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FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE

Form 10-K

August 16, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

Commission File No.: 0-50231

Federal National Mortgage Association
(Exact name of registrant as specified in its charter)
Fannie Mae

Federally chartered corporation
*(State or other jurisdiction of
incorporation or organization)*

52-0883107
*(I.R.S. Employer
Identification No.)*

**3900 Wisconsin Avenue,
NW Washington, DC**
(Address of principal executive offices)

20016
(Zip Code)

Registrant's telephone number, including area code:
(202) 752-7000

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, without par value
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant computed by reference to the price at which the common stock was last sold on June 29, 2007 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$63,724 million.

As of June 30, 2007, there were 973,451,598 shares of common stock of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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PART I

Because of the complexity of our business and the financial services industry in which we operate, we have included in this Annual Report on Form 10-K a glossary under Item 7 MD&A Glossary of Terms Used in This Report beginning on page 152.

Item 1. Business

EXPLANATORY NOTE ABOUT THIS REPORT

We filed our Annual Report on Form 10-K for the year ended December 31, 2005 (2005 Form 10-K) on May 2, 2007, after filing our Annual Report on Form 10-K for the year ended December 31, 2004 (2004 Form 10-K) on December 6, 2006. The filing of these reports represented a significant step in our efforts to return to timely financial reporting. Our 2004 Form 10-K contained our consolidated financial statements and related notes for the year ended December 31, 2004, as well as a restatement of our previously issued consolidated financial statements and related notes for the years ended December 31, 2003 and 2002, and for the quarters ended June 30, 2004 and March 31, 2004. The filing of the 2004 Form 10-K, the 2005 Form 10-K and this Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K) were delayed significantly as a result of the substantial time and effort devoted to ongoing controls remediation, and systems reengineering and development in order to complete the restatement of our financial results for 2003 and 2002, as presented in our 2004 Form 10-K. Because of the delay in our periodic reporting, where appropriate, the information contained in this report reflects more current information about our business, including information of the type we have included in previous Forms 12b-25 that we have filed with the Securities and Exchange Commission (SEC) to report the late filing of prior periodic reports. All amounts in this 2006 Form 10-K affected by the restatement adjustments reported in our 2004 Form 10-K reflect those amounts as restated.

In lieu of filing quarterly reports for 2006, we have included in this report substantially all of the information required to be included in quarterly reports. We have made significant progress in our efforts to remediate material weaknesses that have prevented us from reporting our financial results on a timely basis. On June 8, 2007, we announced that we plan to become a current filer by the end of February 2008 with the filing of our Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K) with the SEC. At this time, we are confirming our expectation that we will file our 2007 Form 10-K on a timely basis. In addition, we expect to file our Forms 10-Q for the first, second, and third quarters of 2007 by December 31, 2007.

OVERVIEW

Fannie Mae's activities enhance the liquidity and stability of the mortgage market and contribute to making housing in the United States more affordable and more available to low-, moderate- and middle-income Americans. These activities include providing funds to mortgage lenders through our purchases of mortgage assets, and issuing and guaranteeing mortgage-related securities that facilitate the flow of additional funds into the mortgage market. We also make other investments that increase the supply of affordable housing.

We are a government-sponsored enterprise (GSE) chartered by the U.S. Congress under the name Federal National Mortgage Association and are aligned with national policies to support expanded access to housing and increased opportunities for homeownership. We are subject to government oversight and regulation. Our regulators include the Office of Federal Housing Enterprise Oversight (OFHEO), the Department of Housing and Urban Development (HUD), the SEC, and the Department of the Treasury.

Although we are a corporation chartered by the U.S. Congress, the U.S. government does not guarantee, directly or indirectly, our securities or other obligations. We are a stockholder-owned corporation, and our business is self-sustaining and funded exclusively with private capital. Our common stock is listed on the New York Stock Exchange (NYSE), and traded under the symbol FNM. Our debt securities are actively traded in the over-the-counter market.

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We operate in the U.S. residential mortgage market, specifically in the secondary mortgage market where mortgages are bought and sold. We discuss below the dynamics of the residential mortgage market and our role in the secondary mortgage market.

Residential Mortgage Market

Our business operates within the U.S. residential mortgage market, and therefore, we consider the amount of U.S. residential mortgage debt outstanding to be the best measure of the size of our overall market. As of March 31, 2007, the latest date for which information was available, the amount of U.S. residential mortgage debt outstanding was estimated by the Federal Reserve to be approximately \$11.2 trillion (including \$10.4 trillion of single-family mortgages). Our mortgage credit book of business, which includes mortgage assets we hold in our investment portfolio, our Fannie Mae mortgage-backed securities held by third parties and credit enhancements that we provide on mortgage assets, was \$2.6 trillion as of March 31, 2007, or approximately 23% of total U.S. residential mortgage debt outstanding. Fannie Mae mortgage-backed securities or Fannie Mae MBS generally refers to those mortgage-related securities that we issue and with respect to which we guarantee to the related trusts that we will supplement amounts received by those MBS trusts as required to permit timely payment of principal and interest on the Fannie Mae MBS. We also issue some forms of mortgage-related securities for which we do not provide this guaranty.

The U.S. residential mortgage market has experienced strong long-term growth. According to Federal Reserve estimates, growth in U.S. residential mortgage debt outstanding averaged 10.6% per year from 1945 to 2006, which is faster than the 6.9% average growth in the overall U.S. economy over the same period, as measured by nominal gross domestic product. Growth in U.S. residential mortgage debt outstanding was particularly strong between 2001 and mid-2006 (with an average annualized growth rate of 12.8%). As indicated in the table below, which provides a comparison of overall housing and mortgage market statistics to our business activity, total U.S. residential mortgage debt outstanding grew at an even faster rate of approximately 14% in 2005. Growth in U.S. residential mortgage debt slowed to approximately 9% in 2006, and slowed further in early 2007, with an annualized first quarter growth rate of nearly 6%, the slowest rate of growth in almost 10 years.

Housing Market Data

	2006	2005	2004	% Change from Prior Year	
				2006	2005
Housing and mortgage market: ⁽¹⁾					
Home sales (units in thousands)	7,529	8,359	7,981	(10)%	5%
Home price appreciation ⁽²⁾	9.1%	13.1%	10.7%		
Single-family mortgage originations (in billions)	\$ 2,761	\$ 3,034	\$ 2,791	(9)	9
Purchase share	52.4%	49.8%	47.8%		
Refinance share	47.6%	50.2%	52.2%		
ARM share ⁽³⁾	27.6%	31.4%	32.0%		
Fixed-rate mortgage share	72.4%	68.6%	68.0%		

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Residential mortgage debt outstanding (in billions)	\$ 11,017	\$ 10,066	\$ 8,866	9	14
Fannie Mae:					
New business acquisitions ⁽⁴⁾ (in billions)	\$ 603	\$ 612	\$ 725	(2)	(16)
Mortgage credit book of business ⁽⁵⁾ (in billions)	\$ 2,526	\$ 2,356	\$ 2,340	7	1
Interest rate risk market share ⁽⁶⁾	6.6%	7.2%	10.2%		
Credit risk market share ⁽⁷⁾	21.4%	21.8%	24.2%		

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- (1) The sources of the housing and mortgage market data are the Federal Reserve Board, the Bureau of the Census, HUD, the National Association of Realtors, the Mortgage Bankers Association, and OFHEO. Mortgage originations, as well as the purchase and refinance shares, are based on July 2007 estimates from Fannie Mae's Economics & Mortgage Market Analysis Group. Certain previously reported data may have been changed to reflect revised historical data from any or all of these organizations.
- (2) OFHEO publishes a House Price Index (HPI) quarterly using data provided by Fannie Mae and Freddie Mac. The HPI is a truncated measure because it is based solely on loans from Fannie Mae and Freddie Mac. As a result, it excludes loans in excess of conventional loan amounts, or jumbo loans, and includes only a portion of total subprime and Alt-A loans outstanding in the overall market. The HPI is a weighted repeat transactions index, meaning that it measures average price changes in repeat sales or refinancings on the same properties. House price appreciation reported above reflects the annual average HPI of the reported year compared with the annual average HPI of the prior year.
- (3) The adjustable-rate mortgage share, or ARM share, is the ARM share of the number of mortgage applications reported in the Mortgage Bankers Association's Weekly Mortgage Applications Survey.
- (4) Represents the sum in any given period of the unpaid principal balance of: (1) the mortgage loans and mortgage-related securities we purchase for our investment portfolio; and (2) the mortgage loans we securitize into Fannie Mae MBS that are acquired by third parties. Excludes mortgage loans we securitize from our portfolio.
- (5) Represents the sum of the unpaid principal balance of: (1) the mortgage loans we hold in our investment portfolio; (2) the Fannie Mae MBS and non-Fannie Mae mortgage-related securities we hold in our investment portfolio; (3) Fannie Mae MBS held by third parties; and (4) credit enhancements that we provide on mortgage assets.
- (6) Represents the estimated share of total U.S. residential mortgage debt outstanding on which we bear the interest rate risk. Calculated based on the unpaid principal balance of mortgage loans and mortgage-related securities we hold in our mortgage portfolio as a percentage of total U.S. residential mortgage debt outstanding.
- (7) Represents the estimated share of total U.S. residential mortgage debt outstanding on which we bear the credit risk. Calculated based on the unpaid principal balance of mortgage loans we hold in our mortgage portfolio and Fannie Mae MBS outstanding as a percentage of total U.S. residential mortgage debt outstanding.

The unusually strong growth in U.S. residential mortgage debt outstanding between 2001 and mid-2006 was driven primarily by record home sales, strong home price appreciation and historically low interest rates. Also contributing to that growth was the increased use of mortgage debt financing by homeowners and demographic trends that contributed to increased household formation and higher homeownership rates. Growth in U.S. residential mortgage debt outstanding moderated in 2006 in response to slower home price growth, a sharp drop-off in home sales and declining refinance activity. With even less housing activity and slower home price growth through June 2007, growth in total U.S. residential mortgage debt outstanding likely has slowed further. We expect this slower growth trend in U.S. residential mortgage debt outstanding to continue throughout 2007, and we believe average home prices are likely to continue to decline in 2007.

The amount of residential mortgage debt available for us to purchase or securitize and the mix of available mortgage loan products are affected by several factors, including the volume of single-family mortgages within the loan limits imposed under our charter, consumer preferences for different types of mortgages, changes in depository institution

requirements relating to allowable mortgage products in the primary market, and the purchase and securitization activity of other financial institutions. See Item 1A Risk Factors for a description of the risks associated with the recent slowdown in home price appreciation, as well as competitive factors affecting our business.

Our Role in the Secondary Mortgage Market

The mortgage market comprises a major portion of the domestic capital markets and provides a vital source of financing for the large housing segment of the economy, as well as one of the most important means for Americans to achieve their homeownership objectives. The U.S. Congress chartered Fannie Mae and certain other GSEs to help ensure stability and liquidity within the secondary mortgage market. In addition, we believe our activities and those of other GSEs help lower the costs of borrowing in the mortgage market, which makes housing more affordable and increases homeownership, especially for low- to moderate-income families. We believe our activities also increase the supply of affordable rental housing.

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We operate in the secondary mortgage market where mortgages are bought and sold. We securitize mortgage loans originated by lenders in the primary mortgage market into Fannie Mae MBS, which can then be readily bought and sold in the secondary mortgage market. We also participate in the secondary mortgage market by purchasing mortgage loans (often referred to as whole loans) and mortgage-related securities, including Fannie Mae MBS, for our mortgage portfolio. By delivering loans to us in exchange for Fannie Mae MBS, lenders gain the advantage of holding a highly liquid instrument that offers them the flexibility to determine under what conditions they will hold or sell the MBS. By selling loans and mortgage-related securities to us, lenders replenish their funds and, consequently, are able to make additional loans. Under our charter, we may not lend money directly to consumers in the primary mortgage market.

OUR CUSTOMERS

Our principal customers are lenders that operate within the primary mortgage market where mortgage loans are originated and funds are loaned to borrowers. Our customers include mortgage banking companies, investment banks, savings and loan associations, savings banks, commercial banks, credit unions, community banks, and state and local housing finance agencies. Lenders originating mortgages in the primary mortgage market often sell them in the secondary mortgage market in the form of loans or in the form of mortgage-related securities.

Our lender customers supply mortgage loans both for securitization into Fannie Mae MBS and for purchase for our mortgage portfolio. During 2006, over 1,000 lenders delivered mortgage loans to us, either for securitization or for purchase. We acquire a significant portion of our single-family mortgage loans from several large mortgage lenders. During 2006, our top five lender customers, in the aggregate, accounted for approximately 51% of our single-family business volume compared with 49% in 2005. Our top customer, Countrywide Financial Corporation (through its subsidiaries), accounted for approximately 26% of our single-family business volume in 2006 compared with 25% in 2005. Due to increasing consolidation within the mortgage industry, we, as well as our competitors, seek business from a decreasing number of large mortgage lenders. See Item 1A Risk Factors for a discussion of the risks that this customer concentration poses to our business.

BUSINESS SEGMENTS

We operate an integrated business that contributes to providing liquidity to the mortgage market and increasing the availability and affordability of housing in the U.S. We are organized in three complementary business segments:

Our **Single-Family Credit Guaranty** (Single-Family) business works with our lender customers to securitize single-family mortgage loans into Fannie Mae MBS and to facilitate the purchase of single-family mortgage loans for our mortgage portfolio. Our Single-Family business has responsibility for managing our credit risk exposure relating to the single-family Fannie Mae MBS held by third parties, as well as managing and pricing the credit risk of the single-family mortgage loans and single-family Fannie Mae MBS held in our own mortgage portfolio. Revenues in the segment are derived primarily from the guaranty fees the segment receives as compensation for assuming the credit risk on the mortgage loans underlying single-family Fannie Mae MBS and on the single-family mortgage loans held in our portfolio.

Our **Housing and Community Development** (HCD) business works with our lender customers to securitize multifamily mortgage loans into Fannie Mae MBS and to facilitate the purchase of multifamily mortgage loans for our mortgage portfolio. Our HCD business also helps to expand the supply of affordable housing by investing in rental and for-sale housing projects, including rental housing that is eligible for federal low-income housing tax credits. Our HCD business has responsibility for managing our credit risk exposure relating to the multifamily Fannie Mae MBS held by third parties, as well as managing and pricing the credit risk of the multifamily mortgage loans and multifamily Fannie Mae MBS held in our mortgage portfolio. Revenues in the segment are

derived from a variety of sources, including the guaranty fees the segment receives as compensation for assuming the credit risk on the mortgage

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loans underlying multifamily Fannie Mae MBS and on the multifamily mortgage loans held in our portfolio, transaction fees associated with the multifamily business and bond credit enhancement fees. In addition, HCD's investments in rental housing projects eligible for the federal low-income housing tax credit generate both tax credits and net operating losses that reduce our federal income tax liability. Other investments in rental and for-sale housing generate revenue from operations and the eventual sale of the assets.

Our **Capital Markets** group manages our investment activity in mortgage loans and mortgage-related securities, and has responsibility for managing our assets and liabilities and our liquidity and capital positions. Through the issuance of debt securities in the capital markets, our Capital Markets group attracts capital from investors globally to finance housing in the U.S. In addition, our Capital Markets group increases the liquidity of the mortgage market by maintaining a constant presence as an active investor in mortgage assets and in particular supports the liquidity and value of Fannie Mae MBS in a variety of market conditions. Our Capital Markets group has responsibility for managing the credit risk of the non-Fannie Mae mortgage-related securities in our portfolio and for managing our interest rate risk. Our Capital Markets group generates income primarily from the difference, or spread, between the yield on the mortgage assets we own and the cost of the debt we issue in the global capital markets to fund these assets.

The table below displays net revenues, net income and total assets for each of our business segments for each of the three years during the period ended December 31, 2006.

Business Segment Summary Financial Information

	For the Year Ended December 31,		
	2006	2005	2004
	(Dollars in millions)		
Net revenues: ⁽¹⁾			
Single-Family Credit Guaranty	\$ 6,073	\$ 5,585	\$ 5,007
Housing and Community Development	510	607	527
Capital Markets	5,202	10,764	16,666
Total	\$ 11,785	\$ 16,956	\$ 22,200
Net income:			
Single-Family Credit Guaranty	\$ 2,044	\$ 2,623	\$ 2,396
Housing and Community Development	338	503	425
Capital Markets	1,677	3,221	2,146
Total	\$ 4,059	\$ 6,347	\$ 4,967
		As of December 31,	
		2006	2005
Total assets:			
Single-Family Credit Guaranty		\$ 15,777	\$ 14,450
Housing and Community Development		14,100	12,075
Capital Markets		814,059	807,643

Total	\$ 843,936	\$ 834,168
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(1) Includes net interest income, guaranty fee income, and fee and other income.

We use various management methodologies to allocate certain balance sheet and income statement line items, including capital and administrative costs, and to apply guaranty fees for managing credit risk, to the responsible operating segment. For a description of our allocation methodologies, see Notes to Consolidated Financial Statements Note 15, Segment Reporting. For further information on the results of operations and assets of our business segments, see Item 7 MD&A Business Segment Results.

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Single-Family Credit Guaranty

Our Single-Family business provides guaranty services principally by assuming the credit risk of the single-family mortgage loans underlying our guaranteed Fannie Mae MBS held by third parties. Our Single-Family business also assumes the credit risk of the single-family mortgage loans held in our investment portfolio, as well as the single-family mortgage loans underlying Fannie Mae MBS held in our portfolio.

Our most common type of guaranty transaction is referred to as a lender swap transaction. Mortgage lenders that operate in the primary mortgage market generally deliver pools of mortgage loans to us in exchange for Fannie Mae MBS backed by these loans. After receiving the loans in a lender swap transaction, we place them in a trust that is established for the sole purpose of holding the loans separate and apart from our assets. We serve as trustee for the trust. Upon creation of the trust, we deliver to the lender (or its designee) Fannie Mae MBS that are backed by the pool of mortgage loans in the trust and that represent a beneficial ownership interest in each of the loans. We guarantee to each MBS trust that we will supplement amounts received by the MBS trust as required to permit timely payment of principal and interest on the related Fannie Mae MBS. The mortgage servicers for the underlying mortgage loans collect the principal and interest payments from the borrowers. We permit them to retain a portion of the interest payment as compensation for servicing the mortgage loans before distributing the principal and remaining interest payments to us. We retain a portion of the interest payment as the fee for providing our guaranty. Then, on behalf of the trust, we make monthly distributions to the Fannie Mae MBS certificate holders from the principal and interest payments and other collections on the underlying mortgage loans.

The following diagram illustrates the basic process by which we create a typical Fannie Mae MBS in the case where a lender chooses to sell the Fannie Mae MBS to a third-party investor.

The aggregate amount of single-family guaranty fees we receive in any period depends on the amount of Fannie Mae MBS outstanding during that period and the applicable guaranty fee rates. The amount of Fannie Mae MBS outstanding at any time is primarily determined by the rate at which we issue new Fannie Mae MBS and by the repayment rate for the loans underlying our outstanding Fannie Mae MBS. Less significant factors affecting the amount of Fannie Mae MBS outstanding are the rates of borrower defaults on the loans

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and the extent to which lenders repurchase loans from the pools because the loans do not conform to the representations made by the lenders.

Since we began issuing our Fannie Mae MBS over 25 years ago, the total amount of our outstanding single-family Fannie Mae MBS, which includes both Fannie Mae MBS held in our portfolio and Fannie Mae MBS held by third parties, has grown steadily. As of December 31, 2006, 2005 and 2004, our total outstanding single-family Fannie Mae MBS was \$1.9 trillion, \$1.8 trillion and \$1.7 trillion, respectively. Growth in our total outstanding Fannie Mae MBS has been supported by the value that lenders and other investors place on Fannie Mae MBS.

TBA Market

The TBA, or to be announced, securities market is a forward, or delayed delivery, market for 30-year and 15-year fixed-rate single-family mortgage-related securities issued by us and other agency issuers. Most of our single-class, single-family Fannie Mae MBS are sold by lenders in the TBA market. Lenders use the TBA market both to purchase and sell Fannie Mae MBS. The TBA feature of the mortgage market is unique in the fixed-income capital markets.

A TBA trade represents a forward contract for the purchase or sale of single-family mortgage-related securities to be delivered on a specified future date; however, the specific pool of mortgages that will be delivered to fulfill the forward contract are unknown at the time of the trade. Parties to a TBA trade agree upon the issuer, coupon, price, product type, amount of securities and settlement date for delivery. Settlement for TBA trades is standardized and 30-year MBS and 15-year MBS settle on separate pre-arranged days each month. TBA sales enable originating mortgage lenders to hedge their interest rate risk and efficiently lock in interest rates for mortgage loan applicants throughout the loan origination process. The TBA market lowers transaction costs, increases liquidity and facilitates efficient settlement of sales and purchases of mortgage-related securities.

Housing and Community Development

Our HCD business is organized into three groups: the Multifamily Group, the Community Investment Group, and the Community Lending Group.

Multifamily Group

HCD's Multifamily Group securitizes multifamily mortgage loans into Fannie Mae MBS and facilitates the purchase of multifamily mortgage loans for our mortgage portfolio. Our multifamily mortgage loans relate to properties with five or more residential units, which may be apartment communities, cooperative properties or manufactured housing communities. Our Multifamily Group generally creates multifamily Fannie Mae MBS in the same manner as our Single-Family business creates single-family Fannie Mae MBS. In recent years, the percentage of our multifamily business activity that has consisted of purchases for our investment portfolio has increased relative to our securitization activity.

Most of the multifamily loans we purchase or securitize are made by lenders that participate in our Delegated Underwriting and Servicing, or DUS[®], program. Under the DUS program, we delegate the underwriting of loans to lenders that we approve for the program. As long as the lender is in good standing and represents and warrants that eligible loans meet our underwriting guidelines, we do not require the lender to obtain loan-by-loan approval before we acquire the loans.

Community Investment Group

HCD's Community Investment Group makes investments that increase the supply of affordable housing. Most of these investments are in rental housing that is eligible for federal low-income housing tax credits, and the remainder are in conventional rental and primarily entry-level, for-sale housing. These investments are consistent with our focus on serving communities and making affordable housing more available and easier to rent or own.

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The Community Investment Group's investments have been made predominantly in low-income housing tax credit (LIHTC) limited partnerships or limited liability companies (referred to collectively as LIHTC partnerships) that directly or indirectly own an interest in rental housing developed or rehabilitated by the LIHTC partnerships. By renting a specified portion of the housing units to qualified low-income tenants over a 15-year period, the LIHTC partnerships become eligible for the federal low-income housing tax credit, which was enacted as part of the Tax Reform Act of 1986 to encourage investment by private developers and investors in low-income rental housing. Failure to qualify as an affordable housing project over the entire 15-year period may result in the recapture of a portion of the tax credits. The LIHTC partnerships are generally organized by fund manager sponsors who seek investments with third-party developers that, in turn, develop or rehabilitate the properties and then manage them. We invest in these partnerships as a limited partner or non-managing limited liability company member, with the fund manager acting as the general partner or managing member. We earn a return on our investments in LIHTC partnerships through reductions in our federal income tax liability that result from both our use of the tax credits for which the LIHTC partnerships qualify, and the deductibility of the LIHTC partnerships' net operating losses.

In addition to investing in LIHTC partnerships, HCD's Community Investment Group makes equity investments in rental and for-sale housing, typically through fund managers or directly with developers and operators that are well-recognized firms within the industry. Because we invest as a limited partner or as a non-managing member in a limited liability company, our exposure is generally limited to the amount of our investment. Our equity investments in for-sale housing generally involve the acquisition, development and/or construction of entry-level homes or the conversion of existing housing to entry-level homes.

Community Lending Group

HCD's Community Lending Group supports the expansion of available housing by participating in specialized debt financing for a variety of customers and by acquiring mortgage loans. These activities include:

- acquiring multifamily loans from a variety of lending institutions that do not participate in our DUS® program;

- helping to meet the financing needs of single-family and multifamily home builders by purchasing participation interests in acquisition, development and construction (AD&C) loans from lending institutions;

- providing loans to Community Development Financial Institution intermediaries to re-lend for community revitalization projects that expand the supply of affordable housing stock; and

- providing financing for single-family and multifamily housing to housing finance agencies, public housing authorities and municipalities.

