the Pool. In the case of a VRM, the Corporation will enforce or refrain from enforcing any "due-on-sale" clause in the related Mortgage Note in accordance with the then-current practice of the related Lender without consideration of the ownership status of the Mortgage Note. If the Corporation is then directly servicing the Mortgage Loan, it will enforce the "due-on-sale" clause unless such enforcement is prohibited by law or the Corporation elects to withdraw such Mortgage Loan from the Pool. See "Maturity and Prepayment Assumptions." In the case of an ARM, the related Issue Supplement will provide that the Corporation will not enforce the "due-on-sale clause," but will permit creditworthy transferees of the Mortgaged Property securing the ARM to assume the ARM.

In the event that, for any reason, the Corporation is not obligated to accelerate the maturity of a Conventional Mortgage Loan upon the transfer, or prospective transfer, of title to the underlying Mortgaged Property, the Corporation may enter into a transaction by which the obligor is released from liability on the related Mortgage Loan and the transferee assumes such liability; provided, however, that no such transaction shall (i) be entered into which would not have been entered into had the Mortgage Loan been held in the Corporation's own portfolio, (ii) provide for

reduction of the Mortgage Interest Rate or, in the case of any ARM, provide for any change in any interest rate adjustment provision or provision governing the calculation of scheduled payments if any such change would be adverse to the interests of Certificateholders, or (iii) in the case of any VRM, provide for any change in the original index applicable thereto.

The Trust Indenture provides that the Corporation may repurchase from the related Pool, at a price equal to the Stated Principal Balance thereof plus accrued interest thereon at the applicable Pass-Through Rate (or the applicable Accrual Rate in the case of a Graduating GPM or an ARM), any Mortgage Loan respecting which the underlying Mortgaged Property is transferred, or proposed to be transferred, under circumstances permitting the Corporation to accelerate the maturity of such Mortgage Loan pursuant to the terms of any "due-on-sale" clause contained therein.

Certain Matters Regarding the Corporation

The Trust Indenture provides that the Corporation may not resign from its obligations and duties thereunder, except upon determination that those duties are no longer permissible under applicable law. No such resignation will become effective until a successor has assumed the Corporation's obligations and duties under the Trust Indenture; provided, however, that no successor will succeed to the Corporation's guaranty obligations described above, the Corporation continuing to be responsible thereunder notwithstanding any termination of its other duties and responsibilities under the Trust Indenture. In the event that the Corporation is unable to fulfill its continuing guaranty obligations, the Trust Indenture may be modified to provide for monthly distributions to be made from then-available Mortgage Loan payments and other recoveries in a manner similar to practices and procedures followed in the servicing of whole loans for institutional investors. (TI Section 9.01)

The Trust Indenture also provides that neither the Corporation nor any director, officer, employee, or agent of the Corporation will be under any liability to the Trust Fund or to Certificateholders for any action taken, or for refraining from the taking of any action, in good faith pursuant to such Trust Indenture or for errors in judgment; provided, however, that neither the Corporation nor any such person will be protected against any liability that would otherwise be imposed by reason of willful misfeasance, bad faith, or gross negligence or by reason of willful disregard of obligations and duties.

In addition, the Trust Indenture provides that the Corporation is not under any obligation to appear in, prosecute, or defend any legal action that is not incidental to its responsibilities under the Trust Indenture and that in its opinion may involve it in any expense or liability. The Corporation may, however, in its discretion undertake any such legal action that it may deem necessary or desirable in the interests of the Certificateholders. In such event, the legal expenses and costs of such action and any liability resulting therefrom will be expenses, costs, and liabilities of the Corporation that will not be reimbursable to the Corporation out of the Trust Fund. (TI Section 8.02)

Any corporation into which the Corporation may be merged or consolidated, or any corporation resulting from any merger, conversion, or consolidation to which the Corporation is a party, or any corporation succeeding to the business of the Corporation, will be the successor to the Corporation under the terms of the Trust Indenture. (TI Section 9.02)

Events of Default

Events of Default under the Trust Indenture will consist of (i) any failure by the Corporation to distribute to Certificateholders any required payment that continues unremedied for 15 days after the giving of written notice of such failure to the Corporation by the Holders of Certificates

evidencing Fractional Undivided Interests aggregating not less than five percent of the related Trust Fund; (ii) any failure by the Corporation duly to observe or perform in any material respect any other of its covenants or agreements in the Trust Indenture which failure continues unremedied for 60 days after the giving of written notice of such failure to the Corporation by the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 25 percent of the related Trust Fund; and (iii) certain events of insolvency, readjustment of debt, marshalling of assets and liabilities, or similar proceedings and certain actions by or against the Corporation indicating its insolvency, reorganization, or inability to pay its obligations. (TI Section 9.03)

Rights Upon Event of Default

As long as an Event of Default under the Trust Indenture for any Issue remains unremedied, the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 25 percent of the related Trust Fund may, in writing, terminate all of the obligations and duties of the Corporation as Trustee and in its corporate capacity under the Trust Indenture in respect of such Issue (other than its guaranty obligations described above which continue notwithstanding any such termination) and name and appoint, in writing, a successor to succeed to all such responsibilities, duties, and obligations of the Corporation thereunder (other than the Corporation's guaranty obligations) and to the legal title to the Mortgage Loans held in such Trust Fund. (TI Section 9.03)

Amendment

The Corporation may amend the Trust Indenture as it relates to any Issue without the consent of or notice to any of the Certificateholders, for one or more of the following purposes: (i) to add to the covenants of the Corporation; (ii) to evidence the succession of another party or parties to the Corporation and the assumption by such successor or successors of the obligations of the Corporation thereunder in its corporate capacity or in its capacity as Trustee or in both such capacities; (iii) to eliminate any right reserved to or conferred upon the Corporation in its corporate capacity; (iv) to make provisions for the purpose of curing any ambiguity or correcting or supplementing any provision in the Trust Indenture or any Issue Supplement, provided such provisions do not adversely affect the interests of any Certificateholder; or (v) to modify the Trust Indenture under the circumstances and for the purposes set forth in the final sentence of the first paragraph under "Certain Matters Regarding the Corporation" above. (TI Section 11.01)

The Corporation may amend the Trust Indenture as it relates to any Issue with the consent of the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 66 percent of the related Trust Fund so as to waive compliance by the Corporation with any terms of the Trust Indenture or related Issue Supplement, or to allow the Corporation to eliminate, change, add to, or modify the terms of the Trust Indenture or Issue Supplement. However, no such waiver or amendment may, without the consent of all Certificateholders, terminate or modify the guaranty obligations of the Corporation or reduce the percentages of Certificates the Holders of which are required to consent to any waiver or amendments. In addition, no waiver or amendment shall, without the consent of each Certificateholder affected thereby, reduce in any manner the amount of, or delay the timing of, payments received on Mortgage Loans that are required to be distributed on any Certificate. (TI Section 11.02)

Termination

The Trust Indenture as it relates to each Issue terminates upon the final payment or liquidation of the last Mortgage Loan remaining in the related Pool and distribution of all proceeds thereof. The Trust Indenture as it relates to each Issue will terminate also upon repurchase by the

Corporation, at its option, of all remaining Mortgage Loans in the related Pool at a price equal to 100 percent of the Stated Principal Balance of each such Mortgage Loan together with one month's interest thereon at the Pass-Through Rate (or, in the case of a VRM Pool, one month's interest on the Stated Principal Balance at the Weighted Average Pass-Through Rate, or, in the case of a GPM Pool or an ARM Pool, one month's interest on the Stated Principal Balance of each Graduating GPM or ARM, as the case may be, at the applicable Pool Accrual Rate). (TI Section 10.01) The exercise of such option will effect early retirement of the Certificates of that Issue, but the Corporation's right to repurchase is conditioned upon the Pool Principal Balance at the time of repurchase being less than ten percent of the Pool Principal Balance on the Issue Date. In addition, the Corporation has stated that it will be its policy not to exercise any such option in respect of any Pool if (i) it has knowledge that any related Certificate has been pledged to secure an issue of cash flow obligations or is included in a pool underlying an issue of cash flow obligations and (ii) the exercise of such option would take place prior to the earliest date upon which the issuer of such cash flow obligations or the sponsor of such Pool can exercise an option to redeem such obligations or purchase such Certificates without premium. In no event, however, will the trust relating to each Pool as created by the Trust Indenture continue beyond the expiration of 21 years from the death of the last survivor of the persons named in the Trust Indenture. For each Issue, the Corporation will give written notice of termination of the Trust Indenture as it relates to such Issue to each affected Certificateholder, and the final distribution will be made to the person entitled thereto. (TI Section 10.01)

CERTAIN FEDERAL INCOME TAX CONSEQUENCES

This is a discussion of certain federal income tax consequences to persons purchasing Certificates. For purposes of this discussion, in applying a federal income tax rule that depends upon the origination date of a mortgage note or the characteristics of a mortgage note at its origination, the term "Mortgage Loan," in the case of a participation interest, shall mean the underlying mortgage note and not the participation interest therein.

The discussion does not purport to deal with all aspects of federal taxation that may be relevant to particular investors. Prospective investors are advised to consult their own tax advisors regarding the federal income tax consequences of holding and disposing of Certificates as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

Revenue Ruling 84-10, 1984-1 C.B. 155, sets forth certain federal income tax consequences relating to investments in the Certificates issued with respect to a Pool. Pursuant to Revenue Ruling 84-10, a Pool will not be classified as an association taxable as a corporation, but will be classified as a trust of which the beneficial owners of the Certificates (the "Owners") are the owners under Subpart E of Part I of Subchapter J of the Internal Revenue Code of 1986, as amended (the "Code"). Each Owner will be treated as the owner of a pro rata undivided interest in the ordinary income and corpus of the trust attributable to that particular Pool and will be considered to be the equitable owner of a pro rata undivided interest in each of the Mortgage Loans included therein, subject to the discussion below concerning a possible recharacterization of a portion of the servicing compensation. Although Revenue Ruling 84-10 does not specifically address participation interests in mortgage notes, other IRS pronouncements clearly indicate that the holdings of Revenue Ruling 84-10 are equally applicable to a Certificate backed by a Pool consisting (in whole or in part) of participation interests.

Accordingly, Owners of a particular series will be required to report on their federal income tax returns, consistent with their methods of accounting, their pro rata share of the entire income from the Mortgage Loans in that particular Pool, including interest, prepayment penalties, assumption fees and late payment charges attributable to the Mortgage Loans in the Pool, plus

any amount paid by the Corporation as interest under its guaranty. Owners will be entitled to deduct their pro rata share of the servicing compensation paid to the Corporation, as provided in section 162 or section 212 of the Code, consistent with their methods of accounting and subject to the discussions below.

The deduction for an Owner's share of the Corporation's servicing compensation is limited under section 67 of the Code in the case of (i) estates and trusts, and (ii) individuals owning an interest in a Certificate directly or through an investment in a "pass-through entity" (other than in connection with such individual's trade or business). Pass-through entities include partnerships, S corporations, grantor trusts, and non-publicly offered regulated investment companies but do not include estates, nongrantor trusts, cooperatives, real estate investment trusts and publicly offered regulated investment companies. Generally, such deduction, when aggregated with certain of the Owner's other miscellaneous itemized deductions, is allowable only to the extent that such aggregate amount exceeds 2 percent of the Owner's adjusted gross income. Adjusted gross income for an estate or nongrantor trust is to be computed in the same manner as in the case of an individual except that deductions for administrative expenses of the estate or trust that would not have been incurred if the property were not held in such trust or estate are treated as allowable in arriving at adjusted gross income.

Revenue Ruling 84-10 does not contemplate either (i) the mandatory repurchase of ARMs from Pools pursuant to a borrower's exercise of an option to convert an ARM to a fixed-rate mortgage loan; or (ii) the difference between the biweekly payments of interest received under Biweekly Mortgages from mortgagors and the monthly payments of interest made to Owners. However, Dewey Ballantine, special tax counsel to the Corporation, has rendered its opinion to the Corporation that the conclusions of Revenue Ruling 84-10 will be applicable to ARM Pools and to Biweekly Mortgage Pools.

Owners must also report as ordinary income their pro rata share of any original issue discount on each of the Mortgage Loans in a manner consistent with the special rules of section 1272 of the Code. Under these rules, Owners are required to include their share of any original issue discount in income as it accrues, possibly before the receipt of cash attributable to that income, regardless of their methods of accounting. The special rules of section 1272 of the Code will not apply, however, with respect to Mortgage Loans originated before March 2, 1984, if the mortgagors of such Mortgage Loans were natural persons.

Proposed regulations were issued in April 1986 by the Treasury Department relating to the determination and treatment of original issue discount under sections 1271 through 1275 of the Code (the "Proposed Regulations"). Under the Proposed Regulations, certain arrangements in connection with the origination of the Mortgage Loans, such as the charging of points, may give rise to original issue discount subject to the special rules of section 1272 of the Code. In the case of Mortgage Loans originated after May 8, 1986, the Proposed Regulations provide that lenders that made the Mortgage Loans must give notice of original issue discount on such Mortgage Loans at the time they sell them to the Corporation. The Corporation will report annually to holders of record their share of any such original issue discount. However, the Owner's share of any original issue discount is income to the Owner regardless of whether it is reported to the Corporation by the Lender.

With respect to ARMs that provide for an incentive interest rate, the Proposed Regulations may require a reallocation of a portion of the interest from the periods when such rate is not in effect to the period during which such rate is in effect. Under the Proposed Regulations, an Owner is also required to treat any interest, the payment of which is deferred, as includible in income at the time such interest would have been payable in the absence of such deferral. Owners are advised to consult their own tax advisors concerning these matters.

With respect to any undivided interest in a Mortgage Loan purchased at a premium, an Owner may elect to allocate the premium among the interest payments received on the Mortgage Loan on a yield to maturity basis under the rules of section 171 of the Code if the Mortgage Loan was originated after September 27, 1985. The amount of any such premium so allocated shall be applied against (and operate to reduce) the amount of any such interest includible in income. Correspondingly, an Owner's basis in its undivided interest shall be decreased by the amount of premium applied to reduce any interest income. For Mortgage Loans originated before September 28, 1985, an Owner will be entitled to premium amortization under section 171 only if the mortgagor is not an individual and the other conditions for the application of that section are met. If section 171 is inapplicable or if an Owner does not make an election thereunder, (i) such an Owner must include the full amount of each interest payment in income, and (ii) the premium must be allocated to the principal distributions on the Mortgage Loan and, when each such distribution is received, a loss equal to the premium allocated to such distribution will be recognized. Any tax benefit from the premium not previously recognized will be taken into account in computing gain or loss upon the sale or disposition of the Certificate.

The Internal Revenue Service (the "IRS") also ruled in Revenue Ruling 84-10 as follows:

1. A Certificate owned by a domestic building and loan association is considered as representing "loans secured by an interest in real property" within the meaning of section 7701(a)(19)(C)(v) of the Code, provided the real property underlying each Mortgage Loan is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code.

2. A Certificate is considered as representing "qualifying real property loans" within the meaning of section 593(d) of the Code, provided the real property underlying each Mortgage Loan is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code. Thus, a Certificate owned by a domestic building and loan association or any other thrift institution described in section 593(a) of the Code will represent "qualifying real property loans" within the meaning of section 593(d) of the Code, provided the real property underlying each Mortgage Loan is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code.

3. A Certificate owned by a real estate investment trust is considered as representing "real estate assets" within the meaning of section 856(c)(5)(A) of the Code, and the interest income is considered "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B) of the Code.

In certain cases, a Mortgage Loan may be secured by additional collateral consisting of an escrow account held with a financial institution (an "Escrow Mortgage Loan"). The escrow account consists of an interest rate buydown account that meets the requirements of the Corporation's Selling Guide, an achievement escrow that meets the requirements of the Corporation's Multifamily Guide, or any other escrow account described in the related Prospectus Supplement. Although the rulings described in the preceding paragraphs do not specifically refer to Escrow Mortgage Loans, the conclusions reflected in paragraphs 1 and 2 should be generally applicable to an Owner's investment in an Escrow Mortgage Loan if the escrow account does not represent an account with the Owner. Owners and their tax advisors are advised to review section 1.593-11(d) of the Treasury Regulations and to compare Revenue Ruling 81-203, 1981-2 C.B. 137. In the case of the rulings referred to in paragraph 3, an investment in an Escrow Mortgage Loan by a real estate investment trust should also be treated in its entirety as a "real estate asset" within the meaning of section 856(c)(5)(A) of the Code if the fair market value of the real property securing the Escrow Mortgage Loan equals or exceeds the principal amount of such Escrow Mortgage Loan at the time the real estate investment trust makes a commitment to acquire a Certificate. This conclusion is supported by Treasury Regulation section 1.856-5(c)(1)(i), which specifies that if a mortgage loan is

secured by both real property and by other property and the value of the real property alone equals or exceeds the amount of the loan, then all interest income will be treated as "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B) of the Code. Since there are no directly applicable precedents with respect to the federal income tax treatment of investments in Escrow Mortgage Loans, Owners should consult with their tax advisors concerning such tax treatment.

Lenders may provide the monies for the interest rate buydown accounts that secure certain Escrow Mortgage Loans ("Lender Buydown Loans"). Under the Corporation's Selling Guide, the borrower is liable for the entire payment on a Lender Buydown Loan, without offset by any payments due from the buydown account. Accordingly, the Corporation plans to treat Lender Buydown Loans entirely as the obligation of the borrower.

It is possible, however, that the IRS will take the position that a Lender Buydown Loan should be treated as if the borrower were obligated only to the extent of the net payment after application of the interest rate buydown account. If the IRS were able to maintain this position successfully, an Owner of a Lender Buydown Loan would be treated as holding two debt instruments: one issued by the Lender (to the extent of payments from the buydown account), and the other issued by the borrower (to the extent of the net payment by the borrower). Such treatment would require a reallocation of a portion of the interest to the period when the buydown account is in existence from the remaining term of the Certificate. Moreover, during the buydown period and to the extent of the buydown account, the three rulings described above would be inapplicable. Owners are advised to consult with their tax advisors concerning the tax treatment of Lender Buydown Loans.

In general, for purposes of sections 1276 and 1277 of the Code, an Owner's interest in a Mortgage Loan will be considered to be acquired at a market discount if the face amount of such interest exceeds the Owner's basis in such interest. Market discount will be considered *de minimis* and treated as zero, however, if it is less than 0.25 percent of the remaining principal balance of the Mortgage Loan multiplied by its weighted average remaining life. Pursuant to section 1276 of the Code, an Owner will be required to include as ordinary income, with respect to any Mortgage Loan originated after July 18, 1984 that is acquired at a market discount, (i) any partial principal payment on such Mortgage Loan to the extent such payment does not exceed the accrued market discount (as defined in section 1276 of the Code) on such Mortgage Loan, and (ii) gain realized on the disposition of such Mortgage Loan or of such Owner's Certificate representing an interest in such Mortgage Loan that is attributable to accrued market discount on such Mortgage Loan to the extent not previously included as ordinary income under section 1276 of the Code. Pursuant to section 1277 of the Code, an Owner's deduction for interest paid or accrued to purchase or carry a Certificate that represents Mortgage Loans acquired (by virtue of the acquisition of the Certificate) at a market discount after July 18, 1984 may have to be deferred to the extent such interest is attributed under section 1277 of the Code to the portion of such market discount that accrued during the taxable year. A deduction for such deferred interest or a portion thereof will, in general, be allowed only when such Mortgage Loans are disposed of or when an Owner disposes of its Certificate. Although the matter is not free from doubt, such a deduction should also be allowed to the extent that such market discount is included in ordinary income by virtue of a partial principal payment. Any gain recognized upon a disposition of a Mortgage Loan originated on or before July 18, 1984 or of a Certificate representing an interest in such Mortgage Loan will have to be recognized as ordinary income to the extent of the deferred interest deduction. The Treasury Department has not yet issued regulations implementing the market discount rules, and Owners should consult their tax advisors regarding the application of these rules as well as the advisability of making any elections relating to such rules.

In August 1991, the IRS issued guidance on the tax treatment of Mortgage Loans in cases in which the fee retained by the servicer of the Mortgage Loans exceeds what is established under tax law to be reasonable compensation for the services to be performed. This guidance is directed

primarily to servicers and, in most cases, should not have a significant effect on Owners of Mortgage Loans. Investors are advised, however, to consult their tax advisors about the IRS guidance and its application to investments in Mortgage Loans.

Under the IRS guidance, if a servicing fee on a Mortgage Loan is determined to exceed reasonable compensation, the payments of the excess servicing fee are treated as a series of "stripped coupons" and the Mortgage Loan is treated as a "stripped bond" within the meaning of section 1286 of the Code. A Mortgage Loan is effectively not treated as a stripped bond, however, if the Mortgage Loan meets either the "100 basis point" test or the "*de minimis*" test. A Mortgage Loan meets the 100 basis point test if the total amount of servicing compensation on the Mortgage Loan does not exceed reasonable compensation for servicing by more than 100 basis points. A Mortgage Loan meets the *de minimis* test if (i) the discount at which the Mortgage Loan is acquired is less than 0.25 percent of the remaining principal balance of the Mortgage Loan multiplied by its weighted average remaining life; or (ii) in the case of wholly self-amortizing Mortgage Loans, the acquisition discount is less than $\frac{1}{6}$ of one percent times the number of whole years to final stated maturity.

One consequence for Owners of Mortgage Loans that are treated as stripped bonds is that such Mortgage Loans will be treated as if originally issued on the date the Owner purchased the Certificate representing such Mortgage Loans. As a result, (i) any market discount on such a Mortgage Loan will be recharacterized as original issue discount and (ii) any premium on such a Mortgage Loan may be amortized over its remaining life. Another consequence is that the excess portion of servicing compensation will be excluded from the income of Owners and thus will not be subject to the limitations on the deductibility of miscellaneous itemized deductions. See the discussion of original issue discount, premium and miscellaneous itemized deductions above.

Servicers are given the opportunity to elect to treat mortgage servicing fees up to a specified number of basis points (which depends on the type of Mortgage Loans) as "reasonable" servicing. No guidance has been provided as to the effect, if any, of such safe harbors and any elections thereunder on Owners of Mortgage Loans.

The IRS guidance also contains a number of ambiguities. For example, it is not clear whether the rules described above are to be applied on an individual loan or an aggregate basis. These problems may result in further guidance from the IRS.

The Corporation will furnish to each holder of record with each distribution a statement setting forth the amount of such distribution allocable to principal and to interest. In addition, the Corporation will furnish or make available, within a reasonable time after the end of each calendar year, to each holder who at any time during such year received a distribution from the Corporation, a statement setting forth such holder's pro rata share of interest received and administrative expense for such calendar year.

Payments of interest and principal, as well as payments of proceeds from the sale of Certificates, may be subject to the "backup withholding" tax under section 3406 of the Code at a rate of 20 percent if the recipient of such a payment is not an "exempt recipient" and fails to furnish certain information, including its taxpayer identification number, to the Corporation or its agent, or otherwise fails to establish an exemption from such tax. Any amounts deducted and withheld from such a payment would be allowed as a credit against the Owner's federal income tax. Furthermore, certain penalties may be imposed by the IRS on a holder or Owner who is required to supply information but who does not do so in the proper manner.

Payments made to, or on behalf of, an Owner who is not a U.S. Person (a "Non-U.S. Person") on a Certificate that represents an undivided interest in a Pool of Mortgage Loans all of which were originated after July 18, 1984 generally will be exempt from U.S. federal income and withholding taxes, provided the following conditions are satisfied: (a) such Owner does not hold the Certificate in connection with the conduct by such person of a trade or business in the United States, (b) the Owner is not, with respect to the United States, a personal holding company or a corporation that

accumulates earnings in order to avoid U.S. federal income tax, (c) the Owner is not a U.S. expatriate or former U.S. resident who is taxable in the manner provided in section 877(b) of the Code, (d) the Owner is not an "excluded person" (i.e., a 10 percent shareholder of the Corporation within the meaning of section 871(h)(3)(B) of the Code or a "controlled foreign corporation" related to the Corporation within the meaning of section 881(c)(3)(C) of the Code), (e) the Owner signs a statement under penalties of perjury that certifies that it is a Non-U.S. Person or, in the case of an individual, that the Owner is neither a citizen nor resident of the United States, and provides the name, address and taxpayer identification number, if any, of the Owner and (f) the last U.S. Person in the chain of payment to the Owner (the "Withholding Agent") receives such non-U.S. beneficial ownership statement from the Owner or a financial institution holding on behalf of the Owner and does not have actual knowledge that such statement is false. That portion of interest income of an Owner who is a Non-U.S. Person on a Certificate that represents an interest in one or more Mortgage Loans originated before July 19, 1984 will be subject to a U.S. withholding tax at the rate of 30 percent or lower treaty rate, if applicable. Regardless of the date of origination of the Mortgage Loans, backup withholding will not apply to payments made to an Owner that is such a Non-U.S. Person if the Owner or a financial institution holding on behalf of the Owner provides the non-U.S. beneficial ownership statement to the Withholding Agent.