In July 2006, OFHEO advised us to suspend new AD&C business until we finalized and implemented specified policies and procedures required to strengthen risk management practices related to this business. We have implemented these new policies and procedures and have also implemented new controls and reporting mechanisms relating to our AD&C business. We received approval from OFHEO on June 8, 2007 to re-enter the secured AD&C business in a graduated manner. However, OFHEO advised us not to re-enter the unsecured AD&C business until matters relating to our engagement in certain market activities and unsecured lending are resolved with HUD.

Capital Markets

Our Capital Markets group manages our investment activity in mortgage loans, mortgage-related securities and other liquid investments. We purchase mortgage loans and mortgage-related securities from mortgage lenders, securities dealers, investors and other market participants. We also sell mortgage loans and mortgage-related securities. We fund

these investments primarily through proceeds from our issuance of debt securities in the domestic and international capital markets.

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Our Capital Markets group earns most of its income from the difference, or spread, between the interest we earn on our mortgage portfolio and the interest we pay on the debt we issue to fund this portfolio. We refer to this spread as our net interest yield. Our Capital Markets group uses various debt and derivative instruments to help manage the interest rate risk inherent in our mortgage portfolio. Changes in the fair value of the derivative instruments and trading securities we hold impact the net income reported by the Capital Markets group business segment.

Mortgage Investments

Our net mortgage portfolio totaled \$726.1 billion and \$736.5 billion as of December 31, 2006 and 2005, respectively. We estimate that the amount of our net mortgage portfolio was approximately \$720.0 billion as of June 30, 2007. As part of our May 2006 consent order with OFHEO, we agreed not to increase our net mortgage portfolio assets above the amount shown in our minimum capital report as of December 31, 2005 (\$727.75 billion), except in limited circumstances at OFHEO's discretion. Our net mortgage portfolio assets are defined as the unpaid principal balance of our mortgage assets, net of market valuation adjustments, allowance for loan losses, impairments, and unamortized premiums and discounts, excluding consolidated mortgage-related assets acquired through the assumption of debt. We will be subject to this limitation on mortgage investment growth until the Director of OFHEO has determined that modification or expiration of the limitation is appropriate in light of specified factors such as resolution of accounting and internal control issues. We estimate that our net mortgage portfolio assets totaled approximately \$714.9 billion and \$719.6 billion as of June 30, 2007 and December 31, 2006, respectively. On August 1, 2007, we requested that OFHEO grant us a 10% increase in the limit on the amount of our net mortgage portfolio assets. On August 10, 2007, OFHEO advised us that, while it will keep under active consideration our request for this increase, it is not authorizing any significant changes at this time. For additional information on our capital requirements and regulations affecting the amount of our mortgage investments, see Our Charter and Regulation of Our Activities.

Our mortgage investments include both mortgage-related securities and mortgage loans. We purchase primarily conventional single-family fixed-rate or adjustable-rate, first lien mortgage loans, or mortgage-related securities backed by these types of loans. In addition, we purchase loans insured by the Federal Housing Authority (FHA), loans guaranteed by the Department of Veterans Affairs (VA) or by the Rural Housing Service of the Department of Agriculture (RHS), manufactured housing loans, multifamily mortgage loans, subordinate lien mortgage loans (for example, loans secured by second liens) and other mortgage-related securities. Most of these loans are prepayable at the option of the borrower. We make some of our investments in mortgage-related securities in the TBA market, which we describe above under Single-Family TBA Market. Our investments in mortgage-related securities include structured mortgage-related securities such as real estate mortgage investment conduits (REMICs). The interest rates on the structured mortgage-related securities held in our portfolio may not be the same as the interest rates on the underlying loans. For example, we may hold a floating rate REMIC security with an interest rate that adjusts periodically based on changes in a specified market reference rate, such as the London Inter-Bank Offered Rate (LIBOR); however, the REMIC may be backed by fixed-rate mortgage loans. For information on the composition of our mortgage investment portfolio by product type, refer to Table 12 in Item 7 MD&A Consolidated Balance Sheet Analysis.

Investment Activities

Our Capital Markets group seeks to maximize long-term total returns while fulfilling our chartered liquidity function. The Capital Markets group's purchases and sales of mortgage assets in any given period generally has been determined by the rates of return that we expect to be able to earn on the equity capital underlying our investments. When we expect to earn returns greater than our cost of equity capital, we generally will be an active purchaser of mortgage loans and mortgage-related securities. When few opportunities exist to earn returns above our cost of equity capital, we generally will be a less active purchaser, and may be a net seller, of mortgage loans and mortgage-related securities. This investment strategy is consistent with our chartered liquidity function, as the periods during which our

purchase of mortgage assets is economically attractive to us generally have been periods in which market demand for mortgage assets is low.

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The spread between the amount we earn on mortgage assets available for purchase or sale and our funding costs, after consideration of the net risks associated with the investment, is an important factor in determining whether we are a net buyer or seller of mortgage assets. When the spread between the yield on mortgage assets and our borrowing costs is wide, which is typically when demand for mortgage assets from other investors is low, we will look for opportunities to add liquidity to the market primarily by purchasing mortgage assets and issuing debt to investors to fund those purchases. When this spread is narrow, which is typically when market demand for mortgage assets is high, we will look for opportunities to meet demand by selling mortgage assets from our portfolio. Even in periods of high market demand for mortgage assets, however, we expect to be an active purchaser of less liquid forms of mortgage loans and mortgage-related securities. The amount of our purchases of these mortgage loans and mortgage-related securities may be less than the amortization, prepayments and sales of mortgage loans we hold and, as a result, our investment balances may decline during periods of high market demand. In normal market conditions, however, we expect our selling activity will represent a modest portion of the total change in the total portfolio for the year.

Customer Transactions and Services

Our Capital Markets group provides our lender customers and their affiliates with services that include:

offering to purchase a wide variety of mortgage assets, including non-standard mortgage loan products, which we either retain in our portfolio for investment or sell to other investors as a service to assist our customers in accessing the market;

segregating customer portfolios to obtain optimal pricing for their mortgage loans (for example, segregating Community Reinvestment Act or CRA eligible loans, which typically command a premium);

providing funds at the loan delivery date for purchase of loans delivered for securitization; and

assisting customers with the hedging of their mortgage business, including by entering into options and forward contracts on mortgage-related securities, which we offset in the capital markets.

These activities provide a significant flow of assets for our mortgage portfolio, help to create a broader market for our customers and enhance liquidity in the secondary mortgage market.

In connection with our customer transactions and services activities, we may enter into forward commitments to purchase mortgage loans or mortgage-related securities that we decide not to retain in our portfolio. In these instances, we generally will enter into an offsetting sell commitment with another investor or require the lender to deliver a sell commitment to us when the lender delivers the loans to be pooled into mortgage-related securities.

Funding Our Investments

Our Capital Markets group funds its investments primarily through the issuance of debt securities, primarily short-term debt securities, in the domestic and international capital markets. The objective of our debt financing activities is to manage our liquidity requirements while obtaining funds as efficiently as possible. We structure our financings not only to satisfy our funding and risk management requirements, but also to access the capital markets in an orderly manner using debt securities designed to appeal to a wide range of investors. International investors, seeking many of the features offered in our debt programs for their U.S. dollar-denominated investments, have been a significant and growing source of funding in recent years.

Although we are a corporation chartered by the U.S. Congress, neither the U.S. government nor any instrumentality of the U.S. government guarantees any of our debt, and we are solely responsible for our debt obligations. Our debt

trades in the agency sector of the capital markets, along with the debt of other GSEs. Debt in the agency sector benefits from bank regulations that allow commercial banks to invest in our debt and other agency debt to a greater extent than other debt. These factors, along with the high credit rating of our senior unsecured debt securities and the manner in which we conduct our financing programs, contribute to the favorable trading characteristics of our debt. As a result, we generally are able to borrow at lower interest rates than other corporate debt issuers. For information on the credit ratings of our long-term and

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short-term senior unsecured debt, qualifying subordinated debt and preferred stock, refer to Item 7 MD&A Liquidity and Capital Management Liquidity Credit Ratings and Risk Ratings.

Securitization Activities

Our Capital Markets group engages in two principal types of securitization activities:

creating and issuing Fannie Mae MBS from our mortgage portfolio assets, either for sale into the secondary market or to retain in our portfolio; and

issuing structured Fannie Mae MBS for customers in exchange for a transaction fee.

Our Capital Markets group creates Fannie Mae MBS using mortgage loans and mortgage-related securities that we hold in our investment portfolio, referred to as portfolio securitizations. We currently securitize a majority of the single-family mortgage loans we purchase within the first month of purchase. Our Capital Markets group may sell these Fannie Mae MBS into the secondary market or may retain the Fannie Mae MBS in our investment portfolio. In addition, the Capital Markets group issues structured, or multi-class, Fannie Mae MBS. The structured Fannie Mae MBS are generally created through swap transactions, typically with our lender customers or securities dealer customers. In these transactions, the customer swaps a mortgage-related security they own for a structured Fannie Mae MBS we issue. This process is referred to as resecuritization. Our Capital Markets group earns transaction fees for issuing structured Fannie Mae MBS for third parties.

RISK MANAGEMENT

Risk is an inherent part of our business activities. Our risk management framework and governance structure is intended to provide comprehensive controls and ongoing management of the major risks inherent in our business activities. Our ability to properly identify, measure, monitor and report risk is critical to our soundness and profitability. Our businesses expose us to the following four major categories of risk:

Credit Risk. Credit risk is the risk of financial loss resulting from the failure of a borrower or institutional counterparty to honor its contractual obligations to us and exists primarily in our mortgage credit book of business, derivatives portfolio and liquid investment portfolio.

Market Risk. Market risk represents the exposure to potential changes in the market value of our net assets from changes in prevailing market conditions. A significant market risk we face and actively manage is interest rate risk the risk of changes in our long-term earnings or in the value of our net assets due to changes in interest rates.

Operational Risk. Operational risk relates to the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events.

Liquidity Risk. Liquidity risk is the risk to our earnings and capital arising from an inability to meet our cash obligations in a timely manner.

For a complete discussion of our methods for managing risk, refer to Item 7 MD&A Risk Management.

COMPETITION

Our competitors include the Federal Home Loan Mortgage Corporation, referred to as Freddie Mac, the Federal Home Loan Banks, financial institutions, securities dealers, insurance companies, pension funds, investment funds, and other

investors.

We compete to purchase mortgage assets for our investment portfolio or to securitize them into Fannie Mae MBS. Our market share of mortgage assets purchased for our investment portfolio or securitized into Fannie Mae MBS is affected by the amount of residential mortgage loans offered for sale in the secondary market by loan originators and other market participants. The decreased rate of growth in U.S. residential mortgage debt outstanding in 2006 and continuing into 2007 has decreased the supply of mortgage originations, available for

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purchase or securitization. Our market share is also affected by the mix of available mortgage loan products and the credit risk and prices associated with those loans.

In addition, we compete for low-cost debt funding with institutions that hold mortgage portfolios, including Freddie Mac and the Federal Home Loan Banks.

We have been the largest issuer of mortgage-related securities in every year since 1990. Competition for the issuance of mortgage-related securities is intense and participants compete on the basis of the value of their products and services relative to the prices they charge. Value can be delivered through the liquidity and trading levels for an issuer's securities, the range of products and services offered, and the reliability and consistency with which it conducts its business. In recent years, there has been a significant increase in the issuance of mortgage-related securities by non-agency issuers, which has caused a decrease in our share of the market for new issuances of single-family mortgage-related securities. Non-agency issuers, also referred to as private-label issuers, are those issuers of mortgage-related securities other than agency issuers Fannie Mae, Freddie Mac and Ginnie Mae. Our estimated market share of new single-family mortgage-related securities issuance has fallen during the past several years, from 45.0% in 2003 to 23.7% in 2006, a slight increase from our estimated market share of 23.5% in 2005. We estimate that total single-family mortgage-related securities issued by all mortgage market participants, including Fannie Mae, during the quarter ended June 30, 2007 increased by approximately 6.9% to an estimated \$530.9 billion, compared with an estimated \$496.8 billion issued during the quarter ended December 31, 2006. In the quarter ended June 30, 2007, our estimated market share of new single-family mortgage-related securities issuance was 28.3%. Our estimates of market share are based on publicly available data and exclude previously securitized mortgages. Although we expect our market share to increase in 2007 compared to 2006, we expect our Single-Family business to continue to face significant competition from private-label issuers.

We also expect private-label issuers to provide increased competition to our HCD business through their use of commercial mortgage-backed securities (CMBS), which often package loans secured by multifamily residential property with higher yielding loans secured by commercial properties.

OUR CHARTER AND REGULATION OF OUR ACTIVITIES

We are a stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act, which we refer to as the Charter Act or our charter. We were established in 1938 pursuant to the National Housing Act and originally operated as a U.S. government entity. Title III of the National Housing Act amended our charter in 1954, and we became a mixed-ownership corporation, with our preferred stock owned by the federal government and our non-voting common stock held by private investors. In 1968, our charter was further amended and our predecessor entity was divided into the present Fannie Mae and Ginnie Mae. Ginnie Mae remained a government entity, but all of the preferred stock of Fannie Mae that had been held by the U.S. government was retired, and Fannie Mae became privately owned.

Charter Act

The Charter Act, as it was further amended from 1970 through 1998, sets forth the activities that we are permitted to conduct, authorizes us to issue debt and equity securities, and describes our general corporate powers. The Charter Act states that our purpose is to:

provide stability in the secondary market for residential mortgages;

respond appropriately to the private capital market;

provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

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promote access to mortgage credit throughout the nation (including central cities, rural areas and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

In addition to the alignment of our overall strategy with these purposes, all of our business activities must be permissible under the Charter Act. Our charter authorizes us to, among other things, purchase, service, sell, lend on the security of, or otherwise deal in certain mortgage loans; issue debt obligations and mortgage-related securities; and do all things as are necessary or incidental to the proper management of [our] affairs and the proper conduct of [our] business.

Loan Standards

Mortgage loans we purchase or securitize must meet the following standards required by the Charter Act.

Principal Balance Limitations. Our charter permits us to purchase and securitize conventional mortgage loans (*i.e.*, loans that are not federally insured or guaranteed) secured by either a single-family or multifamily property. Single-family conventional mortgage loans are generally subject to maximum original principal balance limits. The principal balance limits are often referred to as conforming loan limits and are established each year by OFHEO based on the national average price of a one-family residence. For 2006 and 2007, the conforming loan limit for a one-family residence is \$417,000. Higher original principal balance limits apply to mortgage loans secured by two- to four-family residences and also to loans in Alaska, Hawaii, Guam and the Virgin Islands. No statutory limits apply to the maximum original principal balance of multifamily mortgage loans that we purchase or securitize. In addition, the Charter Act imposes no maximum original principal balance limits on loans we purchase or securitize that are either insured by the FHA or guaranteed by the VA.

Quality Standards. The Charter Act requires that, so far as practicable and in our judgment, the mortgage loans we purchase or securitize must be of a quality, type and class that generally meet the purchase standards of private institutional mortgage investors. To comply with this requirement and for the efficient operation of our business, we have eligibility policies and make available guidelines for the mortgage loans we purchase or securitize as well as for the sellers and servicers of these loans.

Loan-to-Value and Credit Enhancement Requirements. The Charter Act generally requires credit enhancement on any conventional single-family mortgage loan that we purchase or securitize if it has a loan-to-value ratio over 80% at the time of purchase. Credit enhancement may take the form of insurance or a guaranty issued by a qualified insurer, a repurchase arrangement with the seller of the loans or a seller-retained loan participation interest.

Other Charter Act Limitations and Requirements

In addition to specifying our purpose, authorizing our activities and establishing various limitations and requirements relating to the loans we purchase and securitize, the Charter Act has the following provisions.

Issuances of Our Securities. The Charter Act authorizes us, upon approval of the Secretary of the Treasury, to issue debt obligations and mortgage-related securities. At the discretion of the Secretary of the Treasury, the U.S. Department of the Treasury may purchase obligations of Fannie Mae up to a maximum of \$2.25 billion outstanding at any one time. We have not used this facility since our transition from government ownership in 1968. Neither the U.S. nor any of its agencies guarantees our debt or mortgage-related securities or is obligated to finance our operations or assist us in any other manner.

Exemptions for Our Securities. Securities we issue are exempted securities under laws administered by the SEC. As a result, registration statements with respect to offerings of our securities are not filed with the SEC. In March 2003, however, we voluntarily registered our common stock with the SEC under Section 12(g) of the Securities Exchange Act of 1934 (the Exchange Act). As a result, we are required to file periodic and current reports with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Since undertaking to restate our 2002 and 2003 consolidated financial statements and improve our accounting practices and internal control over financial

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reporting, we have not been a current filer of our periodic reports on Form 10-K or Form 10-Q. We have issued or restated financial statements for 2002-2005, and with the filing of this 2006 Form 10-K, we are issuing financial statements for 2006. We are continuing to improve our accounting and internal control over financial reporting and are striving to become a current filer as soon as practicable. We are also required to file proxy statements with the SEC. We have not filed a proxy statement relating to an annual meeting of shareholders since 2004. On June 8, 2007, we announced plans to hold an annual meeting of shareholders on December 14, 2007. In addition, our directors and certain officers are required to file reports with the SEC relating to their ownership of Fannie Mae equity securities.

Exemption from Specified Taxes. Pursuant to the Charter Act, we are exempt from taxation by states, counties, municipalities or local taxing authorities, except for taxation by those authorities on our real property. However, we are not exempt from the payment of federal corporate income taxes.

Other Limitations and Requirements. Under the Charter Act, we may not originate mortgage loans or advance funds to a mortgage seller on an interim basis, using mortgage loans as collateral, pending the sale of the mortgages in the secondary market. In addition, we may only purchase or securitize mortgages originated in the U.S., including the District of Columbia, the Commonwealth of Puerto Rico, and the territories and possessions of the U.S.

Regulation and Oversight of Our Activities

As a federally chartered corporation, we are subject to Congressional legislation and oversight and are regulated by HUD and OFHEO. In addition, we are subject to regulation by the U.S. Department of the Treasury and by the SEC. The Government Accountability Office is authorized to audit our programs, activities, receipts, expenditures and financial transactions.

HUD Regulation

Program Approval

HUD has general regulatory authority to promulgate rules and regulations to carry out the purposes of the Charter Act, excluding authority over matters granted exclusively to OFHEO. We are required under the Charter Act to obtain approval of the Secretary of HUD for any new conventional mortgage program that is significantly different from those approved or engaged in prior to the enactment of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act). The Secretary of HUD must approve any new program unless the Charter Act does not authorize it or the Secretary finds that it is not in the public interest.

HUD periodically conducts reviews of our activities to ensure compliance with the Charter Act and other regulatory requirements. On June 13, 2006, HUD announced that it would conduct a review of our investments and holdings, including certain equity and debt investments classified in our consolidated financial statements as other assets/other liabilities, to determine whether our investment activities are consistent with our charter authority. We are fully cooperating with this review, but cannot predict whether the outcome of this review may require us to modify our investment approach or restrict our current business activities.

Annual Housing Goals and Subgoals

For each calendar year, we are subject to housing goals and subgoals set by HUD. The goals, which are set as a percentage of the total number of dwelling units underlying our total mortgage purchases, are intended to expand housing opportunities (1) for low- and moderate-income families, (2) in HUD-defined underserved areas, including

central cities and rural areas, and (3) for low-income families in low-income areas and for very low-income families, which is referred to as special affordable housing. In addition, HUD has established three home purchase subgoals that are expressed as percentages of the total number of mortgages we purchase that finance the purchase of single-family, owner-occupied properties located in metropolitan areas, and a subgoal for multifamily special affordable housing that is expressed as a dollar amount. We report

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our progress toward achieving our housing goals to HUD on a quarterly basis, and we are required to submit a report to HUD and Congress on our performance in meeting our housing goals on an annual basis.

Included in eligible mortgage loan purchases are loans underlying our Fannie Mae MBS issuances, subordinate mortgage loans and refinanced mortgage loans. Several activities are excluded from eligible mortgage loan purchases, such as most purchases of non-conventional mortgage loans, equity investments (even if they facilitate low-income housing), mortgage loans secured by second homes and commitments to purchase or securitize mortgage loans at a later date.

In November 2004, HUD published a final regulation amending its housing goals rule, effective January 1, 2005. The regulation increased the housing goal levels for each year through 2008 and also created the three home purchase mortgage subgoals described above. These increasing housing goals and subgoals are designed to expand the amount of mortgage financing that we make available to those populations and geographic areas defined by the goals. The increased housing goals and subgoals for the period 2005-2008 are shown below.

Housing Goals and Subgoals

	2008	2007	2006	2005
Housing goals: ⁽¹⁾				
Low- and moderate-income housing	56.0%	55.0%	53.0%	52.0%
Underserved areas	39.0	38.0	38.0	37.0
Special affordable housing	27.0	25.0	23.0	22.0
Housing subgoals:				
Home purchase subgoals: ⁽²⁾				
Low- and moderate-income housing	47.0%	47.0%	46.0%	45.0%
Underserved areas	34.0	33.0	33.0	32.0
Special affordable housing	18.0	18.0	17.0	17.0
Multifamily special affordable housing subgoal (\$ in billions) ⁽³⁾	\$ 5.49	\$ 5.49	\$ 5.49	\$ 5.49

(1) A dwelling unit may be counted in more than one category of the goals. Goals are expressed as a percentage of the total number of dwelling units financed by eligible mortgage loan purchases during the period.

(2) Home purchase subgoals measure our performance by the number of loans (not dwelling units) that provide purchase money for owner-occupied single-family housing in metropolitan areas.

(3) The multifamily subgoal is measured by loan amount and expressed as a dollar amount.

The following table compares our performance against the housing goals and subgoals for the years 2004 through 2006.

Housing Goals and Subgoals Performance

	2006		2005		2004	
	Result ⁽¹⁾	Goal	Result ⁽²⁾	Goal	Result ⁽²⁾	Goal

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Housing goals: ⁽³⁾						
Low- and moderate-income housing	56.9%	53.0%	55.1%	52.0%	53.4%	50.0%
Underserved areas	43.6	38.0	41.4	37.0	33.5	31.0
Special affordable housing	27.8	23.0	26.3	22.0	23.6	20.0
Housing subgoals:						
Home purchase subgoals: ⁽⁴⁾						
Low- and moderate-income housing	46.9%	46.0%	44.6%	45.0%		
Underserved areas	34.5	33.0	32.6	32.0		
Special affordable housing	17.9	17.0	17.0	17.0		
Multifamily special affordable housing subgoal (\$ in billions) ⁽⁵⁾	\$ 13.39	\$ 5.49	\$ 10.39	\$ 5.49	\$ 7.32	\$ 2.85

(1) The source of this data is our Annual Housing Activities Report for 2006. HUD has not yet determined our results for 2006.

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- (2) The source of this data is HUD's analysis of data we submitted to HUD. Some results differ from the results we reported in our Annual Housing Activities Reports for 2005 and 2004. Actual results reflect the impact of provisions that allow us to estimate the affordability of units with missing income and rent data.
- (3) Goals are expressed as a percentage of the total number of dwelling units financed by eligible mortgage loan purchases during the period.
- (4) Home purchase subgoals measure our performance by the number of loans (not dwelling units) providing purchase money for owner-occupied single-family housing in metropolitan areas.
- (5) The multifamily subgoal is measured by loan amount and expressed as a dollar amount.

As shown by the table above, we were able to meet our housing goals and subgoals in 2006 and 2004. In 2005, we met all three of our housing goals and three of the four subgoals. We fell slightly short of the low- and moderate-income home purchase subgoal.

The housing goals are subject to enforcement by the Secretary of HUD. The subgoals, however, are treated differently. Pursuant to the 1992 Act, the low- and moderate-income housing subgoal and the underserved areas subgoal are not enforceable by HUD. However, HUD has taken the position that the special affordable subgoals are enforceable. HUD's regulations state that HUD shall require us to submit a housing plan if we fail to meet one or more housing goals and HUD determines that achievement was feasible, taking into account market and economic conditions and our financial condition. The housing plan must describe the actions we will take to meet the goal in the next calendar year. If HUD determines that we have failed to submit a housing plan or to make a good faith effort to comply with the plan, HUD has the right to take certain administrative actions. The potential penalties for failure to comply with the housing plan requirements are a cease-and-desist order and civil money penalties. Because the low- and moderate-income home purchase subgoal is not enforceable, there was no penalty for our failing to meet this subgoal in 2005.

We have made significant adjustments to our mortgage loan sourcing and purchase strategies in an effort to meet the increased housing goals and subgoals. These strategies include entering into some purchase and securitization transactions with lower expected economic returns than our typical transactions. We have also relaxed some of our underwriting criteria to obtain goals-qualifying mortgage loans and increased our investments in higher-risk mortgage loan products that are more likely to serve the borrowers targeted by HUD's goals and subgoals, which could further increase our credit losses. The Charter Act explicitly authorizes us to undertake activities ... involving a reasonable economic return that may be less than the return earned on other activities in order to support the secondary market for housing for low- and moderate-income families. We continue to evaluate the cost of these activities.

Meeting the higher goals and subgoals for 2007 in the face of previous increases in home prices and, more recently, higher interest rates, which have reduced housing affordability during the past several years, is extremely challenging. Since HUD set the home purchase subgoals in 2004, the housing markets have experienced a dramatic change. Home Mortgage Disclosure Act data released in 2006 show that the share of the primary mortgage market serving low- and moderate-income borrowers declined in 2005, reducing our ability to purchase and securitize mortgage loans that meet the HUD subgoals. The National Association of REALTORS® housing affordability index has dropped from 130.7 in 2003 to 106.1 in 2006. In addition, because subprime mortgages tended to meet many of the HUD goals and subgoals, the recent disruption in the subprime market has further limited our ability to meet these goals. Our housing goals and subgoals continue to increase in 2007 and 2008. If our efforts to meet the housing goals and subgoals prove to be insufficient, we may become subject to a housing plan that could require us to take additional steps that could have an adverse effect on our profitability. See Item 1A Risk Factors for more information on how changes we are

making to our business strategies in order to meet HUD's housing goals and subgoals may reduce our profitability.

OFHEO Regulation

OFHEO is an independent office within HUD that is responsible for ensuring that we are adequately capitalized and operating safely in accordance with the 1992 Act. OFHEO has examination authority with respect to us, and we are required to submit to OFHEO annual and quarterly reports on our financial condition and results of operations. OFHEO is authorized to levy annual assessments on Fannie Mae and Freddie Mac,

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to the extent authorized by Congress, to cover OFHEO's reasonable expenses. OFHEO's formal enforcement powers include the power to impose temporary and final cease-and-desist orders and civil monetary penalties on us and our directors and executive officers.

OFHEO Consent Order

In 2003, OFHEO began a special examination of our accounting policies and practices, internal controls, financial reporting, corporate governance, and other matters. On May 23, 2006, concurrently with OFHEO's release of its final report of the special examination, we agreed to OFHEO's issuance of a consent order that resolved open matters relating to their investigation of us. Under the consent order, we neither admitted nor denied any wrongdoing and agreed to make changes and take actions in specified areas, including our accounting practices, capital levels and activities, corporate governance, Board of Directors, internal controls, public disclosures, regulatory reporting, personnel and compensation practices.

In the OFHEO consent order, we agreed to the following additional restrictions relating to our capital activity:

We must maintain a 30% capital surplus over our statutory minimum capital requirement until such time as the Director of OFHEO determines that the requirement should be modified or allowed to expire, taking into account factors such as the resolution of accounting and internal control issues.

As long as the capital restoration plan is in effect, we must seek the approval of the Director of OFHEO before engaging in any transaction that could have the effect of reducing our capital surplus below an amount equal to 30% more than our statutory minimum capital requirement. For a discussion of the capital restoration plan, see [Capital Adequacy Requirements](#), [Capital Restoration Plan](#) and [OFHEO-Directed Minimum Capital Requirement](#).

We must submit a written report to OFHEO detailing the rationale and process for any proposed capital distribution before making such distribution.

We are not permitted to increase our net mortgage portfolio assets above the amount shown in our minimum capital report to OFHEO as of December 31, 2005 (\$727.75 billion), except in limited circumstances at the discretion of OFHEO. We will be subject to this limitation on portfolio growth until the Director of OFHEO has determined that expiration of the limitation is appropriate in light of information regarding any or all of the following:

our capital;

market liquidity issues;

housing goals;

risk management improvements;

our outside auditor's opinion that our consolidated financial statements present fairly in all material respects our financial condition;

receipt of an unqualified opinion from an outside audit firm that our internal control over financial reporting is effective pursuant to section 404 of the Sarbanes-Oxley Act of 2002; or

other relevant information.

We submitted an updated business plan to OFHEO on February 28, 2007 that included an update on our progress in remediating our internal control deficiencies, completing the requirements of the consent order and other matters. OFHEO reviewed our business plan and directed us to maintain compliance with the \$727.75 billion portfolio cap. On August 10, 2007, in response to our request that OFHEO grant us a 10% increase in our \$727.75 billion portfolio cap, OFHEO advised us to maintain compliance with the existing portfolio cap.

As part of the OFHEO consent order, our Board of Directors agreed to review all individuals who at the time of the review were affiliated with us, including Board members, and who were mentioned in OFHEO's final

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report of the special examination as participating in any misconduct for suitability to remain in their positions or for other remedial actions. The Board created a special committee made up of independent Board members, none of whom had served on the Board prior to December 2004, to conduct this review. In October 2006, the special committee completed its review and reported its findings and recommendations to OFHEO. We have since implemented the actions recommended in that report.

In its Annual Report to Congress released April 10, 2007, OFHEO recognized that, as of December 31, 2006, we had complied with 67% of the requirements of the OFHEO consent order. We believe that we are making progress toward completing the OFHEO consent order requirements.

In addition, as part of the OFHEO consent order, we agreed to pay a \$400 million civil penalty, with \$50 million payable to the U.S. Treasury and \$350 million payable to the SEC for distribution to stockholders pursuant to the Fair Funds for Investors provision of the Sarbanes-Oxley Act of 2002. We paid this civil penalty in full in 2006 and recorded an expense in our 2004 consolidated financial statements. This expense was not deductible for tax purposes.

Capital Adequacy Requirements

We are subject to capital adequacy requirements established by the 1992 Act. The statutory capital framework incorporates two different quantitative assessments of capital – a minimum capital requirement and a risk-based capital requirement. The minimum capital requirement is ratio-based, while the risk-based capital requirement is based on simulated stress test performance. The 1992 Act requires us to maintain sufficient capital to meet both of these requirements in order to be classified as adequately capitalized. OFHEO is permitted or required to take remedial action if we fail to meet our capital requirements, depending on which requirement we fail to meet. We are required to submit a capital restoration plan if OFHEO classifies us as significantly undercapitalized. Even if we meet our capital requirements, OFHEO has the ability to take additional supervisory actions if the Director determines that we have failed to make reasonable efforts to comply with that plan or are engaging in unapproved conduct that could result in a rapid depletion of our core capital, or if the value of the property securing mortgage loans we hold or have securitized has decreased significantly.

The 1992 Act also gives OFHEO the authority, after following prescribed procedures, to appoint a conservator. Under OFHEO's regulations, appointment of a conservator is mandatory, with limited exceptions, if we are critically undercapitalized (that is, if our core capital is less than our required critical capital). OFHEO has discretion under its rules to appoint a conservator if we are significantly undercapitalized (that is, if our core capital is less than our required minimum capital), and alternative remedies are unavailable. The 1992 Act and OFHEO's rules also specify other grounds for appointing a conservator.

In addition, under the OFHEO consent order, we are currently required to maintain a 30% capital surplus over our statutory minimum capital requirement. Consistent with OFHEO's disclosures, we refer to this requirement, which is described in more detail below under Capital Restoration Plan and OFHEO-Directed Minimum Capital Requirement, as the OFHEO-directed minimum capital requirement. We are subject to continuous examination by OFHEO to ensure that we meet these capital adequacy requirements on an ongoing basis.

Statutory Minimum Capital Requirement. OFHEO's ratio-based minimum capital standard ties our capital requirements to the size of our book of business. For purposes of the statutory minimum capital requirement, we are in compliance if our core capital equals or exceeds our minimum capital requirement. Core capital is defined by statute as the sum of the stated value of outstanding common stock (common stock less treasury stock), the stated value of outstanding non-cumulative perpetual preferred stock, paid-in capital and retained earnings, as determined in accordance with U.S. generally accepted accounting principles (GAAP). Our minimum capital requirement is generally equal to the sum of:

2.50% of on-balance sheet assets;

0.45% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and

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up to 0.45% of other off-balance sheet obligations.

Each quarter, as part of its capital classification announcement, OFHEO publishes our standing relative to the statutory minimum capital requirement and the OFHEO-directed minimum capital requirement. For a description of the amounts by which our core capital exceeded our statutory minimum capital requirement as of March 31, 2007, December 31, 2006, and December 31, 2005, see [Item 7 MD&A Liquidity and Capital Management Capital Management Capital Classification Measures](#).

Statutory Risk-Based Capital Requirement. OFHEO's risk-based capital standard ties our capital requirements to the risk in our book of business, as measured by a stress test model. The stress test simulates our financial performance over a ten-year period of severe economic conditions characterized by both extreme interest rate movements and high mortgage default rates. Simulation results indicate the amount of capital required to survive this prolonged period of economic stress without new business or active risk management action. In addition to this model-based amount, the risk-based capital requirement includes a 30% surcharge to cover unspecified management and operations risks.

Our total capital base is used to meet our risk-based capital requirement. Total capital is defined by statute as the sum of our core capital plus the total allowance for loan losses and reserve for guaranty losses in connection with Fannie Mae MBS, less the specific loss allowance (that is, the allowance required on individually-impaired loans). Each quarter, OFHEO runs a detailed profile of our book of business through the stress test simulation model. The model generates cash flows and financial statements to evaluate our risk and measure our capital adequacy during the ten-year stress horizon. As part of its quarterly capital classification announcement, OFHEO makes these stress test results publicly available. For a description of the amounts by which our total capital exceeded our statutory risk-based capital requirement as of December 31, 2006 and 2005, see [Item 7 MD&A Liquidity and Capital Management Capital Management Capital Classification Measures](#).

Capital Restoration Plan and OFHEO-Directed Minimum Capital Requirement. OFHEO concluded in its September 2004 interim report on its special examination that we had misapplied GAAP relating to hedge accounting and the amortization of purchase premiums and discounts on securities and loans and on other deferred charges. In December 2004, the SEC's Office of the Chief Accountant affirmed OFHEO's conclusion. We estimated that the disallowed hedge accounting treatments would result in a \$9.0 billion cumulative reduction in our core capital as of September 30, 2004. As a result, on December 21, 2004, OFHEO classified us as significantly undercapitalized as of September 30, 2004, and directed us to submit a capital restoration plan that would provide for compliance with our statutory minimum capital requirement plus a surplus of 30% over the statutory minimum capital requirement. Pursuant to OFHEO's directive, we submitted a capital restoration plan. On February 17, 2005, OFHEO accepted our capital restoration plan, which indicated our intention to achieve the OFHEO-directed minimum capital requirement by September 30, 2005.

We implemented the capital restoration plan by generating additional capital through retained earnings, significantly reducing the size of our investment portfolio, issuing \$5.0 billion of non-cumulative preferred stock, reducing our dividend and implementing cost-cutting efforts. OFHEO announced on November 1, 2005 that, as of September 30, 2005, we had achieved the OFHEO-directed minimum capital requirement. OFHEO actively monitors our compliance with the capital restoration plan, pursuant to which we provide quarterly capital plan updates to OFHEO. We believe that we continue to be in compliance with the plan as of the date of this filing. For a description of the amounts by which our core capital exceeded the OFHEO-directed minimum capital requirement as of March 31, 2007, December 31, 2006 and 2005, see [Item 7 MD&A Liquidity and Capital Management Capital Management Capital Classification Measures](#).

Statutory Critical Capital Requirement. Our critical capital requirement is the amount of core capital below which we would be classified as critically undercapitalized and generally would be required to be placed in conservatorship. Our

critical capital requirement is generally equal to the sum of:

1.25% of on-balance sheet assets;

0.25% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and

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up to 0.25% of other off-balance sheet obligations.

For a description of the amounts by which our core capital exceeded our statutory critical capital requirement as of December 31, 2006 and 2005, see Item 7 MD&A Liquidity and Capital Management Capital Management Capital Classification Measures.

OFHEO Direction on Interagency Guidance on Nontraditional Mortgages and Subprime Lending

In September 2006, five federal financial regulatory agencies jointly issued Interagency Guidance on Nontraditional Mortgage Product Risks to address risks posed by mortgage products that allow borrowers to defer repayment of principal or interest, and the layering of risks that results from combining these product types with other features that may compound risk. In June 2007, the same financial regulatory agencies published the final Statement on Subprime Mortgage Lending, which addresses risks relating to certain subprime mortgages. Together, the agencies directed regulated financial institutions that originate nontraditional and subprime mortgage loans to follow prudent lending practices, including safe and sound underwriting practices and providing borrowers with clear and balanced information about the relative benefits and risks of these products sufficiently early in the process to enable them to make informed decisions.

OFHEO directed us to apply the risk management, underwriting and consumer protection principles of the nontraditional and subprime mortgage guidances to mortgages we purchase or guarantee. In response to the guidance and OFHEO's directive, we are implementing changes to our Desktop Underwriter[®] automated underwriting system and have notified our lender customers of the dates by which we expect all loans sent to us to be in compliance with the guidances.

Recent Legislative Developments and Possible Changes in Our Regulations and Oversight

There is legislation pending before the U.S. Congress that would change the regulatory framework under which we, Freddie Mac and the Federal Home Loan Banks operate. On May 22, 2007, the House of Representatives approved a bill that would establish a new, independent regulator for us and the other GSEs, with broad authority over both safety and soundness and mission.

As of the date of this filing, one GSE reform bill has been introduced in the Senate and another is expected. For a description of how the changes in the regulation of our business contemplated by these GSE reform bills or other legislative proposals could materially adversely affect our business and earnings, see Item 1A Risk Factors.

EMPLOYEES

As of December 31, 2006, we employed approximately 6,600 personnel, including full-time and part-time employees, term employees and employees on leave. As of June 30, 2007, we employed approximately 6,400 personnel, including full-time and part-time employees, term employees and employees on leave.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file reports, proxy statements and other information with the SEC. We make available free of charge through our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all other SEC reports and amendments to those reports as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC. Our Web site address is www.fanniemae.com. Materials that we file with the SEC are also available from the SEC's Web site, www.sec.gov. In addition, these materials may be inspected, without charge, and copies may be obtained at prescribed rates, at the SEC's Public Reference Room at 100 F Street, NE,

Room 1580, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also request copies of any filing from us, at no cost, by telephone at (202) 752-7000 or by mail at 3900 Wisconsin Avenue, NW, Washington, DC 20016.

Effective March 31, 2003, we voluntarily registered our common stock with the SEC under Section 12(g) of the Exchange Act. Our common stock, as well as the debt, preferred stock and mortgage-backed securities we

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issue, are exempt from registration under the Securities Act of 1933 and are exempt securities under the Exchange Act. The voluntary registration of our common stock does not affect the exempt status of the debt, equity and mortgage-backed securities that we issue.

With regard to OFHEO's regulation of our activities, you may obtain materials from OFHEO's Web site, www.ofheo.gov. These materials include the September 2004 interim report of OFHEO's findings of its special examination and the May 2006 final report on its findings.

We are providing our Web site address and the Web site addresses of the SEC and OFHEO solely for your information. Information appearing on our Web site or on the SEC's Web site or OFHEO's Web site is not incorporated into this Annual Report on Form 10-K except as specifically stated in this Annual Report on Form 10-K.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, which are statements about matters that are not historical facts. In addition, our senior management may from time to time make forward-looking statements orally to analysts, investors, the news media and others. Forward-looking statements often include words such as expects, anticipates, intends, plans, believes, seeks, estimates, would, should, could, may, or similar words.

Forward-looking statements reflect our management's expectations or predictions of future conditions, events or results based on various assumptions and management's estimates of trends and economic factors in the markets in which we are active, as well as our business plans. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. Our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. There are a number of factors that could cause actual conditions, events or results to differ materially from those described in the forward-looking statements contained in this report, including those factors described in Item 1A Risk Factors.

Factors that could cause actual conditions, events or results to differ materially from those expressed in any forward-looking statements include, among others:

- our expectation that we will file our 2007 Form 10-K on a timely basis, and that we will file our Forms 10-Q for the first, second, and third quarters of 2007 by December 31, 2007;

- our ability to compete in the mortgage and financial services industry and to develop and implement strategies to adapt to changing industry trends;

- our ability to achieve and maintain effective internal control over financial reporting;

- our ability to become and remain current in our SEC financial reporting obligations;

- our ability to overcome reputational harm and negative publicity;

- our ability to continue to operate in compliance with the terms of the OFHEO consent order, including complying with the capital restoration plan provided for by the order;

- changes in applicable legislative or regulatory requirements, including enactment of new oversight legislation, changes to our charter, housing goals, regulatory capital requirements, the exercise or assertion of regulatory or administrative authority beyond historical practice, or regulation of the subprime market;

the expiration of the limitation on our portfolio growth, or our ability to obtain relief from the limitation;

volatility in our financial results due to volatility in the fair value of our financial instruments;

our ability to manage credit risk successfully;

changes in our assumptions regarding interest rates, rates of growth of our business and spreads we expect to earn or required capital levels;

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our ability to issue debt securities in sufficient quantity and at attractive rates to fund our investments;

our ability to maintain our current credit ratings;

failure of our institutional counterparties to perform their obligations;

changes in pricing or valuation methodologies, models, assumptions, estimates or other measurement techniques;

changes in general economic conditions, primarily the U.S. residential housing market;

borrower preferences for fixed-rate mortgages or ARMs;

investor preferences for mortgage loans and mortgage-backed securities rather than other instruments;

our estimates regarding our 2006 and 2007 business results and market share;

our belief that we met our 2006 housing goals and subgoals;

our expectation that meeting our housing goals in 2007 and 2008 will continue to present challenges;

our belief that home prices are likely to continue to decline in 2007;

our expectation that our credit loss ratio in 2007 will increase to what we believe represents our more normal historical range of 4 to 6 basis points;

our expectation that multifamily property vacancy rates will increase;

our expectation that losses on certain guaranty contracts will more than double in 2007 compared to 2006;

our expectation of continued increased investments in goals-targeted products in 2007;

our expectation that we will continue to invest in LIHTC partnerships;

our expectation that, for the Capital Markets group, in normal market conditions, our selling activity will represent a modest portion of the total change in the total portfolio for the year;

our expectation that we will reduce our administrative expenses by \$200 million in 2007 compared to 2006; and

our expectation that our ongoing daily operations costs will be reduced to approximately \$2 billion in 2008.

Readers are cautioned not to place undue reliance on forward-looking statements in this report or that we make from time to time, and to consider carefully the factors discussed in Item 1A Risk Factors in evaluating these forward-looking statements. These forward-looking statements are representative only as of the date they are made, and we undertake no obligation to update any forward-looking statement as a result of new information, future events or otherwise except as required under the federal securities laws.

Item 1A. Risk Factors

This section identifies specific risks that should be considered carefully in evaluating our business. The risks described in **Company Risks** are specific to us and our business, while those described in **Risks Relating to Our Industry** relate to the industry in which we operate. Any of these risks could adversely affect our business, results of operations, cash flow or financial condition. We believe that these risks represent the material risks relevant to us, our business and our industry, but new material risks to our business may emerge that we are currently unable to predict. The risks discussed below could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report.

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COMPANY RISKS

We are subject to credit risk relating to both the mortgage assets that we hold in our portfolio and the mortgage loans that back our Fannie Mae MBS, and any resulting delinquencies and credit losses could adversely affect our financial condition, liquidity and results of operations.

We are exposed to credit risk on our mortgage credit book of business because either we hold the mortgage assets in our portfolio, which consists of mortgage loans, Fannie Mae MBS and non-Fannie Mae mortgage-related securities, or we have issued a guaranty in connection with the creation of Fannie Mae MBS backed by mortgage assets. Borrowers of mortgage loans that we own or that back our Fannie Mae MBS or non-Fannie Mae mortgage-related securities may fail to make the required payments of principal and interest on those loans, exposing us to the risk of credit losses. Factors that affect the level of our risk of credit losses include the financial strength and credit profile of the borrower, the structure of the loan, the type and characteristics of the property securing the loan, and local, regional and national economic conditions.

For example, loans that have unpaid principal balances that are high in relation to the value of the property, which are commonly referred to as loans with high loan-to-value (LTV) ratios, generally tend to have a higher risk of default and, if a default occurs, a greater risk that the amount of the gross loss will be high compared to loans with lower LTV ratios. The LTV ratio of an outstanding mortgage loan changes as the unpaid principal balance of the loan and the value of the property securing the loan change. Depending on the structure of the loan, the unpaid principal balance of the loan may increase or decrease over time. Similarly, depending on local, regional and national economic conditions, or the underlying supply and demand for housing, the value of the property securing the loan may increase or decrease over time. As of December 31, 2006, approximately 10% of our conventional single-family mortgage credit book of business consisted of loans with a mark-to-market estimated loan-to-value ratio greater than 80%.

The proportion of higher risk mortgage loans that were originated in the market between 2003 and mid-2006 increased significantly. As a result, our purchase and securitization of loans that pose a higher credit risk, such as negative-amortizing adjustable-rate mortgages (ARMs), interest-only loans and subprime mortgage loans, also increased, although to a lesser degree than many other institutions. In addition, we increased the proportion of reduced documentation loans that we purchased to hold or to back our Fannie Mae MBS.

For example, negative-amortizing ARMs represented approximately 3% of our conventional single-family business volume in both 2005 and 2006. Interest-only ARMs represented approximately 9% of our conventional single-family business volume in both 2005 and 2006, and approximately 7% as of June 30, 2007. Negative-amortizing ARMs and interest-only ARMs together represented approximately 6% of our conventional single-family mortgage credit book of business as of December 31, 2005, December 31, 2006, and June 30, 2007.

We also estimate that approximately 12% and 11% of our single-family mortgage credit book of business as of June 30, 2007 and December 31, 2006, respectively, consisted of Alt-A mortgage loans or structured Fannie Mae MBS backed by Alt-A mortgage loans, and approximately 1% of our single-family mortgage credit book of business consisted of private-label mortgage-related securities backed by Alt-A mortgage loans, including resecuritizations, as of both June 30, 2007 and December 31, 2006. We estimate that subprime loans represented approximately 2.2% of our single-family mortgage credit book of business as of both June 30, 2007 and December 31, 2006, of which approximately 0.2% consisted of subprime mortgage loans or structured Fannie Mae MBS backed by subprime mortgage loans and approximately 2% consisted of private-label mortgage-related securities backed by subprime mortgage loans, including resecuritizations.

We expect to experience increased delinquencies and credit losses in 2007 compared with 2006, and the increase in our exposure to credit risk resulting from our purchase or securitization of loans with higher credit risk may cause a

further increase in the delinquencies and credit losses we experience. An increase in the delinquencies and credit losses we experience is likely to reduce our earnings during that period and also could adversely affect our financial condition.

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We depend on our institutional counterparties to provide services that are critical to our business, and our earnings and liquidity may be reduced if one or more of our institutional counterparties defaults in its obligations to us.