The non-U.S. beneficial ownership statement referred to in the preceding paragraph may be made on an IRS Form W-8 or substantially similar substitute form. The Owner or financial institution holding on behalf of the Owner must inform the Withholding Agent of any change in the information on the statement within 30 days of such change. In all cases, the Form W-8 or substitute form must be filed by the Withholding Agent with the IRS. "U.S. Person" means a citizen or resident of the United States, a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, or an estate or trust that is subject to U.S. federal income tax regardless of the source of its income.

LEGAL OPINION

Any purchaser of Certificates will be furnished upon request an opinion by Caryl S. Bernstein, Esq., Executive Vice President, General Counsel, and Secretary of the Corporation, as to the validity of the Certificates, the applicable Trust Indenture, and the relevant Issue Supplement.

ERISA CONSIDERATIONS

The Department of Labor issued a final regulation on November 13, 1986, which provides that in the case where an employee benefit plan ("plan") subject to the Employee Retirement Income Security Act of 1974 ("ERISA") acquires a "guaranteed governmental mortgage pool certificate" then, for purposes of the fiduciary responsibility provisions of ERISA and the prohibited transaction provisions of the Code, the plan's assets include the certificate and all of its rights with respect to such certificate under applicable law, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying such certificate. Under the regulation, the term "guaranteed governmental mortgage pool certificate" is specifically defined to include a certificate "backed by, or evidencing an interest in specified mortgages or participation interests therein" and with respect to which interest and principal payable pursuant to the certificate are guaranteed by the Corporation. The effect of such regulation is to make clear that the sponsor (that is, the entity that organizes and services the pool, in this case the Corporation), the trustee, and other persons, in providing services with respect to the mortgages in the pool, would not be subject to the fiduciary responsibility provisions of Title I of ERISA, nor be subject to the prohibited transaction provisions of section 4975 of the Code, merely by reason of the plan's investment in a certificate. The Corporation has been advised by its counsel, Brown & Wood, that, on the basis of the final regulation and class exemptions previously issued by the Department of Labor, the acquisition from the Corporation and holding of the Certificates by plans are not prohibited either by ERISA or related provisions of the Code.

Information Statement

Federal National Mortgage Association



This Information Statement describes the business and operations of the Federal National Mortgage Association as of the date hereof and its financial condition as of June 30, 1991. 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 Information Statement Supplement, Offering Circular, Prospectus, or otherwise. This Information Statement does not itself constitute an offer to purchase such securities.

This Information Statement contains audited financial statements with respect to the Corporation for the year ended December 31, 1990 and unaudited financial information for the six months ended June 30, 1991 and 1990. Fannie Mae prepares such an Information Statement quarterly.

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.

September 1, 1991

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Copies of the Corporation’s current Information Statement, as well as its most recent proxy statement, can be obtained without charge from Paul Paquin, Senior Vice President—Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone: 202-752-7115). The Corporation is not subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

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, with a net portfolio of \$120.1 billion of mortgage loans as of June 30, 1991. 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 may not ordinarily 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"). The Corporation receives guaranty fees for its guaranty of timely payment of principal of and interest on MBS certificates. The Corporation issues MBS primarily in exchange for pools of mortgage loans from lenders. The issuance of MBS enables the Corporation to further its statutory purpose of increasing the liquidity of residential mortgage loans. MBS outstanding as of June 30, 1991 totaled \$331.1 billion.

CAPITALIZATION

The following table sets forth the capitalization of the Corporation as of June 30, 1991.

	<u>Average Maturity</u>	<u>Average Cost (3)</u>	<u>Outstanding</u> (Dollars in millions)
Debtures, notes, and bonds (1):			
Due within one year			
Short-term notes	3 mos.	6.17%	\$ 18,182
Debentures	6 mos.	8.82	13,570
Other (2)	—	6.73	<u>5,319</u>
Total due within one year			<u>37,071</u>
Due after one year			
Debentures	5 yrs., 9 mos.	8.98	79,235
Subordinated capital debentures	14 yrs., 0 mos.	9.25	1,892
Other	7 yrs., 2 mos.	8.37	<u>8,408</u>
Total due after one year			<u>89,535</u>
Total debtures, notes, and bonds			<u>\$126,606</u>
Stockholders' equity			<u>\$ 4,986</u>

- (1) See "Business—Corporate Indebtedness" for a description of certain limitations applicable to debt issued by the Corporation. Amounts shown are net of unamortized discount.
- (2) Average maturity is indeterminate because the outstanding amount includes investment agreements that have varying maturities.
- (3) The average cost includes the amortization of discounts, issuance costs, hedging results, and the effect of foreign currency swaps.

The Corporation issues debentures, notes, and other debt obligations frequently. The amount of debentures, notes, and bonds outstanding on any date subsequent to June 30, 1991 may differ from that shown in the table above.

SELECTED FINANCIAL DATA

The following income statement and balance sheet data for the years 1986 through 1990 (which data are not covered by the report of independent certified public accountants) have been summarized or derived from the audited financial statements. The financial data for the six months ended June 30, 1991 and 1990 are unaudited and include, in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation. Operating results for the six months ended June 30, 1991 are not necessarily indicative of the results expected for the entire year. These data should be read in conjunction with the audited financial statements and notes to financial statements.

(Dollars in millions, except per share amounts)	Six Months Ended June 30,		Year Ended December 31,				
	1991	1990	1990	1989	1988	1987	1986
Income Statement Data:							
Net interest income	\$ 865	\$ 774	\$ 1,593	\$ 1,191	\$ 837	\$ 890	\$ 384
Guaranty fees	319	249	536	408	328	263	175
Income before extraordinary item	738	566	1,173	807	507	376	105
Extraordinary loss (1)	(86)	—	—	—	—	—	—
Net income	652	566	1,173	807	507	376	105
Per share:							
Earnings before extraordinary item (fully diluted)	2.71	2.15	4.49	3.10	2.11	1.54	.47
Earnings (fully diluted)	2.40	2.15	4.49	3.10	2.11	1.54	.47
Cash dividends .....	.48	.32	.72	.43	.24	.12	.07
Balance Sheet Data (as of end of period):							
Mortgage portfolio, net	\$120,103	\$110,008	\$113,875	\$107,756	\$ 99,867	\$ 93,470	\$93,949
Total assets	138,181	126,913	133,113	124,315	112,258	103,459	99,621
Total borrowings	126,606	117,964	123,403	116,064	105,459	97,057	93,563
Stockholders' equity	4,986	3,509	3,941	2,991	2,260	1,811	1,182
Other Data:							
Net interest margin	1.40%	1.38%	1.39%	1.16%	0.89%	1.00%	0.40%
Return on average equity	28.2	34.9	33.7	31.1	25.2	23.5	9.5
Return on average assets	1.0	.9	.9	.7	.5	.4	.1
Ratio of earnings to fixed charges(2)	1.20:1	1.15:1	1.15:1	1.11:1	1.07:1	1.06:1	1.02:1
Mortgage purchases	\$ 16,097	\$ 10,833	\$ 23,959	\$ 22,518	\$ 23,110	\$ 20,531	\$30,826
MBS issued	47,877	47,208	96,695	69,764	54,878	63,229	60,566
MBS outstanding at period end(3)	331,089	263,330	299,833	228,232	178,250	139,960	97,174

- (1) Fannie Mae repurchased \$1.3 billion of high-coupon debt, resulting in a loss of \$130 million (\$86 million after tax).
- (2) For the purpose of calculating the ratio of earnings to fixed charges, "earnings" consists of income before federal income taxes and fixed charges. "Fixed charges" consists of interest expense and interest capitalized on real estate owned.
- (3) Included are Fannie Mae MBS held in the mortgage portfolio totaling \$13.4 and \$12.0 billion at June 30, 1991 and 1990, respectively, and \$11.8, \$11.7, \$8.1, \$4.2 and \$1.6 billion at December 31, 1990, 1989, 1988, 1987 and 1986, respectively.

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 home mortgages, (2) respond appropriately to the private capital market by developing new finance and mortgage products, and (3) provide ongoing assistance to the secondary market for home mortgages (including mortgages securing housing for low- and moderate-income families involving a reasonable economic return to the Corporation) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for home 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, and approval of the Secretary of HUD is required for the Corporation's issuance of stock and securities convertible into stock. Obligations of the Corporation issued under section 304(b) of the Charter Act are subject to limitations imposed by the Charter Act and regulations adopted by HUD. See "Business—Corporate Indebtedness."

In addition to specific enumerated powers, the Secretary of HUD is granted general regulatory power over the Corporation under the Charter Act, with authority to promulgate rules and regulations to carry out the purposes of the Charter Act. Also, the Secretary may require, pursuant to the Charter Act, that a reasonable portion of the Corporation's mortgage loan purchases be related to the national goal of providing adequate housing for low- and moderate-income families, but with a reasonable economic return to the Corporation. The Secretary recently published for comment proposed revisions to HUD's regulations covering the Corporation. See "Recent Legislative and Regulatory Developments."

While the Charter Act authorizes the Corporation to require entities selling mortgages to it to make nonrefundable capital contributions, as determined from time to time by the Corporation with the approval of the Secretary of HUD and subject to Charter Act restrictions, the Corporation currently imposes no such requirements on mortgage sellers.

The Charter Act requires that each servicer of the Corporation's mortgages own a minimum amount of common stock. The Secretary of HUD must approve stock holding requirements imposed upon such mortgage servicers. The common stock ownership requirement currently is one share.

The Charter Act also gives the Secretary of HUD the authority to audit and examine the books and financial transactions of the Corporation, but this authority has never been exercised. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 authorizes the General Accounting Office ("GAO") to audit the Corporation's mortgage transactions.

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. One such appointed director is required to be from each of the home building, mortgage lending, and real estate industries. Any member of the Board of Directors, including a member elected by stockholders, may be removed by the President of the United States for good cause.

In addition to placing the Corporation under federal regulation, the Charter Act also grants to the Corporation certain privileges and immunities. For instance, securities issued by the Corporation are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Registration statements with respect to the Corporation's securities are not filed with the Securities and Exchange Commission. The Corporation also is not required to file periodic reports with the Securities and Exchange Commission.

As described in "Business—Corporate Indebtedness," 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 qualification 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.

As discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Years Ended December 31, 1988-1990—GSE Studies," the GAO, the U.S. Treasury, and the Congressional Budget Office ("CBO") have been studying the financial safety and soundness, including the adequacy of government regulation, of Fannie Mae and other government-sponsored enterprises ("GSEs"). The Treasury and the CBO submitted reports to Congress in April 1991, and the GAO submitted a report to Congress in May 1991. The Treasury also prepared recommended legislation, as required by the Omnibus Budget Reconciliation Act of 1990. That Act also calls for the Congressional committees that have jurisdiction over the various GSEs to report by September 15, 1991 legislation to ensure the financial soundness of GSEs. On July 30, 1991, the House Banking Committee approved proposed GSE legislation. See "Recent Legislative and Regulatory Developments."

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

Years Ended December 31, 1988-1990

Results of Operations

The Corporation earned net income of \$1,173 million in 1990, the most profitable year in its history. Net income was \$807 million in 1989 and \$507 million in 1988. The growth in net income in 1990 was attributable mainly to increases in net interest income and guaranty fee income. Another factor that contributed to higher earnings in 1990 was increased fee income for issuing real estate mortgage investment conduit ("REMIC") securities.

Net income in 1989 surpassed 1988 net income mainly because of higher net interest income. Increased guaranty fee income and a reduction in the provision for losses also contributed to the higher net income in 1989.

A summary of selected financial information for the years 1988-1990 follows:

Selected Financial Information: 1988-1990

(Dollars in millions, except per share amounts)

	Year Ended December 31,			% Change	
	1990	1989	1988	1990 Over 1989	1989 Over 1988
Income Statement Data:					
Net interest income	\$ 1,593	\$ 1,191	\$ 837	34%	42%
Guaranty fees	536	408	328	31	24
Gain on sales of mortgages	7	9	12	(22)	(25)
Miscellaneous income, net	107	60	69	78	(13)
Provision for losses	(310)	(310)	(365)	—	(15)
Administrative expenses	(286)	(254)	(218)	13	17
Income before federal income taxes	1,647	1,104	663	49	67
Provision for federal income taxes	(474)	(297)	(156)	60	90
Net income	<u>\$ 1,173</u>	<u>\$ 807</u>	<u>\$ 507</u>	45	59
Per share:					
Earnings:					
Primary	\$ 4.50	\$ 3.14	\$ 2.14	43	47
Fully diluted	4.49	3.10	2.11	45	47
Cash dividends .....	.72	.43	.24	67	79
December 31,					
Balance Sheet Data:					
Mortgage portfolio, net	\$113,875	\$107,756	\$ 99,867	6	8
Total assets	133,113	124,315	112,258	7	11
Borrowings:					
Due within one year	38,453	36,346	36,599	6	(1)
Due after one year	84,950	79,718	68,860	7	16
Total liabilities	129,172	121,324	109,998	6	10
Stockholders' equity	3,941	2,991	2,260	32	32
Other Data:					
Net interest margin	1.39%	1.16%	0.89%	20	30
Return on average equity	33.7	31.1	25.2	8	23
Return on average assets .....	.9	.7	.5	29	40
Mortgage purchases	\$ 23,959	\$ 22,518	\$ 23,110	6	(3)
MBS issued	96,695	69,764	54,878	39	27
MBS outstanding at period end(1)	299,833	228,232	178,250	31	28

(1) Included are Fannie Mae MBS held in the mortgage portfolio totaling \$11.8 billion, \$11.7 billion, and \$8.1 billion at December 31, 1990, 1989, and 1988, respectively.

Net Interest Income

Net interest income represents the excess of income from the net investment portfolio—the net mortgage portfolio and other investments—over the interest paid on borrowings and related costs. In 1990, net interest income was \$1,593 million compared with \$1,191 million in 1989 and \$837 million in 1988.

The following table presents selected average balances, effective interest rates earned and paid, and interest income and expense for 1990, 1989, and 1988.

Net Interest Income and Average Balances

	(Dollars in millions)								
	1990			1989			1988		
	Average Balance	Interest	Effective Interest Rate (1)	Average Balance	Interest	Effective Interest Rate (1)	Average Balance	Interest	Effective Interest Rate (1)
Interest-earning assets:									
Mortgage portfolio, net (2)	\$110,385	\$10,958	10.02%	\$101,714	\$10,103	10.01%	\$ 98,012	\$ 9,629	9.90%
Investments and cash equivalents	13,252	1,111	8.63	10,732	977	9.51	7,585	597	8.35
Total interest-earning assets	<u>\$123,637</u>	<u>\$12,069</u>	<u>9.86%</u>	<u>\$112,446</u>	<u>\$11,080</u>	<u>9.96%</u>	<u>\$105,597</u>	<u>\$10,226</u>	<u>9.78%</u>
Interest-bearing liabilities:									
Borrowings due within 1 year	\$ 21,855	\$ 1,778	8.14%	\$ 22,800	\$ 1,975	8.66%	\$ 20,532	\$ 1,726	8.41%
Borrowings due after 1 year	95,696	8,698	9.09	85,002	7,914	9.31	81,228	7,663	9.43
Total interest-bearing liabilities	<u>\$117,551</u>	<u>\$10,476</u>	<u>8.91%</u>	<u>\$107,802</u>	<u>\$ 9,889</u>	<u>9.17%</u>	<u>\$101,760</u>	<u>\$ 9,389</u>	<u>9.23%</u>
Net interest income		<u>\$ 1,593</u>			<u>\$ 1,191</u>			<u>\$ 837</u>	
Investment spread			<u>.95%</u>			<u>.79%</u>			<u>.55%</u>
Net interest margin(3)			<u>1.39%</u>			<u>1.16%</u>			<u>.89%</u>

- (1) Tax equivalent basis using the statutory federal tax rate. Also includes the amortization of debt issuance costs, hedging results, and the effect of currency and interest rate swaps.
- (2) Includes average balance of nonperforming loans of \$0.7 billion, \$0.8 billion, and \$1.1 billion in 1990, 1989, and 1988, respectively.
- (3) Represents the difference between the rate of interest on earning assets and the effective rate paid on both interest-bearing and non-interest-bearing funds.

Net interest income was higher in 1990 than in 1989 because of increases in the net interest margin and in the size of the average net investment portfolio. Net interest margin represents net interest income, on a tax equivalent basis, expressed as a percentage of the net investment portfolio.

The increase in the net interest margin for 1990 was attributable primarily to a rise in the average investment spread and a higher interest-free return, i.e., the return on that portion of the net investment portfolio funded by equity and non-interest-bearing liabilities. The average investment spread, which represents the difference between the interest earned on average assets and the interest paid on average liabilities, increased mainly because of a decline in the cost of debt outstanding. The interest-free return increased in 1990 primarily due to an increase in the proportion of equity relative to debt.

The increase in net interest income in 1989 compared with 1988 was due primarily to an increase in the average investment spread and a larger earning asset base. The increase in investment spread was due mainly to an improvement in the average portfolio yield and, to a lesser extent, a reduction in the cost of debt outstanding.

Net interest income does not include accrued interest on nonperforming loans. A loan is classified as nonperforming and accrued interest is reversed out of income when a payment is 90 days or more past due. If nonperforming assets had been fully performing, they would have contributed an additional \$49 million to net interest income in 1990, \$48 million in 1989, and \$89 million in 1988. Nonperforming loans outstanding were \$0.7 billion at December 31, 1990 and 1989, and \$0.9 billion at December 31, 1988.

The following rate/volume analysis shows the relative contribution of asset growth and interest rate changes to changes in net interest income for the years ended December 31, 1990, 1989, and 1988.

Rate/Volume Analysis

(Dollars in millions)

	Increase	Attributable to Changes in (1)	
		Volume	Rate
1990 vs. 1989			
Interest income	\$989	\$1,093	\$(104)
Interest expense	587	875	(288)
Net interest income	<u>\$402</u>	<u>\$ 218</u>	<u>\$ 184</u>
1989 vs. 1988			
Interest income	\$854	\$ 672	\$ 182
Interest expense	500	554	(54)
Net interest income	<u>\$354</u>	<u>\$ 118</u>	<u>\$ 236</u>

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

Other Income

Guaranty fee income increased in 1990 compared with 1989, and in 1989 compared with 1988, due to the growth in the amount of Mortgage-Backed Securities ("MBS") outstanding. In return for these fees, the Corporation guarantees the timely payment of principal and interest to MBS investors.

The following table shows guaranty fee income as a percentage of the average balance of MBS outstanding in 1990, 1989, and 1988.

	Dollars in millions		
	1990	1989	1988
Guaranty fee income	\$ 536	\$ 408	\$ 328
Average balance of MBS outstanding (1)	\$254,703	\$191,037	\$152,107
Effective guaranty fee rate .....	.211%	.213%	.216%

(1) Excludes \$11.9 billion, \$9.8 billion, and \$6.4 billion in 1990, 1989, and 1988, respectively, of the average balances of Fannie Mae MBS held in the mortgage portfolio.

Guaranty fee income as a percentage of average MBS outstanding declined in 1990 compared with 1989 despite an increase in the proportion of nonrecourse business (i.e., where the Corporation has no recourse to the lender in the event of borrower default), which generally has a higher guaranty fee. The decline was due to increased competitive pressures and a larger proportion of fixed-rate MBS issuances, which carry a lower guaranty fee rate than adjustable-rate MBS. The decline in 1989 compared with 1988 was due primarily to an increased percentage of fixed-rate MBS business.

A major reason for the increase in miscellaneous income in 1990 was an increase in REMIC issuances which resulted in higher REMIC fee income. REMIC issuances increased in 1990 because of greater investor demand. The Corporation issued \$60.9 billion of REMICs in 1990 compared with \$37.6 billion in 1989, and \$11.2 billion in 1988. The related fees recognized in income were \$62 million, \$37 million, and \$16 million, respectively. To the extent needed to offset expected future administrative and other REMIC costs, a portion of the fees received for REMIC issuances is deferred and amortized into income over the life of the REMIC.

The decrease in miscellaneous income in 1989 compared with 1988 was attributable mainly to the repurchase of high-cost debt at a premium and a decline in fees from unexercised mortgage purchase commitments and in other sources of miscellaneous income. Higher REMIC fee income partially offset these decreases.

Provision for Losses, Real Estate Owned, and Allowance for Losses

In evaluating the risk of loss on the mortgage loan portfolio and MBS outstanding, management considers recent experience, current economic conditions, and estimates of future losses on seriously delinquent and foreclosed loans. The following table shows for 1990, 1989, and 1988 the number of conventional single-family and multifamily foreclosed properties acquired during the year and in inventory at year-end.

<u>Number of Properties (1)</u>	<u>1990</u>	<u>1989</u>	<u>1988</u>
Single-Family:			
Acquired	9,034	10,948	14,334
In inventory at year-end	3,585	4,975	7,458
Multifamily:			
Acquired	25	23	27
In inventory at year-end	32	33	41

(1) Includes properties acquired from foreclosures of conventional single-family and multifamily loans in portfolio or backing MBS.

Fewer property acquisitions led to a decline in net charge-offs to \$234 million in 1990 compared with \$243 million in 1989 and \$315 million in 1988. Despite the continued moderation in the level of foreclosures, management did not reduce the overall provision for losses in 1990 as it did in 1989. Instead, because of higher levels of MBS issues and portfolio purchases in 1990, the provision was maintained at \$310 million in 1990 (the same level as in 1989), compared with \$365 million in 1988. Because the provision exceeded charge-offs in each of these years, the allowance for losses increased to \$539 million at the end of 1990, compared with \$463 million and \$396 million at the end of 1989 and 1988, respectively. Management maintains the allowance for losses at a level it believes is adequate, considering current and anticipated charge-offs and the amount of portfolio and MBS outstanding.

Administrative Expenses

Administrative expenses were \$286 million in 1990, compared with \$254 million and \$218 million in 1989 and 1988, respectively. Increased salaries and compensation-related expenses were the primary reasons for the overall increases. The ratio of total administrative expenses to average mortgage portfolio plus average MBS outstanding was .08 percent in 1990, 1989, and 1988.

Income Taxes

The effective federal income tax rate in 1990 was 29 percent, compared with 27 percent in 1989 and 24 percent in 1988. The effective tax rate increased in both 1990 and 1989 primarily due to the

growth in taxable income without a proportionate increase in income from tax-advantaged investments.

As discussed in the Notes to Financial Statements, "Income Taxes," the Corporation has several unresolved issues with the Internal Revenue Service, relating to current and prior examinations.

Financial Condition

Management believes the Corporation is in sound financial condition as a result of strategies adopted over the past decade. These strategies have addressed two primary risks faced by the Corporation—interest rate risk and credit risk. Interest rate exposure is managed through asset/liability strategies designed to match the estimated durations of the Corporation's assets and liabilities, and to maintain this duration match throughout a wide range of interest rate scenarios. To mitigate credit risk, the Corporation establishes strict underwriting guidelines and maintains a geographically diverse business base. While active interest rate and credit risk management diminish the prospect for significant losses, the Corporation maintains a growing capital base (equity and allowance for losses) to absorb future losses.

Management of Interest Rate Risk

The sensitivity of earnings to changes in interest rates can be measured by the duration gap, or the difference between the estimated durations of mortgage assets and those of the liabilities that fund the mortgages. Duration represents the estimated weighted-average maturity of the present values of future cash flows. The Corporation's duration gap in the years 1986 through 1990 ranged between 3 months (at December 31, 1990) and 11 months (at December 31, 1986), compared with 29 months at the end of 1984. Having successfully narrowed the duration gap, management now is focusing on maintaining the duration gap in circumstances in which interest rates change appreciably.

The durations of assets and liabilities may respond differently to significant interest rate changes. For example, when interest rates decline significantly, mortgage durations also decline because of higher prepayments. The durations of non-callable liabilities, however, stay more or less the same. The resulting duration mismatch could increase earnings volatility. One way to reduce the projected duration gap that can result when interest rates change significantly is to issue callable debt (i.e., debt with optional or mandatory call provisions) that better matches the optional prepayment characteristics of the mortgages the Corporation is funding. Should rates decline appreciably and mortgages prepay, the resulting decline in asset durations would be paralleled by a decline in liability durations effected by redeeming such callable debt.

Recent financing strategies employed by the Corporation have emphasized the issuance of callable debt, including Indexed Sinking Fund Debentures ("ISFDs"), and callable and ISFD swaps that effectively convert non-callable debt to callable debt. Management believes that, despite its higher cost, the early redemption feature of callable debt makes it a desirable tool for managing the interest rate risk associated with mortgage loan prepayments.

Management of Credit Risk

Credit risk results from the possibility that the Corporation will not recover amounts due from borrowers or lenders on its mortgage portfolio, or will be called upon to meet guaranteed payments to investors on its outstanding MBS. Another, less significant, type of credit risk arises from the possibility that counterparties to the positions the Corporation has taken in interest rate and currency swaps, futures contracts, and other off-balance-sheet financial arrangements to reduce interest rate risk, will fail to meet their contractual obligations. Off-balance-sheet credit risk is minimized by setting high credit standards for counterparties and by requiring collateral in certain cases.

The Corporation manages its mortgage-related credit risk through its underwriting guidelines, credit requirements for lenders that service its loans, collateral requirements, and the geographical

diversity of its business base. In late 1985, the Corporation revised its underwriting guidelines and net worth requirements for lenders. Management believes these revisions have contributed to improved loan loss experience. As of December 31, 1990, 90 percent of the conventional single-family mortgages, either in the Corporation's portfolio or backing MBS, consisted of loans acquired or guaranteed since January 1, 1986. The revised guidelines resulted in lower loan-to-value ratios on many loans purchased for portfolio or backing MBS. At December 31, 1990, 76 percent of the conventional single-family loans in the Corporation's portfolio or backing MBS had an original loan-to-value ratio not higher than 80 percent (34 percent not higher than 70 percent).

Seriously delinquent conventional single-family mortgages in the portfolio or backing MBS for which Fannie Mae bears the primary default risk have decreased from 1.48 percent at December 31, 1985 to 0.58 percent at December 31, 1990. Serious delinquency includes loans 90 or more days delinquent, in foreclosure, or in relief.

A comparison, based on available data, of the delinquency trends of conventional single-family loans purchased in 1985 with the trends for conventional single-family loans purchased in 1986, 1987, and 1988 revealed that approximately two years after origination, the 1986, 1987, and 1988 loans had a serious delinquency rate of 0.38 percent, 0.30 percent, and 0.58 percent, respectively, compared with 2.31 percent for the 1985 loans. Management attributes the improved delinquency experience to the change in underwriting guidelines and to the more favorable loan-to-value distribution on loans purchased after 1985.

On the majority of the multifamily loans the Corporation owns or guarantees, it has recourse to the lender or others, or has required pledged collateral. The percentage of multifamily loans in portfolio or backing MBS for which the Corporation bears the primary default risk was 40 percent in 1990, compared with 31 percent and 28 percent in 1989 and 1988, respectively. Of these totals, 19 percent, 9 percent, and 2 percent, respectively, relate to Fannie Mae's delegated underwriting and servicing ("DUS") program. Under DUS, selected lenders are permitted to sell to the Corporation multifamily loans that meet published guidelines without the Corporation's prior approval of the underwriting, provided the lenders agree to share in a portion of any subsequent losses on such loans.

Additional information on the Corporation's exposure to credit risk is presented in the Notes to Financial Statements, "Financial Instruments with Off-Balance-Sheet Risk" and "Concentrations of Credit Risk."

Liquidity Management

The role of liquidity management at Fannie Mae is to ensure that funds are available to meet the Corporation's regular business requirements and to take advantage of market opportunities. Fannie Mae's primary sources of cash are issuances of debt obligations, mortgage loan repayments, interest income, MBS guaranty fees, and proceeds from the sale of mortgages. In addition, at December 31, 1990, Fannie Mae had a portfolio of cash equivalents and short-term and other liquid investments totaling \$14 billion. Primary uses of cash include the purchase of mortgages, repayment of debt, and payment of interest expense.

Fannie Mae's statutory mission requires that it buy mortgage assets from approved lending institutions on an ongoing basis. The Corporation, therefore, must raise funds continually to support this 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 funds.

Most long-term funding is obtained through monthly sales of debentures, generally scheduled to coincide with maturities of outstanding debentures and to avoid conflicts with borrowings scheduled by the Treasury and other government agencies. The Corporation raises short-term funds primarily through short-term discount notes and residential financing securities. Residential financing securities are six-month, one-year, or two-year unsecured general obligations bearing interest at fixed rates.

At December 31, 1990, the Corporation had mandatory delivery commitments and lender option commitments outstanding to purchase \$1.9 billion and \$7.7 billion of mortgage loans, respectively, compared with \$2.3 billion and \$3.7 billion, respectively, of such commitments outstanding at December 31, 1989. As in the past, the Corporation expects to fund mortgage purchases pursuant to such commitments through the sources of cash noted above.

Mortgage Portfolio

The net mortgage portfolio totaled \$113.9 billion at December 31, 1990, compared with \$107.8 billion at December 31, 1989 and \$99.9 billion at December 31, 1988. The yield on the net mortgage portfolio (before deducting the allowance for losses) at December 31, 1990 was 9.94 percent, compared with 10.03 percent at December 31, 1989 and 9.84 percent at December 31, 1988. The decrease in yield in 1990 compared with 1989 was due primarily to a decline in conventional mortgage yields and an increase in the proportion of intermediate-term fixed-rate mortgages, which generally have a lower yield relative to 30-year fixed-rate mortgages. The increase in yield in 1989 compared with 1988 was attributable, in large part, to the upward adjustment of interest rates on ARMs in portfolio and to a decrease in purchases of ARMs, which generally have a lower initial interest rate than fixed-rate mortgages.

The following table summarizes mortgage purchases.

		Mortgage Purchases						% Change			
		(Dollars in millions)									
		<u>1990</u>		<u>1989</u>		<u>1988</u>		<u>1990</u>	<u>1989</u>		
								<u>Over</u>	<u>Over</u>		
								<u>1989</u>	<u>1988</u>		
Mortgage type:											
Single-family:											
FHA/VA	\$	698	2.9%	\$	940	4.2%	\$	503	2.2%	(26)%	87%
Conventional:											
30-year fixed-rate		12,417	51.8	11,813	52.5	8,957	38.7	5	32		
Intermediate-term											
fixed-rate		4,872	20.4	3,306	14.7	2,933	12.7	47	13		
ARMs		2,826	11.8	4,492	19.9	9,862	42.7	(37)	(54)		
Second mortgages		654	2.7	406	1.8	433	1.9	61	(6)		
Total single-family		21,467	89.6	20,957	93.1	22,688	98.2	2	(8)		
Multifamily		2,492	10.4	1,561	6.9	422	1.8	60	270		
Total	\$	23,959	100.0%	22,518	100.0%	23,110	100.0%	6	(3)		
Average net purchase yield		<u>9.82%</u>		<u>9.88%</u>		<u>9.40%</u>		(1)	5		

The increase in mortgage purchases in 1990 compared with 1989 was due primarily to an increase in the number of mortgages offered for sale in the secondary market, an increase in the Corporation's market share, and increased buy/sell activity. "Buy/sell" activity refers to the Corporation's practice of committing to purchase mortgages and simultaneously committing to sell mortgages as MBS. Buy/sell activity allows the Corporation to continue to provide funds to the primary mortgage market in periods characterized by narrow spreads between mortgage yields and the Corporation's debt costs, when it is not desirable to purchase large amounts of mortgages for portfolio. The decrease in mortgage purchases in 1989 compared with 1988 was attributable to a decrease in the number of mortgages offered for sale in the secondary market.

The decrease in the percentage of ARMs purchased in 1990 compared with 1989, and in 1989 compared with 1988, was primarily the result of lower interest rates on fixed-rate mortgages, and narrower spreads between interest rates on fixed-rate mortgages and initial rates on ARMs, which led to an increase in originations of fixed-rate mortgages and fewer ARM originations. The proportion of intermediate-term fixed-rate mortgage purchases in 1990 compared with 1989 increased primarily because of an increase in purchases of balloon mortgages.

Multifamily loan purchases rose significantly between 1988 and 1990, in large part due to the increased use of the DUS program, which was introduced in 1988.

Sales from portfolio totaled \$5.8 billion in 1990 compared with \$3.0 billion in 1989 and \$5.0 billion in 1988. The higher sales level in 1990 compared with 1989 reflects the Corporation's increased use of buy/sell activities in 1990. Sales in connection with buy/sell activities were \$5.5 billion, \$2.8 billion, and \$2.3 billion in 1990, 1989, and 1988, respectively. Buy/sell activity does not materially affect net interest margin nor does it generate significant gains or losses. Sales were lower in 1989 compared with 1988, because more structured transactions, such as REMICs, were initiated by dealers using their own collateral rather than by sales out of portfolio.

Mortgage repayments, which include prepayments and normal principal amortization, totaled \$11.6 billion in 1990, compared with \$11.0 billion in 1989 and \$10.7 billion in 1988.

Mortgage-Backed Securities

MBS outstanding continued to grow at a rapid pace during 1990. At December 31, 1990, there were \$299.8 billion of MBS outstanding, compared with \$228.2 billion at December 31, 1989, and \$178.3 billion at December 31, 1988. 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 representing a proportionate share of a larger pool. MBS may back other securities, including Fannie Megas, Stripped MBS ("SMBS"), and REMICs.

MBS are not assets of the Corporation, except when acquired for investment purposes, nor are the related outstanding securities liabilities of the Corporation. However, the Corporation is liable under its guaranty to make timely payments to investors of principal and interest on the mortgage loans in the underlying pools. The issuance of MBS creates a source of guaranty fee income without assuming any debt refinancing risk on the underlying pooled mortgages.

Sellers of pools of mortgage loans may retain or transfer to one or more third parties the primary default risk on loans comprising the pools, or they may elect to transfer this credit risk to Fannie Mae for a higher guaranty fee. The Corporation, however, assumes the ultimate risk of loss on all MBS. In recent years, largely because of new capital standards for financial institutions, an increasing proportion of MBS pools have been securitized without recourse to the lenders. During 1990, 88 percent of MBS issued were nonrecourse, compared with 66 percent and 47 percent in 1989 and 1988, respectively. Management closely monitors and manages the additional credit risk related to nonrecourse MBS.

The following table summarizes MBS activity for the years ended December 31, 1990, 1989, and 1988:

Summary of MBS Activity

(Dollars in millions)

	1990		1989		1988		% Change	
							1990 Over 1989	1989 Over 1988
MBS Issued:								
Lender originated	\$ 91,184	94%	\$ 64,396	92%	\$ 48,942	89%	42%	32%
Fannie Mae originated	<u>5,511</u>	<u>6</u>	<u>5,368</u>	<u>8</u>	<u>5,936</u>	<u>11</u>	3	(10)
Total	<u>\$ 96,695</u>	<u>100%</u>	<u>\$ 69,764</u>	<u>100%</u>	<u>\$ 54,878</u>	<u>100%</u>	39	27
MBS Outstanding (1):								
Lender risk (2)	\$ 97,752	33%	\$ 94,343	41%	\$ 84,143	47%	4	12
Fannie Mae risk (3)	<u>202,081</u>	<u>67</u>	<u>133,889</u>	<u>59</u>	<u>94,107</u>	<u>53</u>	51	42
Total (4)	<u>\$299,833</u>	<u>100%</u>	<u>\$228,232</u>	<u>100%</u>	<u>\$178,250</u>	<u>100%</u>	31	28

- (1) This table classifies 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 \$35.9 billion, \$30.6 billion, and \$23.8 billion at December 31, 1990, 1989, and 1988, 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 \$9.3 billion, \$11.1 billion, and \$11.2 billion at December 31, 1990, 1989, and 1988, respectively, which are backed by government insured or guaranteed mortgages.
- (4) Included are \$11.8 billion, \$11.7 billion, and \$8.1 billion at December 31, 1990, 1989, and 1988, respectively, of Fannie Mae MBS in portfolio.

Fannie Mae issued more MBS in 1990 compared with 1989, and in 1989 compared with 1988, primarily due to an increase in the volume of fixed-rate mortgages available in the secondary market to create MBS and an increase in the Corporation's market share. In addition, in both 1990 and 1989, higher proportions of fixed-rate originations were securitized than in the preceding year, partly in response to new risk-based capital guidelines for thrifts, banks, and bank holding companies. The new guidelines specify a lower risk-based capital requirement for mortgage-backed securities issued or guaranteed by a U.S. government agency or a U.S. government-sponsored agency than for mortgage loans. A number of thrifts and banks have sold or securitized a portion of their residential mortgage assets in the secondary market in response to the new guidelines.

During 1990, international investors purchased increased amounts of MBS directly as well as through private mutual funds, structured and managed by third parties. This increase in the amount of MBS purchased by international investors was attributable, in part, to growing investor familiarity with the MBS structure, increased market liquidity, and attractive yields relative to comparable investments. In addition, the Corporation intensified its efforts to create greater name recognition and understanding of the product.

Financing Activities

Debt Issued and Outstanding

The average cost of debt outstanding at December 31, 1990 was 8.81 percent compared with 9.04 percent and 9.20 percent at December 31, 1989 and 1988, respectively. These decreases were 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 outstanding debt. Lower interest rates in recent years have allowed the Corporation to reduce the average cost of debt outstanding while maintaining the desired average maturity.

The average maturity of debt outstanding at December 31, 1990 and December 31, 1989 increased each year compared with the prior year-end primarily because the Corporation issued a higher percentage of callable debt relative to non-callable debt. In achieving its duration targets, the Corporation's increased use of callable debt in 1990 and 1989 lengthened the average maturity of debt outstanding because the final maturity of callable debt (used in calculating the average maturity of debt outstanding) is greater than the maturity of equivalent duration non-callable debt.

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

	1990	1989	1988	% Change	
				1990 Over 1989	1989 Over 1988
	(Dollars in millions)				
Debt Issued During Year					
Amount	\$113,988	\$ 78,568	\$ 64,260	45%	22%
Average cost (1)	8.03%	8.60%	7.84%	(7)	10
Debt Repaid During Year					
Amount	\$106,974	\$ 68,043	\$ 55,766	57	22
Average cost (1)	8.27%	8.77%	8.18%	(6)	7
Debt Outstanding at Year-end					
Amount, net	\$123,403	\$116,064	\$105,459	6	10
Average cost (1)	8.81%	9.04%	9.20%	(3)	(2)
Average maturity (months)	50	47	43	6	9

(1) Includes commissions, hedging costs, and the effect of currency, debt, and interest rate swaps.

Callable debt issues plus the notional amount of callable and ISFD swaps totaled \$13.3 billion, \$6.5 billion, and \$1.7 billion in 1990, 1989, and 1988, respectively. In 1990, 1989, and 1988, such callable instruments were 66 percent, 28 percent, and 12 percent, respectively, of total long-term debt issued in those years. Callable debt outstanding plus the notional amount of callable and ISFD swaps was \$22.3 billion, \$9.4 billion, and \$3.0 billion at December 31, 1990, 1989, and 1988, respectively, which represented 22 percent, 10 percent, and 4 percent of total long-term debt outstanding at year-end in each of those years.

The Secretary of Housing and Urban Development requires that the Corporation's debt-to-capital ratio not exceed 20:1. Capital, for this purpose, includes stockholders' equity, subordinated capital debentures, convertible capital debentures, and loss allowances. Also, the Corporation is subject to a restriction in connection with certain subordinated capital debenture issues, which limits the amount of such debentures outstanding to not more than two times the sum of common stock, additional paid-in capital, and retained earnings.

Presented in the following table are the aforementioned capital ratios at December 31, 1990, 1989, and 1988.

	<u>1990</u>	<u>1989</u>	<u>1988</u>
Debt-to-capital	18.9:1	19.7:1	19.1:1
Subordinated debt-to-equity	0.5:1	0.8:1	1.2:1

Despite the maturing in 1990 of \$0.4 billion of subordinated debentures, the debt-to-capital ratio at December 31, 1990 decreased compared with December 31, 1989 largely because of a net increase in retained earnings of \$1.0 billion and higher loss allowances. At December 31, 1989, the debt-to-capital ratio increased compared with the ratio at December 31, 1988, primarily due to a net decrease in outstanding subordinated capital debentures.

Common Stock

On August 23, 1990, the Corporation announced its intention to repurchase common stock and common stock warrants, in an amount up to the expected proceeds from the exercise of the warrants, approximately \$500 million. As of December 31, 1990, 3.4 million shares of common stock had been repurchased at a cost of \$93 million. At December 31, 1990, there were outstanding 238.3 million shares of common stock and 33.4 million common stock warrants, which expire in February 1991. In 1990, the Board twice voted to increase the quarterly cash dividend by 4 cents per share. The dividend payable in the fourth quarter of 1990 was 22 cents per share.

GSE Studies

In 1990, both the General Accounting Office ("GAO") and the U.S. Treasury reported on their studies of a variety of government sponsored enterprises ("GSEs"), including Fannie Mae. The studies, mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), were designed to evaluate, among other aspects, the financial soundness of GSEs and their capitalization. Both the Treasury and the GAO submitted to Congress in 1990 reports addressing the financial safety and soundness of eight GSEs, including regulation of the GSEs. Under FIRREA, the GAO must complete an additional GSE study by May 1991. The Omnibus Budget Reconciliation Act of 1990 ("Budget Act") requires the Treasury and the Congressional Budget Office each to prepare and submit to Congress by April 30, 1991, a study of GSEs. Those studies will include a discussion of financial risks each GSE assumes and the adequacy of GSE regulation, and, in the Treasury's case, recommended legislation. The Budget Act also calls for the Congressional committees that have jurisdiction over the various GSEs to report by September 15, 1991, legislation to ensure the financial soundness of GSEs.

Six Months Ended June 30, 1991 and 1990

Results of Operations

Fannie Mae's net income for the first six months of 1991 was \$652 million compared with \$566 million for the first six months of 1990, an increase of 15 percent. Net income increased primarily as a result of increases in net interest income and guaranty fee income. The 1991 first half results included the recognition of \$239 million of interest income as a result of the resolution of a tax case, a pre-tax loss of \$59 million on the sale of low coupon mortgages, and a pre-tax loss of \$130 million due to the repurchase of high coupon debt at a premium. In addition, the provision for losses was increased by \$50 million in the second quarter of 1991, as compared with the preceding three quarters. The net impact of these transactions did not materially affect first half earnings.

	Six months ended June 30,	
	1991	1990
	(Dollars in millions, except per share amounts)	
Net interest income	\$ 865	\$ 774
Guaranty fees	319	249
Income from IRS settlement	239	—
Gain (loss) on sales of mortgages	(50)	5
Miscellaneous income, net	42	51
Provision for losses	(210)	(150)
Administrative expenses	(150)	(137)
Income before federal income taxes and extraordinary item	1,055	792
Provision for federal income taxes	(317)	(226)
Income before extraordinary item	738	566
Extraordinary loss—repurchase of debt (net of tax effect of \$44 million)	(86)	—
Net income	<u>\$ 652</u>	<u>\$ 566</u>
Per share:		
Earnings before extraordinary item (fully diluted)	\$ 2.71	\$2.15
Earnings (fully diluted)	2.40	2.15
Cash dividends .....	.48	.32

Net Interest Income

Net interest income for the first six months of 1991 was 12 percent higher than for the comparable period in 1990. The growth in net interest income resulted primarily from the increase in the average net investment balance and the growth in interest-free funds and was partially offset by a decline in the investment spread as the yield on interest-earning assets declined by a larger amount than the cost of debt.

Presented in the following table are selected average balances, interest rates earned and paid, and interest income and expense for the six months ended June 30, 1991 and 1990.

Net Interest Income and Average Balances

(Dollars in millions)

	Six Months Ended June 30,					
	1991			1990		
	Average Balance	Interest	Effective Interest Rate (1)	Average Balance	Interest	Effective Interest Rate (1)
Interest-earning assets:						
Mortgage portfolio, net(2) ..	\$116,694	\$5,712	9.88%	\$109,297	\$5,433	10.03%
Investments	15,610	557	7.27	12,336	526	8.84
Total interest-earning assets	<u>\$132,304</u>	<u>\$6,269</u>	<u>9.57%</u>	<u>\$121,633</u>	<u>\$5,959</u>	<u>9.91%</u>
Interest-bearing liabilities:						
Borrowings due within 1 year	\$ 23,383	\$ 816	6.98%	\$ 22,417	\$ 999	8.27%
Borrowings due after 1 year	101,257	4,588	9.06	93,572	4,186	9.10
Total interest-bearing liabilities	<u>\$124,640</u>	<u>\$5,404</u>	<u>8.67%</u>	<u>\$115,989</u>	<u>\$5,185</u>	<u>8.94%</u>
Net interest income		\$ 865			\$ 774	
Investment spread .....			.90%			.97%
Net interest margin(3)			<u>1.40%</u>			<u>1.38%</u>

(1) Tax equivalent basis. Also includes the amortization of issuance costs, hedging results, and the effect of currency and interest rate swaps.

(2) Includes the average balance of nonperforming loans of \$0.9 billion and \$0.7 billion for the six months ended June 30, 1991 and 1990, respectively.

(3) Represents the difference between the rate of interest on earning assets and the effective rate paid on both interest-bearing and non-interest-bearing funds.

The rate/volume analysis below shows the relative contribution of asset and debt growth and interest rate changes to changes in net interest income for the six months ended June 30, 1991 and 1990.

Rate/Volume Analysis

(Dollars in millions)

Six months ended 1991 vs. 1990	Increase (Decrease)	Attributable to Changes in (1)	
		Volume	Rate
Interest income	\$310	\$511	\$(201)
Interest expense	219	378	(159)
Net interest income	<u>\$ 91</u>	<u>\$133</u>	<u>\$(42)</u>

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

Other Income

Guaranty fee income increased 28 percent in the first six months of 1991 compared with the same period in 1990, primarily due to the increase in the amount of MBS outstanding.

As described in the Notes to Financial Statements, "Income Taxes," at December 31, 1990 the Corporation had pending a case involving an unresolved issue with the Internal Revenue Service ("IRS") relating to concurrent mortgage sales. In April 1991, the Supreme Court denied the IRS's petition for certiorari in the Corporation's case. This action by the Supreme Court left standing a lower court's ruling favoring the Corporation's tax position. As a result, the Corporation recognized \$239 million in pre-tax income in the second quarter of 1991.

Loss on sales of mortgages in the first half of 1991 was \$50 million, compared with a gain of \$5 million in the first half of 1990. In 1991, the Corporation sold \$800 million of low-coupon mortgages resulting in a pre-tax loss of \$59 million.

A decline in REMIC and SMBS fee income was the primary reason for the 18 percent decrease in miscellaneous income in the first six months of 1991 compared with the first six months of 1990. REMIC fee income declined primarily because of lower REMIC fee rates in response to increased competition with the Federal Home Loan Mortgage Corporation. SMBS fee income declined as a result of lower demand for new SMBS issuances.

Provision for Losses, Real Estate Owned, and Allowance for Losses

The Corporation's provision for losses for the first half of 1991 was \$210 million, up from \$150 million in the first half of 1990. In the second quarter of 1991, the Corporation increased the provision for loan losses by \$50 million as compared with the preceding three quarters. Management considered this increase to be prudent in light of actual and anticipated growth in business volumes. Total foreclosure losses charged off for portfolio and MBS were \$98 million in the first six months of 1991 compared with \$119 million in the first six months of 1990, a decrease of 18 percent. The higher provision combined with a decline in charge-offs caused the increase in the allowance for losses to \$652 million at June 30, 1991, compared with \$539 million at December 31, 1990 and \$494 million at June 30, 1990.

Administrative Expenses

Administrative expenses were \$150 million in the first six months of 1991, 10 percent higher than in the first six months of 1990, primarily due to increased salaries and compensation-related expenses. Compensation expense represented 54 percent and 53 percent of administrative expenses in the first six months of 1991 and 1990, respectively.

Income Taxes

The effective federal income tax rates for the first six months of 1991 and 1990 were 30 percent and 29 percent, respectively. The increase for the first six months of 1991 was primarily due to an increase in taxable income without a proportionate increase in income from tax-advantaged investments.

Extraordinary Loss—Repurchase of Debt

The Corporation repurchased \$1.3 billion of high-coupon debt, resulting in a pre-tax loss of \$130 million (\$86 million after tax). The repurchase of high-coupon debt will decrease the Corporation's cost of funds in future periods.

Mortgage Portfolio

The Corporation purchased \$16.1 billion of mortgages at an average yield of 9.20 percent in the first six months of 1991, compared with \$10.8 billion of mortgages at an average yield of 9.86 percent in the first six months of 1990. The increase in mortgage purchases was primarily due to an increase in refinancing activity as interest rates declined. The Corporation also sold \$800 million of low

coupon mortgages at a pre-tax loss of \$59 million. The sale of low coupon mortgages will enhance the Corporation's future income.

ARMs represented 14 percent of the Corporation's mortgage purchases in the first six months of 1991 compared with 9 percent in the first six months of 1990. This increase reflects, in large part, growth in the volume of the Two-Step® mortgages. A Two-Step mortgage is an ARM with one interest rate for the first 5 or 7 years that adjusts automatically to another interest rate for the next 25 or 23 years, respectively. The Corporation began purchasing Two-Step mortgages in March 1990.