We face the risk that one or more of our institutional counterparties may fail to fulfill their contractual obligations to us. Our primary exposure to institutional counterparty risk is with our mortgage insurers, mortgage servicers, depository institutions, lender customers, dealers that commit to sell mortgage pools or loans to us, issuers of investments held in our liquid investment portfolio, and derivatives counterparties. In some cases, our business with institutional counterparties is heavily concentrated. As of December 31, 2006, our ten largest single-family mortgage servicers serviced 73% of our single-family mortgage credit book of business, and Countrywide Financial Corporation, which is our largest single-family mortgage servicer, serviced 22% of our single-family mortgage credit book of business. Also, as of December 31, 2006, we had outstanding transactions with 21 interest rate and foreign currency derivatives counterparties, of which seven counterparties accounted for approximately 78% of the total outstanding notional amount of our derivatives contracts. Each of these seven counterparties accounted for between approximately 6% and 16% of the year-end 2006 total outstanding notional amount. Further, as of December 31, 2006, our ten largest depository counterparties held 88% of the \$34.5 billion in deposits held by all of our depository counterparties for scheduled MBS payments. In addition, we anticipate that consolidations may occur within the mortgage or other industries that are significant to our business, which would further increase our concentration risk to individual counterparties. Some of our counterparties also may become subject to serious liquidity problems affecting, either temporarily or permanently, the viability of their business plans due to mortgage repurchase obligations, margin calls, or lack of market access to regular sources of funding, which likely would adversely affect their ability to meet their obligations to us. The products or services that these counterparties provide are critical to our business operations, and a default by a counterparty with significant obligations to us could adversely affect our ability to conduct our operations efficiently and at cost-effective rates, which in turn could adversely affect our results of operations and our financial condition.

We have several key lender customers, and the loss of business volume from any one of these customers could adversely affect our business and result in a decrease in our market share and earnings.

Our ability to generate revenue from the purchase and securitization of mortgage loans depends on our ability to acquire a steady flow of mortgage loans from the originators of those loans. We acquire a significant portion of our mortgage loans from several large mortgage lenders. For 2006 and for the first six months of 2007, our top five lender customers of single-family mortgage loans accounted for approximately 51% and 57%, respectively, of our single-family business volume, and the top five lender customers of multifamily mortgage loans accounted for approximately 50% and 53%, respectively, of our multifamily business volume during those periods. In addition, during 2006 and during the first six months of 2007, our largest lender customer of single-family mortgage loans accounted for approximately 26% and 31%, respectively, of our single-family business volume, and our largest lender customer of multifamily mortgage loans accounted for approximately 16% and 20%, respectively, of our multifamily business volume during those periods. Accordingly, maintaining our current business relationships and business volumes with our top lender customers is critical to our business. During the recent disruption in the subprime market, a number of lenders began to originate fewer mortgage loans. If any of our key lender customers significantly reduces the volume of mortgage loans that the lender delivers to us or that we are willing to buy from them, we could lose significant business volume that we might be unable to replace. The loss of business from any one of our key lender customers could adversely affect our business and result in a decrease in our market share and earnings. In addition, a significant reduction in the volume of mortgage loans that we securitize, whether resulting from a decrease in the volume of mortgage loans available to us from lenders or from our inability to purchase loans as a result of the limit on the size of our portfolio, could reduce the liquidity of Fannie Mae MBS, which in turn could have an adverse effect on their market value.

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Changes in option-adjusted spreads or interest rates, or our inability to manage interest rate risk successfully, could have a material adverse effect on our financial condition and our earnings.

We fund our operations primarily through the issuance of debt and invest our funds primarily in mortgage-related assets that permit the mortgage borrowers to prepay the mortgages at any time. These business activities expose us to market risk, which is the risk of loss from adverse changes in market conditions. Our most significant market risks are interest rate risk and option-adjusted spread risk. Changes in interest rates affect both the value of our mortgage assets and prepayment rates on our mortgage loans.

Option-adjusted spread risk is the risk that the option-adjusted spreads on our mortgage assets relative to those on our funding and hedging instruments (referred to as the OAS of our net assets) may increase or decrease. These increases or decreases may be a result of market supply and demand dynamics. A widening, or increase, of the OAS of our net mortgage assets typically causes a decline in the fair value of the company. A narrowing, or decrease, of the OAS of our net mortgage assets will reduce our opportunities to acquire mortgage assets and therefore could have a material adverse effect on our future earnings and financial condition. We do not attempt to actively manage or hedge the impact of changes in the OAS of our net mortgage assets after we purchase mortgage assets, other than through asset monitoring and disposition.

Changes in interest rates could have a material adverse effect on our business results and financial condition, including asset impairments or losses on assets sold, particularly if actual conditions differ significantly from our expectations. Our ability to manage interest rate risk depends on our ability to issue debt instruments with a range of maturities and other features at attractive rates and to engage in derivative transactions. We must exercise judgment in selecting the amount, type and mix of debt and derivative instruments that will most effectively manage our interest rate risk. The amount, type and mix of financial instruments we select may not offset possible future changes in the spread between our borrowing costs and the interest we earn on our mortgage assets.

We make significant use of business and financial models to manage risk. We recognize that models are inherently imperfect predictors of actual results because they are based on the information we input based on data available to us and on our assumptions about factors such as future loan demand, prepayment speeds and other factors that may overstate or understate future experience. Therefore, our financial condition, results of operations and liquidity could be adversely affected if our models fail to produce reliable results.

Our ability to operate our business, meet our obligations and generate net interest income depends primarily on our ability to issue substantial amounts of debt frequently and at attractive rates.

The issuance of short-term and long-term debt securities in the domestic and international capital markets is our primary source of funding for purchasing assets for our mortgage portfolio and repaying or refinancing our existing debt. Moreover, our primary source of revenue is the net interest income we earn from the difference, or spread, between our borrowing costs and the return that we receive on our mortgage assets. Our ability to obtain funds through the issuance of debt, and the cost at which we are able to obtain these funds, depends on many factors, including:

- our corporate and regulatory structure, including our status as a GSE;
- legislative or regulatory actions relating to our business, including any actions that would affect our GSE status;
- rating agency actions relating to our credit ratings;
- our financial results and changes in our financial condition;

significant events relating to our business or industry;

the public's perception of the risks to and financial prospects of our business or industry;

the preferences of debt investors;

the breadth of our investor base;

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prevailing conditions in the capital markets;

foreign exchange rates;

interest rate fluctuations;

competition from other issuers of AAA-rated agency debt;

general economic conditions in the U.S. and abroad; and

broader trade and political considerations among the U.S. and other countries.

Approximately 49.1% of the Benchmark Notes we issued in 2006 were purchased by non-U.S. investors, including both private institutions and non-U.S. governments and government agencies. Accordingly, a significant reduction in the purchase of our debt securities by non-U.S. investors could have a material adverse effect on both the amount of debt securities we are able to issue and the price we are able to obtain for these securities. Many of the factors that affect the amount of our securities that foreign investors purchase, including economic downturns in the countries where these investors are located, currency exchange rates and changes in domestic or foreign fiscal or monetary policies, are outside our control.

If we are unable to issue debt securities at attractive rates in amounts sufficient to operate our business and meet our obligations, it would have a material adverse effect on our liquidity, financial condition and results of operations.

On June 13, 2006, the U.S. Department of the Treasury announced that it would undertake a review of its process for approving our issuances of debt, which could adversely impact our flexibility in issuing debt securities in the future, including our ability to issue securities that are responsive to the marketplace. We cannot predict whether the outcome of this review will materially impact our current business activities.

Our business is subject to laws and regulations that restrict our operations, that limit the amount of our net mortgage portfolio assets and that restrict our ability to compete optimally, any of which may adversely affect our profitability.

As a federally chartered corporation, we are subject to the limitations imposed by the Charter Act, extensive regulation, supervision and examination by OFHEO and HUD, and regulation by other federal agencies, such as the U.S. Department of the Treasury and the SEC. We are also subject to many laws and regulations that affect our business, including those regarding taxation and privacy. In addition, the policy, approach or regulatory philosophy of these agencies can materially affect our business.

Regulation by OFHEO could adversely affect our results of operations and financial condition. OFHEO has broad authority to regulate our operations and management in order to ensure our financial safety and soundness. For example, to meet our capital plan requirements in 2005, we made significant changes to our business in 2005, including reducing the size of our mortgage portfolio by approximately 20% and reducing our quarterly common stock dividend by 50%. Pursuant to our May 2006 consent order with OFHEO, we may not increase our net mortgage portfolio assets above the amount shown in our minimum capital report as of December 31, 2005 (\$727.75 billion), except in limited circumstances at OFHEO's discretion. As of August 10, 2007, OFHEO has advised us that we should continue to comply with the \$727.75 billion limit on our net mortgage portfolio assets. We anticipate that this limit on the size of our mortgage portfolio may restrict the growth of our net income or may cause it to decrease. This limitation on the size of our portfolio currently prevents us from purchasing assets that we would purchase if we were not subject to this limitation. In addition, to comply with our remediation obligations, we have incurred significant

administrative expenses. Together, these changes contributed to a reduction in our earnings for the year ended December 31, 2006, as compared to the year ended December 31, 2005. We expect the limitation on the size of our mortgage portfolio will have, and the amount of our administrative expenses will continue to have, a negative impact on our earnings in 2007. Similarly, any new or additional regulations that OFHEO may adopt in the future could adversely affect our future earnings and financial condition.

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The consent order also prohibits our Board of Directors from increasing the dividend at any time if payment of the increased dividend would reduce our capital surplus to less than the OFHEO-directed minimum capital requirement. In addition, the OFHEO consent order requires us to provide OFHEO with prior notice of any planned dividend and a description of the rationale for its payment.

If we fail to comply with any of our agreements with OFHEO or with any OFHEO regulation, including those relating to our minimum, core, risk-based or OFHEO-directed capital, we may incur penalties and could be subject to further restrictions on our activities and operations, or to investigation and enforcement actions by OFHEO.

Regulation by HUD and Charter Act limitations could adversely affect our results of operations. HUD supervises our compliance with the Charter Act, which defines our permissible business activities. For example, we may not purchase single-family loans in excess of our conforming loan limits, which are set annually based on U.S. home prices. The conforming loan limit for a one-family mortgage loan in most geographic regions is currently \$417,000. In addition, under the Charter Act, our business is limited to the U.S. housing finance sector. As a result of these limitations on our ability to diversify our operations, our financial condition and earnings depend almost entirely on conditions in a single sector of the U.S. economy, specifically, the U.S. housing market. Our substantial reliance on conditions in the U.S. housing market may adversely affect the investment returns we are able to generate. In addition, the Secretary of HUD must approve any new Fannie Mae conventional mortgage program that is significantly different from those approved or engaged in prior to the enactment of the 1992 Act. As a result, our ability to respond quickly to changes in market conditions by offering new programs in response to these changes is subject to HUD's prior approval process. These restrictions on our business operations may negatively affect our ability to compete successfully with other companies in the mortgage industry from time to time, which in turn may reduce our market share, our earnings and our financial condition.

HUD has established housing goals and subgoals for our business. HUD's housing goals require that a specified portion of our business relate to the purchase or securitization of mortgage loans that finance housing for low- and moderate-income households, housing in underserved areas and qualified housing under the definition of special affordable housing. HUD has increased our housing goals through 2008, and has created purchase money mortgage subgoals that also increase through 2008. These changes in our housing goals and subgoals and declining affordability have made it increasingly challenging to meet our housing goals and subgoals. If we do not meet any enforceable housing goal or subgoal, we may become subject to increased HUD oversight for the following year or be subject to civil money penalties.

Our efforts to meet the increased housing goals and subgoals established by HUD for 2007 and future years may reduce our profitability. In order to obtain business that contributes to our housing goals and subgoals, we have made significant adjustments to our mortgage loan sourcing and purchase strategies. These strategies include entering into some purchase and securitization transactions with lower expected economic returns than our typical transactions. We have also relaxed some of our underwriting criteria to obtain goals-qualifying mortgage loans and increased our investments in higher-risk mortgage loan products that are more likely to serve the borrowers targeted by HUD's goals and subgoals, which could further increase our credit losses.

A decrease in our current credit ratings would have an adverse effect on our ability to issue debt on acceptable terms, which would reduce our liquidity and our earnings.

Our borrowing costs and our broad access to the debt capital markets depend in large part on our high credit ratings, particularly on our senior unsecured debt. Our ratings are subject to revision or withdrawal at any time by the rating agencies. Any reduction in our credit ratings could increase our borrowing costs, limit our access to the capital markets and trigger additional collateral requirements in derivative contracts and other borrowing arrangements. A substantial reduction in our credit ratings would reduce our earnings and materially adversely affect our liquidity, our

ability to conduct our normal business operations and our competitive position. A description of our credit ratings and current ratings outlook is included in Item 7 MD&A Liquidity and Capital Management Liquidity Credit Ratings and Risk Ratings.

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Material weaknesses and other control deficiencies relating to our internal control over financial reporting could result in errors in our reported results and could have a material adverse effect on our operations, investor confidence in our business and the trading prices of our securities.

Management's assessment of our internal control over financial reporting as of December 31, 2006 identified eight material weaknesses in our internal control over financial reporting. As described in Item 9A Controls and Procedures Management's Report on Internal Control Over Financial Reporting Description of Material Weaknesses as of December 31, 2006, we have not yet remediated material weaknesses in our application of GAAP relating to our accounting for certain 2006 securities sold under agreements to repurchase and certain 2006 securities purchased under agreements to resell, our financial reporting process, our information technology applications and infrastructure access controls, and our multifamily lender loss sharing modifications. Until they are remediated, these material weaknesses could lead to errors in our reported financial results and could have a material adverse effect on our operations, investor confidence in our business and the trading prices of our securities. In addition, we are not able at this time to file our periodic reports with the SEC on a timely basis. We believe that we will not have remediated the material weakness relating to our disclosure controls and procedures until we are able to file required reports with the SEC and the NYSE on a timely basis and have remediated all material weaknesses.

In the future, we may identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date. In addition, we cannot be certain that we will be able to maintain adequate controls over our financial processes and reporting in the future.

Our business faces significant operational risks and an operational failure could materially adversely affect our business and our operations.

Shortcomings or failures in our internal processes, people or systems could have a material adverse effect on our risk management, liquidity, financial condition and results of operations; disrupt our business; and result in legislative or regulatory intervention, damage to our reputation and liability to customers. For example, our business is dependent on our ability to manage and process, on a daily basis, a large number of transactions across numerous and diverse markets. These transactions are subject to various legal and regulatory standards. We rely on the ability of our employees and our internal financial, accounting, cash management, data processing and other operating systems, as well as technological systems operated by third parties, to process these transactions and to manage our business. As a result of events that are wholly or partially beyond our control, these employees or third parties could engage in improper or unauthorized actions, or these systems could fail to operate properly. In the event of a breakdown in the operation of our or a third party's systems, or improper actions by employees or third parties, we could experience financial losses, business disruptions, legal and regulatory sanctions, and reputational damage.

Because we use a process of delegated underwriting (with lenders representing and warranting certain criteria) for the single-family mortgage loans we purchase and securitize, we do not independently verify most borrower information that is provided to us. This exposes us to mortgage fraud risk, which is the risk that one or more of the parties involved in a transaction (the borrower, seller, broker, appraiser, title agent, lender or servicer) will misrepresent the facts about a mortgage loan. We may experience financial losses and reputational damage as a result of mortgage fraud.

In addition, our operations rely on the secure processing, storage and transmission of a large volume of private borrower information, such as names, residential addresses, social security numbers, credit rating data and other consumer financial information. Despite the protective measures we take to reduce the likelihood of information breaches, this information could be exposed in several ways, including through unauthorized access to our computer systems, employee error, computer viruses that attack our computer systems, software or networks, accidental delivery of information to an unauthorized party and loss of unencrypted media containing this information. Any of these events could result in significant financial losses, legal and regulatory sanctions, and reputational damage.

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Competition in the mortgage and financial services industries, and the need to develop, enhance, and implement strategies to adapt to changing trends in the mortgage industry and capital markets, may adversely affect our financial condition and earnings.

We compete to acquire mortgage assets for our mortgage portfolio or to securitize mortgage assets into Fannie Mae MBS based on a number of factors, including our speed and reliability in closing transactions, our products and services, the liquidity of Fannie Mae MBS, our reputation and our pricing. We face competition in the secondary mortgage market from other GSEs and from large commercial banks, savings and loan institutions, securities dealers, investment funds, insurance companies and other financial institutions. In addition, increased consolidation within the financial services industry has created larger financial institutions, increasing pricing pressure. The recent decreased rate of growth in U.S. residential mortgage debt outstanding in 2006 and continuing into 2007 has also increased competition in the secondary mortgage market by decreasing the supply of new mortgage loans available for purchase.

We also expect private-label issuers to provide increased competition to our HCD business through their use of CMBS, which often package loans secured by multifamily residential property together with higher yielding loans secured by commercial properties.

This increased competition may adversely affect our business and financial condition and reduce our earnings.

Our ability to develop, enhance, and implement strategies to adapt to changing conditions in the mortgage industry and capital markets, may adversely affect our financial condition and earnings.

The manner in which we compete and the products for which we compete are affected by changing conditions which can take the form of trends or sudden changes to trends in our industry. If we do not effectively respond to these changes, or if our strategies to respond to these changes are not as successful as our prior business strategies, our earnings and liquidity may be reduced and our business and financial condition could be adversely affected. For example, in recent years, the proportion of single-family mortgage loan originations consisting of nontraditional mortgages has increased, and demand for traditional 30-year fixed-rate mortgages, which represents the largest portion of our business volume, decreased. We did not purchase or guarantee large amounts of these nontraditional mortgages in 2004, 2005 or 2006 and, as a result, our estimated share of the single-family mortgage market decreased substantially during this period.

Additionally, we may not be able to execute successfully any new or enhanced strategies that we adopt to address changing conditions. In addition, our strategies, even if fully implemented, may not increase our share of the secondary mortgage market, our revenues or our earnings due to factors beyond our control.

Legislation that would change the regulation of our business could, if enacted, reduce our competitiveness and adversely affect our liquidity, results of operations and financial condition.

The U.S. Congress continues to consider legislation that, if enacted, could materially restrict our operations and adversely affect our business and our earnings. On May 22, 2007, the House of Representatives approved a bill, H.R. 1427, that would establish a new, independent regulator for us and the other GSEs, with broad authority over both safety and soundness and mission. The bill, if enacted into law, would affect us in significant ways, including:

- authorizing the regulator to establish standards by which it may limit the composition and growth of our mortgage investment portfolio;

- authorizing the regulator to increase the level of our required capital for safety and soundness;

authorizing the regulator to review new and existing products and activities for safety and soundness and mission compliance, and requiring prior regulatory approval for all new products;

restructuring the housing goals and changing the method for enforcing compliance;

authorizing, and in some instances requiring, the appointment of a receiver if we become critically undercapitalized; and

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requiring us and Freddie Mac to contribute a percentage of our book of business the sponsor of the bill has estimated a total contribution by us and Freddie Mac combined of \$500 million to \$600 million per year to a fund to support affordable housing.

More recently, on July 31, 2007, the House Committee on Financial Services approved a bill to create an affordable housing trust fund (H.R. 2895). This bill creates an annually funded Trust Fund that does not seek to impose any new obligations on us that do not already exist under H.R. 1427, but is dependent upon passage of H.R. 1427 for funding.

As of the date of this filing, the only GSE reform bill that has been introduced in the Senate is S. 1100. This bill is substantially similar to a bill that was approved by the Senate Committee on Banking, Housing, and Urban Affairs in July 2005, and differs from H.R. 1427 in a number of respects. It is expected that a version of GSE reform legislation more similar to H.R. 1427 could be introduced in the Senate, but the timing is uncertain. Further, we cannot predict the content of any Senate bill that may be introduced or its prospects for Committee approval or passage by the full Senate.

Enactment of GSE legislation similar to these bills could significantly increase the costs of our compliance with regulatory requirements and limit our ability to compete effectively in the market, resulting in a material adverse effect on our business and earnings, our ability to fulfill our mission, and our ability to recruit and retain qualified officers and directors. We cannot predict the prospects for the enactment, timing or content of any congressional legislation, or the impact that any enacted legislation could have on our financial condition or results of operations.

In many cases, our accounting policies and methods, which are fundamental to how we report our financial condition and results of operations, require management to make estimates and rely on the use of models about matters that are inherently uncertain.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in applying many of these accounting policies and methods so that these policies and methods comply with GAAP and reflect management's judgment of the most appropriate manner to report our financial condition and results of operations. In some cases, management must select the appropriate accounting policy or method from two or more alternatives, any of which might be reasonable under the circumstances but might affect the amount of assets, liabilities, revenues and expenses that we report. See Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies for a description of our significant accounting policies.

We have identified the following four accounting policies as critical to the presentation of our financial condition and results of operations:

estimating the fair value of financial instruments;

amortizing cost basis adjustments on mortgage loans and mortgage-related securities held in our portfolio and underlying outstanding Fannie Mae MBS using the effective interest method;

determining our allowance for loan losses and reserve for guaranty losses; and

determining whether an entity in which we have an ownership interest is a variable interest entity and whether we are the primary beneficiary of that variable interest entity and therefore must consolidate the entity.

We believe these policies are critical because they require management to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts

would be reported under different conditions or using different assumptions. Due to the complexity of these critical accounting policies, our accounting methods relating to these policies involve substantial use of models. Models are inherently imperfect predictors of actual results because they are based on assumptions, including assumptions about future events, and actual results could differ significantly.

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The lack of current financial and operating information about the company, along with the restatement of our consolidated financial statements and related events, have had, and likely will continue to have, a material adverse effect on our business and reputation, including increased regulatory requirements and legislative and regulatory scrutiny.

We are subject to risks associated with our announcement in December 2004 that we would restate our previously filed consolidated financial statements. The 2004 Form 10-K that we filed in December 2006, which included restated consolidated financial statements for the years ended December 31, 2003 and 2002 and the six months ended June 30, 2004, was the first periodic report we filed with the SEC since August 2004. Since that time, we have filed our 2005 Form 10-K and this 2006 Form 10-K. Our need to restate our historical financial statements, the delay in producing both restated and more current consolidated financial statements and related problems have had, and in the future may continue to have, an adverse effect on our business and reputation. In addition, we believe that the negative publicity to which we have been subject as a result of our restatement of prior period financial statements and related problems has further contributed to declines in the price of our common stock, an increase in the regulatory requirements to which we are subject, and in legislative and regulatory scrutiny of our business, and could increase our cost of funds and affect our customer relationships.

We are subject to pending civil litigation that, if decided against us, could require us to pay substantial judgments, settlements or other penalties.

A number of lawsuits have been filed against us and certain of our current and former officers and directors relating to our accounting restatement. These suits are currently pending in the U.S. District Court for the District of Columbia and fall within three primary categories: a consolidated shareholder class action lawsuit and two related individual securities actions filed by institutional investors; a consolidated shareholder derivative lawsuit; and a consolidated Employee Retirement Income Security Act of 1974 (ERISA)-based class action lawsuit. The consolidated shareholder derivative action was dismissed on May 31, 2007, but the plaintiffs have initiated an appeal with the U.S. Court of Appeals for the District of Columbia, and, in addition, two new derivative actions have been filed. We may be required to pay substantial judgments, settlements or other penalties and incur significant expenses in connection with the consolidated shareholder class action and consolidated ERISA-based class action, which could have a material adverse effect on our business, our results of operations and our cash flows. In addition, our current and former directors, officers and employees may be entitled to reimbursement for the costs and expenses of these lawsuits pursuant to our indemnification obligations with those persons. We are also a party to several other lawsuits that, if decided against us, could require us to pay substantial judgments, settlements or other penalties. These include a proposed class action lawsuit alleging violations of federal and state antitrust laws and state consumer protection laws in connection with the setting of our guaranty fees and a proposed class action lawsuit alleging that we violated purported fiduciary duties with respect to certain escrow accounts for FHA-insured multifamily mortgage loans. We are unable at this time to estimate our potential liability in these matters. We expect all of these lawsuits to be time-consuming, and they may divert management's attention and resources from our ordinary business operations. More information regarding these lawsuits is included in Item 3 Legal Proceedings and Notes to Consolidated Financial Statements Note 20, Commitments and Contingencies.

The occurrence of a major natural or other disaster in the U.S. could increase our delinquency rates and credit losses or disrupt our business operations and lead to financial losses.

The occurrence of a major natural disaster, terrorist attack or health epidemic in the U.S. could increase our delinquency rates and credit losses in the affected region or regions, which could have a material adverse effect on our financial condition and results of operations. For example, we experienced an increase in our delinquency rates and credit losses as a result of Hurricane Katrina. In addition, as of December 31, 2006, approximately 16% of the gross unpaid principal balance of the conventional single-family loans we held or securitized in Fannie Mae MBS and

approximately 26% of the gross unpaid principal balance of the multifamily loans we held or securitized in Fannie Mae MBS were concentrated in California. Due to this

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geographic concentration in California, a major earthquake or other disaster in that state could lead to significant increases in delinquency rates and credit losses.