Mortgage repayments during the first six months of 1991 totaled \$7.4 billion compared with \$5.9 billion in the first six months of 1990. The increase in repayments primarily was due to declining interest rates. Sales from portfolio totaled \$2.2 billion for the first six months of 1991 compared with \$2.5 billion for the first six months of 1990.

At June 30, 1991 and 1990, the net mortgage portfolio (mortgage loans less the allowance for losses and less unamortized discount and fees) was \$120.1 billion with a yield of 9.78 percent and \$110.0 billion with a yield of 9.99 percent, respectively.

Delinquencies

Serious delinquencies experienced on conventional mortgage loans in the Corporation's portfolio and underlying MBS, for which the Corporation has the primary risk of loss, are summarized in the following table.

	<u>June 30,</u>	
	<u>1991</u>	<u>1990</u>
Single-family(1)		
Portfolio	1.04%	.96%
MBS .....	.37	.32
Total	<u>.60%</u>	<u>.57%</u>
Multifamily(2)	<u>2.93%</u>	<u>2.00%</u>

(1) Single-family loans that are seriously delinquent in the portfolio and underlying MBS are those loans that are 90 or more days delinquent, in relief, or in foreclosure, for which the Corporation has primary risk of loss. The percentages are based on the number of such loans in portfolio or underlying MBS.

(2) Multifamily loan percentages are for loans that are 2 months or more delinquent for which the Corporation has primary risk of loss and are based on the dollar amount of such loans in portfolio and underlying MBS.

The percentage increase in single-family and multifamily loan delinquencies was due primarily to adverse economic conditions in certain geographical areas.

Mortgage-Backed Securities

The following table summarizes MBS activity for the six months ended June 30, 1991 and 1990.

Summary of MBS Activity

(Dollars in millions)

	<u>June 30,</u> <u>1991</u>	<u>June 30,</u> <u>1990</u>	<u>%</u> <u>Change</u> <u>1991</u> <u>Over</u> <u>1990</u>
MBS Issued:			
Lender originated	\$ 45,106	\$ 44,486	1%
Fannie Mae originated	<u>2,771</u>	<u>2,722</u>	2
Total	<u>\$ 47,877</u>	<u>\$ 47,208</u>	1
MBS Outstanding(1):			
Lender risk(2)	\$ 97,010	\$ 98,039	(1)
Fannie Mae risk(3)	<u>234,079</u>	<u>165,291</u>	42
Total(4)	<u>\$331,089</u>	<u>\$263,330</u>	26

(1) This table classifies 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, but does not include the resulting Megas, SMBS, and REMICs.

(2) Included in lender risk are \$38.1 billion and \$31.4 billion at June 30, 1991 and 1990, respectively, on which the seller or a third party has agreed to bear default risk limited to a certain percentage of the loans delivered, and in some cases the seller has pledged collateral to secure that obligation.

(3) Included are \$9.7 billion at June 30, 1991 and 1990, that are backed by government insured or guaranteed mortgages.

(4) Included are \$13.4 billion and \$12.0 billion at June 30, 1991 and 1990, respectively, of Fannie Mae MBS in portfolio.

The increase in MBS outstanding where Fannie Mae has primary default risk is primarily due to lender reaction to new capital rules that require lenders to have more capital for MBS where they bear default risk. This shift in risk results in greater guaranty fee income to Fannie Mae.

Megas, SMBS, and REMICs issued during the first six months of 1991 aggregated \$7.3 billion, \$0.4 billion, and \$37.0 billion, respectively, compared with \$7.4 billion, \$3.9 billion, and \$29.1 billion, respectively, for the first six months of 1990. The decrease in SMBS volume was primarily due to diminished investor demand. The increase in REMIC issuances was the result of increased investor demand for targeted maturity investments and greater availability of the underlying collateral.

Liquidity and Capital Resources

The Corporation's shareholders' equity was \$5.0 billion at June 30, 1991, compared with \$3.9 billion at December 31, 1990 and \$3.5 billion at June 30, 1990. This increase in equity was primarily due to an increase in retained earnings and conversions of stock warrants in the first half of 1991.

Total commitments outstanding to purchase mortgages were \$7.5 billion and \$10.7 billion at June 30, 1991 and 1990, respectively.

Financing and Other Activities

In the first six months of 1991, the Corporation issued \$91.3 billion of debt at an average cost of 6.40 percent, and redeemed \$88.1 billion at an average cost of 6.79 percent. The redemptions include the repurchase of \$1.3 billion in high coupon debt at a pre-tax loss of \$130 million. In the first six

months of 1990, debt issues totaled \$45.1 billion at an average cost of 8.26 percent, and debt redemptions were \$43.4 billion at an average cost of 8.53 percent. The average cost of debt issued was lower in the first six months of 1991 compared with the same period in 1990 because more short-term debt was issued and interest rates were lower in the 1991 period. The average cost of debt outstanding at June 30, 1991 and 1990 was 8.53 percent and 8.93 percent, respectively. The average maturity of debt outstanding at June 30, 1991 and 1990 was 53 months and 48 months, respectively. The average maturity increased as the Corporation acquired longer term assets and issued debt that closely matched expected maturities of the assets being financed.

The Corporation's statutory debt-to-capital ratio at June 30, 1991 was 16.4, compared with 18.2 at June 30, 1990. The Secretary of Housing and Urban Development requires that this ratio not exceed 20:1. At June 30, 1991, the Corporation's subordinated debt-to-equity ratio was 0.4:1, compared with 0.7:1 at June 30, 1990.

On July 16, 1991, the Board of Directors approved a dividend of 26 cents per share on the Corporation's common stock. The dividend was payable on August 25, 1991 to shareholders of record on July 31, 1991. As of June 30, 1991, there were 273 million shares of common stock outstanding.

BUSINESS

The Corporation purchases and holds in portfolio mortgage loans on residential properties. The Corporation obtains funds to purchase mortgage loans from various capital markets. The Corporation also issues MBS.

In this document, both whole loans and participation interests in loans are referred to as "loans," "mortgage loans," and "mortgages." 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 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 Veterans Administration ("VA"), multifamily mortgage loans and second mortgage loans. 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 (20 years or less), loans secured by second mortgages, and multifamily 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 and of its loan purchases during the last five years is shown in the table in "Portfolio Composition and Purchases." Of the single-family mortgage loans that the Corporation purchased in 1990, approximately 47 percent were from mortgage banking companies, 22 percent were from savings and loan associations, 21 percent were from commercial and mutual savings banks, and 10 percent were from other companies.

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 exceeds \$191,250, except for loans secured by properties in Alaska and Hawaii. Higher principal balance limits apply to loans secured by properties in those states or secured by two or more family dwelling units. The maximum principal balance limits applicable to such conventional mortgage loans secured by one- to four-family dwellings can be adjusted annually based on the national average price of a one-family dwelling as surveyed by the

Office of Thrift Supervision. On January 1, 1991, the limitation for one-family dwellings was increased from \$187,450 to the current level.

Under the Charter Act, maximum principal balance limits also apply to the Corporation's purchases of conventional multifamily mortgage loans (*i.e.*, loans secured by more than four dwelling units). Such limits are affected by the location of the unit and other factors.

FHA-insured mortgage loans 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.

Conventional/FHA/VA. In recent years the Corporation has purchased predominantly conventional mortgage loans (*i.e.*, mortgage loans that are not federally insured or guaranteed). In 1990, 97 percent of the total amount of the loans purchased by the Corporation were conventional mortgage loans. The remaining 3 percent were insured by the FHA or guaranteed by the VA.

Fixed-Rate/Adjustable-Rate. The interest rate on fixed-rate mortgage loans is fixed for the term of the loan. Substantially all fixed-rate mortgage loans purchased by the Corporation provide for level monthly installments of principal and interest. The Corporation also purchases some growing-equity mortgage loans and graduated-payment mortgage loans (1 percent of loans purchased in 1990), which are fixed-rate loans with planned annual increases in the monthly payments over a specified period of time. With a growing-equity mortgage loan, the increase in the payment generally applies initially to interest and then later to the original principal balance, resulting in faster amortization. To the extent scheduled payments are less than the interest accruing on the mortgage loan initially, the difference is paid from a subsidy account established at the time the mortgage loan is originated. With a graduated-payment mortgage loan, payments during the early years do not cover the full amount of interest on the loan at the fixed interest rate, and the increases in the payments apply solely to interest and additions previously made to the original principal balance; therefore, the payment increases do not result in faster amortization.

The Corporation also purchases fixed-rate balloon mortgage loans with balloon payments due after 7 or 10 years, but with monthly payments based on 30-year amortization schedules. Many of the 7-year balloon mortgage loans permit the borrower to refinance the balloon payment at maturity with a 23-year fixed-rate mortgage loan. During 1990, the Corporation's purchases of balloon mortgage loans represented 8 percent of its purchases.

In February 1988, the Corporation commenced purchasing conventional fixed-rate loans with biweekly payments and original maturities of up to 30 years. During 1990, biweekly fixed-rate loans constituted 2 percent of the Corporation's purchases.

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 purchases ARMs only if the ARMs have a cap on the amount the interest rate may change over the life of the loan. The volume of the Corporation's purchases of ARMs has fluctuated, in part, because the level of interest rates and the difference between the interest rates on fixed-rate loans and the initial interest rates on ARMs with the same maturity influence the number of ARMs originated. As a result of the relatively lower interest rate environment and the narrower interest rate spread between fixed interest rates and initial interest rates on ARMs, the Corporation's purchases of ARMs in 1990 constituted 12 percent of the total amount of loans purchased, compared with 20 percent in 1989. 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.

In 1990, the Corporation began purchasing 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. The loans, called Two-Step Mortgages®, have initial interest rates lower than those on traditional 30-year fixed-rate mortgage loans.

Payments on both fixed-rate loans and ARMs consist primarily of interest during the early and middle years, with the major portion of the original principal balance scheduled to be paid during the years immediately preceding maturity, except that in the case of balloon mortgage loans the major portion of the original principal balance is scheduled to be paid at maturity.

First Mortgage/Second Mortgage. In addition to mortgage loans secured by first liens on residential properties (“first mortgage loans”), the Corporation also purchases fixed-rate, conventional mortgage loans secured by second liens (“second mortgage loans”). The Corporation also has purchased some conventional ARM second mortgage loans in negotiated transactions. Second mortgage loans generally bear higher interest rates and have shorter maturities than first mortgage loans. During 1990, the Corporation’s purchases of second mortgage loans constituted 3 percent of total loans purchased.

Whole Loan/Participation Interest. In addition to purchasing the complete ownership interest in mortgage loans (typically called whole loans), the Corporation also purchases less than 100 percent ownership of mortgage loans (typically called participation interests). The Corporation purchases participation interests that range from 50 to 99 percent.

Single-Family/Multifamily. The mortgage loans secured by multifamily properties (*i.e.*, properties with more than four dwelling units) that the Corporation purchases are primarily conventional, fixed-rate mortgage loans that typically have a shorter term than mortgage loans secured by one- to four-family properties (“single-family” or “home” loans). During 1990, the Corporation’s purchases of multifamily loans constituted 10 percent of the amount of loans it purchased, compared with 7 percent in 1989. The increase in multifamily loan purchases in 1990 largely reflects increased use of the Corporation’s delegated underwriting and servicing program, which was adopted in 1988. See “Mortgage Loan Portfolio—Underwriting Guidelines.”

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, with a minimum of 10 years for ARMs. Only a small portion of such ARMs purchased have maturities of more than 30 years. Prior to 1986, the large majority of the Corporation’s single-family conventional mortgage loan purchases were 30-year loans. In 1987, the Corporation also began to purchase actively 10- and 20-year conventional, fixed-rate, first mortgage loans and the conventional, fixed-rate mortgage loans with 7- and 10-year balloon payments described above. During 1990 and 1989, the Corporation’s purchases of intermediate-term, fixed-rate, first mortgage loans constituted 20 percent and 15 percent, respectively, of its purchases.

The multifamily mortgage loans that the Corporation currently purchases generally have an effective term not exceeding 15 years. The Corporation owns a significant amount of FHA-insured multifamily loans that had an original maturity of 40 years.

Portfolio Composition and Purchases. The following table shows the composition of the Corporation’s mortgage loan portfolio, purchase activity, and the weighted-average yields (net of servicing) on the mortgage loan portfolio and mortgage loan purchases. The table includes mortgage

loans that back MBS held in the Corporation's mortgage loan portfolio. At December 31, 1990, 1989, and 1988, \$11.8 billion, \$11.7 billion, and \$8.1 billion, respectively, of MBS were held in portfolio.

Mortgage Loan Portfolio Composition and Purchases

(Dollars in millions)

	Year Ended December 31,				
	1990	1989	1988	1987	1986
Unpaid Principal Balances ("UPB") at End of Period					
Single-family: Government insured or guaranteed	\$ 11,204	\$ 11,857	\$ 12,235	\$13,306	\$15,968
Conventional: Fixed-rate	72,290	66,804	60,997	61,314	58,176
Adjustable-rate	20,736	22,020	21,040	13,722	14,343
Second mortgage	1,851	1,614	1,561	1,421	2,169
Multifamily: Government insured	4,243	4,361	4,397	4,482	4,852
Conventional	6,304	4,065	2,783	2,501	2,325
Total UPB	<u>\$116,628</u>	<u>\$110,721</u>	<u>\$103,013</u>	<u>\$96,746</u>	<u>\$97,833</u>
Average net yield	<u>9.94%</u>	<u>10.03%</u>	<u>9.84%</u>	<u>9.98%</u>	<u>10.17%</u>
Purchases During Period					
Single-family: Government insured or guaranteed	\$ 698	\$ 940	\$ 503	\$ 1,784	\$ 438
Conventional: Fixed-rate	17,289	15,119	11,890	15,775	27,454
Adjustable-rate	2,826	4,492	9,862	2,512	1,108
Second mortgage	654	406	433	139	498
Multifamily: Government insured	—	117	23	—	—
Conventional	2,492	1,444	399	321	1,328
Total UPB mortgage loans purchased	<u>\$ 23,959</u>	<u>\$ 22,518</u>	<u>\$ 23,110</u>	<u>\$20,531</u>	<u>\$30,826</u>
Average net yield	<u>9.82%</u>	<u>9.88%</u>	<u>9.40%</u>	<u>9.63%</u>	<u>9.68%</u>

At December 31, 1990, the weighted-average remaining life of the mortgage loans in the Corporation's mortgage loan portfolio was approximately 19 years, assuming normal scheduled amortization and no prepayments.

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 home relative to the amount of the mortgage loan. The Corporation, in its discretion, accepts deviations from the guidelines. The Corporation generally relies on lender representations to ensure that the mortgage loans it purchases conform to its underwriting guidelines, which the Corporation changes from time to time.

In 1988, the Corporation introduced the delegated underwriting and servicing ("DUS") program for multifamily loans. Under DUS, selected lenders that have been specifically approved to participate in the DUS program are permitted to sell to the Corporation multifamily loans that meet published guidelines without the Corporation's prior approval of the underwriting, provided that the lenders agree to share in a portion of any subsequent loss on such loans and establish and maintain a reserve with a designated custodian to secure their loss-sharing obligation. Previously, the Corporation required its approval of the underwriting of all multifamily loans before it would purchase such loans. It continues to require such prior approval for multifamily loans that it purchases from non-DUS lenders.

For single-family mortgages, the Corporation generally requires that the unpaid principal amount of each conventional 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. Mortgage insurance is required for as long as the principal balance of the mortgage loan is greater than 80 percent of the original value (or of the appraised value as determined by a subsequent appraisal). Under the Charter Act, mortgage insurance is not required on

mortgage loans with loan-to-value ratios greater than 80 percent if the mortgage loan seller retains a participation interest in the loan of not less than 10 percent or the seller agrees to repurchase the loan in the event of default. The Corporation, however, is requiring mortgage insurance in cases where the lender retains a participation interest of 10 percent or more, except where the lender agrees to repurchase the loan in the event of default or the lender or a third party credit enhancer agrees to bear a certain amount of losses, in which case the Corporation may require the lender to pledge collateral to secure such obligation. The Corporation generally requires mortgage insurance for second mortgage loans if the combined loan-to-value ratios of the first and second mortgage loans on the property exceed 70 percent. The Corporation bears the risk that in some cases mortgage insurers or lenders may be unable to satisfy fully their obligations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Years Ended December 31, 1988-1990—Financial Condition—Management of Credit Risk."

Because of their government backing, FHA-insured and VA-guaranteed mortgage loans involve less risk to the Corporation from a credit standpoint than conventional loans. The Corporation's basic eligibility criterion for the purchase of FHA/VA loans is simply the FHA insurance or the VA guaranty.

Commitments

The Corporation issues commitments to purchase, at a later date, 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's standard single-family mortgage loan products currently include 10-, 15-, 20-, and 30-year fixed-rate mortgage loans, 7-year fixed-rate balloon mortgage loans with 30-year amortization periods, FHA-insured and VA-guaranteed fixed-rate mortgage loans, many types of ARMs, and second mortgage loans. A negotiated commitment is used when the mortgage loans or proposed commitment terms differ in some manner from the Corporation's standard mortgage loan products or standard 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, 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 MBS or convert to a mandatory delivery mortgage purchase commitment with the yield established at the time of conversion. Master commitments outstanding at December 31, 1990 were \$49.3 billion compared with \$16.6 billion at December 31, 1989.

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. The combined term of the standby and mandatory commitments currently can be up to 14 months.

The Corporation offers lenders obtaining mandatory commitments the choice of obtaining such a commitment without fees at competitive yields or at lower yields with fees. The Corporation has eliminated such upfront fees for standard product standby commitments and most negotiated standby commitments.

Commitments outstanding at December 31, 1990 and 1989 were \$9.6 billion and \$6.0 billion, respectively, including standby commitments of \$7.7 billion at December 31, 1990 and \$3.7 billion at December 31, 1989.

Servicing

The Corporation does not service mortgage loans held in the portfolio, except for government-insured multifamily loans, most conventional multifamily mortgage loans that are in default, and loans that have been foreclosed. 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. With the Corporation's approval, sellers or servicers may transfer responsibility for servicing loans to others, or they may subcontract servicing to another lender approved by the Corporation. 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.

Repayments and Sales

Mortgage repayments include mortgage loan prepayments, loans paid-in-full, normal amortization, and foreclosures. Because the majority of mortgage loans in the Corporation's portfolio are prepayable by the borrower (in some cases with a small penalty), the decline in mortgage interest rates experienced in 1986 and during part of 1987 resulted in a significant increase in prepayments of the higher interest rate mortgage loans in the Corporation's loan portfolio. In general, when the level of interest rates declines significantly below the interest rates on portfolio mortgage loans, the rate of prepayment is likely to increase, although the rate of principal payments is influenced by a variety of economic, geographic, and other factors. Changes in the level of repayments in the years 1988-1990 were relatively small primarily due to greater stability of interest rates.

Mortgage Loan Portfolio Repayments

(Dollars in millions)

	Year Ended December 31,				
	1990	1989	1988	1987	1986
Single-Family:					
Government insured or guaranteed.....	\$ 1,239	\$ 1,342	\$ 1,425	\$ 2,011	\$ 2,876
Conventional: Fixed-rate.....	6,070	6,509	7,310	10,206	12,396
Adjustable-rate	4,119	3,262	2,548	3,143	3,756
Second mortgage	417	354	293	887	1,228
Multifamily.....	375	320	229	270	481
Total mortgage loan repayments(1)...	<u>\$12,220</u>	<u>\$11,787</u>	<u>\$11,805</u>	<u>\$16,517</u>	<u>\$20,737</u>
Repayments as a percentage of total average unpaid principal balance	10.8%	11.2%	11.7%	17.3%	21.1%

(1) Repayments include \$616 million, \$786 million, \$1,115 million, \$1,123 million, and \$1,142 million in 1990, 1989, 1988, 1987, and 1986, respectively, of loans removed from portfolio as a result of foreclosures.

The following table shows the unpaid principal balances of mortgage loans sold from portfolio for the years 1986 through 1990. The Corporation sold \$1.6 billion of low-yielding loans in 1987 to

improve future interest spreads on the portfolio. The sales in 1986 included a special \$10 billion sale of mortgage loans that were primarily assumable FHA/VA mortgage loans.

Mortgage Loan Sales from Portfolio

(Dollars in millions)

	Year Ended December 31,				
	<u>1990</u>	<u>1989</u>	<u>1988</u>	<u>1987</u>	<u>1986</u>
Single-Family:					
Government insured or guaranteed	\$ 112	\$ —	\$ 150	\$2,436	\$ 9,011
Conventional: Fixed-rate	5,733	3,036	4,897	2,528	1,946
Multifamily	—	—	—	250	—
Total sales	<u>\$5,845</u>	<u>\$3,036</u>	<u>\$5,047</u>	<u>\$5,214</u>	<u>\$10,957</u>

Affordable Housing Initiative

In March 1991, the Corporation announced a four-year, \$10 billion housing initiative to improve and increase the Corporation's delivery of home mortgage funds to low- and moderate-income families and others with special needs. Under this initiative, the Corporation will create new products and expand the use of existing ones to help meet the needs such families have in accumulating down payments and other funds to cover closing costs and monthly housing expenses. The Corporation's plan is to produce \$10 billion in commitments for low- and moderate-income and other special housing needs by July of 1993 and to have \$10 billion in mortgage loans delivered under such commitments by December 31, 1994.

Among other things, the Corporation will be offering commitments to purchase a variety of new employer-assisted loan products. Another new product will be the "3/2 Option," whereby home buyers may qualify for the minimum 5 percent down payment requirement by using 3 percent of their own funds and obtaining the remaining 2 percent in the form of a gift from a family member or a grant or unsecured loan from a non-profit organization or public entity. Under the 3/2 Option, the percentage of monthly gross income that may be used for monthly housing expenses will be raised from the customary 28 percent to 33 percent of income. As part of its affordable housing initiative, the Corporation also intends to expand its public finance activities with state and local housing finance agencies, increase its tax-credit equity investments in low-income rental housing, and develop new mortgage products for the elderly and residents in rural communities.

Mortgage-Backed Securities

MBS are guaranteed mortgage pass-through trust certificates issued 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 representing a proportionate share of a larger pool. MBS may back other securities, including Fannie Megas® ("Megas," formerly called MegaPools), Stripped MBS ("SMBS"), and real estate mortgage investment conduit securities ("REMICs").

The pools of mortgage loans or MBS are not assets of the Corporation, except when acquired for investment purposes, nor are the related outstanding securities liabilities of the Corporation. 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.

The Corporation issues and guarantees several forms of MBS. 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. Interests in the pool are represented by a single class of certificates, so each investor receives a portion of the principal and interest payments on the pool equal to his undivided interest in the pool.

Fannie Majors[®], introduced in 1987, are MBS backed by large pools of mortgage loans from multiple lenders. Interests in the pool are represented by a single class of certificates, so each investor receives principal and interest payments proportionate to his undivided interest in the pool. Fannie Majors issues totaled \$20.0 billion in 1990 and \$14.0 billion in 1989.

In 1988, the Corporation introduced Fannie Megs[®], which allow investors to consolidate small or partially paid down pools of MBS of the same type (and of the same pass-through rate for fixed-rate Megs). In return for their MBS, investors receive Mega certificates representing undivided interests in the consolidated pool.

There is no special allocation of the cash flows from the mortgage loans underlying standard MBS, Fannie Majors, and Megs, because in each case there is 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. In contrast, SMBS, which the Corporation introduced in 1986, are issued in series, with two classes that are entitled to different cash flows from the underlying mortgage loans, MBS or certificates guaranteed by the Government National Mortgage Association ("GNMA certificates"). Each class of SMBS receives a different proportion of the principal and interest payments on the underlying mortgages; a class 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 or GNMA certificates.

REMICs represent beneficial interests in a trust having multiple classes of securities. Cash flows from the underlying mortgage loans, MBS (which may be standard MBS, Fannie Majors, Megs, or SMBS) or GNMA certificates are allocated to the different classes. Some REMIC trusts are structured so the investors in any regular class of the REMIC are paid interest currently on their pro rata share of the remaining principal, but principal payments are made to the regular classes sequentially so the investors in a regular class receive principal payments only when all regular classes with a shorter maturity have been retired. REMICs with different structures have been offered, including REMICs with (i) one or more accrual or "Z" classes that accrue interest but receive neither interest nor principal payments until certain other classes have been retired, (ii) classes bearing interest at floating rates rather than fixed rates, or (iii) planned or targeted amortization classes having a schedule of principal payments that will be met under certain prepayment conditions but that is not guaranteed to be met. All REMICs include a residual class, although the exact nature of the residual class depends upon the structure of the REMIC. REMICs were authorized by the Tax Reform Act of 1986, and the Corporation first issued these securities in 1987.

The following tables show the Corporation's activity in MBS for the years 1986 through 1990. MBS issued may be exchanged subsequently for Megas, SMBS, or REMICs. The table below includes MBS issued and outstanding that underlie Megas, SMBS, and REMICs, but does not include the resulting Megas, SMBS, or REMICs. Those resulting securities are shown in the table entitled "Summary of Mega, SMBS, and REMIC Activity."

MBS Issued and Outstanding

(Dollars in millions)

	Year Ended December 31,				
	1990	1989	1988	1987	1986
Issued during period	\$ 96,695	\$ 69,764	\$ 54,878	\$63,229	\$60,566
Outstanding at period end(1)	299,833	228,232	178,250	139,960	97,174

(1) Included in MBS outstanding are \$11.8 billion, \$11.7 billion, \$8.1 billion, \$4.2 billion and \$1.6 billion of MBS in portfolio at December 31, 1990, 1989, 1988, 1987, and 1986, respectively.

The following table summarizes Mega, SMBS, and REMIC activity in 1990, 1989, 1988, 1987, and 1986.

Summary of Mega, SMBS, and REMIC Activity

(Dollars in millions)

	Year Ended December 31,				
	1990	1989	1988	1987	1986
Issued during period:					
Megas(1)	\$ 16,186	\$23,282	\$ 9,928	\$ —	\$ —
SMBS(2)	7,374	4,132	5,556	9,001	2,400
REMICs	60,917	37,583	11,199	916	—
Outstanding at period end(3):					
Megas(1)	41,773	29,401	9,774	—	—
SMBS(2)	22,964	17,266	15,013	10,462	2,283
REMICs	104,314	47,560	11,647	897	—

(1) Megas can back SMBS or REMICs.

(2) SMBS can back REMICs.

(3) Includes \$3.4 billion, \$3.2 billion, \$1.6 billion, and \$0.1 billion at December 31, 1990, 1989, 1988, and 1987, respectively, held in the Corporation's mortgage portfolio.

The Corporation issues MBS backed by single-family first or second mortgage loans, or multifamily first mortgage loans, with fixed or adjustable rates. The mortgage loans may be either conventional or FHA/VA 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," except to the extent compliance with those guidelines is waived by the Corporation. The majority of the Corporation's MBS outstanding represents beneficial interests in conventional fixed-rate mortgage loans on single-family dwellings.

Most standard MBS and Fannie Majors are issued in "swap" transactions in which lenders exchange pools of mortgage loans for MBS. In addition to swap transactions, the Corporation pools

mortgage loans from its own portfolio or purchases mortgage loans from lenders in exchange for cash, assembles the mortgage loans in a pool, and sells the related certificates.

The Corporation issues its MBS (other than Fannie Majors and Megas) pursuant to commitments by which it agrees in advance to issue these securities in exchange for a specified dollar amount of loans or MBS. Such commitments may be standard product commitments or negotiated commitments. Standard product commitments provide for optional delivery, while negotiated commitments provide for either mandatory or optional delivery. Under optional delivery commitments, lenders generally have 180 days to deliver the mortgage loans, although the delivery period can be extended by the Corporation for another 180 days. Under mandatory delivery commitments, lenders must deliver the mortgage loans within specified time periods. SMBS and REMICs are issued only pursuant to mandatory delivery commitments. The Corporation also allows lenders to deliver MBS pools under a master commitment, see "Mortgage Loan Portfolio—Commitments." At December 31, 1990, the Corporation had outstanding \$6.4 billion of mandatory delivery MBS commitments and \$72.2 billion of optional delivery MBS commitments, compared with \$8.4 billion of mandatory delivery commitments and \$34.2 billion of optional delivery commitments at December 31, 1989.

MBS carry the Corporation's guaranty of timely payment of principal and interest on the underlying pooled mortgage loans, whether or not such payments are received from the mortgagor. In addition, pursuant to its guaranty of REMICs, the Corporation is obligated to make timely distribution of required installments of principal and interest and to distribute the principal balance in full by a specified date, whether or not sufficient funds are available in the related REMIC trust. Because of the Corporation's guaranties, it assumes the ultimate credit risk of borrowers' defaults on all mortgage loans underlying MBS, as it does for portfolio mortgage loans. The Corporation's risk may be offset somewhat to the extent sellers of pools of mortgage loans elect to remain at risk on the loans sold to the Corporation or agree to obtain special credit enhancement in connection with pooled mortgage loans. Lenders are provided an option to assume the credit risk in exchange for paying a lower guaranty fee. In recent years, largely because of new capital standards for financial institutions, an increasing proportion of MBS pools have been securitized without recourse to the lenders. During 1990, 88 percent of MBS issued were nonrecourse, compared with 66 percent and 47 percent in 1989 and 1988, respectively. Management closely monitors and manages the additional credit risk related to nonrecourse MBS. At December 31, 1990, \$97.8 billion of conventional MBS pools had underlying mortgage loans where the Corporation has recourse to the sellers, third party credit enhancement providers (through a letter of credit or pool insurance coverage), or other credit enhancement structures in the event of default by the borrowers. For further information regarding the primary foreclosure risk category of mortgage loans underlying MBS outstanding at December 31, 1990, 1989 and 1988, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Years Ended December 31, 1988-1990—Financial Condition—Mortgage-Backed Securities." If the loss rate on conventional mortgage loans in pools should appreciably increase, the Corporation's losses could, to the extent not offset by recourse to sellers or others, become significant. For information on the Corporation's loss and delinquency experience on mortgage loans underlying MBS, see "Provision for Losses, Charge-Offs, and Allowance for Losses."

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 foreclosure). For the years ended December 31, 1990, 1989 and 1988, MBS guaranty fees totaled \$536 million, \$408 million, and \$328 million, respectively. The Corporation also receives fees for swapping SMBS, REMICs and Megas for standard MBS, except that no fee is charged for Megas swapped for standard MBS issued during the same month as the Mega.

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 prepayment is likely to increase, although the rate of principal payments is influenced by a variety of economic, geographic and other factors.

Insurance companies, money managers, and commercial banks have been substantial buyers of MBS. At times, thrift institutions also have been major purchasers of MBS, although they were less significant purchasers in 1990 and 1989. During 1990, international investors purchased increased amounts of MBS directly as well as through private mutual funds structured and managed by third parties. This increase in the amount of MBS purchased by international investors was attributable, in part, to growing investor familiarity with the MBS structure, increased market liquidity, and attractive yields relative to comparable investments. In addition, the Corporation intensified its efforts to create greater name recognition and understanding of the product.

In 1989, risk-based capital standards were adopted by federal banking regulators, who assigned a lower risk-based capital requirement for mortgage-backed securities issued or guaranteed by a U.S. government agency or a U.S. government-sponsored agency than for mortgage loans. A number of thrifts and banks have sold or securitized a portion of their residential mortgage assets in the secondary market in response to the new guidelines.

The Federal Financial Institutions Examination Council has proposed a revised supervisory policy statement with respect to investments in zero coupon bonds, stripped mortgage-backed securities, asset-backed securities residuals, and certain other securities for depository institutions that they regulate. If approved by the Council, this proposal would supersede the supervisory policy statement adopted in April 1988. Presently, the Council consists of the federal banking regulatory agencies, the National Credit Union Administration, and the Office of Thrift Supervision. This proposal states that high risk collateralized mortgage obligation ("CMO") tranches such as support/companion bonds, Z-bonds, super principal-only ("PO") strips, and inverse floaters are generally unsuitable for investment by depository institutions because of their price and yield volatility. However, these products could be used for reducing interest-rate risk by institutions with well-managed portfolios and specific policies for interest-rate risk management. It is unclear what impact these proposals, if approved, will have on the MBS market.

In most instances, the lenders that originated the loans in an MBS pool created from the Corporation's portfolio or the 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 lender also may subcontract servicing to another lender approved by the Corporation as well as transfer servicing with the Corporation's prior approval. 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.

Provision for Losses, Charge-Offs, and Allowance for Losses

The allowance for losses is established by charges to expense (the provision for losses) and is reduced through charge-offs (net of recoveries) of foreclosure losses. As mortgage loans are foreclosed, the Corporation reduces the allowance for loan losses by the amount of the estimated loss. The estimated losses are adjusted to actual losses when the underlying properties are sold. See also "Summary of Significant Accounting Policies—Allowance for Losses" in the notes to financial

statements. The following table summarizes the changes in the allowance for losses for the years 1986 through 1990 for loans in the portfolio and loans in MBS pools:

Portfolio and MBS Allowances and Provisions for Loan Losses

(Dollars in millions)

	Mortgage Portfolio			MBS			Total
	Conventional Single-family	Conventional Multifamily	Government Insured or Guaranteed	Conventional Single-family	Conventional Multifamily	Government Insured or Guaranteed	
Balance, January 1, 1986	\$ 107	\$—	\$ 26	\$ 33	\$—	\$—	\$ 166
Provision	226	23	11	34	12	—	306
Net foreclosures losses charged off	(173)	(5)	(14)	(9)	—	—	(201)
Transfers	(9)	—	—	9	—	—	—
Balance, December 31, 1986	151	18	23	67	12	—	271
Provision	241	25	14	70	10	—	360
Net foreclosures losses charged off	(208)	(21)	(13)	(41)	(2)	—	(285)
Transfers	(15)	—	—	15	—	—	—
Balance, December 31, 1987	169	22	24	111	20	—	346
Provision	255	24	6	73	6	1	365
Net foreclosures losses charged off	(195)	(21)	(12)	(77)	(9)	(1)	(315)
Transfers	(26)	—	—	26	—	—	—
Balance, December 31, 1988	203	25	18	133	17	—	396
Provision	138	23	5	123	17	4	310
Net foreclosures losses charged off	(129)	(18)	(10)	(62)	(20)	(4)	(243)
Transfers	(22)	—	—	22	—	—	—
Balance, December 31, 1989	190	30	13	216	14	—	463
Provision	91	22	6	164	23	4	310
Net foreclosures losses charged off	(124)	(22)	(11)	(51)	(22)	(4)	(234)
Balance, December 31, 1990	<u>\$ 157</u>	<u>\$ 30</u>	<u>\$ 8</u>	<u>\$ 329</u>	<u>\$ 15</u>	<u>\$—</u>	<u>\$ 539</u>

The ratio of net losses charged off to average principal balance outstanding for conventional loans in portfolio and for MBS backed by conventional mortgage loans are summarized in the following table:

Portfolio and MBS Conventional Loan Charge-off Experience

(Percent of net loss charged off to average principal balance outstanding)

	Year Ended December 31,				
	1990	1989	1988	1987	1986
Portfolio Conventional Loans(1):					
Single-family	.1342%	.1514%	.2400%	.2831%	.2542%
Multifamily	.4187	.5525	.8155	.8505	.2588
MBS Conventional Loans(1):					
Single-family	.0330	.0646	.1075	.0782	.0350
Multifamily(2)	2.1616	2.0619	.9890	.2766	—

(1) Net losses charged off used in calculation exclude portfolio conventional mortgage loans and MBS backed by conventional mortgage loans where lenders or third parties have agreed to retain the primary default risk or have agreed to bear default risk limited to a certain portion or percentage of the loans delivered.

(2) Multifamily losses relate to a credit enhancement product line that was discontinued in 1987.

Delinquencies and REO

Delinquencies

Delinquencies of three months or more experienced on single-family conventional mortgage loans in the Corporation's loan portfolio and underlying MBS, for which the Corporation has the primary risk of loss, are summarized in the following table:

Portfolio and MBS Single-family Conventional Loan Delinquency Experience

(Percent of portfolio by number of loans and percent of MBS by number of underlying loans)

	December 31,				
	1990	1989	1988	1987	1986
Portfolio:					
Three or more months delinquent . . . . .	.36%	.42%	.50%	.59%	.80%
In relief . . . . .	.32	.33	.35	.46	.30
In foreclosure . . . . .	.34	.35	.45	.62	.63
Total	<u>1.02%</u>	<u>1.10%</u>	<u>1.30%</u>	<u>1.67%</u>	<u>1.73%</u>
MBS (1):					
Three or more months delinquent . . . . .	.14%	.17%	.20%	.20%	.33%
In relief(2) . . . . .	.09	.08	.08	.03	.04
In foreclosure . . . . .	.10	.11	.18	.23	.24
Total	<u>.33%</u>	<u>.36%</u>	<u>.46%</u>	<u>.46%</u>	<u>.61%</u>
Total Portfolio and MBS (1):					
Three or more months delinquent . . . . .	.22%	.28%	.35%	.42%	.65%
In relief(2) . . . . .	.17	.19	.22	.26	.22
In foreclosure . . . . .	.19	.22	.31	.44	.51
Total(2)	<u>.58%</u>	<u>.69%</u>	<u>.88%</u>	<u>1.12%</u>	<u>1.38%</u>

(1) Only includes MBS where Fannie Mae has primary default risk.

(2) MBS data for years prior to 1988 for loans in relief only includes loans pooled from portfolio, as such data for loans pooled from MBS lenders is not available. MBS loans in relief represented .06 percent of combined total loans for 1990 and .04 percent for 1989 and 1988.

Delinquencies of two months or more experienced on multifamily conventional mortgage loans in the Corporation's loan portfolio and underlying MBS for which the Corporation has the primary risk of loss at December 31, 1990 and December 31, 1989 were 1.70 percent and 3.24 percent, respectively, of the total dollar amount of such loans in portfolio and underlying MBS.

REO

When a mortgage loan for which Fannie Mae bears the default risk is liquidated by foreclosure, the Corporation acquires the underlying property ("REO") and holds it for sale. The number of REO increased significantly in 1986 and 1987. The incidence of foreclosures increased sharply in economically distressed areas that have been dependent upon the oil exploration and services industry. The average loss per foreclosure also increased in these areas as property values declined. In addition, the number of foreclosures increased somewhat due to significant growth in the number of portfolio and MBS loans. The number of REO declined significantly in 1990 and 1989 and to a lesser extent in 1988 as a result of a slowdown in foreclosures and as dispositions of REO exceeded acquisitions.

Information as to the number of REO properties owned by the Corporation and the carrying value of the properties is contained in the following table:

REO Experience

(Dollars in thousands)

	December 31,				
	1990	1989	1988	1987	1986
Single-family					
Number of REO (1)	3,585	4,975	7,458	9,434	8,104
Aggregate carrying value (2)	\$146,000	\$172,000	\$250,000	\$312,000	\$294,000
Average carrying value (2)	\$ 41	\$ 35	\$ 34	\$ 33	\$ 36
Multifamily					
Number of REO	32	33	41	16	1
Aggregate carrying value (2)	\$111,000	\$ 84,000	\$ 89,000	\$ 30,000	\$ 2,000
Average carrying value (2)	\$ 3,500	\$ 2,500	\$ 2,200	\$ 1,900	\$ 2,000

- (1) The number of REO for 1986 excludes properties acquired upon foreclosure of loans where the Corporation had a participation interest. In 1987, the Corporation began acquiring and managing such properties. As of December 31, 1990, the Corporation held 211 properties in which it had a participation interest. The Corporation believes that the addition of such properties in 1986 would not have increased the inventory by more than 15 percent.
- (2) The carrying value of a property is the lower of the Corporation's net investment (after deducting any mortgage insurance proceeds) and the current estimated net realizable value.

Competition

The Corporation competes, within the limits prescribed by its Charter Act, in the purchase of mortgage loans for portfolio and the issuance of mortgage-backed securities in the secondary mortgage market. The Corporation competes primarily with the Federal Home Loan Mortgage Corporation ("Freddie Mac"), a government sponsored enterprise regulated by HUD whose primary business consists of the issuance of mortgage-backed securities, and to a lesser extent with savings and loan associations, savings banks, commercial banks, mortgage bankers, government-sponsored corporations, and companies that pool mortgage loans for sale to investors as whole loans or mortgage-backed securities.

The Corporation's market share of loans purchased for portfolio 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, the amount purchased by other market participants that compete with the Corporation, and the adequacy of funds to meet the demands of the housing industry. In its purchase of mortgage loans for portfolio, the Corporation competes primarily on the basis of yield, products and services offered. The Corporation and Freddie Mac compete for mortgage-backed securities business primarily on the basis of the amount of the guaranty fee or other fees charged, the relative market price of the securities, the products and services offered, and differences in such matters as mortgage loan eligibility standards and delivery requirements. Competition has been particularly intense for ARMs because many savings and loan associations and other market participants have purchased or retained such loans to better match the terms of their assets and liabilities.

Competition between the Corporation and Freddie Mac intensified beginning in the last quarter of 1990 as Freddie Mac began issuing a new mortgage-backed security called the "Gold PC." One of the most effective means of competition between the two entities is to increase the price that lenders

can obtain for sale of the respective entity's securities by issuing REMICs backed by such securities in swap transactions with securities dealers (thereby increasing demand for such securities). Freddie Mac has been increasing its REMIC activity in order to support the price of its Gold PC and thereby enhance the market for such securities while it develops sufficient liquidity for them. The increased competition has resulted in lowering of the REMIC fees that the Corporation and Freddie Mac earn on their REMICs.

Corporate Indebtedness

Although the Corporation is stockholder-owned and its obligations are not backed by the United States or any agency or instrumentality thereof other than the Corporation, the Corporation's debt has traditionally been treated as "Federal Agency" debt in the U.S. marketplace. The Corporation, as a result, has historically enjoyed ready access to funds in the U.S. credit markets at rates that are slightly higher than the yields on U.S. Treasury obligations of comparable maturities.

The following table sets forth at December 31, 1990 the maturity profile of the Corporation's debt obligations that were originally issued with a maturity of one year or longer.

<u>Maturing Within</u>	<u>Book Value</u> (Dollars in millions)	<u>Average Cost (1)</u>
One year	\$15,646	8.49%
One to two years	12,792	9.09
Two to three years	9,461	8.85
Three to four years	10,658	8.97
Four to five years	11,399	9.76
Over five years	39,366	8.94

(1) Includes the amortization of issuance costs and hedging results, and the effect of currency and interest rate swaps.

The outstanding indebtedness of the Corporation consists of general unsecured obligations issued under section 304(b) of the Charter Act, subordinated capital debentures (including convertible capital debentures), which are unsecured subordinated general obligations issued under section 304(e) of the Charter Act, mortgage-backed bonds issued under section 304(d) of the Charter Act, and securities sold under agreements to repurchase.

Section 304(b) of the Charter Act provides that the aggregate amount of obligations outstanding under such subsection shall not exceed, at any one time, fifteen times the sum of the capital (including, for this purpose, capital debentures), capital surplus, general surplus, reserves, and undistributed earnings of the Corporation unless a greater ratio is fixed by the Secretary of HUD. From 1968 to 1982 this ratio was set by the Secretary of HUD at 25:1. In 1982, the Secretary of HUD increased this ratio to 30:1, but in April 1987 the Secretary advised the Corporation that he would immediately lower the debt-to-capital ratio to 25:1, with the intention of further lowering this ratio to 20:1 by December 31, 1988. Regulations adopted by HUD provide that this ratio is, in the event of a reduction in the Corporation's capital, automatically increased to such ratio as shall be necessary to include all obligations outstanding pursuant to section 304(b). At December 31, 1990, this debt-to-capital ratio was 18.9:1, compared with 19.7:1 at December 31, 1989. At December 31, 1990, the Corporation could have issued approximately \$7.3 billion of obligations under section 304(b) of the Charter Act in addition to its then outstanding obligations under that section.

The Corporation is obligated to holders of certain outstanding issues of subordinated capital debentures to maintain the total principal amount of obligations issued under section 304(e) of the Charter Act at any one time outstanding at a level not more than two times the sum of (i) the capital of the Corporation represented by its outstanding common stock and (ii) its surplus and undistributed earnings at such time until such outstanding debentures mature or are redeemed. At

December 31, 1990 and 1989, the Corporation's subordinated debt-to-equity ratio was 0.5:1 and 0.8:1, respectively. At December 31, 1990, the Corporation could have issued approximately \$6.0 billion of additional subordinated obligations and still have been in compliance with the 2:1 subordinated debt-to-equity ratio. The latest maturity date of a series of subordinated debentures containing the subordinated debt-to-equity restriction is September 30, 2002, although that series is callable at the Corporation's option. No noncallable subordinated obligations containing the subordinated debt-to-equity restriction remain outstanding. Regulations adopted by HUD provide that, at the maturity or other event requiring the payment or redemption of obligations issued under section 304(e) of the Charter Act, the permitted debt-to-capital ratio is automatically increased as necessary to permit the issuance of obligations under section 304(b) of the Charter Act in an amount sufficient to provide the proceeds required to pay the principal of and interest on the outstanding subordinated obligations required to be paid at such time.

Issuances of indebtedness pursuant to section 304(b) of the Charter Act are also subject to the condition that, at the time of any such issuance, the aggregate amount of such indebtedness then outstanding under such section 304(b), after giving effect to the indebtedness being issued, is not greater than the Corporation's ownership, free from any liens or encumbrances, of cash, mortgages or other security holdings and obligations, participations or other investments. Unlike the debt-to-capital ratio limitation described above, this section 304(b) limitation is statutory and may not be waived or varied by the Secretary of HUD. For purposes of each of the foregoing calculations, the Corporation accounts for debt obligations issued at a discount or premium at their book value (face amount adjusted for unamortized discount or premium).

Section 304(d) of the Charter Act, pursuant to which MBS and mortgage-backed bonds are outstanding, imposes a requirement with respect to securities issued thereunder that the mortgages pledged or set aside must be sufficient at all times to make timely debt service payments on the securities. There is no other limitation on the amount of MBS and mortgage-backed bonds that may be outstanding.

Section 304(c) of the Charter Act authorizes the Secretary of the Treasury, in his discretion, as a public debt transaction, to purchase obligations of the Corporation up to a maximum of \$2.25 billion outstanding at any one time. This authority has not been used since the Corporation's transition from government ownership. Although the Secretary of the Treasury is authorized to purchase the obligations of the Corporation, the Secretary is under no requirement to do so. Any such obligations purchased by the Secretary of the Treasury must be issued pursuant to section 304(b) of the Charter Act and, accordingly, would be subject to the applicable limitations and restrictions described above.

The following table sets forth the Corporation's borrowing activity and outstanding borrowings, the respective costs of borrowings, and average maturities. The amounts given are book value (face amount net of unamortized premium and discount) except for short-term notes, which, because they have a maturity of less than one year, are reported at their face amount.

		Debt				
		(Dollars in millions)				
		Year Ended December 31,				
		1990	1989	1988	1987	1986
Short-Term Notes, Master Notes, Securities						
Sold under Agreements to Repurchase,						
Residential Financing Securities, and						
Short-Term Investment Agreements						
Issued during period:						
Amount		\$ 94,407	\$ 55,037	\$ 50,180	\$26,950	\$22,066
Average cost		7.83%	8.46%	7.58%	6.84%	6.39%
Average maturity—days(1)		82	126	169	156	217
Outstanding at end of period:						
Amount		\$ 23,253	\$ 24,753	\$ 24,492	\$15,986	\$13,971
Average cost		7.74%	8.62%	8.33%	7.56%	6.40%
Average maturity—days(1)		90	87	137	149	161
Debentures, Medium-Term Notes, Bonds,						
and Long-Term Investment Agreements						
Issued during period:						
Amount		\$ 19,705	\$ 23,595	\$ 14,183	\$18,776	\$17,857
Average cost		8.93%	8.90%	8.76%	8.39%	7.95%
Average maturity—months		96	84	68	75	85
Outstanding at end of period:						
Amount		\$100,456	\$ 91,574	\$ 81,371	\$81,341	\$79,745
Average cost		8.98%	9.06%	9.32%	9.70%	10.41%
Average maturity—months		61	57	53	54	49
Total Debt						
Issued during period:						
Amount		\$114,112	\$ 78,632	\$ 64,363	\$45,726	\$39,923
Average cost(2)		8.03%	8.60%	7.84%	7.49%	7.10%
Average maturity—months(1)(2)		20	28	20	36	47
Outstanding at end of period:						
Amount		\$123,709	\$116,327	\$105,863	\$97,327	\$93,716
Average cost(2)		8.81%	9.04%	9.20%	9.46%	10.01%
Average maturity—months(1)(2)		50	47	43	48	46

(1) This is calculated exclusive of certain investment agreements for which the average maturity is indeterminate because the balances associated with such investment agreements fluctuate over the life of the agreement.

(2) Average cost and maturity of total debt issued and outstanding include the amortization of issuance costs, hedging results, and the effect of currency and interest rate swaps.

Net Interest Margin and Investment Spread

The table below presents average net investment balances, effective interest rates earned and paid, and investment spread and net interest margin for selected months.