The contingency plans and facilities that we have in place may be insufficient to prevent a disruption in the infrastructure that supports our business and the communities in which we are located from having an adverse effect on our ability to conduct business. Potential disruptions may include those involving electrical, communications, transportation and other services we use or that are provided to us. Substantially all of our senior management and investment personnel work out of our offices in the Washington, DC metropolitan area. If a disruption occurs and our senior management or other employees are unable to occupy our offices, communicate with other personnel or travel to other locations, our ability to service and interact with each other and with our customers may suffer, and we may not be successful in implementing contingency plans that depend on communication or travel.

RISKS RELATING TO OUR INDUSTRY

A continuing, or broader, decline in U.S. home prices or in activity in the U.S. housing market could negatively impact our earnings and financial condition.

U.S. home prices rose significantly in recent years. This period of extraordinary home price appreciation has ended. By many measures, prices have declined in 2007, and we expect that they will continue to decline for the remainder of this year and in 2008. Declines in home prices are likely to result in increased delinquencies or defaults on the mortgage assets we own or that back our guaranteed Fannie Mae MBS. In addition, home price declines would reduce the fair value of our mortgage assets. Further, a significant portion of mortgage loans made in recent years contain adjustable-rate terms in which the interest rates are likely to increase periodically throughout the term of the loan or after an initial period in which the rates are fixed. Many ARMs are expected to reset during the remainder of 2007 and 2008 and are expected to require increases in monthly payments, which may lead to increased delinquencies or defaults. In addition, the prevalence of loans made based on limited or no credit or income documentation also increases the likelihood of future increases in delinquencies or defaults on mortgage loans. An increase in delinquencies or defaults likely will result in a higher level of credit losses, which in turn will reduce our earnings.

Our business volume is affected by the rate of growth in total U.S. residential mortgage debt outstanding and the size of the U.S. residential mortgage market. Recently, the rate of growth in total U.S. residential mortgage debt outstanding has slowed sharply in response to the reduced activity in the housing market and national declines in home prices. This trend could be exacerbated if recent increases in mortgage delinquencies and defaults continue. A decline in this growth rate reduces the number of mortgage loans available for us to purchase or securitize, which in turn could lead to a reduction in our net interest income and guaranty fee income. In addition, spreads have expanded in all sectors of the mortgage market, including in the fixed-rate agency MBS market, resulting in at least some price deterioration. This, in turn, has affected the liquidity of many lenders, including lenders that primarily offered only prime mortgage loans. If liquidity issues continue, or increase, the amount of U.S. residential mortgage debt outstanding may decrease, perhaps significantly, which would adversely affect our earnings and could adversely affect the liquidity of our Fannie Mae MBS.

Changes in general market and economic conditions in the U.S. and abroad may adversely affect our financial condition and results of operations.

Our financial condition and results of operations may be adversely affected by changes in general market and economic conditions in the U.S. and abroad. These conditions include short-term and long-term interest rates, the value of the U.S. dollar compared with the value of foreign currencies, fluctuations in both the debt and equity capital markets, employment growth and unemployment rates, and the strength of the U.S. national economy and local economies in the U.S. and economies of other countries with investors that hold our debt. These conditions are beyond

our control, and may change suddenly and dramatically.

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Changes in market and economic conditions could adversely affect us in many ways, including the following:

fluctuations in the global debt and equity capital markets, including sudden and unexpected changes in short-term or long-term interest rates, could decrease the fair value of our mortgage assets, derivatives positions and other investments, negatively affect our ability to issue debt at attractive rates, and reduce our net interest income; and

an economic downturn or rising unemployment in the U.S. could decrease homeowner demand for mortgage loans and increase the number of homeowners who become delinquent or default on their mortgage loans. An increase in delinquencies or defaults would likely result in a higher level of credit losses, which would reduce our earnings. Also, decreased homeowner demand for mortgage loans could reduce our guaranty fee income, net interest income and the fair value of our mortgage assets. An economic downturn could also increase the risk that our counterparties will default on their obligations to us, resulting in an increase in our liabilities and a reduction in our earnings.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own our principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, as well as additional Washington, DC facilities at 3939 Wisconsin Avenue, NW and 4250 Connecticut Avenue, NW. We also own two office facilities in Herndon, Virginia, as well as two additional facilities located in Reston, Virginia, and Urbana, Maryland. These owned facilities contain a total of approximately 1,460,000 square feet of space. We lease the land underlying the 4250 Connecticut Avenue building pursuant to a ground lease that automatically renews on July 1, 2029 for an additional 49 years unless we elect to terminate the lease by providing notice to the landlord of our decision to terminate at least one year prior to the automatic renewal date. In addition, we lease approximately 407,038 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to our principal office. The present lease term for 4000 Wisconsin Avenue expires in April 2008. We have exercised the second of three 5-year renewal options that were included under the original lease terms and this will extend the lease through April 2013. We have one additional 5-year renewal option remaining under the original lease. We also lease an additional approximately 471,000 square feet of office space at seven locations in Washington, DC, suburban Virginia and Maryland. We maintain approximately 454,000 square feet of office space in leased premises in Pasadena, California; Atlanta, Georgia; Chicago, Illinois; Philadelphia, Pennsylvania; and Dallas, Texas. In addition, we lease offices for 58 Fannie Mae Community Business Centers around the U.S., which work with cities, rural areas and underserved communities.

Item 3. Legal Proceedings

This item describes the material legal proceedings, examinations and other matters that: (1) were pending as of December 31, 2006; (2) were terminated during the period from January 1, 2006 through the date of filing of this report; or (3) are pending as of the date of filing of this report. Accordingly, if applicable, the description of a matter will include developments that have occurred since December 31, 2006, as well as those that occurred during 2006.

In addition to the matters specifically described in this item, we are involved in a number of legal and regulatory proceedings that arise in the ordinary course of business that do not have a material impact on our business.

Litigation claims and proceedings of all types are subject to many factors that generally cannot be predicted accurately. For additional information on these proceedings, see Notes to Consolidated Financial Statements Note 20,

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RESTATEMENT-RELATED MATTERS

Securities Class Action Lawsuits

In re Fannie Mae Securities Litigation

Beginning on September 23, 2004, 13 separate complaints were filed by holders of our securities against us, as well as certain of our former officers, in three federal district courts. The complaints in these lawsuits purport to have been made on behalf of a class of plaintiffs consisting of purchasers of Fannie Mae securities between April 17, 2001 and September 21, 2004. The complaints alleged that we and certain of our former officers made material misrepresentations and/or omissions of material facts in violation of the federal securities laws. Plaintiffs' claims were based on findings contained in OFHEO's September 2004 interim report regarding its findings to that date in its special examination of our accounting policies, practices and controls.

All of the cases were consolidated and/or transferred to the U.S. District Court for the District of Columbia. A consolidated complaint was filed on March 4, 2005 against us and former officers Franklin D. Raines, J. Timothy Howard, and Leanne Spencer. The court entered an order naming the Ohio Public Employees Retirement System and State Teachers Retirement System of Ohio as lead plaintiffs. The consolidated complaint generally made the same allegations as the individually-filed complaints. More specifically, the consolidated complaint alleged that the defendants made materially false and misleading statements in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and SEC Rule 10b-5 promulgated thereunder, largely with respect to accounting statements that were inconsistent with the GAAP requirements relating to hedge accounting and the amortization of premiums and discounts. Plaintiffs contend that the alleged fraud resulted in artificially inflated prices for our common stock. Plaintiffs seek unspecified compensatory damages, attorneys' fees, and other fees and costs. Discovery commenced in this action following the denial of the motions to dismiss filed by us and the former officer defendants on February 10, 2006.

On April 17, 2006, the plaintiffs in the consolidated class action filed an amended consolidated complaint that added purchasers of publicly traded call options and sellers of publicly traded put options to the putative class and sought to extend the end of the putative class period from September 21, 2004 to September 27, 2005. On August 14, 2006, the plaintiffs filed a second amended complaint adding KPMG LLP and Goldman, Sachs & Co. as additional defendants and adding allegations based on the May 2006 report issued by OFHEO and the February 2006 report issued by Paul, Weiss, Rifkind, Wharton & Garrison LLP. Our answer to the second amended complaint was filed on January 16, 2007. Plaintiffs filed a motion for class certification on May 17, 2006, and a hearing on that motion was held on June 21, 2007.

On April 16, 2007, KPMG filed cross-claims against us in this action for breach of contract, fraudulent misrepresentation, fraudulent inducement, negligent misrepresentation, and contribution. KPMG is seeking unspecified compensatory, consequential, restitutionary, rescissory, and punitive damages, including purported damages related to injury to KPMG's reputation, legal costs, exposure to legal liability, costs and expenses of responding to investigations related to our accounting, and lost fees. KPMG is also seeking attorneys' fees, costs, and expenses. Fannie Mae filed a motion to dismiss certain of KPMG's cross-claims. That motion was denied on June 27, 2007. We have separately filed a case against KPMG, which is discussed below under "Other Legal Proceedings - KPMG Litigation."

In addition, two individual securities cases have been filed by institutional investor shareholders in the U.S. District Court for the District of Columbia. The first case was filed on January 17, 2006 by Evergreen Equity Trust, Evergreen Select Equity Trust, Evergreen Variable Annuity Trust, and Evergreen International Trust against us and the following current and former officers and directors: Franklin D. Raines, J. Timothy Howard, Leanne Spencer, Thomas P.

Gerrity, Anne M. Mulcahy, Frederick V. Malek, Taylor Segue, III, William Harvey, Joe K. Pickett, Victor Ashe, Stephen B. Ashley, Molly Bordonaro, Kenneth M. Duberstein, Jamie Gorelick, Manuel Justiz, Ann McLaughlin Korologos, Donald B. Marron, Daniel H. Mudd, H. Patrick Swygert, and Leslie Rahl.

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The second individual securities case was filed on January 25, 2006 by 25 affiliates of Franklin Templeton Investments against us, KPMG LLP, and the following current and former officers and directors: Franklin D. Raines, J. Timothy Howard, Leanne Spencer, Thomas P. Gerrity, Anne M. Mulcahy, Frederick V Malek, Taylor Segue, III, William Harvey, Joe K. Pickett, Victor Ashe, Stephen B. Ashley, Molly Bordonaro, Kenneth M. Duberstein, Jamie Gorelick, Manuel Justiz, Ann McLaughlin Korologos, Donald B. Marron, Daniel H. Mudd, H. Patrick Swygert, and Leslie Rahl. On April 27, 2007, KPMG also filed cross-claims against us in this action that are essentially identical to those it alleges in the consolidated class action case.

The two related individual securities actions assert various federal and state securities law and common law claims against us and certain of our current and former officers and directors based upon essentially the same alleged conduct as that at issue in the consolidated shareholder class action, and also assert insider trading claims against certain former officers. Both cases seek unspecified compensatory and punitive damages, attorneys' fees, and other fees and costs. In addition, the Evergreen plaintiffs seek an award of treble damages under state law.

On May 12, 2006, the individual securities plaintiffs voluntarily dismissed defendants Victor Ashe and Molly Bordonaro from both cases. On June 29, 2006 and then again on August 14 and 15, 2006, the individual securities plaintiffs filed first amended complaints and then second amended complaints adding additional allegations regarding improper accounting practices. The second amended complaints each added Radian Guaranty Inc. as a defendant. The court has consolidated these cases as part of the consolidated shareholder class action for pretrial purposes and possibly through final judgment. On July 31, 2007, the court dismissed all of the individual securities plaintiffs' claims against Thomas P. Gerrity, Anne M. Mulcahy, Frederick V. Malek, Taylor Segue, III, William Harvey, Joe K. Pickett, Victor Ashe, Stephen B. Ashley, Molly Bordonaro, Kenneth M. Duberstein, Jamie Gorelick, Manuel Justiz, Ann McLaughlin Korologos, Donald B. Marron, Daniel H. Mudd, H. Patrick Swygert, Leslie Rahl, and Radian Guaranty Inc. In addition, the court dismissed the individual securities plaintiffs' state law claims and certain of their federal securities law claims against us, Franklin D. Raines, J. Timothy Howard, and Leanne Spencer. It also limited the individual securities plaintiffs' insider trading claims against Franklin D. Raines, J. Timothy Howard and Leanne Spencer.

Shareholder Derivative Lawsuits

In re Fannie Mae Shareholder Derivative Litigation

Beginning on September 28, 2004, ten plaintiffs filed twelve shareholder derivative actions (*i.e.*, lawsuits filed by shareholder plaintiffs on our behalf) in three different federal district courts and the Superior Court of the District of Columbia on behalf of the company against certain of our current and former officers and directors and against us as a nominal defendant. Plaintiffs contend that the defendants purposefully misapplied GAAP, maintained poor internal controls, issued a false and misleading proxy statement, and falsified documents to cause our financial performance to appear smooth and stable, and that Fannie Mae was harmed as a result. The claims are for breaches of the duty of care, breach of fiduciary duty, waste, insider trading, fraud, gross mismanagement, violations of the Sarbanes-Oxley Act of 2002, and unjust enrichment. Plaintiffs seek unspecified compensatory damages, punitive damages, attorneys' fees, and other fees and costs, as well as injunctive relief related to the adoption by us of certain proposed corporate governance policies and internal controls.

All of these individual actions have been consolidated into the U.S. District Court for the District of Columbia and the court entered an order naming Pirelli Armstrong Tire Corporation Retiree Medical Benefits Trust and Wayne County Employees Retirement System as co-lead plaintiffs. A consolidated complaint was filed on September 26, 2005. The consolidated complaint named the following current and former officers and directors as defendants: Franklin D. Raines, J. Timothy Howard, Thomas P. Gerrity, Frederick V. Malek, Joe K. Pickett, Anne M. Mulcahy, Daniel H. Mudd, Kenneth M. Duberstein, Stephen B. Ashley, Ann McLaughlin Korologos, Donald B. Marron, Leslie Rahl,

H. Patrick Swygert, and John K. Wulff.

The plaintiffs filed an amended complaint on September 1, 2006. Among other things, the amended complaint added The Goldman Sachs Group, Inc., Goldman, Sachs & Co., Inc., Lehman Brothers, Inc., and Radian

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Insurance Inc. as defendants, added allegations concerning the nature of certain transactions between these entities and Fannie Mae, added additional allegations from OFHEO's May 2006 report on its special examination and the Paul Weiss report, and added other additional details. The plaintiffs have since voluntarily dismissed those newly added third-party defendants. We filed motions to dismiss the first amended complaint and on May 31, 2007, the court issued a Memorandum Opinion and Order dismissing plaintiffs' derivative lawsuit for failing to make a demand on the Board of Directors or to plead specific facts demonstrating that such a demand was excused based upon futility. On June 27, 2007, plaintiffs filed a Notice of Appeal with the U.S. Court of Appeals for the District of Columbia.

On June 29, 2007, one of the original plaintiffs (James Kellmer) in the derivative action filed a new derivative action in the U.S. District Court for the District of Columbia. Mr. Kellmer had originally filed a shareholder derivative action on January 10, 2005, which was later consolidated into the main derivative case. Mr. Kellmer's new complaint alleges that he made a demand on the Board of Directors on September 24, 2004, and that his action should now be allowed to proceed independently. In addition to naming all of the defendants who were named in the amended consolidated complaint, Mr. Kellmer names the following new defendants: James Johnson, Lawrence Small, Jamie Gorelick, Victor Ashe, Molly Bordonaro, William Harvey, Taylor Segue, III, Manuel Justiz, Vincent Mai, Roger Birk, Stephen Friedman, Garry Mauro, Maynard Jackson, Esteban Torres, KPMG LLP and The Goldman Sachs Group, Inc.

The factual allegations in Mr. Kellmer's new complaint are largely duplicative of those in the amended consolidated complaint and it alleges causes of action against the current and former officers and directors based on theories of breach of fiduciary duty, indemnification, negligence, violations of the Sarbanes-Oxley Act of 2002 and unjust enrichment. The complaint seeks unspecified money damages, including legal fees and expenses, disgorgement and punitive damages, as well as injunctive relief.

In addition, another derivative action based on Mr. Kellmer's alleged September 24, 2004 demand was filed on July 6, 2007 by Arthur Middleton in the United States District Court for the District of Columbia. This complaint names the following current and former officers and directors as defendants: Franklin D. Raines, J. Timothy Howard, Daniel H. Mudd, Kenneth M. Duberstein, Stephen B. Ashley, Thomas P. Gerrity, Ann Korologos, Frederic V. Malek, Donald B. Marron, Joe K. Pickett, Leslie Rahl, H. Patrick Swygert, Anne M. Mulcahy, John K. Wulff, The Goldman Sachs Group, Inc., and Goldman, Sachs & Co. The allegations in this new complaint are essentially identical to the allegations in the amended consolidated complaint referenced above, and this plaintiff seeks the identical relief.

ERISA Action

In re Fannie Mae ERISA Litigation (formerly David Gwyer v. Fannie Mae)

Three ERISA-based cases have been filed against us, our Board of Directors' Compensation Committee, and against the following former and current officers and directors: Franklin D. Raines, J. Timothy Howard, Daniel H. Mudd, Vincent A. Mai, Stephen Friedman, Anne M. Mulcahy, Ann McLaughlin Korologos, Joe K. Pickett, Donald B. Marron, Kathy Gallo and Leanne Spencer.

On October 15, 2004, David Gwyer filed a class action complaint in the U.S. District Court for the District of Columbia. Two additional class action complaints were filed by other plaintiffs on May 6, 2005 and May 10, 2005. These cases were consolidated on May 24, 2005 in the U.S. District Court for the District of Columbia. A consolidated complaint was filed on June 15, 2005. The plaintiffs in the consolidated ERISA-based lawsuit purport to represent a class of participants in our ESOP between January 1, 2001 and the present. Their claims are based on alleged breaches of fiduciary duty relating to accounting matters discussed in our SEC filings and in OFHEO's interim report. Plaintiffs seek unspecified damages, attorneys' fees, and other fees and costs, and other injunctive and equitable relief. We and the other defendants filed motions to dismiss the consolidated complaint. These motions were denied on May 8, 2007.

We believe we have defenses to the claims in all of these restatement-related lawsuits and intend to defend these lawsuits vigorously.

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Department of Labor ESOP Investigation

In November 2003, the Department of Labor commenced a review of our ESOP and Retirement Savings Plan. The Department of Labor has concluded its investigation of our Retirement Savings Plan, but continues to review the ESOP. We continue to cooperate fully in this investigation.

RESTATEMENT-RELATED INVESTIGATIONS BY THE U.S. ATTORNEY S OFFICE, OFHEO AND THE SEC

U.S. Attorney s Office Investigation

In October 2004, we were told by the U.S. Attorney s Office for the District of Columbia that it was conducting an investigation of our accounting policies and practices. In August 2006, we were advised by the U.S. Attorney s Office for the District of Columbia that it was discontinuing its investigation of us and does not plan to file charges against us.

OFHEO Special Examination and Settlement

In July 2003, OFHEO notified us that it intended to conduct a special examination of our accounting policies and internal controls, as well as other areas of inquiry. OFHEO began its special examination in November 2003 and delivered an interim report of its findings in September 2004. On May 23, 2006, OFHEO released the final report on its special examination. OFHEO s final report concluded that, during the period covered by the report (1998 to mid-2004), a large number of our accounting policies and practices did not comply with GAAP and we had serious problems in our internal controls, financial reporting and corporate governance. The final OFHEO report is available on our Web site (www.fanniemae.com) and on OFHEO s Web site (www.ofheo.gov).

Concurrent with OFHEO s release of its final report, we entered into comprehensive settlements that resolved open matters with the OFHEO special examination, as well as with the SEC s related investigation (described below). As part of the OFHEO settlement, we agreed to OFHEO s issuance of a consent order. In entering into this settlement, we neither admitted nor denied any wrongdoing or any asserted or implied finding or other basis for the consent order. We also agreed to pay a \$400 million civil penalty, with \$50 million payable to the U.S. Treasury and \$350 million payable to the SEC for distribution to certain shareholders pursuant to the Fair Funds for Investors provision of the Sarbanes-Oxley Act of 2002. We have paid this civil penalty in full. For a description of the OFHEO consent order, see Item 1 Business Our Charter and Regulation of Our Activities OFHEO Regulation OFHEO Consent Order.

SEC Investigation and Settlement

Following the issuance of the September 2004 interim OFHEO report, the SEC informed us that it was investigating our accounting practices.

Concurrently, at our request, the SEC reviewed our accounting practices with respect to hedge accounting and the amortization of premiums and discounts, which OFHEO s interim report had concluded did not comply with GAAP. On December 15, 2004, the SEC s Office of the Chief Accountant announced that it had advised us to (1) restate our financial statements filed with the SEC to eliminate the use of hedge accounting, and (2) evaluate our accounting for the amortization of premiums and discounts, and restate our financial statements filed with the SEC if the amounts required for correction were material. The SEC s Office of the Chief Accountant also advised us to reevaluate the GAAP and non-GAAP information that we previously provided to investors.

On May 23, 2006, without admitting or denying the SEC's allegations, we consented to the entry of a final judgment requiring us to pay the civil penalty described above and permanently restraining and enjoining us from future violations of the anti-fraud, books and records, internal controls and reporting provisions of the federal securities laws. The settlement resolved all claims asserted against us in the SEC's civil proceeding. Our consent to the final judgment was filed as an exhibit to the Form 8-K that we filed with the SEC on

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May 30, 2006. The final judgment was entered by the U.S. District Court of the District of Columbia on August 9, 2006.

OTHER LEGAL PROCEEDINGS

Former CEO Arbitration

On September 19, 2005, Franklin D. Raines, our former Chairman and Chief Executive Officer, initiated arbitration proceedings against Fannie Mae before the American Arbitration Association. On April 10, 2006, the parties convened an evidentiary hearing before the arbitrator. The principal issue before the arbitrator was whether we were permitted to waive a requirement contained in Mr. Raines' s employment agreement that he provide six months notice prior to retiring. On April 24, 2006, the arbitrator issued a decision finding that we could not unilaterally waive the notice period, and that the effective date of Mr. Raines' s retirement was June 22, 2005, rather than December 21, 2004 (his final day of active employment). Under the arbitrator' s decision, Mr. Raines' s election to receive an accelerated, lump-sum payment of a portion of his deferred compensation must now be honored. Moreover, we must pay Mr. Raines any salary and other compensation to which he would have been entitled had he remained employed through June 22, 2005, less any pension benefits that Mr. Raines received during that period. On November 7, 2006, the parties entered into a consent award, which partially resolved the issue of amounts due Mr. Raines. In accordance with the consent award, we paid Mr. Raines \$2.6 million on November 17, 2006. By agreement, final resolution of the unresolved issues was deferred until after our accounting restatement results were announced. On June 26, 2007, counsel for Mr. Raines notified the arbitrator that the parties have been unable to resolve the following issues: Mr. Raines' s entitlement to additional shares of common stock under our performance share plan for the three-year performance share cycle that ended in 2003; Mr. Raines' s entitlement to shares of common stock under our performance share plan for the three-year performance share cycles that ended in each of 2004, 2005 and 2006; and Mr. Raines' s entitlement to additional compensation of approximately \$140,000.

Antitrust Lawsuits

In re G-Fees Antitrust Litigation

Since January 18, 2005, we have been served with 11 proposed class action complaints filed by single-family borrowers that allege that we and Freddie Mac violated the Clayton and Sherman Acts and state antitrust and consumer protection statutes by agreeing to artificially fix, raise, maintain or stabilize the price of our and Freddie Mac' s guaranty fees. Two of these cases were filed in state courts. The remaining cases were filed in federal court. The two state court actions were voluntarily dismissed. The federal court actions were consolidated in the U.S. District Court for the District of Columbia. Plaintiffs filed a consolidated amended complaint on August 5, 2005. Plaintiffs in the consolidated action seek to represent a class of consumers whose loans allegedly contain a guarantee fee set by us or Freddie Mac between January 1, 2001 and the present. The consolidated amended complaint alleges violations of federal and state antitrust laws and state consumer protection and other laws. Plaintiffs seek unspecified damages, treble damages, punitive damages, and declaratory and injunctive relief, as well as attorneys' fees and costs.