	<u>December</u> <u>1990</u>	<u>December</u> <u>1989</u>	<u>December</u> <u>1988</u>	<u>December</u> <u>1987</u>	<u>December</u> <u>1986</u>
	(Dollars in millions)				
Average net investment balance	\$128,816	\$120,994	\$108,879	\$99,142	\$96,303
Investment yield(1)	9.76%	9.92%	9.77%	9.87%(2)	10.12%
Borrowing cost(1)	8.82	9.01	9.16	9.49	10.04
Investment spread(3) . . . . .	.94	.91	.61	.38(2)	.08
Net interest margin(4)	1.40	1.23	.98	5.82(5)	.46

- (1) Average investment yield is calculated for the month shown and converted to an annual interest rate using as the numerator interest income on a tax equivalent basis (excluding out-of-cycle adjustments), and as the denominator the average outstanding unpaid investment less unamortized discount and fees. Similarly, the average borrowing cost is calculated using net interest expense (including the amortization of issuance costs, hedging results and the effect of currency and interest rate swaps) and the average outstanding applicable net indebtedness during the month.
- (2) Excludes a cumulative adjustment under Financial Accounting Standard No. 91 ("FAS 91") discussed in note (5) below.
- (3) Investment spread is the difference between the interest rate earned on average assets and the interest rate paid on average liabilities.
- (4) Net interest margin represents net interest income including out-of-cycle adjustments, on a tax equivalent basis, expressed as a percentage of the net investment portfolio. The primary difference between investment spread and net interest margin is that net interest margin also reflects the return on that portion of the net investment portfolio funded by equity and non-interest-bearing liabilities.
- (5) Includes a cumulative adjustment on adopting FAS 91 for additional interest income due to a higher than expected level of mortgage repayments, net of certain other adjustments. FAS 91 requires that commitment fees, together with purchase discount, be deferred and amortized over the estimated life of the related mortgages using the interest method.

The Corporation is managing the effective maturities and repricing characteristics of its assets and liabilities and has developed its MBS business to reduce its sensitivity to increases in interest rates. The operations and earnings of the Corporation continue to be influenced, however, by the level of interest rates and the availability of alternative sources of mortgage credit.

The rate obtained by the Corporation on its refinancing of maturing debt is one of the factors that affects spread and net interest margin. Information on the maturity profile of the Corporation's debt obligations is contained in "Corporate Indebtedness." The spread between the rate obtained by the Corporation on debt used to acquire new assets and the rate received on those assets also is an important factor affecting investment spread and net interest margin. In addition, net interest margin is affected by the proportion of equity and net non-interest-bearing liabilities relative to debt.

Facilities

The principal office of the Corporation is located at 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone: 202/752-7000), in a building that the Corporation owns. The Corporation also leases approximately 369,000 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to the Corporation's principal office. The present lease, with annual rental expense in 1991

of approximately \$11.1 million, expires in 2001, but the Corporation has options to extend the lease for up to 15 additional years, in 5-year increments.

The Corporation also maintains regional offices in leased premises (with the approximate square footage and year of lease expiration indicated) in Pasadena, California (69,000 square feet, 1999), Atlanta, Georgia (64,000 square feet, 1997); Chicago, Illinois (38,000 square feet, 1994); Philadelphia, Pennsylvania (56,000 square feet, 1996); and Dallas, Texas (57,000 square feet, 2000). The regional offices negotiate mortgage loan and MBS business with lenders in their regions, 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 staff of lenders in their region. The Corporation has options to extend the leases in Atlanta and Philadelphia for 5 years and the leases in Chicago and Pasadena for up to 10 years (in 5-year increments). The annual rental cost in 1991 of each of the leases for the regional offices is between \$1.2 and \$1.7 million. The annual rental cost for space leased by Fannie Mae in Washington, DC and its regional offices generally is subject to increase each year based, in part, upon increased costs related to the space leased, including operating costs, taxes, and insurance.

Fannie Mae also leases much smaller amounts of office space in Anchorage, Alaska, Miami, Florida, and Houston, Texas, for employees providing support services to the regional offices.

Employees

At June 30, 1991 the Corporation employed approximately 2,600 full-time personnel.

RECENT LEGISLATIVE AND REGULATORY DEVELOPMENTS

On April 30, 1991, the United States Treasury Department and the Congressional Budget Office ("CBO") delivered to Congress separate reports assessing the risks and federal oversight of various government-sponsored enterprises ("GSEs"). Treasury and CBO found that none of the GSEs presents any imminent threat to taxpayers. CBO further concluded that both Fannie Mae and Freddie Mac are "reasonably well capitalized relative to, and pose a low level of risk of loss from, their exposure to credit risk and interest rate risk." Treasury proposed the creation of a new, arm's-length bureau within HUD to regulate the safety and soundness of Fannie Mae and Freddie Mac. While CBO made no recommendations, it analyzed the possibility of relocating supervision of Fannie Mae and Freddie Mac to the Federal Housing Finance Board or setting up a new, independent federal agency for GSE oversight. The General Accounting Office ("GAO") also delivered to Congress a report on federal oversight and capital rules for GSEs on May 22, 1991. The GAO supported enhanced GSE supervision through creation of an independent regulatory board to oversee all GSE activities.

The Omnibus Budget Reconciliation Act of 1990 calls for the Congressional committees that have jurisdiction over the various GSEs to report GSE legislation by September 15, 1991. On July 31, 1991, the House Banking Committee approved proposed legislation (H.R. 2900) that would create an independent Office of Secondary Market Examination and Oversight within HUD to oversee the safety and soundness of Fannie Mae and The Federal Home Loan Mortgage Corporation ("Freddie Mac"). That office would be headed by a Director, appointed to a five-year term by the President and confirmed by the Senate. The proposed legislation also proposes three capital standards for Fannie Mae and Freddie Mac. Both the critical capital level and the medium capital level are based upon a percentage of on-balance-sheet assets and a lower percentage of outstanding MBS and other off-balance-sheet obligations, except for commitments to purchase mortgages or issue securities. The risk-based capital level would equal the level of capital needed to maintain positive capital for interest rate and credit risk under stressful economic circumstances, plus capital to protect against management and operations risk. The proposed legislation specifies certain mandatory and discretionary supervisory actions in the event Fannie Mae's or Freddie Mac's capital fell beneath the various levels described above. With respect to affordable housing programs, Fannie Mae and Freddie Mac would be required to set goals to promote affordable housing for low- and very low-income families, consistent

with each corporation's overall mission. Fannie Mae's goal for the two-year 1992-1993 period would be the purchase or securitization of not less than \$2 billion of mortgages on housing for low- and very low-income families, and Fannie Mae's goal for 1994 would be for the purchase or securitization of such mortgages in an amount aggregating not less than 1 percent of the total amount of mortgage purchases of the Corporation during 1993.

On August 16, 1991, HUD published in the *Federal Register* proposed revisions to HUD's existing regulations relating to oversight of Fannie Mae and proposed new regulations applicable to Freddie Mac. The proposed regulations would require that the Secretary of HUD approve annual dividend policies adopted by Fannie Mae's Board of Directors, any repurchases by Fannie Mae of its stock or debt or other obligations convertible into stock, and any significant and material changes in existing Fannie Mae programs (as well as new program proposals) for the purchase or securitization of conventional mortgages. They also would require that Fannie Mae meet risk-based capital requirements to be imposed by the Secretary and comply with certain other restrictions and reporting requirements, including a requirement that Fannie Mae submit annual audit reports certified by a certified public accounting firm acceptable to the Secretary. The due date for comments on the proposed regulations is October 15, 1991. Fannie Mae expects to submit extensive critical comments on the proposed regulations.

On August 8, 1991, the Internal Revenue Service released new tax rules relating to the taxation of mortgage servicing. The new rules generally provide that when a lender sells mortgage loans, while retaining the right to service those loans, any amount retained by the lender in excess of "reasonable compensation" will be considered stripped coupons from the mortgage loans for tax purposes. There are several collateral tax consequences that follow from this general provision, but the new rules essentially affect the timing and not the amount of income from mortgages and mortgage servicing. Management currently is analyzing the rules and their impact on our business practices and those of other mortgage institutions.

Another recent development is action by some states to override the Secondary Mortgage Market Enhancement Act of 1984 (the "Act"). The Act exempted mortgage-backed securities from state securities registration requirements and provided that securities issued or guaranteed by Fannie Mae and Freddie Mac must be treated as obligations of the U.S. government for purposes of state investment laws. The Act, however, permitted the states to pass legislation to override the federal preemption by October 3, 1991. Approximately fifteen states already have passed legislation to override the federal preemption set forth in the Act, and proposed legislation is pending in several states, including California. The override legislation in some states subjects insurance companies to state laws and regulations limiting the percentage of their investment portfolio that may be invested in the securities, including mortgage-backed securities, of any one issuer. It is unclear what impact such legislation may have on Fannie Mae's business or on the market for its debt and MBS.

The Bush Administration's recommendations for the 1992 fiscal year budget, as released on February 4, 1991, contained no recommendation that Fannie Mae and other GSEs pay user fees to the United States Treasury. In addition, the budget report stated that the Corporation did not have the rising loan losses and deteriorating income problems associated with commercial banks and thrift institutions. The report also examined projections regarding housing appreciation and mortgage rates and determined that the Corporation's present policies would enable the Corporation to maintain its profitability. In examining the Corporation's financial condition, the budget report developed a scenario of interest rate and credit risk stress. Under this scenario, there would be virtually no taxpayer exposure. The report concluded that the Corporation's continued profitability and operating efficiency were key to protecting taxpayers. There also is a proposal, which is a part of the budget recommendations, to allow HUD to establish fees and charges against entities that it regulates. These assessments would cover the costs of regulating and auditing such entities. It is unclear what impact, if approved, this proposal would have on Fannie Mae.

COMMON STOCK

The following information is summarized from the Charter Act, the bylaws, and certain resolutions of the Board of Directors and stockholders of the Corporation. Such summaries do not purport to be complete and are qualified in their entirety by reference to such Charter Act, bylaws, and resolutions, copies of which are obtainable from the Corporation. The Charter Act, the Corporation's governing instrument, cannot be amended by the stockholders but only by an Act of Congress.

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 per share in the election of directors and on all matters presented for their vote. The holders of the Corporation's common stock elect thirteen directors and the President of the United States appoints the remaining five directors pursuant to the terms of the Charter Act. Any member of the Board of Directors, including a member elected by stockholders, may be removed by the President of the United States for good cause.

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.

The Charter Act contains no limitation on the amount of stock that may be issued, except that no stock may be issued by the Corporation without the prior approval of the Secretary of HUD. At June 30, 1991, there were outstanding approximately 273 million shares of common stock.

Holders of common stock are entitled to receive cash dividends if, as and when declared by the Board of Directors. Cash dividends on the common stock in any one fiscal year may not exceed a rate determined from time to time by the Secretary of HUD to be a fair rate of return after consideration of the current earnings and capital condition of the Corporation. The Secretary has not established any rate limitation to date. The payment of dividends on the common stock also may be subject to any requirements imposed with respect to future series of preferred stock. During 1990 and 1989, Fannie Mae paid dividends of \$173 million and \$103 million, respectively, on the aggregate outstanding shares of common stock.

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, including amounts payable to the holders of obligations of the Corporation described under "Business—Corporate Indebtedness" and amounts payable to the holders of any series of preferred stock issued in the future. There are no provisions under the Charter Act that would govern the liquidation of the Corporation as a corporate entity.

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 Corporation's purchase of its own common stock, holding such common stock in its treasury, and reselling the same.

The Corporation's common stock is publicly traded on the New York, Pacific, and Midwest stock exchanges and is identified by the ticker symbol "FNM". The transfer agent and registrar for the common stock is Manufacturers Hanover Trust Company, 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*.

<u>Quarter</u>	<u>1991</u>		<u>1990</u>		<u>1989</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
1st	\$48.50	\$32.38	\$37.88	\$28.50	\$23.00	\$16.71
2nd	51.75	42.63	44.63	32.00	31.38	21.25
3rd.....			44.50	24.88	42.67	29.79
4th.....			36.25	26.00	46.38	30.50

On August 29, 1991, the closing price of the Corporation's common stock as so reported was \$60.88.

MANAGEMENT

Directors

The age and background, as of August 15, 1991, of each of the members of the Board of Directors of the Corporation are as follows:

<u>Name and Age</u>	<u>Principal Occupation, Business Experience, and Residence</u>	<u>First Became Director</u>	<u>Other Directorships (1)</u>
Felix M. Beck, 65	Chairman of the Board and Chief Executive Officer, Margaretten & Co., Inc., a mortgage banking company, 1969 to present; Livingston, New Jersey	1985	
Roger E. Birk, 61	President and Chief Operating Officer of the Corporation, November 1987 to present; Chairman of the Board, International Securities Clearing Corporation, November 1986 to October 1987; Chairman of the Board, January 1981 to April 1985, Chief Executive Officer, January 1981 to July 1984, and President, July 1976 to January 1982, Merrill Lynch & Co., Inc., a financial services company; Rumson, New Jersey and Washington, D.C.	1985	New Jersey Resources Corporation; Penske Transportation
Eli Broad, 58	Chairman of the Board, 1961 to present, Chief Executive Officer, 1976 to present, and President, May 1990 to present, Broad Inc. (formerly Kaufman and Broad, Inc.), a financial services corporation; Chairman, Kaufman and Broad Home Corporation, June 1986 to present; Chairman and Chief Executive Officer, SunAmerica Corporation (formerly Sun Life U.S.A., Inc., and Sun Life Group of America, Inc., where he was Chairman and Chief Executive Officer since 1987 and 1978, respectively); Chairman, 1987 to present, Sun Life Insurance Company of America, Inc., Los Angeles, California	1984	
George L. Clark, Jr.(2), 50	President, September 1987 to present, and Vice President, 1962 to September 1987, George L. Clark, Inc., a real estate company; Brooklyn, New York	1989(3)	
Christine M. Diemer(2), 39	Executive Director, Building Industry Association of Southern California, Orange County Region, a building association, July 1989 to present; Director, January 1987 to June 1989, and Acting Director, May 1986 to January 1987, California Department of Housing and Community Development, a state housing department; Deputy Secretary of Housing, California Business, Transportation and Housing Agency, a business, transportation, and housing agency, 1984 to May 1986; Corona del Mar, California	1989	
J. Brian Gaffney (2), 58	Partner, Gaffney, Pease & DiFabio, a law firm practicing in Connecticut, January 1989 to present; Partner, Gaffney & DiFabio, a law firm practicing in Connecticut, 1975 to December 1988, New Britain, Connecticut	1989	
Joseph P. Hayden, 61	Chairman of the Board and Chief Executive Officer, 1980 to present, The Midland Company and its subsidiaries, businesses engaged primarily in financing, insurance and river transportation; Cincinnati, Ohio	1969	Star Banc Corporation; Star Bank, N.A.

<u>Name and Age</u>	<u>Principal Occupation, Business Experience, and Residence</u>	<u>First Became Director</u>	<u>Other Directorships (1)</u>
James A. Johnson, 47	Chairman of the Board of Directors and Chief Executive Officer, February 1991 to present; Vice Chairman of the Corporation, January 1990 to January 1991; Managing Director, Shearson Lehman Hutton, Inc., an investment banking firm, April 1985 to December 1989; President, Public Strategies, a Washington, D.C.-based consulting firm, 1981 to April 1985; Washington, D.C.	1990	
Vincent A. Mai, 51	President and Chief Executive Officer, AEA Investors, Inc., an investment company, April 1989 to present; Managing Director, Shearson Lehman Hutton, Inc., an investment banking firm, 1974-1989; Port Washington, New York	1991	
John M. O'Mara, 64	Chairman of the Executive Committee, Quality Care Systems, Inc., a health care cost containment corporation, July 1990 to present; President, Chemvest International, Inc., an international merchant banking corporation, January 1990 to July 1990; Chairman of the Board and Chief Executive Officer, Global Natural Resources, Inc., an independent oil and gas exploration and production company, August 1988 to December 1989; Managing Director, Chase Manhattan Bank, September 1985 to August 1988; Greenwich, Connecticut	1970	Baldwin & Lyons, Inc.; The Midland Company
Richard D. Parsons, 43	Chairman of the Board and Chief Executive Officer, January 1991 to present, President and Chief Executive Officer, July 1990 to January 1991, President and Chief Operating Officer, July 1988 to June 1990, and Director, July 1988 to present, The Dime Savings Bank of New York, FSB, a financial institution; Partner, Patterson, Belknap, Webb & Tyler, a law firm practicing in New York, May 1979 to June 1988; Pocantico Hills, New York	1989	College Retirement Equities Fund; Philip Morris Companies, Inc.; Time Warner, Inc.
Samuel J. Simmons, 64	President and Chief Executive Officer, The National Caucus and Center on Black Aged, Inc., a non-profit organization, 1982 to present; housing consultant, 1981 to present; Washington, D.C.	1978	
Christopher J. Sumner, 45	Vice Chairman and Director, April 1990 to present, and President and Director, March 1987 to April 1990, CrossLand Savings, FSB (Utah) (formerly Western Savings and Loan Company), a financial institution; President and Director, CrossLand Mortgage Corp., a mortgage banking corporation, May 1988 to present; President and Chief Executive Officer, Western Savings and Loan Company, a financial institution, 1980 to March 1987; Salt Lake City, Utah	1985	
Mallory Walker, 52	President, Chief Executive Officer and Director, Walker & Dunlop, Inc., a mortgage banking and real estate company, 1976 to present; Washington, D.C.	1981	
Karen Hastie Williams, 46	Partner, Crowell & Moring, a law firm practicing in the District of Columbia, December 1982 to present; Washington, D.C.	1988	Crestar Financial Corporation

(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 President currently has appointed three directors only and may appoint two additional directors.
- (3) From 1986 to 1987, Mr. Clark also served as a director of the Corporation appointed by the President of the United States.

The term of each director will end on the date of the May 1992 annual meeting of stockholders, except that any director may be removed by the President of the United States for good cause.

On June 18, 1991, the Board of Directors elected Mr. Lawrence M. Small and Mr. Franklin D. Raines as members of Fannie Mae's Board of Directors, effective on September 18, 1991. Mr. Small, formerly a Vice Chairman of Citicorp, also was elected to serve as President and Chief Operating Officer-Designate of Fannie Mae during a transition period between September 1991 and January 1992 and will assume the position of President and Chief Operating Officer on February 1, 1992. Mr. Raines, a former General Partner of Lazard Freres and Company, was elected to serve as Vice Chairman-Designate during a transition period between July 1991 and September 1991 and will assume the position of Vice Chairman on September 18, 1991.

Executive Officers

The age and business experience, as of August 15, 1991, of each of the executive officers of the Corporation, are as follows:

James A. Johnson, 47, has been Chairman of the Board of Directors and Chief Executive Officer since February 1991. Mr. Johnson was Vice Chairman of the Corporation from January 1990 to January 1991. Mr. Johnson was a Managing Director in Corporate Finance at Shearson Lehman Hutton, Inc. from April 1985 to December 1989 and was President of Public Strategies from January 1981 to April 1985.

Roger E. Birk, 61, has been President and Chief Operating Officer of the Corporation since November 1987 and a director of the Corporation since 1985. Mr. Birk was Chairman of the Board of International Securities Clearing Corporation from November 1986 to October 1987. He was Chairman of Merrill Lynch & Co., Inc. from 1981 to April 1985.

Franklin D. Raines, 42, has been Vice Chairman-Designate since July 1991. Mr. Raines will assume the position of Vice Chairman on September 18, 1991. Prior to his employment with the Corporation, Mr. Raines was a Limited Partner with Lazard Freres and Company from January 1991 to June 1991 and a General Partner with that firm from January 1985 to December 1990.

Caryl S. Bernstein, 57, has been Executive Vice President since February 1982, General Counsel since May 1981 and Secretary since July 1981.

J. Timothy Howard, 43, 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, Executive Vice President—Economics, Strategic Planning, and Financial Analysis from September 1987 to December 1987, and Senior Vice President—Economics and Corporate Planning from November 1985 to September 1987.

Robert J. Levin, 35, has been Executive Vice President—Marketing since June 1990. Mr. Levin was Senior Vice President—Marketing and MBS from June 1989 to June 1990, Senior Vice President—Mortgage-Backed Securities and Portfolio Acquisition from February 1988 to June 1989, Senior Vice President—Mortgage-Backed Securities from February 1987 to February 1988, Senior Vice President and Assistant to the Chairman of the Board from May 1986 to February 1987, and Senior Vice President—Corporate Finance from November 1985 to May 1986.

Michael A. Smilow, 53, has been Executive Vice President and Chief Credit Officer since March 1989. Mr. Smilow was Executive Vice President—Marketing and Customer Services from January 1988 to March 1989 and Executive Vice President—Mortgage Operations from July 1984 through December 1987.

Glenn T. Austin, Jr., 43, has been Senior Vice President—Southeastern Regional Office since May 1985.

Douglas M. Bibby, 44, has been Senior Vice President—Administration since October 1988. Mr. Bibby was Senior Vice President and Assistant to the Chairman of the Board from March 1987 until October 1988, and Senior Vice President—Corporate Affairs from October 1983 to March 1987.

Larry H. Dale, 45, has been Senior Vice President—Marketing and MBS since June 1990. He was Senior Vice President—Multifamily Finance and Housing Initiatives from May 1989 to June 1990 and Senior Vice President—Multifamily Activities from June 1987 to May 1989. Prior to his employment with the Corporation, Mr. Dale was Vice President of Newman and Associates from 1984 to June 1987.

Judith Dedmon, 40, has been Senior Vice President—Southwestern Regional Office since July 1987. Ms. Dedmon was Senior Vice President—Quality Standards from April 1987 to July 1987, and Vice President for Quality Standards from July 1985 and July 1987.

John H. Fulford, III, 42, has been Senior Vice President—Western Regional Office since November 1985. Mr. Fulford was Regional Vice President—Western Regional Office from May 1985 to November 1985.

John R. Hayes, 52, has been Senior Vice President—Midwestern Regional Office since November 1985.

Lynda Horvath, 38, has been Senior Vice President—Mortgage Operations since February 1991. Ms. Horvath was Acting Senior Vice President—Mortgage Operations from November 1990 to February 1991, Vice President—Product Acquisition and Development from January 1989 to November 1990, and Vice President—MBS Financial Analysis from September 1985 to January 1989.

William E. Kelvie, 44, has been Senior Vice President and Chief Information Officer since November 1990. Prior to his employment with the Corporation, Mr. Kelvie was a managing principal with Nolan, Norton & Co. from March 1987 to November 1990, a branch manager of that firm's New York office from March 1986 to March 1987, and a principal of that firm as of March 1985.

Thomas A. Lawler, 38, has been Senior Vice President—Portfolio Management since November 1989. Mr. Lawler was Vice President for Portfolio Management from January 1989 to November 1989, and Vice President and Senior Economist from February 1986 to December 1988.

Ann D. Logan, 36, has been Senior Vice President—Northeastern Regional Office since June 1989. Ms. Logan was Vice President for Regional Activities from May 1989 to June 1989, Vice President for Mortgage Operations from November 1987 to May 1989, and Executive Assistant to the Executive Vice President—Mortgage Operations from January 1986 to November 1987.

William R. Maloni, 46, has been Senior Vice President—Policy and Public Affairs since March 1989. Mr. Maloni was Senior Vice President—Government Relations from April 1987 to March 1989, Vice President for Government Relations from February 1986 to April 1987, and Vice President for Congressional Relations from March 1984 to February 1986.

Gary L. Perlin, 40, has been Senior Vice President—Finance and Treasurer since November 1985.

Michael A. Quinn, 36, has been Senior Vice President and Controller since March 1991. Prior to his employment with the Corporation, Mr. Quinn was Vice President and Assistant Controller with

Chemical Bank from September 1987 to March 1991, and Vice President and Controller with Dune Resources from April 1984 to September 1987.

Mr. Roger E. Birk, President and Chief Operating Officer, has announced his retirement effective on January 31, 1992. Mr. Lawrence M. Small will become President and Chief Operating Officer-Designate of the Corporation in September 1991 as further described herein under "Management—Board of Directors."

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 25, 1991, for the Corporation's 1991 annual meeting of stockholders ("Proxy Statement").

The Corporation will provide without charge a copy of the Proxy Statement mentioned above to each person to whom this Offering Circular 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, 1990 and 1989 and for each of the years in the three-year period ended December 31, 1990, included herein, have been included in reliance upon the report of KPMG Peat Marwick, independent certified public accountants, and upon the authority of that firm as experts in accounting and auditing.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Federal National Mortgage Association:

We have audited the accompanying balance sheets of Federal National Mortgage Association as of December 31, 1990 and 1989, and the related statements of income and cash flows for each of the years in the three-year period ended December 31, 1990. These financial statements are the responsibility of the Corporation'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 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 Federal National Mortgage Association at December 31, 1990 and 1989, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1990, in conformity with generally accepted accounting principles.

KPMG PEAT MARWICK

Washington, DC
January 15, 1991

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF INCOME

	<u>Year Ended December 31,</u>		
	<u>1990</u>	<u>1989</u>	<u>1988</u>
	(Dollars in millions, except per share amounts)		
Interest income:			
Mortgage portfolio, net of servicing fees	\$10,958	\$10,103	\$9,629
Investments and cash equivalents	<u>1,111</u>	<u>977</u>	<u>597</u>
Total interest income	12,069	11,080	10,226
Interest expense	<u>10,476</u>	<u>9,889</u>	<u>9,389</u>
Net interest income	<u>1,593</u>	<u>1,191</u>	<u>837</u>
Other income:			
Guaranty fees	536	408	328
Gain on sales of mortgages	7	9	12
Miscellaneous, net	<u>107</u>	<u>60</u>	<u>69</u>
Total other income	<u>650</u>	<u>477</u>	<u>409</u>
Other expenses:			
Provision for losses	310	310	365
Administrative	<u>286</u>	<u>254</u>	<u>218</u>
Total other expenses	<u>596</u>	<u>564</u>	<u>583</u>
Income before federal income taxes	<u>1,647</u>	<u>1,104</u>	<u>663</u>
Provision for federal income taxes:			
Current	523	358	285
Deferred	<u>(49)</u>	<u>(61)</u>	<u>(129)</u>
Total provision for federal income taxes	<u>474</u>	<u>297</u>	<u>156</u>
Net income	<u>\$ 1,173</u>	<u>\$ 807</u>	<u>\$ 507</u>
Per share:			
Earnings:			
Primary	\$ 4.50	\$ 3.14	\$ 2.14
Fully diluted	4.49	3.10	2.11
Cash dividends .....	.72	.43	.24

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1990	1989	1988
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	\$ 1,173	\$ 807	\$ 507
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for deferred federal income taxes.....	(49)	(61)	(129)
Provision for losses	310	310	365
Net cash portion of amortization of purchase discount and loan fees.....	41	93	140
(Decrease) increase in accrued interest payable...	(23)	233	(2)
(Increase) decrease in accrued interest receivable	32	(125)	(128)
Gain on sales of mortgages	(7)	(9)	(12)
Other increases, net	108	98	20
Net cash provided by operating activities	1,585	1,346	761
Cash flows from investing activities:			
Purchases of mortgages	(23,743)	(22,293)	(22,795)
Proceeds from sales of mortgages	5,817	2,992	5,012
Mortgage principal repayments, net of discount	11,216	10,544	10,031
Net proceeds from disposition of foreclosed properties	464	519	812
Net increase in investments	(1,530)	(2,873)	(1,996)
Net cash used in investing activities	(7,776)	(11,111)	(8,936)
Cash flows from financing activities:			
Cash proceeds from issuance of debentures.....	19,666	23,567	14,285
Cash payments to repay debentures	(12,249)	(12,698)	(14,002)
Cash proceeds from issuance of short-term debt ..	93,245	54,084	48,914
Cash payments to repay short-term debt, net of discount	(93,596)	(54,241)	(40,732)
Cash proceeds from issuance of common stock ...	37	4	1
Cash payments for repurchase of common stock ..	(93)	—	(7)
Dividends paid	(173)	(103)	(57)
Net cash provided by financing activities	6,837	10,613	8,402
Net increase in cash and cash equivalents	646	848	227
Cash and cash equivalents at beginning of year	3,532	2,684	2,457
Cash and cash equivalents at end of year	\$ 4,178	\$ 3,532	\$ 2,684

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION

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. Certain amounts in prior years' financial statements have been reclassified to conform with the current presentation.

Mortgage Portfolio and Investments

Mortgages and mortgage-backed securities acquired for investment are carried at their unpaid principal balances ("UPBs") less unamortized purchase discount and deferred loan fees. Discount and deferred loan fees are recognized as income using the interest method over the estimated life of the related mortgages. The accrual of interest on conventional mortgages, other than those that are federally insured or guaranteed, is discontinued when the mortgages become 90 days 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.

Other, non-mortgage investments are carried at their historical cost adjusted for unamortized discount or premium. The mortgage portfolio and other investments are acquired with the objective of earning a net interest spread over the related cost of funds. The Corporation has the ability to hold these investments until their maturity and currently intends to hold them for the foreseeable future.

Commitment Fees and Purchase Discount/Premium

The Corporation, in compliance with Financial Accounting Standard No. 91 ("FAS 91"), treats purchase discount and premium and most commitment fees as an adjustment to interest income over the estimated life of the related mortgages using the interest method.

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

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 MBS held in trust by the Corporation. The pools of mortgages or MBS are not assets of the Corporation, except when acquired for investment purposes, nor are the related outstanding securities liabilities of the Corporation; accordingly, neither is reflected in the accompanying balance sheets. The Corporation receives monthly guaranty fees for each MBS pool based on a percentage of the pool's outstanding balance.

Allowance for Losses

The allowance for losses on the conventional mortgage portfolio is maintained at a level that, in management's judgment, is adequate to provide for estimated losses. This judgment is based on such factors as economic conditions, geographic concentrations, mortgage characteristics, and actual and expected loan loss experience. The allowance is increased by provisions charged as an expense in the income statement and decreased by charge-offs, net of recoveries.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

The Corporation establishes an allowance for losses on U.S. government insured or guaranteed loans when foreclosure appears probable. At that time, a provision is recorded to provide for estimated unreimbursable foreclosure losses.

A liability for estimated losses is maintained for MBS because the Corporation has assumed the ultimate default risk on the underlying mortgages. Provisions for losses are recorded to maintain the liability at a level that, in management's judgment, is adequate to provide for estimated losses.

Acquired Property

Real estate acquired and held for sale as a result of foreclosure is carried at the lower of the investment in the property or its estimated net realizable value. In making these estimates, current appraised values of properties and estimated interest carrying costs are considered in the calculations.

Gain/Loss on Sales of Mortgages

When the Corporation sells mortgages, it places them in MBS pools and sells them as securities. A gain or loss is recognized at the time of sale to the extent the sale proceeds differ from the recorded value of the assets sold. An adjustment to the gain or loss is recognized in an amount measured by the present value 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.

Risk Management Activities

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

Securities Sold Under Agreements to Repurchase

The Corporation enters into sales of securities under agreements to repurchase substantially similar securities at a later date. Such transactions are treated as financings. The obligations to repurchase securities sold are reflected as liabilities on the balance sheets and the mortgage securities underlying the agreements remain in the asset accounts. The counterparty to the repurchase agreement acquires legal ownership of the securities transferred.

Securities Purchased Under Agreements to Resell

The Corporation purchases securities under agreements to resell the same securities at a later date (repurchase agreements). The securities are recorded as investment assets on the balance sheet, and the Corporation acquires legal ownership of the securities purchased. To reduce exposure to credit risk, the Corporation requires the fair market value of the securities purchased to be greater than the investment amount.

Foreign Currency Translation

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

Cash and Cash Equivalents

The Corporation considers overnight federal funds and all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

Income Taxes

Deferred income taxes are provided for timing differences between financial and taxable income. Investment and other tax credits are deferred and amortized over the lives of the related assets.

Earnings Per Share

Earnings per share are computed using the weighted-average number of common shares outstanding, including dilutive common stock equivalents. Common stock equivalents include common stock warrants. Fully diluted earnings per share are computed on the assumption 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. The weighted-average shares outstanding used to compute fully diluted earnings per share were 261 million, 260 million, and 241 million for the years ended December 31, 1990, 1989, and 1988, respectively.

2. Financial Instruments with Off-Balance-Sheet Risk

The Corporation is a party to transactions involving financial instruments with off-balance-sheet risk. These financial instruments include MBS, commitments to purchase mortgages or to issue and guarantee MBS, interest rate futures contracts, short sales of Treasury securities, interest rate swaps, and currency swaps. The Corporation uses these financial instruments in the normal course of business to fulfill its statutory purpose of increasing the liquidity of residential mortgage loans and to reduce its exposure to fluctuations in interest rates and foreign exchange rates.

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 is also 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. In some cases, the Corporation may require credit enhancement based upon its review of the mortgage product, lender performance, and the transaction risk profile. Such credit enhancement to protect against losses on loans underlying MBS may include lender recourse, pledged collateral, mortgage insurance, letters of credit, lender-funded cash reserves, and various forms of third party insurance coverage.

In recourse arrangements, the lender accepts either 100 percent recourse or limited recourse. By accepting 100 percent recourse, the lender assumes the risk of any losses due to borrower default. Because the Corporation assumes the ultimate risk of loss on all MBS, the main risk that the Corporation bears in such cases is that the lender will be unable to honor the recourse obligation. For lenders that want to provide only limited recourse, that is, recourse limited in terms of dollar or time protection, the Corporation may require that the limited recourse obligation be supported by pledged collateral in the form of Fannie Mae MBS or Treasury securities, or, in certain situations, letters of credit and Ginnie Mae securities.

The Corporation requires that loans with a loan-to-value ("LTV") ratio greater than 80 percent at origination have either mortgage insurance coverage from an approved mortgage insurance company or some other form of credit enhancement. In the event a mortgage insurer is unable to pay claims submitted, or the alternative credit enhancement is insufficient, the Corporation bears the risk of additional loss on related foreclosures.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

The total outstanding principal balance of MBS guaranteed by the Corporation was \$299.8 billion at December 31, 1990, compared with \$228.2 billion at December 31, 1989 (which includes \$11.8 billion and \$11.7 billion, respectively, of Fannie Mae MBS in portfolio). At December 31, 1990, \$97.8 billion of the MBS outstanding had some credit enhancement structure in the event of borrowers' default, including \$61.9 billion with 100 percent recourse. The Corporation's exposure to credit loss on MBS, if borrowers completely fail to perform and if both the property backing the mortgage and any pledged collateral or other forms of credit enhancement provided by the lender prove to be of no value, is represented by the face value of the MBS outstanding less the related allowance for losses. At December 31, 1990, this amount was \$299.5 billion.

Commitments

At December 31, the Corporation had commitments outstanding to purchase mortgages and to issue MBS as shown below:

	<u>1990</u>	<u>1989</u>
	(Dollars in millions)	
Commitments to purchase mortgages:		
Mandatory delivery	\$ 1,902	\$ 2,337
Lender option	7,726	3,700
Commitments to issue MBS:		
Mandatory delivery	6,391	8,367
Lender option	72,179	34,236
Master commitments (1)	49,314	16,617

(1) In order to deliver under a master commitment, a lender must convert to either a mandatory delivery MBS or mortgage purchase commitment with the yield established at the time of conversion.

Outstanding commitments to purchase mortgages do not necessarily represent future cash requirements. Some of the lender option commitments are expected to expire without being drawn upon and, under a mandatory delivery commitment, the lender may buy back the commitment at any time during the commitment term for a fee. In addition, the mandatory delivery commitments are subject to good delivery tolerances, which allow unpaid principal balances to deviate from the original commitment amount usually by no more than minus 5 percent. For most of the lender option commitments the yield is set at the date of conversion to a mandatory commitment.

The cost of funding future portfolio purchases generally is hedged upon issuance or conversion to a mandatory commitment; therefore, the interest rate risk for the Corporation is largely mitigated.

Hedge Instruments

The Corporation typically uses interest rate futures contracts, short sales of Treasury securities, interest rate swaps, debt swaps, and currency swaps to hedge against fluctuations in interest rates and foreign exchange rates. Changes in the value of these hedge instruments caused by interest rate or currency fluctuations, are expected to substantially offset changes in the value of the items hedged. Consequently, the primary risks associated with these hedging instruments are that changes in the value of the item hedged will not substantially offset changes in the value of the hedge instrument, and that the counterparty to the agreement will be unable to meet the terms of the agreement. The Corporation reduces counterparty risk by entering into such agreements only with institutions it believes are financially sound based on certain criteria and by diversifying counterparties.

Interest Rate Futures and Short Sales of Treasuries: At December 31, 1990, the contract amount of interest rate futures outstanding was \$25 million compared with \$151 million at December 31, 1989. The

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

contract amount of Treasury securities the Corporation sold short was \$1.7 billion and \$1.4 billion at December 31, 1990 and 1989, respectively. The Corporation sells futures contracts and enters into short sales of Treasury securities to minimize the risk of rising interest rates on its planned debt issuances.

Interest Rate Swaps: 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 (indexed sinking fund swap agreements). The notional amount of long-term interest rate and indexed sinking fund swap agreements outstanding at December 31, 1990 was \$2.1 billion (including \$0.4 billion of callable long-term swaps) and \$1.4 billion, respectively, compared with \$1.8 billion and \$0.5 billion, respectively, at December 31, 1989. The average remaining term of these long-term and indexed sinking fund swaps was six years at December 31, 1990 and at December 31, 1989. The weighted-average interest rate being received under these long-term and indexed sinking fund swaps was 8.22 percent and the weighted-average interest rate being paid was 9.62 percent at December 31, 1990, compared with 8.31 percent and 10.07 percent, respectively, at December 31, 1989.

The Corporation also has interest rate swap agreements that are linked to specific debt issues (debt swaps). These swaps achieve a specific financing objective at a desired cost, usually by effectively converting floating-rate debt into fixed-rate debt. The cost and term of the specific debt issues, as reflected in the financial statements, include the effects of the swaps. At December 31, 1990, the notional amount of debt swaps outstanding totaled \$1.3 billion compared with \$0.8 billion at December 31, 1989.

Currency Swaps: The Corporation has issued 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 entered into currency swaps that convert the proceeds of the borrowings into dollars or provide for scheduled future exchanges of the two currencies. Currency swaps eliminate foreign exchange risk for the Corporation by fixing in U.S. dollars, the interest payable as well as the principal payable at maturity. At December 31, 1990 and 1989, the U.S. dollar equivalent face amounts of these foreign currency or foreign currency-indexed obligations, translated at the then-current exchange rates, were \$2.4 billion and \$1.8 billion, respectively.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

3. Concentrations of Credit Risk

The following schedules summarize concentrations of credit risks by original loan-to-value ratio for the conventional single-family portfolio and conventional mortgages backing MBS, and by location and product type for the entire mortgage portfolio (except for MBS held in portfolio) and all mortgages backing MBS:

Geographic Distribution of Mortgage Portfolio and MBS
As of December 31, 1990
(Dollars in millions)

	<u>Mortgage Portfolio (1)</u>		<u>MBS (1)</u>		
			<u>Fannie Mae Risk (2)</u>	<u>Lender Risk (2)</u>	<u>Total</u>
Gross UPB	\$104,870	Gross UPB	\$202,081	\$97,752	\$299,833
<u>By Region</u>		<u>By Region</u>			
Northeast	22%	Northeast	22%	35%	26%
Southeast	17	Southeast	21	18	20
Midwest	16	Midwest	15	13	15
Southwest	17	Southwest	12	7	10
Western	28	Western	30	27	29
Total	<u>100%</u>	Total	<u>100%</u>	<u>100%</u>	<u>100%</u>
<u>By State</u>		<u>By State</u>			
California	23%	California	25%	25%	25%
New York	7	New York	5	10	7
Texas	7	Florida	6	8	6
Florida	5	New Jersey	5	7	5
Illinois	4	Massachusetts	4	7	5
All others	54	All others	55	43	52
Total	<u>100%</u>	Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Fannie Mae MBS held in portfolio totaling \$11.8 billion are included in MBS but excluded from portfolio statistics.

(2) Based on primary default risk category; however, Fannie Mae bears the ultimate risk of default. Includes MBS that have been pooled to back Megas, SMBS or REMICs.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

**Loan-to-Value (“LTV”) Ratio Distribution of Conventional
Single-Family Mortgage Portfolio and MBS**

As of December 31, 1990
(Dollars in millions)

	Mortgage Portfolio (1)	MBS (1)		Total
		Fannie Mae Risk (2)	Lender Risk (2)	
Gross UPB	\$83,513	\$191,497	\$88,250	\$279,747
Original Loan-To-Value Ratio(3)				
60% and Less	20%	20%	18%	19%
61-70%	13	15	13	15
71-75%	12	15	15	15
76-80%	27	27	30	28
81-90%	18	17	20	18
Over 90%	10	6	4	5
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Fannie Mae conventional single-family MBS held in portfolio totaling \$11.4 billion are included in MBS but excluded from portfolio statistics.

(2) Based on primary default risk category; however, Fannie Mae bears the ultimate risk of default. Includes MBS that have been pooled to back Megas, SMBS, or REMICs.

(3) Current LTV ratios may be higher or lower than original LTV ratios.

Product Distribution of Mortgage Portfolio and MBS

As of December 31, 1990
(Dollars in millions)

	Mortgage Portfolio (1)	MBS (1)		Total
		Fannie Mae Risk (2)	Lender Risk (2)	
Gross UPB	\$104,870	\$202,081	\$97,752	\$299,833
Single-family:				
FHA/VA	11%	5%	2%	4%
Fixed-rate	59	86	62	78
ARMs	18	8	28	15
Seconds	2	—	—	—
Multifamily	10	1	8	3
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Fannie Mae MBS held in portfolio totaling \$11.8 billion are included in MBS but excluded from portfolio statistics.

(2) Based on primary default risk category; however, Fannie Mae bears the ultimate risk of default. Includes MBS that have been pooled to back Megas, SMBS, or REMICs.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS— (Continued)

4. Mortgage Portfolio, Net

The mortgage portfolio consisted of the following investments at December 31:

	<u>1990</u>	<u>1989</u>
	(Dollars in millions)	
Single-family mortgages:		
First mortgages:		
Government insured or guaranteed	\$ 11,204	\$ 11,857
Conventional fixed-rate	72,290	66,804
Conventional adjustable-rate	20,736	22,020
Second mortgages	<u>1,851</u>	<u>1,614</u>
	<u>106,081</u>	<u>102,295</u>
Multifamily mortgages:		
Government insured	4,243	4,361
Conventional	<u>6,304</u>	<u>4,065</u>
	<u>10,547</u>	<u>8,426</u>
Total unpaid principal balance (1)	116,628	110,721
Less:		
Unamortized discount and loan fees	2,562	2,740
Allowance for losses	<u>191</u>	<u>225</u>
	<u>\$113,875</u>	<u>\$107,756</u>

(1) Includes \$11.8 billion and \$11.7 billion of Fannie Mae MBS held in portfolio at December 31, 1990 and December 31, 1989, respectively.

The total unpaid principal balance of loans in nonperforming status (those 90 days or more delinquent) was \$0.7 billion at December 31, 1990 and December 31, 1989.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

5. Allowance for Losses

The total allowance for losses consists of an allowance for portfolio loan losses, an allowance for non-reimbursable foreclosure costs on government claims, and a liability for estimated foreclosure losses on MBS. Changes in the allowance for the years 1988 to 1990 are summarized below:

	Mortgage Portfolio			Total
	Conventional	Government Insured or Guaranteed	MBS	
	(Dollars in millions)			
Balance, January 31, 1988	\$ 191	\$ 24	\$131	\$ 346
Provision	279	6	80	365
Net foreclosure losses charged-off	(216)	(12)	(87)	(315)
Transfers	(26)	—	26	—
Balance, December 31, 1988	228	18	150	396
Provision	161	5	144	310
Net foreclosure losses charged-off	(147)	(10)	(86)	(243)
Transfers	(22)	—	22	—
Balance, December 31, 1989	220	13	230	463
Provision	113	6	191	310
Net foreclosure losses charged-off	(146)	(11)	(77)	(234)
Balance, December 31, 1990	<u>\$ 187</u>	<u>\$ 8</u>	<u>\$344</u>	<u>\$ 539</u>

The total allowance for losses at December 31 is included in the following balance sheet accounts:

	1990	1989
	(Dollars in millions)	
Mortgage portfolio, net	\$191	\$225
Foreclosure claims, net	4	8
Other liabilities	344	230
	<u>\$539</u>	<u>\$463</u>

6. Debt Securities Held for Investment

The amortized cost, unrealized gains and losses, estimated market value, and maturity distribution of debt securities held for investment, including MBS and other mortgage- and asset-backed securities, are summarized in the following tables.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

<u>Account Title (1)</u> <u>(Security Name)</u>	<u>Amortized</u> <u>Cost</u>	<u>Unrealized</u> <u>Gains</u>	<u>Unrealized</u> <u>Losses</u>	<u>Estimated</u> <u>Market Value</u>
	(Dollars in millions)			
Mortgage portfolio, net:				
Fannie Mae MBS	\$11,530	\$184	\$47	\$11,667
Other mortgage-related securities	<u>2,948</u>	<u>45</u>	<u>6</u>	<u>2,987</u>
	<u>14,478</u>	<u>229</u>	<u>53</u>	<u>14,654</u>
Investments:				
Federal funds	5,329	—	—	5,329
Asset-backed securities	1,780	20	—	1,800
Floating-rate notes	1,432	—	17	1,415
Repurchase agreements	951	45	—	996
Other	<u>376</u>	<u>2</u>	<u>2</u>	<u>376</u>
	<u>9,868</u>	<u>67</u>	<u>19</u>	<u>9,916</u>
Cash and cash equivalents:				
Overnight federal funds	1,899	—	—	1,899
Auction rate preferred stock	1,481	—	—	1,481
Other	<u>737</u>	<u>—</u>	<u>—</u>	<u>737</u>
	<u>4,117</u>	<u>—</u>	<u>—</u>	<u>4,117</u>
Total	<u>\$28,463</u>	<u>\$296</u>	<u>\$72</u>	<u>\$28,687</u>

(1) Debt securities are listed according to balance sheet account classification.

<u>Remaining Maturity at December 31, 1990</u>	<u>Amortized</u> <u>Cost</u>	<u>Estimated</u> <u>Market Value</u>
	(Dollars in millions)	
Due within 1 year	\$11,581	\$11,615
Due after 1 year through 5 years	552	548
Due after 5 years through 10 years	50	49
Due after 10 years	<u>2,552</u>	<u>2,581</u>
	14,735	14,793
Mortgage-backed securities(1)	11,948	12,094
Asset-backed securities(1)	<u>1,780</u>	<u>1,800</u>
Total	<u>\$28,463</u>	<u>\$28,687</u>

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

Proceeds from sales of investments in debt securities during 1990 were \$103 million. Gross gains of less than \$1 million and gross losses of \$2 million were realized on those sales.

7. Debentures, Notes, and Bonds, Net

The average cost of all debt outstanding at December 31, 1990 and 1989 (including the amortization of issuance costs and hedging results, and the effect of interest rate, debt, and currency swaps) was 8.81 percent and 9.04 percent, respectively. The average effective maturity of all debt outstanding was 50 months at December 31, 1990 and 47 months at December 31, 1989. This includes the effect of interest

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

rate swaps but excludes \$0.7 billion and \$1.0 billion of investment agreements at December 31, 1990 and December 31, 1989, respectively. Investment agreements are general unsecured obligations that allow the investor to demand payment of all or part of the funds under agreed-upon circumstances. Because of this call feature, the average maturity of investment agreements is indeterminate. Interest paid during 1990, 1989, and 1988 was \$10.4 billion, \$9.4 billion, and \$9.3 billion, respectively.

Pursuant to the Corporation's Charter Act and related regulations, no debt obligations may be issued without the approval of the Secretary of the Treasury. The Secretary of Housing and Urban Development ("HUD") currently requires that the maximum amount of the Corporation's general obligations outstanding at any time, excluding those that are subordinated or secured, not exceed 20 times the sum of stockholders' equity, subordinated capital debentures, and reserves. At December 31, 1990, this ratio was 18.9:1.

In addition to debt restrictions under the Charter Act, the Corporation is subject to a restriction in connection with certain subordinated capital debenture issues, which limits the amount of subordinated capital debentures outstanding to not more than two times the sum of the Corporation's common stock, additional paid-in capital, and retained earnings. At December 31, 1990, the ratio was 0.5:1.

Borrowings Due Within One Year

Borrowings due within one year at December 31 are summarized below:

	1990					1989				
	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)	Month End	Amount	Cost (1)	Amount	Cost (1)	Month End
(Dollars in millions)										
Securities sold under agreements to repurchase (2)	\$ 351	6.06%	\$ 501	6.72%	\$ 1,171	\$ 725	7.09%	\$ 1,178	7.77%	\$ 3,177
Short-term notes (3)	17,594	7.71	14,086	8.07	17,594	14,760	8.56	12,684	8.67	14,760
Master notes	123	7.12	157	7.99	486	132	8.20	171	8.62	345
Residential financing securities	3,814	8.08	4,693	8.46	5,771	6,141	9.00	6,214	9.14	6,648
Other short-term debt (4)	235	7.59	889	8.61	1,575	407	8.90	1,086	8.68	1,250
Current portion of borrowings due after one year (5):										
Mortgage-backed bonds	8	9.03				9	9.02			
Investment agreements	830	7.78				2,325	8.44			
Residential financing securities	820	8.96				—	—			
Long-term—other	5	10.20				5	10.20			
Debentures (6)	13,749	8.32				10,401	9.56			
Medium-term notes (7)	377	8.43				1,006	8.60			
Exchangeable debentures	450	12.66				—	—			
Zero coupon securities (8)	97	8.64				35	8.49			
Subordinated capital debentures	—	—				400	9.15			
Total due within one year	\$ 38,453	8.05%				\$36,346	8.90%			

(1) Cost includes the amortization of discounts, premiums, issuance costs, hedging results, and the effects of currency and debt swaps.