We and Freddie Mac filed a motion to dismiss on October 11, 2005. The motion to dismiss has been fully briefed and remains pending. On June 12, 2007, we and Freddie Mac filed a supplemental memorandum in support of the October 11, 2005 motion to dismiss.

We believe we have defenses to the claims in these lawsuits and intend to defend these lawsuits vigorously.

Escrow Litigation

Casa Orlando Apartments, Ltd., et al. v. Federal National Mortgage Association (formerly known as Medlock Southwest Management Corp., et al. v. Federal National Mortgage Association)

A complaint was filed against us in the U.S. District Court for the Eastern District of Texas (Texarkana Division) on June 2, 2004, in which plaintiffs purport to represent a class of multifamily borrowers whose mortgages are insured under Sections 221(d)(3), 236 and other sections of the National Housing Act and are

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held or serviced by us. The complaint identified as a class low- and moderate-income apartment building developers who maintained uninvested escrow accounts with us or our servicer. Plaintiffs Casa Orlando Apartments, Ltd., Jasper Housing Development Company, and the Porkolab Family Trust No. 1 allege that we violated fiduciary obligations that they contend we owe to borrowers with respect to certain escrow accounts and that we were unjustly enriched. In particular, plaintiffs contend that, starting in 1969, we misused these escrow funds and are therefore liable for any economic benefit we received from the use of these funds. Plaintiffs seek a return of any profits, with accrued interest, earned by us related to the escrow accounts at issue, as well as attorneys' fees and costs.

Our motions to dismiss and motion for summary judgment were denied on March 10, 2005. We filed a partial motion for reconsideration of our motion for summary judgment, which was denied on February 24, 2006.

Plaintiffs have filed an amended complaint and a motion for class certification, which was fully briefed and remains pending.

We believe we have defenses to the claims in this lawsuit and intend to defend this lawsuit vigorously.

KPMG Litigation

Fannie Mae v. KPMG LLP

On December 12, 2006, we filed suit against KPMG LLP, our former outside auditor, in the Superior Court of the District of Columbia. The complaint alleges state law negligence and breach of contract claims related to certain audit and other services provided by KPMG. We are seeking compensatory damages in excess of \$2 billion to recover costs related to our restatement and other damages. On December 12, 2006, KPMG removed the case to the U.S. District Court for the District of Columbia. KPMG filed a motion to dismiss our complaint, which was denied on June 13, 2007. On June 13, 2007, the court granted KPMG's motion to consolidate this action with *In re Fannie Mae Securities Litigation* for pretrial purposes.

See Restatement-Related Matters Securities Class Action Lawsuits *In re Fannie Mae Securities Litigation*, for a discussion of KPMG's cross claims against us.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is publicly traded on the New York and Chicago stock exchanges and is identified by the ticker symbol FNM. The transfer agent and registrar for our common stock is Computershare, P.O. Box 43081, Providence, Rhode Island 02940.

Common Stock Data

The following table shows, for the periods indicated, the high and low sales prices per share of our common stock in the consolidated transaction reporting system as reported in the Bloomberg Financial Markets service, as well as the dividends per share declared in each period.

Quarter	High	Low	Dividend
2005			
First quarter	\$ 71.70	\$ 53.72	\$ 0.26
Second quarter	61.66	49.75	0.26
Third quarter	60.21	41.34	0.26
Fourth quarter	50.80	41.41	0.26
2006			
First quarter	\$ 58.60	\$ 48.41	\$ 0.26
Second quarter	54.53	46.17	0.26
Third quarter	56.31	46.30	0.26
Fourth quarter	62.37	54.40	0.40

Holders

As of June 30, 2007, we had approximately 19,000 registered holders of record of our common stock.

Dividends

The table set forth under **Common Stock Data** above presents the dividends we declared on our common stock from the first quarter of 2005 through and including the fourth quarter of 2006.

In January 2005, our Board of Directors reduced our quarterly common stock dividend rate by 50%, from \$0.52 per share to \$0.26 per share. We reduced our common stock dividend rate in order to increase our capital surplus, which was a component of our capital restoration plan. See **Item 1 Business Our Charter and Regulation of Our Activities OFHEO Regulation Capital Restoration Plan and OFHEO-Directed Minimum Capital Requirement** for a description of our capital restoration plan. In December 2006, the Board of Directors increased the common stock dividend to \$0.40 per share and on May 1, 2007, the Board of Directors again increased the common stock dividend to \$0.50 per share. Our Board of Directors will continue to assess dividend payments for each quarter based upon the facts and conditions existing at the time.

Our payment of dividends is subject to certain restrictions, including the submission of prior notification to OFHEO detailing the rationale and process for the proposed dividend and prior approval by the Director of OFHEO of any dividend payment that would cause our capital to fall below specified capital levels. See Item 1 Business Our Charter and Regulation of Our Activities OFHEO Regulation Capital Adequacy Requirements for a description of these restrictions. Payment of dividends on our common stock is also subject to the prior payment of dividends on our 11 series of preferred stock, representing an aggregate of 110,175,000 shares outstanding as of June 30, 2007. Quarterly dividends declared on the shares of our preferred stock outstanding totaled \$243.6 million for the six months ended June 30, 2007. See Notes to Consolidated Financial Statements Note 17, Preferred Stock for detailed information on our preferred stock dividends.

Table of Contents**Securities Authorized for Issuance under Equity Compensation Plans**

The information required by Item 201(d) of Regulation S-K is provided under Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, which is incorporated herein by reference.

Recent Sales of Unregistered Securities

Information about sales and issuances of our unregistered securities during 2006 was provided in Forms 8-K we filed on May 9, 2006, August 9, 2006, November 8, 2006, and February 27, 2007.

The securities we issue are exempted securities under the Securities Act and the Exchange Act to the same extent as obligations of, or guaranteed as to principal and interest by, the U.S. As a result, we do not file registration statements with the SEC with respect to offerings of our securities.

Purchases of Equity Securities by the Issuer

The following table shows shares of our common stock we repurchased from January 2006 through December 2006.

	Total Number of Shares Purchased⁽¹⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program⁽²⁾ (Shares in thousands)	Maximum Number of Shares that May Yet be Purchased Under the Program⁽³⁾⁽⁴⁾
2006				
January	196	\$ 53.23		60,596
February	58	58.10		60,112
March	61	54.04		60,269
April	10	52.60		61,267
May	13	50.38	4	61,160
June	13	48.11	4	61,046
July	11	48.55		60,983
August	52	49.29	23	60,900
September	19	53.91	7	60,669
October	210	58.32		60,526
November	231	59.92		60,047
December	26	60.07	9	59,517
Total	900	\$ 56.32	47	59,517

(1) In addition to shares repurchased as part of the publicly announced programs described in footnote 2 below, these shares consist of: (a) 349,446 shares of common stock reacquired from employees to pay an aggregate of

approximately \$18.9 million in withholding taxes due upon the vesting of restricted stock; (b) 73,181 shares of common stock reacquired from employees to pay an aggregate of approximately \$4.3 million in withholding taxes due upon the exercise of stock options; (c) 418,847 shares of common stock repurchased from employees and members of our Board of Directors to pay an aggregate exercise price of approximately \$24.4 million for stock options; and (d) 12,150 shares of common stock repurchased from employees in a limited number of instances relating to employees' financial hardship.

- (2) Consists of 47,440 shares of common stock repurchased from employees pursuant to our publicly announced employee stock repurchase program. On May 9, 2006, we announced that the Board of Directors had authorized a stock repurchase program (the "Employee Stock Repurchase Program") under which we may repurchase up to \$100 million of our shares of common stock from non-officer employees. On January 21, 2003, we publicly announced that the Board of Directors had approved a stock repurchase program (the "General Repurchase Authority") under which we could purchase in open market transactions the sum of (a) up to 5% of the shares of common stock outstanding as of December 31, 2002 (49.4 million shares) and (b) additional shares to offset stock issued or expected to be issued under our employee benefit plans. Neither the General Repurchase Authority nor the Employee Stock Repurchase Program has a specified expiration date.

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- (3) Consists of the total number of shares that may yet be purchased under the General Repurchase Authority as of the end of the month, including the number of shares that may be repurchased to offset stock that may be issued pursuant to the Stock Compensation Plan of 1993 and the Stock Compensation Plan of 2003. Repurchased shares are first offset against any issuances of stock under our employee benefit plans. To the extent that we repurchase more shares than have been issued under our plans in a given month, the excess number of shares is deducted from the 49.4 million shares approved for repurchase under the General Repurchase Authority. Because of new stock issuances and expected issuances pursuant to new grants under our employee benefit plans, the number of shares that may be purchased under the General Repurchase Authority fluctuates from month to month. No shares were repurchased from August 2004 through December 2006 in the open market pursuant to the General Repurchase Authority. See Notes to Consolidated Financial Statements Note 13, Stock-Based Compensation Plans, for information about shares issued, shares expected to be issued, and shares remaining available for grant under our employee benefit plans. Excludes the remaining number of shares authorized to be repurchased under the Employee Stock Repurchase Program. Assuming a price per share of \$59.76, the average of the high and low stock prices of Fannie Mae common stock on December 29, 2006, approximately 1.6 million shares may yet be purchased under the Employee Stock Repurchase Program.
- (4) Amounts presented for 2006 do not reflect the determinations made by our Board of Directors in February 2007 and in June 2007 not to pay out certain shares expected to be issued under our plans. See Notes to Consolidated Financial Statements Note 13, Stock-Based Compensation Plans for a description of these shares.

Table of Contents**Item 6. Selected Financial Data**

The selected consolidated financial data presented below is summarized from our results of operations for the five-year period ended December 31, 2006, as well as selected consolidated balance sheet data as of December 31, 2006, 2005, 2004, 2003, and 2002. The data presented below should be read in conjunction with the audited consolidated financial statements and related notes and with Item 7 MD&A included in this Annual Report on Form 10-K.

	For the Year Ended December 31,				
	2006	2005	2004	2003	2002
	(Dollars in millions, except per share amounts)				
<u>Income Statement Data:</u>					
Net interest income	\$ 6,752	\$ 11,505	\$ 18,081	\$ 19,477	\$ 18,426
Guaranty fee income	4,174	3,925	3,715	3,376	2,516
Derivative fair value losses, net	(1,522)	(4,196)	(12,256)	(6,289)	(12,919)
Other income (loss) ⁽¹⁾	(927)	(871)	(923)	(4,315)	(1,735)
Income before extraordinary gains (losses) and cumulative effect of change in accounting principle	4,047	6,294	4,975	7,852	3,914
Extraordinary gains (losses), net of tax effect	12	53	(8)	195	
Cumulative effect of change in accounting principle, net of tax effect				34	
Net income	4,059	6,347	4,967	8,081	3,914
Preferred stock dividends and issuance costs at redemption	(511)	(486)	(165)	(150)	(111)
Net income available to common stockholders	3,548	5,861	4,802	7,931	3,803
<u>Per Common Share Data:</u>					
Earnings per share before extraordinary gains (losses) and cumulative effect of change in accounting principle:					
Basic	\$ 3.64	\$ 5.99	\$ 4.96	\$ 7.88	\$ 3.83
Diluted	3.64	5.96	4.94	7.85	3.81
Earnings per share after extraordinary gains (losses) and cumulative effect of change in accounting principle:					
Basic	\$ 3.65	\$ 6.04	\$ 4.95	\$ 8.12	\$ 3.83
Diluted	3.65	6.01	4.94	8.08	3.81
Weighted-average common shares outstanding:					
Basic	971	970	970	977	992
Diluted	972	998	973	981	998
Cash dividends declared per share	\$ 1.18	\$ 1.04	\$ 2.08	\$ 1.68	\$ 1.32

New Business Acquisition Data:

Fannie Mae MBS issues acquired by third parties ⁽²⁾	\$ 417,471	\$ 465,632	\$ 462,542	\$ 850,204	\$ 478,260
Mortgage portfolio purchases ⁽³⁾	185,507	146,640	262,647	572,852	370,641
New business acquisitions	\$ 602,978	\$ 612,272	\$ 725,189	\$ 1,423,056	\$ 848,901

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	2006	2005	As of December 31, 2004	2003	2002
	(Dollars in millions)				
Balance Sheet Data:					
Investments in securities:					
Trading	\$ 11,514	\$ 15,110	\$ 35,287	\$ 43,798	\$ 14,909
Available-for-sale	378,598	390,964	532,095	523,272	520,176
Mortgage loans:					
Loans held for sale	4,868	5,064	11,721	13,596	20,192
Loans held for investment, net of allowance	378,687	362,479	389,651	385,465	304,178
Total assets	843,936	834,168	1,020,934	1,022,275	904,739
Short-term debt	165,810	173,186	320,280	343,662	293,538
Long-term debt	601,236	590,824	632,831	617,618	547,755
Total liabilities	802,294	794,745	981,956	990,002	872,840
Preferred stock	9,108	9,108	9,108	4,108	2,678
Total stockholders' equity	41,506	39,302	38,902	32,268	31,899
Regulatory Capital Data:					
Core capital ⁽⁴⁾	\$ 41,950	\$ 39,433	\$ 34,514	\$ 26,953	\$ 20,431
Total capital ⁽⁵⁾	42,703	40,091	35,196	27,487	20,831
Mortgage Credit Book of Business Data:					
Mortgage portfolio ⁽⁶⁾	\$ 728,932	\$ 737,889	\$ 917,209	\$ 908,868	\$ 799,779
Fannie Mae MBS held by third parties ⁽⁷⁾	1,777,550	1,598,918	1,408,047	1,300,520	1,040,439
Other guarantees ⁽⁸⁾	19,747	19,152	14,825	13,168	12,027
Mortgage credit book of business	\$ 2,526,229	\$ 2,355,959	\$ 2,340,081	\$ 2,222,556	\$ 1,852,245
Ratios:					
	2006	2005	2004	2003	2002
Return on assets ratio ^{(9)*}	0.42%	0.63%	0.47%	0.82%	0.44%
Return on equity ratio ^{(10)*}	11.3	19.5	16.6	27.6	15.2
Equity to assets ratio ^{(11)*}	4.8	4.2	3.5	3.3	3.2
Dividend payout ratio ^{(12)*}	32.4	17.2	42.1	20.8	34.5
Average effective guaranty fee rate (in basis points) ^{(13)*}	21.8bp	21.8bp	21.4bp	21.6bp	19.3bp
Credit loss ratio (in basis points) ^{(14)*}	2.7bp	1.9bp	1.0bp	0.9bp	0.8bp
Earnings to combined fixed charges and preferred stock dividends and issuance costs at redemption ratio ⁽¹⁵⁾	1.12:1	1.23:1	1.22:1	1.36:1	1.16:1

- (1) Includes losses on certain guaranty contracts, investment losses, net; debt extinguishment gains (losses), net; losses from partnership investments; and fee and other income.
- (2) Unpaid principal balance of MBS issued and guaranteed by us and acquired by third-party investors during the reporting period. Excludes securitizations of mortgage loans held in our portfolio.
- (3) Unpaid principal balance of mortgage loans and mortgage-related securities we purchased for our investment portfolio. Includes advances to lenders and mortgage-related securities acquired through the extinguishment of debt.
- (4) The sum of (a) the stated value of outstanding common stock (common stock less treasury stock); (b) the stated value of outstanding non-cumulative perpetual preferred stock; (c) paid-in-capital; and (d) retained earnings. Core capital excludes accumulated other comprehensive income.
- (5) The sum of (a) core capital and (b) the total allowance for loan losses and reserve for guaranty losses, less (c) the specific loss allowance (that is, the allowance required on individually-impaired loans).
- (6) Unpaid principal balance of mortgage loans and mortgage-related securities held in our portfolio.
- (7) Unpaid principal balance of Fannie Mae MBS held by third-party investors. The principal balance of resecuritized Fannie Mae MBS is included only once.

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- (8) Includes additional credit enhancements that we provide not otherwise reflected in the table.
- (9) Net income available to common stockholders divided by average total assets.
- (10) Net income available to common stockholders divided by average outstanding common equity.
- (11) Average stockholders' equity divided by average total assets.
- (12) Common dividend payments divided by net income available to common stockholders.
- (13) Guaranty fee income as a percentage of average outstanding Fannie Mae MBS and other guaranties.
- (14) Charge-offs, net of recoveries and foreclosed property expense (income), as a percentage of the average mortgage credit book of business.
- (15) Earnings includes reported income before extraordinary gains (losses), net of tax effect and cumulative effect of change in accounting principle, net of tax effect plus (a) provision for federal income taxes, minority interest in earnings (losses) of consolidated subsidiaries, losses from partnership investments, capitalized interest and total interest expense. Combined fixed charges and preferred stock dividends and issuance costs at redemption includes (a) fixed charges (b) preferred stock dividends and issuance costs on redemptions of preferred stock, defined as pretax earnings required to pay dividends on outstanding preferred stock using our effective income tax rate for the relevant periods. Fixed charges represent total interest expense and capitalized interest.

Note:

- * Average balances for purposes of the ratio calculations are based on beginning and end of year balances.

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****ORGANIZATION OF MD&A**

We intend for our MD&A to provide information that will assist the reader in better understanding our consolidated financial statements. Our MD&A explains the changes in certain key items in our consolidated financial statements from year to year, the primary factors driving those changes, our risk management processes and results, any known trends or uncertainties of which we are aware that we believe may have a material effect on our future performance, as well as how certain accounting principles affect our consolidated financial statements. Our MD&A also provides information about our three complementary business segments in order to explain how the activities of each segment impact our results of operations and financial condition. This discussion should be read in conjunction with our consolidated financial statements as of December 31, 2006 and the notes accompanying those consolidated financial statements. Readers should also review carefully Item 1 Business Forward-Looking Statements and Item 1A Risk Factors for a description of the forward-looking statements in this report and a discussion of the factors that might cause our actual results to differ, perhaps materially, from these forward-looking statements. Please refer to Glossary of Terms Used in This Report for an explanation of key terms used throughout this discussion.

Our MD&A is organized as follows:

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EXECUTIVE SUMMARY**Our Mission and Business**

Fannie Mae is a mission-driven company, owned by private shareholders (NYSE: FNM) and chartered by Congress to support liquidity and stability in the secondary mortgage market. Our business includes three integrated business segments Single-Family, HCD and Capital Markets that work together to provide services, products and solutions to our lender customers and a broad range of housing partners. Together, our business segments contribute to our chartered mission objectives, helping to increase the total amount of funds available to finance housing in the U.S. and to make homeownership more available and affordable for low-, moderate- and middle-income Americans. We also work with our customers and partners to increase the availability and affordability of rental housing.

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Market and Economic Factors Affecting Our Business

Market Environment: 2001 to Mid-2006

Our business and financial performance are significantly affected by the dynamics of the U.S. residential mortgage market, including the total amount of residential mortgage debt outstanding, the volume and composition of mortgage originations, the level of competition for mortgage assets generally among investors, and the mortgage credit environment.

Between 2001 and mid-2006, the housing and mortgage markets experienced a sustained period of growth due to a combination of factors, including low mortgage interest rates, positive demographic drivers such as household and immigration growth, and an increase in purchases of homes by investors all of which fueled extraordinary growth in home prices. As home prices climbed, decreasing affordability led to significant mortgage product innovation and rapid growth in mortgage products other than fully amortizing, fixed-rate, prime mortgage loans, especially between 2004 and mid-2006. Notably, there was rapid growth in interest-only and negative-amortizing loans, as well as adjustable rate mortgages with initial periods of low fixed rates. These types of loans generally required lower initial monthly payments either because the initial interest rates were lower or because they allowed borrowers to defer repayment of principal or interest. At the same time, there was a relaxation of credit underwriting standards, as the subprime and Alt-A sectors grew rapidly. The features of these new mortgage products allowed more borrowers to obtain mortgage loans, which contributed to continued growth in the housing market. As these products increased in popularity, the proportion of fully amortizing, fixed-rate mortgage originations, which historically have represented the majority of our mortgage credit book of business, decreased significantly.

Between 2001 and mid-2006, the substantial growth in mortgage originations and residential mortgage debt outstanding led to substantial growth in our mortgage credit book of business. In addition, we experienced historically low levels of credit losses due in part to the significant increase in home prices. As the composition of loan originations shifted from fixed-rate mortgages to a greater share of higher risk, less traditional mortgages, we concluded that the market's pricing of a significant portion of these loans did not appropriately reflect the underlying, and often layered, credit risks associated with these products. Based on this assessment, we made a strategic decision to forgo the guaranty of a significant proportion of mortgage loans because they did not meet our risk and pricing criteria. As a result of our decision to maintain a disciplined approach to managing our participation in the single-family mortgage market, we ceded significant market share of issuances of single-family mortgage-related securities to our competitors. We believe, however, that this decision has helped us maintain a mortgage credit book of business with strong credit characteristics overall.

Change in Market Environment: Mid-2006 to Present

After five consecutive years of record home sales, however, the housing market slowed sharply in 2006, especially in the second half of the year. Housing starts fell by 13%; home sales fell by almost 10%; purchase originations fell for the first time this decade; and national home price appreciation slowed sharply in the second half of the year, with some regions of the country experiencing declines in home prices. Several factors contributed to this softening of the housing market, including: below-trend job growth; a decrease in the affordability of homes; and a decline in the share of mortgage originations made to investors and purchasers of second homes. In addition, as short-term interest rates climbed significantly during 2006 relative to long-term interest rates, the yield curve flattened, causing a continued narrowing of the spreads between the rates available for ARMs and fixed-rate mortgage loans. This change reduced the utility of ARM products as a means of increasing home price affordability for borrowers. As a result, for the first time in six years, residential mortgage debt outstanding grew at single-digit rates in 2006. During the first quarter of 2007, this growth rate declined to 6%, its lowest level in nearly 10 years.

As interest rates increased, many subprime loans (namely, ARMs with interest rates that were fixed for only two to three years) began to reset in 2006 from their below-market initial rates to higher interest rates, often at levels higher than then current market rates. The substantial increase in monthly mortgage payments resulting from the reset of the interest rates on these loans, along with increasing interest rates in the market generally

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and on all types of adjustable rate loans in particular, caused default rates to increase, particularly among subprime mortgages. The Mortgage Bankers Association reported in its June 2007 *National Delinquency Survey* that the serious delinquency rate on subprime loans had increased to 8.45% in the first quarter of 2007, compared with 6.32% in the first quarter of 2006. This increase in foreclosures and depressed home prices contributed to higher levels of unsold inventories during 2006 and into 2007. A number of subprime lenders exited the subprime market, and the federal financial regulatory agencies issued guidance tightening lending standards for nontraditional loans. As a result of these dynamics, the flow of capital for subprime lending has slowed substantially, which has affected the market for mortgage-related securities backed by subprime mortgages.

This combination of narrower spreads between the interest rates available for ARMs and the interest rates available for fixed-rate mortgage loans, increased scrutiny by federal regulators, reduced investor activity in the housing market and the subprime market disruption has led to a sharp decline in the prevalence of ARMs and nontraditional loans, an increase in fixed-rate mortgage originations, and wider spreads across all types of mortgage assets.

Impact of Subprime Market on Our Business

We believe that the limited scale and disciplined nature of our participation in the subprime market has helped to protect the company from a material adverse impact of the recent disruption in that market to date. We estimate that, as of June 30, 2007, subprime mortgage loans or structured Fannie Mae MBS backed by subprime mortgage loans represented approximately 0.2% of our single-family mortgage credit book of business. As of June 30, 2007, we had invested in private-label securities backed by subprime mortgage loans totaling \$47.2 billion, which represented approximately 2% of our single-family mortgage credit book of business. Of this \$47.2 billion, approximately \$46.9 billion was rated AAA or the equivalent by two nationally recognized statistical rating agencies, with an overall weighted average credit enhancement of 32% and a minimum credit enhancement of 13%. As of the close of business on August 15, 2007, the day before this filing, none of our \$47.2 billion of subprime-backed securities had been the subject of a credit ratings downgrade, and none had been placed on negative watch by the ratings agencies.

While we have not suffered significant losses from our investments in subprime mortgage-related securities as of the date of this filing the subprime market disruption has contributed to the overall decline in home prices and to the increased inventory of unsold properties. We expect the overall erosion of property values and excess inventories to slow the sale and reduce the sales price of our foreclosed properties. As a result, we expect higher loss severities on our foreclosed properties in 2007.

Summary of Our Financial Results

Consolidated Results

Net income and diluted earnings per share totaled \$4.1 billion and \$3.65, respectively, in 2006, compared with \$6.3 billion and \$6.01 in 2005, and \$5.0 billion and \$4.94 in 2004. The primary drivers of the decrease in net income in 2006 were substantially lower net interest income, higher administrative expenses, and higher credit-related expenses. The negative impact of these items was partially offset by a decrease in derivative fair value losses, lower investment losses, higher guaranty income and a decrease in our tax provision. Below are additional comparative highlights of our performance.

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2006 versus 2005

New business acquisitions decreased 2% from 2005
 7% growth in our mortgage credit book of business
 41% decrease in net interest income to \$6.8 billion
 46 basis points decrease in net interest yield to 0.85%
 6% increase in guaranty fee income to \$4.2 billion
 Derivative fair value losses of \$1.5 billion, compared
 with derivative fair value losses of \$4.2 billion in 2005
 \$961 million, or 45%, increase in administrative
 expenses to \$3.1 billion
 83% increase in credit-related expenses to
 \$783 million
 \$2.2 billion increase in stockholders' equity to
 \$41.5 billion
 \$702 million increase in the non-GAAP estimated fair
 value of our net assets (net of tax effect) to \$42.9 billion

2005 versus 2004

New business acquisitions decreased 16% from 2004
 1% growth in our mortgage credit book of business
 36% decrease in net interest income to \$11.5 billion
 55 basis points decrease in net interest yield to 1.31%
 6% increase in guaranty fee income to \$3.9 billion
 Derivative fair value losses of \$4.2 billion, compared
 with derivative fair value losses of \$12.3 billion in
 2004
 \$459 million, or 28%, increase in administrative
 expenses to \$2.1 billion
 18% increase in credit-related expenses to \$428
 million
 \$0.4 billion increase in stockholders' equity to
 \$39.3 billion
 \$2.1 billion increase in the non-GAAP estimated fair
 value of our net assets (net of tax effect) to
 \$42.2 billion

Both our GAAP net income and the fair value of net assets are affected by our business activities, as well as changes in market conditions, including changes in the relative spread between our mortgage assets and debt, changes in interest rates and changes in implied interest rate volatility. A detailed discussion of the impact of these market variables on our financial performance and other key drivers of year-over-year changes can be found in Consolidated Results of Operations and Supplemental Non-GAAP Information-Fair Value Balance Sheet.

Because our assets and liabilities consist predominately of financial instruments that are recorded in a variety of ways in our consolidated financial statements, we expect our earnings to vary, perhaps substantially, from period to period and also result in volatility in our stockholders' equity and regulatory capital. Specifically, under GAAP we measure and record some financial instruments at fair value, while other financial instruments are recorded at historical cost. We discuss the manner in which we recognize various financial instruments in our financial statements in Critical Accounting Policies Fair Value of Financial Instruments.

One of the major drivers of volatility in our financial performance measures, including GAAP net income, is the accounting treatment for derivatives used to manage interest rate risk in our mortgage portfolio. When we purchase mortgage assets, we use a combination of debt and derivatives to fund those assets and manage the inherent interest rate risk in our mortgage investments. Our net income reflects changes in the fair value of the derivatives we use to manage interest rate risk; however, it does not reflect offsetting changes in the fair value of the majority of our mortgage investments or in any of our debt obligations.

We do not evaluate or manage changes in the fair value of our various financial instruments on a stand-alone basis. Rather, we manage the interest rate exposure on our net assets, which includes all of our assets and liabilities, on an aggregate basis regardless of the manner in which changes in the fair value of different types of financial instruments are recorded in our consolidated financial statements. In Supplemental Non-GAAP Information Fair Value Balance Sheet, we provide a fair value balance sheet that presents all of our assets and liabilities on a comparable basis. Management uses the fair value balance sheet, in conjunction with other risk management measures, to assess our risk profile, evaluate the effectiveness of our risk management strategies and adjust our risk management decisions as necessary. Because the fair value of our net assets reflects the full impact of management's actions as well as current

market conditions, management uses this information to assess performance and gauge how much management is adding to the long-term value of the company.

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Outlook

Industry trends that we believe will have a continued effect on our financial results during 2007 include the decline in the growth of mortgage debt outstanding, the decline in home prices, increasing mortgage interest rates and the disruption in the mortgage market. These factors have led to an increase in the inventory of unsold homes, which has contributed to slower home sales and reduced sale prices following a borrower default on a mortgage loan. As a result of these same factors, however, we expect the growth in our book of business to exceed growth of U.S. residential mortgage debt outstanding as borrowers refinance into the longer term fixed-rate mortgage loans that have always represented the substantial majority of our mortgage credit book of business.

As a result of the decrease in the volume of our interest-earning assets and further increases in the cost of our debt, we expect to experience a continued decline in our net interest income in 2007 at a rate somewhat below the rate of decline in 2006.

We anticipate that the losses we incur at inception of guaranty contracts will more than double in 2007 compared to 2006 as a result of the decline in home prices.

We anticipate a significant increase in our credit losses and credit-related expenses beginning in 2007 compared to the low, and often historically low, level of credit losses and credit-related expenses that we have experienced during the past few years. We expect that our credit loss ratio in 2007 will increase to what we believe represents our more normal historical range of 4 to 6 basis points, although this ratio may move outside that range depending on market factors and the risk profile of our mortgage credit book of business. Market factors that we believe will have a significant effect on our credit losses and credit-related expenses primarily include lack of job stability or growth, declines in home prices and increases in interest rates.

Based on historical housing market data, we believe that a downturn in the housing market is part of the normal industry cycle. We believe that underlying demographic factors, such as household formation rates, the portion of the population within the age ranges conducive to purchasing homes, and the increase in homeownership rates as a result of the high level of immigration during the past 25 years, will support continued long-term demand for new capital to finance the substantial and sustained housing finance needs of American homebuyers.

Business Segment Results

Single-Family Results

Our Single-Family business generated net income of \$2.0 billion, \$2.6 billion and \$2.4 billion in 2006, 2005 and 2004, respectively. Guaranty fee income for our single-family business totaled \$4.8 billion in 2006 and \$4.5 billion in 2005, reflecting an increase in our total single-family mortgage credit book of business from \$2.2 trillion in 2005 to \$2.4 trillion in 2006, and an increase in the average effective guaranty fee rate on the book. The average effective guaranty fee rate is calculated as guaranty fee income as a percentage of the average single-family mortgage credit book of business and excludes losses on certain guaranty contracts.

Our total issuance of single-family Fannie Mae MBS declined by approximately 5% to \$476.1 billion in 2006 compared with \$500.7 billion in 2005. This decline was consistent with the decline in mortgage-related securities issued by all market participants in 2006. Our total issuance of single-family Fannie Mae MBS for the quarter and six months ended June 30, 2007 increased by approximately 26% and 22%, respectively, to an estimated \$148.5 billion and \$280.2 billion, compared with \$117.7 billion and \$229.9 billion for the quarter and six months ended June 30, 2006.

We estimate that our market share of single-family mortgage-related securities issuance increased in each quarter of 2006, reaching 24.7% in the fourth quarter. This trend continued into 2007 as we recorded estimated market shares of 25.0% and 28.3% in the first and second quarters, respectively. These estimates, which are based on publicly available data, exclude previously securitized mortgages and do not reflect purchases of single-family mortgage whole loans. We remained the largest issuer of mortgage-related securities in 2006 and the first two quarters of 2007. This contributed to our strong position in the overall

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market for outstanding mortgage-related securities, which benefited the liquidity and pricing of our MBS relative to securities issued by other market participants.

We believe that our approach to the management of credit risk during the past several years has contributed to our maintenance of a credit book with strong credit characteristics overall, as measured by loan-to-value ratios, credit scores and other loan characteristics that reflect the effectiveness of our credit risk management strategy. At the end of 2006, we estimate that we held or guaranteed approximately 22% of U.S. single-family mortgage debt outstanding. We anticipate that the nature of our credit book, along with our risk management strategies, will tend to reduce the impact on us of the current disruption in the mortgage market. A detailed discussion of our credit risk management strategies and results can be found in *Risk Management* *Credit Risk Management*.

A detailed discussion of the operations, results and factors impacting our Single-Family business can be found in *Business Segment Results* *Single-Family Business*.

HCD Results

Our HCD business generated net income of \$338 million, \$503 million and \$425 million in 2006, 2005 and 2004, respectively.

Our total issuance of multifamily Fannie Mae MBS declined by approximately 40% to \$5.6 billion in 2006 compared with \$9.4 billion in 2005 due, in part, to a decision to move more of our volume to portfolio purchases. Our total multifamily mortgage credit book of business increased to an estimated \$141.5 billion as of December 31, 2006 compared with \$131.7 billion as of December 31, 2005. For the six months ended June 30, 2007, our total issuance of multifamily Fannie Mae MBS totaled \$2.1 billion and our total multifamily mortgage credit book of business increased to an estimated \$158.8 billion as of June 30, 2007. At the end of 2006, we estimate that we held or guaranteed approximately 17% of U.S. multifamily mortgage debt outstanding.

Our tax-advantaged investments, primarily our LIHTC partnerships, continued to contribute significantly to net income by lowering our effective corporate tax rate. LIHTC investments totaled \$8.8 billion in 2006 compared with \$7.7 billion in 2005. The tax benefit associated with our LIHTC investments was the primary reason our 2006 effective corporate tax-rate was reduced from the federal statutory rate of 35% to approximately 4%.

A detailed discussion of the operations, results and factors impacting our HCD business can be found in *Business Segment Results* *HCD Business*.

Capital Markets Results

Our Capital Markets group generated net income of \$1.7 billion, \$3.2 billion and \$2.1 billion in 2006, 2005 and 2004, respectively.

Our gross mortgage portfolio balance as of December 31, 2006 was essentially unchanged from the balance as of December 31, 2005, decreasing by less than 1% to \$724.4 billion. Net interest income decreased substantially in 2006 due to a lower average portfolio balance and a decline in the spread between the average yield on these assets and our borrowing costs. This decline was offset by a 92%, or \$1.2 billion, decline in interest expense accruals on interest rate swaps, which we consider an important component of our cost of funding. Our gross mortgage portfolio balance decreased to \$722.5 billion as of June 30, 2007, consisting of Fannie Mae MBS, loans, non-Fannie Mae agency securities, and non-Fannie Mae non-agency securities totaling \$274.5 billion, \$293.0 billion, \$32.2 billion, and \$122.8 billion, respectively. Our gross mortgage portfolio balance is calculated as the unpaid principal balances of our mortgage loans, and does not reflect, for example, market valuation adjustments, allowance for loan losses,

impairments, unamortized premiums and discounts and the amortization of discounts, premiums, and issuance costs.

The effective management of interest rate risk is fundamental to the overall management of our Capital Markets group. We employ an integrated interest rate risk management strategy that includes asset selection and structuring of our liabilities to match and offset the interest rate characteristics of our balance sheet assets

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and liabilities as much as possible. We believe one measure of the general effectiveness of our interest rate risk management is the estimated impact on our financial condition of changes in the level and slope of the yield curve. We discuss our interest rate risk management in Risk Management Interest Rate Risk and Other Market Risks.

A detailed discussion of the operations, results and factors impacting our Capital Markets group can be found in Business Segment Results Capital Markets Group.

Key 2006 Priorities

We evaluated our performance in 2006 based not only on our financial results, but also in terms of key non-financial priorities for the year. We entered 2006 focused on building a fundamentally stronger and more sound company while managing our businesses effectively in an extremely challenging competitive environment. We gained further clarity on areas of deficiency or weakness in our company in two reports issued during the course of 2006. In February 2006, the law firm of Paul, Weiss, Rifkind, Wharton & Garrison LLP issued a report which was the result of an extensive, independent investigation commissioned by our Board of Directors that reviewed matters related to our accounting, governance, structure and internal controls. In May 2006, OFHEO released the final report of its special examination. Our overriding objective, to effectively and expeditiously address matters raised in these reports while working to achieve our primary mission and business objectives, was reflected in the following corporate priorities, which were approved by our Board of Directors for 2006.

Stabilization: Completing the restatement of our financial statements, effectively managing our capital surplus, building strong and productive relationships with our regulators, and strengthening relationships with our shareholders and the investment community. These formed the key elements of our objective to stabilize our company.

We completed the restatement of our financial statements with the filing of our 2004 10-K on December 6, 2006. We achieved other milestones in our efforts to become a current filer when we filed our 2005 10-K on May 2, 2007, and with the filing of this 2006 10-K. We expect to become a current filer by the end of February 2008.

We made progress toward our stated objective of establishing a common stock dividend competitive with a peer group of large financial institutions by increasing our dividend in the fourth quarter of 2006 and again in the second quarter of 2007. Additionally, our efforts to effectively deploy excess capital have included the redemption of two expensive series of preferred shares.

We view our comprehensive settlements with OFHEO and the SEC, announced on May 23, 2006, as an important early step in building strong relationships with our regulators.

Build our businesses: Building on the existing strengths of our three businesses. This was a key objective for 2006. During the year, we introduced a number of initiatives focused on optimizing business operations, increasing profitability, identifying opportunities to expand sources of revenue within our charter and generating shareholder value. For example, our Capital Markets group teamed with our HCD business to add multifamily-only CMBS to the asset classes in which we invest. In our Single-Family business, we continued to work with our lender partners to support mortgage products across a broader range of the credit spectrum in ways that we believe will represent an attractive use of our shareholders' capital.

Deliver on mission: Achieving our mission objectives, which we view as one of the primary measures of our company's success. In 2006, we took significant steps to address the challenges of meeting our liquidity mission and our HUD goals, including implementing enhancements to MyCommunityMortgage®, an affordable housing

outreach program. In 2007, we introduced HomeStay™, a set of initiatives designed to help our lender partners protect borrowers and to provide some stability to the subprime mortgage market.

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Instill operational discipline: Making continued progress in building out robust controls and instilling operational discipline into all of our functions. We have also made considerable progress in our efforts to remediate identified material weaknesses in our internal control over financial reporting. At December 31, 2005, we reported 20 material weaknesses. During 2006 and the first two quarters of 2007, we reduced the number of outstanding material weaknesses to five, and for each remaining material weakness, remediation plans are either underway or have been completed and await testing for effectiveness.

Focus on our customers and employees: Focusing on reshaping the culture of Fannie Mae to fully reflect the levels of service, engagement, accountability and good management that we believe should characterize a company privileged to serve such an important role in a large and vital market. This, including the ongoing renewal of our people strategy, continues to be a priority of the company.

Current Corporate Priorities

We have adopted and are aggressively pursuing the following key corporate objectives, which we believe will contribute to the achievement of our mission and business objectives:

Grow Revenue: We are engaged in a company-wide effort to explore additional opportunities to serve mortgage lenders, housing agencies and organizations, investors, shareholders, the housing finance market and the company's affordable housing mission with the goal of increasing our revenue base.

Reduce Costs: Management is committed to cost competitiveness and productivity, and, to that end, has undertaken a company-wide effort to reduce our projected ongoing daily operations costs in 2007 by \$200 million compared to 2006. For the longer-term, management intends to reduce the overall cost basis of the company through focused efforts to streamline operations and increase productivity. Our stated objective is to reduce our ongoing daily operations costs, which excludes costs associated with our efforts to return to current financial reporting and various costs that we do not expect to incur on a regular basis, to approximately \$2 billion in 2008.

Exceed Mission: In 2006, we achieved all of our housing goals and subgoals. Our objective is to continue to support the populations targeted by the housing goals by developing products to reach underserved populations and those with unique needs, such as residents of the Gulf Coast. We also intend to provide and expand, as far as possible, liquidity to the overall mortgage market.

Get Current : This key objective refers to our commitment to complete and file our 2006 and 2007 financial statements and remediation of the company's operational and control weaknesses. Becoming a current filer with effective internal controls is a top priority.

Operate in Real Time : We have set a longer-term goal of reengineering the company's business operations to make the enterprise more streamlined, efficient, productive and responsive to the market, lender customers and partners, and regulators.

Accelerate Culture Change: Strengthening our corporate culture remains a top corporate priority. Fannie Mae's culture change efforts are designed to foster professionalism, competitiveness, and humility through the attributes of service, engagement, accountability and, good management.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We describe our most significant accounting policies in Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies.

We have identified four of our accounting policies that require significant estimates and judgments and have a significant impact on our financial condition and results of operations. These policies are considered critical

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because the estimated amounts are likely to fluctuate from period to period due to the significant judgments and assumptions about highly complex and inherently uncertain matters and because the use of different assumptions related to these estimates could have a material impact on our financial condition or results of operations. These four accounting policies are: (i) the fair value of financial instruments; (ii) the amortization of cost basis adjustments using the effective interest method; (iii) the allowance for loan losses and reserve for guaranty losses; and (iv) the assessment of variable interest entities. We evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. Management has discussed each of these significant accounting policies, the related estimates and its judgments with the Audit Committee of the Board of Directors.

Fair Value of Financial Instruments

The use of fair value to measure our financial instruments is fundamental to our financial statements and is our most critical accounting estimate because a substantial portion of our assets and liabilities are recorded at estimated fair value. In certain circumstances, our valuation techniques may involve a high degree of management judgment. The principal assets and liabilities that we record at fair value, and the manner in which changes in fair value affect our earnings and stockholders' equity, are summarized below.

Derivatives initiated for risk management purposes and mortgage commitments: Recorded in the consolidated balance sheets at fair value with changes in fair value recognized in earnings;

Guaranty assets and guaranty obligations: Recorded in the consolidated balance sheets at fair value at inception of the guaranty obligation. The guaranty obligation affects earnings over time through amortization into income as we collect guaranty fees and reduce the related guaranty asset receivable;

Investments in available-for-sale (AFS) or trading securities: Recorded in the consolidated balance sheets at fair value. Unrealized gains and losses on trading securities are recognized in earnings. Unrealized gains and losses on AFS securities are deferred and recorded in stockholders' equity as a component of accumulated other comprehensive income (AOCI);

Held-for-sale (HFS) loans: Recorded in the consolidated balance sheets at the lower of cost or market with changes in the fair value (not to exceed the cost basis of these loans) recognized in earnings; and

Retained interests in securitizations and guaranty fee buy-ups on Fannie Mae MBS: Recorded in the consolidated balance sheets at fair value with unrealized gains and losses recorded in stockholders' equity as a component of AOCI.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing unrelated parties, other than in a forced or liquidation sale. We determine the fair value of these assets and obligations based on our judgment of appropriate valuation methods and assumptions. The degree of management judgment involved in determining the fair value of a financial instrument depends on the availability and reliability of relevant market data, such as quoted market prices. Financial instruments that are actively traded and have quoted market prices or readily available market data require minimal judgment in determining fair value. When observable market prices and data are not readily available or do not exist, management must make fair value estimates based on assumptions and judgments. In these cases, even minor changes in management's assumptions could result in significant changes in our estimate of fair value. These changes could increase or decrease the value of our assets, liabilities, stockholders' equity and net income. We estimate fair values using the following practices:

We use actual, observable market prices or market prices obtained from multiple third parties when available. Pricing information obtained from third parties is internally validated for reasonableness prior to use in the consolidated financial statements.

Where observable market prices are not readily available, we estimate the fair value using market data and model-based interpolations using standard models that are widely accepted within the industry. Market data includes prices of instruments with similar maturities and characteristics, duration, interest rate yield curves, measures of volatility and prepayment rates.

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If market data used to estimate fair value as described above is not available, we estimate fair value using internally developed models that employ techniques such as a discounted cash flow approach. These models include market-based assumptions that are also derived from internally developed models for prepayment speeds, default rates and severity.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), which establishes a framework for measuring fair value under GAAP. SFAS 157 provides a three-level fair value hierarchy for classifying the source of information used in fair value measures and requires increased disclosures about the sources and measurements of fair value. SFAS 157 is required to be implemented on January 1, 2008. We are currently evaluating whether adoption of this standard will result in any changes to our valuation practices. See Item 7 MD&A Impact of Future Adoption of New Accounting Pronouncements for further discussion of SFAS 157.

Estimating fair value is also a critical part of our impairment evaluation process. When the fair value of an investment declines below the carrying value, we assess whether the impairment is other-than-temporary based on management's judgment. If management concludes that a security is other-than-temporarily impaired, we reduce the carrying value of the security and record a reduction in our net income. Factors that we consider in determining whether a decline in the fair value of an investment is other-than-temporary include the length of time and the extent to which fair value is less than its carrying amount and our intent and ability to hold the investment until its value recovers.

Fair Value of Derivatives

Of the financial instruments that we record at fair value in our consolidated balance sheets, changes in the fair value of our derivatives generally have the most significant impact on the variability of our earnings. The following table summarizes the estimated fair values of derivative assets and liabilities recorded in our consolidated balance sheets as of December 31, 2006 and 2005.

Table 1: Derivative Assets and Liabilities at Estimated Fair Value

	As of December 31,	
	2006	2005
	(Dollars in millions)	
Derivative assets at fair value	\$ 4,931	\$ 5,803
Derivative liabilities at fair value	(1,184)	(1,429)
Net derivative assets at fair value	\$ 3,747	\$ 4,374

We present the estimated fair values of our derivatives by the type of derivative instrument in Table 18 of Consolidated Balance Sheet Analysis Derivative Instruments. Our derivatives consist primarily of over-the-counter (OTC) contracts and commitments to purchase and sell mortgage assets. While exchange-traded derivatives can generally be valued using observable market prices or market parameters, OTC derivatives are generally valued using industry-standard models or model-based interpolations that utilize market inputs obtained from widely accepted third-party sources. The valuation models that we use to derive the fair values of our OTC derivatives require inputs such as the contractual terms, market prices, yield curves, and measures of volatility. A substantial majority of our OTC derivatives trade in liquid markets, such as generic forwards, interest rate swaps and options; in those cases,

model selection and inputs do not involve significant judgments.

When internal pricing models are used to determine fair value, we use recently executed comparable transactions and other observable market data to validate the results of the model. Consistent with market practice, we have individually negotiated agreements with certain counterparties to exchange collateral based on the level of fair values of the derivative contracts they have executed. Through our derivatives collateral exchange process, one party or both parties to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required. This sharing of fair value information provides additional support of the recorded fair value for relevant OTC derivative instruments. For more information regarding our derivative counterparty risk practices, see Risk

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Management Credit Risk Management Institutional Counterparty Credit Risk Management. In circumstances where we cannot verify the model with market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value. As markets and products develop and the pricing for certain derivative products becomes more transparent, we continue to refine our valuation methodologies. There were no changes to the quantitative models, or uses of such models, that resulted in a material adjustment to our consolidated statement of income for the years ended December 31, 2006, 2005 and 2004.

See Risk Management Interest Rate Risk Management and Other Market Risks for further discussion of the sensitivity of the fair value of our derivative assets and liabilities to changes in interest rates.

Amortization of Cost Basis Adjustments on Mortgage Loans and Mortgage-Related Securities

We amortize cost basis adjustments on mortgage loans and mortgage-related securities recorded in our consolidated balance sheets through earnings using the interest method by applying a constant effective yield. Cost basis adjustments include premiums, discounts and other adjustments to the original value of mortgage loans or mortgage-related securities that are generally incurred at the time of acquisition. When we buy mortgage loans or mortgage-related securities, we may not pay the seller the exact amount of the unpaid principal balance. If we pay more than the unpaid principal balance, we record a premium that reduces the effective yield below the stated coupon amount. If we pay less than the unpaid principal balance, we record a discount that increases the effective yield above the stated coupon amount.