(2) MBS underlying repurchase agreements had a carrying value of \$344 million and \$711 million at December 31, 1990 and 1989, respectively, and a market value of \$354 million and \$723 million at December 31, 1990 and 1989, respectively.

(3) Net of \$311 million and \$263 million of unamortized discount at December 31, 1990 and 1989, respectively.

(4) Includes unamortized premium of \$5 million at December 31, 1990.

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

(6) Includes unamortized premium of \$14 million and \$5 million at December 31, 1990 and 1989, respectively.

(7) Includes unamortized premium of \$4.0 million and \$15 million at December 31, 1990 and 1989, respectively.

(8) Net of unamortized discount of \$4 million and \$1 million at December 31, 1990 and 1989, respectively.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

Borrowings Due After One Year

Borrowings due after one year consist of the following at December 31:

<u>Maturity</u>	<u>1990</u>		<u>1989</u>	
	<u>Amount Outstanding</u>	<u>Average Cost</u>	<u>Amount Outstanding</u>	<u>Average Cost</u>
		(Dollars in millions)		
Mortgage-backed bonds, 1991-2002	\$ 38	9.87%	\$ 46	9.72%
Investment agreements, 1991-2012	2,310	8.05	1,127	7.39
Residential financing securities	296	8.15	821	8.96
Long-term—other, net of \$68 million of discount for 1990 (\$70 million for 1989)	373	9.83	376	9.84
Debentures, net of \$46 million of discount and premium for 1990 (\$23 million for 1989):				
1991	—	—	13,734	8.32
1992	11,710	9.14	11,594	9.14
1993	8,930	8.96	8,469	8.99
1994	10,082	8.99	7,227	9.12
1995	10,466	9.89	7,182	10.44
1996	10,520	8.54	10,669	8.53
1997-2007	22,354	8.97	12,454	8.88
2008-2020	2,585	9.80	1,635	9.78
	76,647	9.09	72,964	8.98
Medium-term notes, includes \$127 million of premium for 1990 (\$39 million for 1989), 1991-2019	2,140	8.59	1,014	8.85
Exchangeable debentures, 1991	—	—	450	12.66
Zero coupon securities, net of \$5,617 million of discount for 1990 (\$5,680 million for 1989), 1991-2014	611	10.63	621	10.41
Zero coupon subordinated capital debentures, net of \$6,366 million of discount for 1990 (\$6,403 million for 1989), 2019	384	10.22	347	10.22
Subordinated capital debentures, net of \$13 million of discount for 1990 (\$14 million for 1989):				
1992	250	9.05	250	9.05
1997	250	7.44	250	7.44
1998	500	9.46	500	9.46
2002	268	9.21	266	9.21
2019	250	9.34	250	9.34
	1,518	9.00	1,516	9.00
Subordinated convertible capital debentures, 1996	1	4.43	1	4.43
	84,318	9.07%	79,283	9.00%
Adjustment for foreign currency translation	632		435	
	<u>\$84,950</u>		<u>\$79,718</u>	

The average cost includes the amortization of discounts, premiums, issuance costs, hedging results, and the effect of currency and debt swaps. At December 31, 1990, principal amounts of debt maturing in the years 1992-1996 were \$12.8, \$10.1, \$10.6, \$11.4, and \$11.3 billion, respectively.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

At December 31, 1990, the Corporation had outstanding \$3.3 billion of Indexed Sinking Fund Debentures (“ISFDs”) at an average cost of 9.61 percent, compared with \$3.7 billion at an average cost of 9.54 percent at December 31, 1989. Such debentures are subject to mandatory redemptions after an initial non-redemption period. The redemption amounts are tied to certain Treasury rates. As such Treasury rates decrease, the percentage of the outstanding principal amount of an ISFD to be redeemed generally will increase; conversely, as such Treasury rates increase, the percentage to be redeemed generally will decrease.

Debentures include callable debt, which is redeemable, in whole or in part, at the option of the Corporation at any time on or after a specified date. The following table summarizes the amounts and call periods of callable debt, including ISFDs, and the notional amount of callable and ISFD swaps. Medium-term notes and subordinated capital debentures that are redeemable at the Corporation’s option are also included in the table.

<u>Call Date</u>	<u>Year of Maturity</u>	<u>Amount Outstanding</u> (Dollars in millions)	<u>Average Cost</u>
Currently	1996-2002	\$ 685	8.10%
1991	1993-1995	900	8.68
1992	1994-1997	3,552	8.65
1993	1995-2013	5,342	9.07
1994	1997-2019	4,476	9.23
1995	2000-2020	2,250	9.65
1997	2020	<u>20</u>	9.46
		17,225	
ISFDs	1993-1999	3,276	9.61
Callable and ISFD swaps (notional amount)	1997-2000	<u>1,800</u>	—
	Total	<u>\$22,301</u>	

In February 1986, the Corporation issued 500,000 units aggregating \$500 million principal amount of debentures due in 1996 with detachable warrants to purchase 34.5 million common shares. Each warrant entitles the holder to purchase one share of common stock at \$14.75 until February 1991. A portion of the proceeds from the issuance (\$68 million) was allocated to the warrants and recorded as additional paid-in capital. As of December 31, 1990, 1.1 million shares had been issued upon exercise of the warrants.

The Corporation may call for the conversion of the exchangeable debentures at any time on or prior to March 15, 1991, in which case the debentureholders have two options. They may accept the conversion and receive ten shares of adjustable-rate preferred stock, series A, for each \$1,000 principal amount of exchangeable debentures. Alternatively, they may reject the call for conversion by extending the maturity date of those debentures to March 15, 1994. The Corporation may call for the conversion only once and only on the entire issue.

The subordinated capital debentures due in 1997 and 2002 are redeemable at par, in whole or in part, at the option of the Corporation, on any interest payment date. The subordinated convertible capital debentures are convertible into 0.2 million shares of common stock at a price of \$6.54 per share, subject to adjustment in certain events. These debentures are redeemable at par, at the option of the Corporation. During 1990, 1989, and 1988, \$0.2 million, \$10 million and \$1 million of debentures were converted into common stock.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

8. Stockholders' Equity

In 1990, the Corporation repurchased 3.4 million shares of common stock under a previously announced repurchase program. There were 33.4 million shares of common stock warrants and 238.3 million shares of common stock outstanding at December 31, 1990.

Transactions in common stock, additional paid-in capital, retained earnings, and treasury stock for the years 1990, 1989 and 1988 are summarized as follows:

	Number of Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
(Dollars in thousands)						
Balance, January 31, 1988	78,725,728	\$512,026	\$777,006	\$ 616,667	\$ (95,184)	\$1,810,515
Shares repurchased	(231,600)	—	—	—	(6,913)	(6,913)
Conversions of convertible debentures	71,405	446	966	—	—	1,412
Treasury stock issued for stock options and benefit plans	96,620	351	2,374	—	1,060	3,785
Accrual for stock appreciation rights	—	—	1,315	—	—	1,315
Net income	—	—	—	506,708	—	506,708
Dividends	—	—	—	(56,517)	—	(56,517)
Balance, December 31, 1988	78,662,153	512,823	781,661	1,066,858	(101,037)	2,260,305
Three-for-one stock split	157,324,306	4,123	(4,123)	—	—	—
Conversions of convertible debentures	1,481,388	3,090	6,660	—	—	9,750
Treasury stock issued for stock options and benefit plans	1,412,300	—	674	—	13,661	14,335
Stock warrants exercised	9,835	21	125	—	—	146
Tax benefit for Employee Stock Purchase Plan	—	—	2,437	—	—	2,437
Net income	—	—	—	807,344	—	807,344
Dividends	—	—	—	(103,110)	—	(103,110)
Balance, December 31, 1989	238,889,982	520,057	787,434	1,771,092	(87,376)	2,991,207
Shares repurchased	(3,443,300)	—	—	—	(92,822)	(92,822)
Conversions of convertible debentures	23,847	50	107	—	—	157
Treasury stock issued for stock options and benefit plans	1,754,929	—	8,837	—	17,214	26,051
Stock warrants exercised	1,046,267	2,198	13,235	—	—	15,433
Tax benefit for Employee Stock Purchase Plan	—	—	639	—	—	639
Net income	—	—	—	1,173,362	—	1,173,362
Dividends	—	—	—	(172,701)	—	(172,701)
Balance, December 31, 1990	<u>238,271,725</u>	<u>\$522,305</u>	<u>\$810,252</u>	<u>\$2,771,753</u>	<u>\$(162,984)</u>	<u>\$3,941,326</u>

Pursuant to the Corporation's Charter Act and related regulations, approval of HUD is required prior to the issuance of any stock of the Corporation or securities convertible into stock. The Corporation is authorized to issue a maximum of 4.5 million shares of adjustable-rate preferred stock, series A, \$100 stated value. These shares may be issued only in exchange for the 12.50 percent exchangeable debentures due 1991. No such shares have been issued.

Stock Compensation Plans

The Federal National Mortgage Association Stock Compensation Plan authorizes certain officers to receive performance awards, which may be 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 financial

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

goals set for the award period. At the end of such time, the awards generally are payable one-half in common stock and one-half in cash. The outstanding contingent grants made for the 1991-1993, 1990-1992, and 1989-1991 award periods were 154,520; 89,650; and 248,134 performance shares, respectively. Stock options also may be granted to key employees under this plan. The options 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 market value of the stock on the date the option is granted.

The following table summarizes stock option activity for the years 1988-1990. At December 31, 1990 and 1989, stock options on 745,126 shares and 482,639 shares, respectively, were exercisable.

	<u>Number of Shares</u>	<u>Option Price</u>
Balance, January 1, 1988	1,605,729	\$ 5.38-\$14.40
Granted in 1988.....	443,100	\$11.98-\$15.75
Less: Exercised in 1988	(213,213)	\$ 5.38-\$13.54
Terminated in 1988	<u>(51,933)</u>	\$ 7.98-\$12.02
Balance, December 31, 1988.....	1,783,683	\$ 5.38-\$15.75
Granted in 1989.....	218,550	\$40.56
Less: Exercised in 1989	(422,482)	\$ 5.38-\$15.75
Terminated in 1989	<u>(57,720)</u>	\$ 9.44-\$15.75
Balance, December 31, 1989.....	1,522,031	\$ 5.38-\$40.56
Granted in 1990.....	544,000	\$32.00-\$34.50
Less: Exercised in 1990	(193,631)	\$ 5.38-\$15.75
Terminated in 1990	<u>(40,490)</u>	\$ 9.44-\$40.56
Balance, December 31, 1990.....	<u>1,831,910</u>	\$ 5.38-\$40.56

In 1990, 48,500 shares of restricted stock (4,173 in 1989) were awarded, issued, and placed in escrow under the Stock Compensation Plan and the Restricted Stock Plan for Directors, 18,402 shares were recovered upon termination of nonvested participants, and 120,468 shares 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 Corporation to issue up to nine million shares of common stock to qualified employees at a price equal to 85 percent of the fair market value of the stock on the first day of the period in which employees can elect to purchase the stock. In 1990, the Corporation granted each qualified employee excluding certain officers, the right to purchase in January 1991 up to 300 shares of stock. Under the 1990 offering, 653,710 shares were purchased in January 1991, at \$25.71 per share compared with 1,514,490 shares purchased in 1990 at \$14.27 per share under the plan's 1989 offering. The Board of Directors has approved a similar offering in 1991 for Fannie Mae employees that limits the number of shares to 400 per eligible employee at a price of \$35.43 per share.

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

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS— (Continued)

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. In 1990, the Corporation contributed \$1.6 million to the ESOP and accrued \$2.0 million toward the 1991 contribution.

9. Income Taxes

Deferred federal income tax expense relating to timing differences consists of the following:

	<u>1990</u>	<u>1989</u>	<u>1988</u>
(Dollars in millions)			
Deferred commitment fees	\$ 2	\$ 22	\$ 28
Amortization of purchase discount	(35)	(59)	(72)
Losses (gains) on dispositions of mortgages	10	10	(3)
Provision for losses	(60)	(58)	(65)
Risk management activities	(10)	17	(24)
Benefits from tax-advantaged investments	29	13	13
Other items, net	15	(6)	(6)
Total provision for deferred federal income taxes	<u>\$ (49)</u>	<u>\$ (61)</u>	<u>\$ (129)</u>

The Corporation's effective tax rates differ from statutory rates as follows:

	<u>1990</u>	<u>1989</u>	<u>1988</u>
Statutory corporate rate	34%	34%	34%
Tax exempt interest and dividends received deductions	(5)	(7)	(10)
Effective rate	<u>29%</u>	<u>27%</u>	<u>24%</u>

The Corporation is exempt from state and local taxes, with the exception of real estate taxes. The Corporation made federal income tax payments of \$547 million, \$222 million, and \$257 million in 1990, 1989, and 1988, respectively.

Financial Accounting Standard No. 96 ("FAS 96")

The Financial Accounting Standards Board ("FASB") has issued FAS 96, which is scheduled to become effective for fiscal years beginning in 1992. Under the new standard, deferred income taxes arising from temporary differences between tax and financial income will be recorded based on taxes payable or refundable in the future as determined at the end of each accounting period. Under the current standard, Accounting Principles Board Opinion No. 11, deferred income tax recognition emphasizes the tax effects of timing differences on income of the period in which the differences originate. Because the FASB is considering further changes to FAS 96, including delayed implementation, management has not established an implementation date. However, management does not expect adoption of the new standard will have a material adverse effect on the earnings or financial condition of the Corporation.

Internal Revenue Service ("IRS") Examinations

The IRS has completed its examinations of the Corporation's federal income tax returns through the year 1985. During 1990, the IRS began its examination of the Corporation's tax returns for 1986 and 1987. All issues raised in years prior to 1979 have been settled.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

NOTES TO FINANCIAL STATEMENTS—(Continued)

With respect to the years 1979 through 1982, the U.S. Tax Court ruled in March 1988 in the Corporation's favor on an issue relating to concurrent mortgage sales and for the IRS on an issue relating to resale/refinance transactions. Both sides in the suit appealed the decisions and oral arguments were presented in January 1990. On February 20, 1990, the U.S. Court of Appeals of the District of Columbia affirmed the U.S. Tax Court decision. The Corporation elected not to seek Supreme Court review of the resale/refinance portion of the decision and, because the issue involved the timing of taxable income, there was no material adverse effect on the Corporation's financial condition. The IRS sought Supreme Court review of the decisions on the concurrent mortgage sales in the Corporation's case and those of three other taxpayers, while one taxpayer sought review of a decision favoring the IRS. The Supreme Court took no action regarding the Corporation's case, but agreed to review the cases of two other taxpayers. The Supreme Court is expected to issue a decision during the first half of 1991. Even if the Corporation should ultimately lose this issue, there would be no material adverse impact on financial condition or results of operations, because the issue involves the timing of taxable income. If the Corporation wins the issue, the IRS would be obligated to refund both taxes and interest. As of the end of 1990, a refund with interest would have had a positive effect on net income of approximately \$150 million.

The IRS, in its audit report for 1983 through 1985, proposed deficiencies relating to deductions for bad debts and hedge transactions. The issue related to bad debts was resolved in late 1990, with no material adverse effect on the Corporation's earnings or financial condition. The IRS has not yet made clear whether the hedging adjustments are to change the timing of the deductions (in which case management believes that no material adverse effect on the Corporation would result) or to characterize them as capital losses. If the 1983 through 1985 deductions are recharacterized as capital losses and the IRS' position is sustained, the Corporation's net income would be adversely affected by approximately \$60 million.

The IRS is currently auditing 1986 and 1987 and has notified the Corporation that it may propose additional deficiencies to recharacterize certain hedging type transactions as capital losses. If these specific deficiencies are formally proposed for 1986 and 1987 and the IRS' position is sustained, the Corporation's net income would be adversely affected by approximately \$90 million. As of December 31, 1990, the cumulative interest, net of tax, related to the preceding adjustments to hedging results for 1984 through 1987 would be approximately \$40 million.

The Corporation believes that the positions and deductions taken in its tax returns are proper, and will contest vigorously any effort to change their timing or characterization.

10. Retirement Plans

All regular, full-time employees of the Corporation are covered by a non-contributory 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 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 earned in the future. Plan assets consist primarily of listed stocks, fixed-income securities, cash, and other liquid assets. No contributions have been made to the retirement plan in recent years because the plan is overfunded.

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NOTES TO FINANCIAL STATEMENTS— (Continued)

The following table sets forth the corporate retirement plan's funded status and amounts recognized in the Corporation's financial statements at December 31, 1990 and 1989:

	<u>1990</u>	<u>1989</u>
	(Dollars in millions)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of \$28.3 million (\$23.9 million in 1989)	\$(31.2)	\$(29.4)
Projected benefit obligation for services rendered to date	\$(59.0)	\$(60.7)
Plan assets at fair value	71.7	74.5
Excess of plan assets over the projected benefit obligation	12.7	13.8
Unrecognized net gain from past experience different from that assumed and effects of changes in assumptions	(6.1)	(4.3)
Unrecognized prior service costs	1.3	2.1
Unrecognized net transition asset recognized over 18.25 years	(15.9)	(17.1)
Pension liability included in other liabilities	<u>\$ (8.0)</u>	<u>\$ (5.5)</u>
Net pension cost included the following components:		
Service cost-benefits earned during the period	\$ 6.1	\$ 5.2
Interest cost on projected benefit obligation	4.9	4.3
Actual return on plan assets	2.0	(9.7)
Net amortization and deferral	(10.5)	2.1
Net periodic pension cost	<u>\$ 2.5</u>	<u>\$ 1.9</u>

The weighted-average discount rate and rate of increase in future compensation levels used for determining the actuarial present value of the projected benefit obligation were 8.5 percent (7.5 percent in 1989) and 7.0 percent, respectively. The expected long-term rate of return on assets was 10 percent in both years. The Corporation uses the straight-line method of amortization for prior service costs.

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

All regular, full-time employees of the Corporation are eligible to participate in the Corporation's Thrift and 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 \$2 million in each of the years 1988 through 1990.

In December 1990, the FASB issued Financial Accounting Standard No. 106 ("FAS 106"), "Employers' Accounting for Postretirement Benefits Other Than Pensions." FAS 106 requires that the cost of retiree medical and other benefits be accrued over employees' working lives. Most firms, including Fannie Mae, currently record the cost of non-pension retiree benefits as they are paid. For Fannie Mae, cash payments totaled less than \$1 million for each of the years 1988 through 1990. FAS 106 permits a phased-in implementation of its accrual accounting requirements beginning in 1993. Because of the relatively small size of the Corporation's workforce in relation to its assets and income, management does not expect that future implementation of FAS 106 will have a material adverse effect on earnings.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
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.

	<u>1991 Quarter Ended</u>	
	<u>June</u>	<u>March</u>
	(Dollars in millions, except per share amounts)	
Net interest income	\$ 438	\$ 427
Guaranty fees	163	156
Income from IRS settlement	239	—
Gain (loss) on sales of mortgages	(53)	3
Miscellaneous income, net	23	19
Provision for losses	(130)	(80)
Administrative expenses	(78)	(72)
Income before federal income taxes and extraordinary item	602	453
Provision for federal income taxes	(184)	(133)
Income before extraordinary item	418	320
Extraordinary loss—repurchase of debt (net of tax effect of \$44 million)	(86)	—
Net income	<u>\$ 332</u>	<u>\$ 320</u>
Per share:		
Earnings before extraordinary item (fully diluted)	\$ 1.52	\$ 1.19
Earnings (fully diluted)	1.21	1.19
Cash dividends .....	.26	.22

	<u>1990 Quarter Ended</u>			
	<u>December</u>	<u>September</u>	<u>June</u>	<u>March</u>
	(Dollars in millions, except per share amounts)			
Net interest income	\$ 415	\$ 404	\$ 396	\$ 378
Guaranty fees	149	138	129	120
Gain on sales of mortgages	2	—	4	1
Miscellaneous income, net	24	32	23	28
Provision for losses	(80)	(80)	(75)	(75)
Administrative expenses	(77)	(72)	(71)	(66)
Income before federal income taxes	433	422	406	386
Provision for federal income taxes	(125)	(123)	(116)	(110)
Net income	<u>\$ 308</u>	<u>\$ 299</u>	<u>\$ 290</u>	<u>\$ 276</u>
Per share:				
Earnings (fully diluted) (1)	\$ 1.19	\$ 1.15	\$ 1.10	\$ 1.06
Cash dividends .....	.22	.18	.18	.14

(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.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
QUARTERLY RESULTS OF OPERATIONS (Unaudited)

	1989 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per share amounts)			
Net interest income	\$ 352	\$ 302	\$ 284	\$ 253
Guaranty fees	111	104	99	94
Gain on sales of mortgages	3	3	—	3
Miscellaneous income, net	10	22	20	8
Provision for losses	(75)	(75)	(80)	(80)
Administrative expenses	(74)	(63)	(61)	(56)
Income before federal income taxes	327	293	262	222
Provision for federal income taxes	(90)	(81)	(69)	(57)
Net income	<u>\$ 237</u>	<u>\$ 212</u>	<u>\$ 193</u>	<u>\$ 165</u>
Per share:				
Earnings (fully diluted) (1)	\$ 0.90	\$ 0.80	\$ 0.75	\$ 0.66
Cash dividends .....	.14	.11	.10	.08

(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.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

INTERIM FINANCIAL STATEMENTS

CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Six Months Ended June 30,	
	1991	1990
	(Dollars in millions, except per share amounts)	
Interest income	\$ 6,269	\$ 5,959
Interest expense	(5,404)	(5,185)
Net interest income	865	774
Guaranty fees	319	249
Income from IRS settlement	239	—
Gain (loss) on sales of mortgages	(50)	5
Miscellaneous income, net	42	51
Provision for losses	(210)	(150)
Administrative expenses	(150)	(137)
Income before federal income taxes and extraordinary item	1,055	792
Provision for federal income taxes	(317)	(226)
Income before extraordinary item	738	566
Extraordinary loss—repurchase of debt (net of tax effect of \$44 million)	(86)	—
Net income	<u>\$ 652</u>	<u>\$ 566</u>
Per share:		
Earnings before extraordinary item:		
Primary	\$ 2.72	\$ 2.16
Fully diluted	2.71	2.15
Earnings:		
Primary	2.40	2.16
Fully diluted	2.40	2.15
Cash dividends .....	.48	.32

CONDENSED BALANCE SHEET

(Unaudited)

	June 30, 1991
	(Dollars in millions)
Assets	
Mortgage portfolio, net	\$120,103
Other assets	18,078
Total assets	<u>\$138,181</u>
Liabilities	
Debentures, notes, and bonds, net:	
Due within one year	\$ 37,071
Due after one year	89,535
Other liabilities	6,589
Total liabilities	133,195
Stockholders' equity	4,986
Total liabilities and stockholders' equity	<u>\$138,181</u>

See Notes to Interim Financial Statements

**FEDERAL NATIONAL MORTGAGE ASSOCIATION
INTERIM FINANCIAL STATEMENTS**

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	1991	1990
	(Dollars in millions)	
Net cash provided by operating activities	\$ 1,320	\$ 693
Cash flows from investing activities:		
Purchases of mortgages	(16,007)	(10,739)
Sales of mortgages	2,097	2,517
Mortgage principal repayments, net of discount	7,565	5,894
Net increase in other investments	(64)	(887)
Net cash used by investing activities	(6,409)	(3,215)
Cash flows from financing activities:		
Cash proceeds from issuance of debt	90,721	44,638
Cash payments to retire debt	(87,562)	(42,770)
Other	384	(51)
Net cash provided by financing activities	3,543	1,817
Net decrease in cash and cash equivalents	(1,546)	(705)
Cash and cash equivalents at beginning of period	4,178	3,531
Cash and cash equivalents at end of period	\$ 2,632	\$ 2,826

See Notes to Interim Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 1991 are not necessarily indicative of the results that may be expected for the year ending December 31, 1991. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented elsewhere herein.

Commitments and Contingencies

The Corporation has outstanding commitments to purchase mortgages and issue MBS. The Corporation also guarantees timely payment of principal and interest on outstanding MBS. As of June 30, 1991, the total MBS outstanding was \$331.1 billion.

Income from IRS

In April 1991, the Supreme Court denied the IRS's petition for certiorari in the Corporation's case relating to concurrent mortgage sales. As a result, the Corporation recognized \$239 million in pre-tax income in the second quarter of 1991.

Extraordinary Loss

During the six months ended June 30, 1991, the Corporation repurchased \$1.3 billion of high-coupon debt at a pre-tax loss of \$130 million.

Earnings Per Share

The weighted average number of common shares outstanding used to compute fully diluted earnings per share were 272.0 million and 263.7 million for the six months ended June 30, 1991 and 1990, respectively.

Mortgage Portfolio

During the six months ended June 30, 1991, the Corporation sold \$800 million of low-coupon mortgages resulting in a pre-tax loss of \$59 million.