Pursuant to SFAS No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (an amendment of FASB Statements No. 13, 60, and 65 and rescission of FASB Statement No. 17)* (SFAS 91), cost basis adjustments are amortized into interest income as an adjustment to the yield of the mortgage loan or mortgage-related security based on the contractual terms of the instrument. SFAS 91, however, permits the anticipation of prepayments of principal to shorten the term of the mortgage loan or mortgage-related security if we (i) hold a large number of similar loans for which prepayments are probable and (ii) the timing and amount of prepayments can be reasonably estimated. We meet both criteria on substantially all of the mortgage loans and mortgage-related securities held in our portfolio. For loans that meet both criteria, we use prepayment estimates to determine periodic amortization of the cost basis adjustments related to these loans. For loans that do not meet the criteria, we do not use prepayment estimates to calculate the rate of amortization. Instead, we assume no prepayment and use the contractual terms of the mortgage loans or mortgage-related securities and factor in actual prepayments that occurred during the relevant period in determining the amortization amount. For mortgage loans and mortgage-related securities that meet the criteria allowing us to anticipate prepayments, we must make assumptions about borrower prepayment patterns in various interest rate environments that involve a significant degree of judgment. Typically, we use prepayment forecasts from independent third parties in estimating future prepayments. If actual prepayments differ from our estimated prepayments, it could increase or decrease current period interest income as well as future recognition of interest income. Refer to Table 2 below for an analysis of the potential impact of changes in our prepayment assumptions on our net interest income.

We calculate and apply an effective yield to determine the rate of amortization of cost basis adjustments into interest income over the estimated lives of the investments using the retrospective effective interest method to arrive at a constant effective yield. When appropriate, we group loans into pools or cohorts based on similar risk categories including origination year, coupon bands, acquisition period and product type. We update our amortization calculations based on changes in estimated prepayment rates and, if necessary, we record cumulative adjustments to reflect the updated constant effective yield as if it had been in effect since acquisition.

Sensitivity Analysis for Amortizable Cost Basis Adjustments

Interest rates are a key assumption used in prepayment estimates. Table 2 shows the estimated effect on our net interest income of the amortization of cost basis adjustments for our investments in loans and securities

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using the retrospective effective interest method applying a constant effective yield assuming (i) a 100 basis point increase in interest rates and (ii) a 50 basis point decrease in interest rates as of December 31, 2006 and 2005. We based our sensitivity analysis on these hypothetical interest rate changes because we believe they reflect reasonably possible near-term outcomes as of December 31, 2006 and 2005.

Table 2: Amortization of Cost Basis Adjustments for Investments in Loans and Securities

	For the Year Ended December 31,	
	2006	2005
	(Dollars in millions)	
Unamortized cost basis adjustments	\$ (140)	\$ 344
Reported net interest income	6,752	11,505
Decrease in net interest income from net amortization	(120)	(97)
Percentage effect on net interest income of change in interest rates: ⁽¹⁾		
100 basis point increase	2.6%	1.6%
50 basis point decrease	(3.1)	(2.2)

⁽¹⁾ Calculated based on an instantaneous change in interest rates.

As mortgage rates increase, expected prepayment rates generally decrease, which slows the amortization of cost basis adjustments. Conversely, as mortgage rates decrease, expected prepayment rates generally increase, which accelerates the amortization of cost basis adjustments.

Allowance for Loan Losses and Reserve for Guaranty Losses

The allowance for loan losses and the reserve for guaranty losses represent our estimate of probable credit losses inherent in our portfolio of loans classified as held for investment in our mortgage portfolio, loans that back mortgage-related securities we guarantee, and loans that we have guaranteed under long-term standby commitments. We use the same methodology to determine our allowance for loan losses and our reserve for guaranty losses as the relevant factors affecting credit risk are the same. We strive to mitigate our credit risk by, among other things, working with lender servicers, monitoring loan-to-value ratios and requiring mortgage insurance. See Risk Management Credit Risk Management below for further discussion of how we manage credit risk.

Estimating the allowance for loan losses and the reserve for guaranty losses is complex and requires judgment by management about the effect of matters that are inherently uncertain. We employ a systematic methodology to determine our best estimate of incurred credit losses. When appropriate, our methodology involves grouping loans into pools or cohorts based on similar risk characteristics, including origination year, loan-to-value ratio, loan product type and credit rating. We use internally developed models that consider relevant factors historically affecting loan collectibility, such as default rates, severity of loss rates and adverse situations that may have occurred affecting the borrowers' ability to repay. Management also applies judgment in considering factors that have occurred but are not yet reflected in the loss factors, such as the estimated value of the underlying collateral, other recoveries and external and economic factors. The methodology and the amount of our allowance for loan losses and reserve for guaranty losses are reviewed and approved on a quarterly basis by our Allowance for Loan Losses Oversight Committee, which is a committee chaired by the Chief Risk Officer or his designee and comprised of senior management from the Single-Family and HCD businesses, the Chief Risk Office and the finance organization.

We adjust our estimate of the allowance for loan losses and reserve for guaranty losses based on period-to-period fluctuations in the factors described above. Changes in assumptions used in estimating our allowance for loan losses and reserve for guaranty losses could have a material effect on our net income.

Given that a minimal change in any factor listed above that is used for calculation purposes would have a significant impact to the allowance and reserve liability and that these factors have significant interdependencies, we do not believe a sensitivity analysis isolating one factor is meaningful. Therefore, the following example loss event illustrates the impact to the allowance and reserve liability given changes to

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multiple assumptions used for these factors. For example, the occurrence of a natural disaster, such as a hurricane, may ultimately have an adverse impact on net income and our allowance for loan losses and reserve for guaranty losses. The damage to the properties that serve as collateral for the mortgages held in our portfolio and the mortgages underlying our mortgage-backed securities could increase our exposure to credit risk if the damage to the properties is not covered by hazard or flood insurance. Our estimate of probable credit losses related to a hurricane would involve considerable judgment and assumptions about the extent of the property damage, the impact on borrower default rates, the value of the collateral underlying the loans and the amount of insurance recoveries. In the case of Hurricane Katrina in 2005, we preliminarily estimated default rates, severity of loss rates, value of the underlying collateral, and other potential recoveries. As more information became available, we determined that the property damage was less extensive than had previously been estimated and the amount of insurance recoveries would be greater than previously expected. Accordingly, we revised our initial September 30, 2005 estimate of \$395 million pre-tax in credit losses to an estimate of \$45 million pre-tax in credit losses by the end of 2006.

Consolidation Variable Interest Entities

We are a party to various entities that are considered to be variable interest entities (VIEs) as defined in FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities (an interpretation of ARB No. 51)* (FIN 46R). Generally, a VIE is a corporation, partnership, trust or any other legal structure that either does not have equity investors with substantive voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. We invest in securities issued by VIEs, including Fannie Mae MBS created as part of our securitization program, certain mortgage- and asset-backed securities that were not issued by us and interests in LIHTC partnerships and other limited partnerships. Our involvement with a VIE may also include providing a guaranty to the entity.

FIN 46R indicates that if an entity is a VIE, either a qualitative or a quantitative assessment may be required to support the conclusion of which party, if any, is the primary beneficiary. The primary beneficiary is the party that will absorb a majority of the expected losses or a majority of the expected returns. If the entity is determined to be a VIE, and we either qualitatively or quantitatively determine that we are the primary beneficiary, we are required to consolidate the assets, liabilities and non-controlling interests of that entity.

There is a significant amount of judgment required in interpreting the provisions of FIN 46R and applying them to specific transactions. To determine whether we are the primary beneficiary of an entity, we first perform a qualitative analysis, which requires certain subjective decisions regarding our assessment, including, but not limited to, the design of the entity, the variability that the entity was designed to create and pass along to its interest holders, the rights of the parties and the purpose of the arrangement. If we cannot conclude after qualitative analysis whether we are the primary beneficiary, we perform a quantitative analysis. Quantifying the variability of a VIE s assets is complex and subjective, requiring analysis of a significant number of possible future outcomes as well as the probability of each outcome occurring. The results of each possible outcome are allocated to the parties holding interests in the VIE and, based on the allocation, a calculation is performed to determine which, if any, is the primary beneficiary. The analysis is required when we first become involved with the VIE and on each subsequent date in which there is a reconsideration event (*e.g.*, a purchase of additional beneficial interests).

We perform qualitative analyses on certain mortgage-backed and asset-backed investment trusts. These qualitative analyses consider whether the nature of our variable interests exposes us to credit or prepayment risk, the two primary drivers of variability for these VIEs. For those mortgage-backed investment trusts that we evaluate using quantitative analyses, we use internal models to generate Monte Carlo simulations of cash flows associated with the different credit, interest rate and home price environments. Material assumptions include our projections of interest rates and home prices, as well as our expectations of prepayment, default and severity rates. The projection of future cash flows is a subjective process involving significant management judgment, primarily due to inherent uncertainties related to

the interest rate and home price environment, as well as the actual credit performance of the mortgage loans and securities that are held by each investment trust. If we determine that an investment trust meets the criteria of a VIE, we consolidate the investment trust when our models indicate that we are likely to absorb more than 50% of the variability in the expected losses or expected residual returns.

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We also examine our LIHTC partnerships and other limited partnerships to determine if consolidation is required. We use internal cash flow models that are applied to a sample of the partnerships to qualitatively evaluate homogenous populations to determine if these entities are VIEs and, if so, whether we are the primary beneficiary. Material assumptions we make in determining whether the partnerships are VIEs and, if so, whether we are the primary beneficiary, include the degree of development cost overruns related to the construction of the building, the probability of the lender foreclosing on the building, as well as an investor's ability to use the tax credits to offset taxable income. The projection of cash flows and probabilities related to these cash flows requires significant management judgment because of the inherent limitations that relate to the use of historical loss and cost overrun data for the projection of future events. Additionally, we apply similar assumptions and cash flow models to determine the VIE and primary beneficiary status of our other limited partnership investments.

We are exempt from applying FIN 46R to certain investment trusts if the investment trusts meet the criteria of a qualifying special purpose entity (QSPE), and if we do not have the unilateral ability to cause the trust to liquidate or change the trust's QSPE status. The QSPE requirements significantly limit the activities in which a QSPE may engage and the types of assets and liabilities it may hold. Management judgment is required to determine whether a trust's activities meet the QSPE requirements. To the extent any trust fails to meet these criteria, we would be required to consolidate its assets and liabilities if, based on the provisions of FIN 46R, we are determined to be the primary beneficiary of the entity.

The FASB currently is assessing the guidance for QSPEs, which may affect the entities we consolidate in future periods.

CONSOLIDATED RESULTS OF OPERATIONS

The following discussion of our consolidated results of operations is based on our results for the years ended December 31, 2006, 2005 and 2004. Table 3 presents a condensed summary of our consolidated results of operations for these periods.

Table 3: Condensed Consolidated Results of Operations

	For the Year Ended			Variance			
	December 31,			2006 vs. 2005		2005 vs. 2004	
	2006	2005	2004	\$	%	\$	%
	(Dollars in millions, except per share amounts)						
Net interest income	\$ 6,752	\$ 11,505	\$ 18,081	\$ (4,753)	(41)%	\$ (6,576)	(36)%
Guaranty fee income	4,174	3,925	3,715	249	6	210	6
Losses on certain guaranty contracts	(439)	(146)	(111)	(293)	(201)	(35)	(32)
Fee and other income	859	1,526	404	(667)	(44)	1,122	278
Investment losses, net	(683)	(1,334)	(362)	651	49	(972)	(269)
Derivatives fair value losses, net	(1,522)	(4,196)	(12,256)	2,674	64	8,060	66
Debt extinguishment gains (losses), net	201	(68)	(152)	269	396	84	55
Losses from partnership investments	(865)	(849)	(702)	(16)	(2)	(147)	(21)

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Administrative expenses	(3,076)	(2,115)	(1,656)	(961)	(45)	(459)	(28)
Credit-related expenses ⁽¹⁾	(783)	(428)	(363)	(355)	(83)	(65)	(18)
Other non-interest expenses	(405)	(249)	(599)	(156)	(63)	350	58
Income before federal income taxes and extraordinary gains (losses)	4,213	7,571	5,999	(3,358)	(44)	1,572	26
Provision for federal income taxes	(166)	(1,277)	(1,024)	1,111	87	(253)	(25)
Extraordinary gains (losses), net of tax effect	12	53	(8)	(41)	(77)	61	763
Net income	\$ 4,059	\$ 6,347	\$ 4,967	\$ (2,288)	(36)%	\$ 1,380	28%
Diluted earnings per common share	\$ 3.65	\$ 6.01	\$ 4.94	\$ (2.36)	(39)%	\$ 1.07	22%

(1) Includes provision for credit losses and foreclosed property expense (income).

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Our GAAP net income and diluted earnings per share totaled \$4.1 billion and \$3.65, respectively, in 2006, compared with \$6.3 billion and \$6.01 in 2005 and \$5.0 billion and \$4.94 in 2004. We expect high levels of period-to-period volatility in our results of operations and financial condition as part of our normal business activities. This volatility is primarily due to changes in market conditions that result in periodic fluctuations in the estimated fair value of our derivative instruments, which we recognize in our consolidated statements of income as Derivatives fair value losses, net. The estimated fair value of our derivatives may fluctuate substantially from period to period because of changes in interest rates, expected interest rate volatility and our derivative activity. Based on the composition of our derivatives, we generally expect to report decreases in the aggregate fair value of our derivatives as interest rates decrease.

Our business segments generate revenues from three principal sources: net interest income, guaranty fee income, and fee and other income. Other significant factors affecting our net income include the timing and size of investment and debt repurchase gains and losses, equity investments, the provision for credit losses, and administrative expenses. We provide a comparative discussion of the effect of our principal revenue sources and other listed items on our consolidated results of operations for the three-year period ended December 31, 2006 below. We also discuss other significant items presented in our consolidated statements of income.

Net Interest Income

Net interest income, which is the difference between interest income and interest expense, is a primary source of our revenue. Interest income consists of interest on our consolidated interest-earning assets, plus income from the amortization of discounts for assets acquired at prices below the principal value, less expense from the amortization of premiums for assets acquired at prices above principal value. Interest expense consists of contractual interest on our interest-bearing liabilities and amortization of any cost basis adjustments, including premiums and discounts, which arise in conjunction with the issuance of our debt. The amount of interest income and interest expense recognized in the consolidated statements of income is affected by our investment activity, debt activity, asset yields and our cost of debt. We expect net interest income to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities. Table 4 presents an analysis of our net interest income and net interest yield for 2006, 2005 and 2004.

As described below in Derivatives Fair Value Losses, Net, we supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. The effect of these derivatives, in particular the periodic net interest expense accruals on interest rate swaps, is not reflected in net interest income. See Derivatives Fair Value Losses, Net for additional information.

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	For the Year Ended December 31,								
	2006			2005			2004		
	Average Balance ⁽¹⁾	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance ⁽¹⁾	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance ⁽¹⁾	Interest Income/ Expense	Average Rates Earned/ Paid
(Dollars in millions)									
Interest-earning assets:									
Mortgage loans ⁽²⁾	\$ 376,016	\$ 20,804	5.53%	\$ 384,869	\$ 20,688	5.38%	\$ 400,603	\$ 21,390	5.34%
Mortgage securities	356,872	19,313	5.41	443,270	22,163	5.00	514,529	25,302	4.92
Non-mortgage securities ⁽³⁾	45,138	2,734	6.06	41,369	1,590	3.84	46,440	1,009	2.17
Mutual funds sold and securities purchased under agreements to resell	13,376	641	4.79	6,415	299	4.66	8,308	84	1.01
Advances to lenders	5,365	135	2.52	4,468	104	2.33	4,773	33	0.69
Total interest-earning assets	\$ 796,767	\$ 43,627	5.48%	\$ 880,391	\$ 44,844	5.09%	\$ 974,653	\$ 47,818	4.91%
Interest-bearing liabilities:									
Short-term debt	\$ 164,566	\$ 7,724	4.69%	\$ 246,733	\$ 6,535	2.65%	\$ 331,971	\$ 4,380	1.32%
Long-term debt	604,555	29,139	4.82	611,827	26,777	4.38	625,225	25,338	4.05
Mutual funds purchased and securities sold under agreements to repurchase	320	12	3.75	1,552	27	1.74	3,037	19	0.63
Total interest-bearing liabilities	\$ 769,441	\$ 36,875	4.79%	\$ 860,112	\$ 33,339	3.88%	\$ 960,233	\$ 29,737	3.10%
Impact of net non-interest bearing funding	\$ 27,326		0.16%	\$ 20,279		0.10%	\$ 14,420		0.05%
Net interest income/net interest yield ⁽⁴⁾		\$ 6,752	0.85%		\$ 11,505	1.31%		\$ 18,081	1.86%

(1) Average balances for 2006 were calculated based on the average of the amortized cost amount at the beginning of the year and the amortized cost amount at the end of each respective quarter of the year. Average balances for 2005 and 2004 were calculated based on the average of the amortized cost amount at the beginning of each respective year and the amortized cost amount at the end of each respective year.

(2) Includes nonaccrual loans with an average balance totaling \$6.7 billion, \$7.4 billion and \$7.6 billion for the years ended December 31, 2006, 2005 and 2004, respectively.

- (3) Includes cash equivalents.
- (4) We calculate our net interest yield by dividing our net interest income for the period by the average balance of our total interest-earning assets during the period.

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Table 5 presents the change, or variance, in our net interest income between 2006 and 2005 and between 2005 and 2004 that is attributable to changes in the volume of our interest-earning assets and interest-bearing liabilities and changes in interest rates.

Table 5: Rate/Volume Analysis of Net Interest Income

	2006 vs. 2005			2005 vs. 2004		
	Total Variance	Variance Due to: ⁽¹⁾ Volume	Rate	Total Variance	Variance Due to: ⁽¹⁾ Volume	Rate
	(Dollars in millions)					
Interest income:						
Mortgage loans	\$ 116	\$ (482)	\$ 598	\$ (702)	\$ (845)	\$ 143
Mortgage securities	(2,850)	(4,570)	1,720	(3,139)	(3,557)	418
Non-mortgage securities	1,144	156	988	581	(121)	702
Federal funds sold and securities purchased under agreements to resell	342	333	9	215	(23)	238
Advances to lenders	31	22	9	71	(2)	73
Total interest income	(1,217)	(4,541)	3,324	(2,974)	(4,548)	1,574
Interest expense:						
Short-term debt	1,189	(2,683)	3,872	2,155	(1,355)	3,510
Long-term debt	2,362	(322)	2,684	1,439	(552)	1,991
Federal funds purchased and securities sold under agreements to repurchase	(15)	(32)	17	8	(13)	21
Total interest expense	3,536	(3,037)	6,573	3,602	(1,920)	5,522
Net interest income	\$ (4,753)	\$ (1,504)	\$ (3,249)	\$ (6,576)	\$ (2,628)	\$ (3,948)

(1) Combined rate/volume variances are allocated to both rate and volume based on the relative size of each variance.

Net interest income of \$6.8 billion for 2006 decreased 41% from \$11.5 billion in 2005, driven by a 9% decrease in our average interest-earning assets and a 35% (46 basis points) decline in our net interest yield to 0.85%. The decrease in our average interest-earning assets was due to a lower level of mortgage asset purchases relative to the level of sales and liquidations during 2006. Sales, liquidations, and reduced purchases had the net effect of reducing our average interest-earning assets and resulted in a decrease of 1% in the balance of our net mortgage portfolio to \$726.1 billion as of December 31, 2006. Lower portfolio balances have the effect of reducing the net interest income generated by our portfolio. We continued to experience compression in our net interest margin as the cost of our debt increased due to the interest rate environment. As the Federal Reserve raised the short-term Federal Funds target rate by 100 basis points to 5.25%, the highest level since 2001, the yield curve remained flat-to-inverted throughout 2006 and the cost of our short-term debt rose significantly. The overall increase in the average cost of our debt of 91 basis points more than offset a 39 basis point increase in the average yield on our interest-earning assets in 2006.

Net interest income of \$11.5 billion for 2005 decreased 36% from \$18.1 billion in 2004, driven by a 10% decrease in our average interest-earning assets and a 30% (55 basis points) decline in our net interest yield to 1.31%. The decrease in our average interest-earning assets was due to a lower volume of interest-earning assets attributable to liquidations and a significant increase in the sale of fixed-rate mortgage assets from our portfolio, coupled with a reduced level of mortgage purchases. Sales, liquidations, and reduced purchases had the net effect of reducing our average interest-earning assets and resulted in a decrease of 20% in the balance of our net mortgage portfolio to \$736.5 billion as of December 31, 2005. While our overall debt funding needs declined in 2005, our net interest yield was compressed because of a 78 basis point increase in our average debt funding costs in 2005 that primarily resulted from increases of short-term interest rates by the Federal Reserve of 200 basis points from year end 2004 to year end 2005 and a significant flattening of the yield curve. The increased cost of our debt more than offset an 18 basis point increase in the average yield on our interest-earning assets in 2005.

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Based on the decrease in the volume of our interest-earning assets and the decline in the spread between the average yield on those assets and our borrowing costs that we began to experience at the end of 2004 and that continued throughout 2006, we expect a continued downward trend in our net interest income and net interest yield in 2007, at a rate somewhat below the rate of decline in 2006.

Guaranty Fee Income

Guaranty fee income primarily consists of contractual guaranty fees related to Fannie Mae MBS held in our portfolio and held by third-party investors, adjusted for the amortization of upfront fees and impairment of guaranty assets, net of a proportionate reduction in the related guaranty obligation and deferred profit, and impairment of buy-ups.

Guaranty fee income is primarily affected by the amount of outstanding Fannie Mae MBS and our other guaranties and the compensation we receive for providing our guaranty on Fannie Mae MBS and for providing other guaranties. The amount of compensation we receive and the form of payment varies depending on factors such as the risk profile of the securitized loans, the level of credit risk we assume and the negotiated payment arrangement with the lender. Our payment arrangements may be in the form of an upfront exchange of payments, an ongoing payment stream from the cash flows of the MBS trusts, or a combination. We typically negotiate a contractual guaranty fee with the lender and collect the fee on a monthly basis based on the contractual fee rate multiplied by the unpaid principal balance of loans underlying a Fannie Mae MBS issuance. In lieu of charging a higher contractual fee rate for loans with greater credit risk, we may require that the lender pay an upfront fee to compensate us for assuming the additional credit risk. We refer to this payment as a risk-based pricing adjustment. We also may adjust the monthly contractual guaranty fee rate so that the pass-through coupon rates on Fannie Mae MBS are in more easily tradable increments of a whole or half percent by making an upfront payment to the lender (buy-up) or receiving an upfront payment from the lender (buy-down).

As we receive monthly contractual payments for our guaranty obligation, we recognize guaranty fee income. We defer upfront risk-based pricing adjustments and buy-down payments that we receive from lenders and recognize these amounts as a component of guaranty fee income over the expected life of the underlying assets of the related MBS trusts. We record buy-up payments we make to lenders as an asset and reduce the recorded asset as cash flows are received over the expected life of the underlying assets of the related MBS trusts. We assess buy-ups for other-than-temporary impairment and include any impairment recognized as a component of guaranty fee income. The extent to which we amortize deferred payments into income depends on the rate of expected prepayments, which is affected by interest rates. In general, as interest rates decrease, expected prepayment rates increase, resulting in accelerated accretion into income of deferred fee amounts, which increases our guaranty fee income. Prepayment rates also affect the estimated fair value of buy-ups. Faster than expected prepayment rates shorten the average expected life of the underlying assets of the related MBS trusts, which reduces the value of our buy-up assets and may trigger the recognition of other-than temporary impairment.

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The average effective guaranty fee rate reflects our average contractual guaranty fee rate adjusted for the impact of amortization of deferred amounts and buy-up impairment. Losses on certain guaranty contracts are excluded from the average effective guaranty fee rate. Table 6 shows our guaranty fee income, including and excluding buy-up impairment, our average effective guaranty fee rate, and Fannie Mae MBS activity for 2006, 2005 and 2004.

Table 6: Analysis of Guaranty Fee Income and Average Effective Guaranty Fee Rate

	For the Year Ended December 31,						% Change	
	2006		2005		2004		2006 vs. 2005	2005 vs. 2004
	Amount	Rate ⁽¹⁾	Amount	Rate ⁽¹⁾	Amount	Rate ⁽¹⁾		
	(Dollars in millions)							
Guaranty fee income/average effective guaranty fee rate, excluding buy-up impairment	\$ 4,212	22.0bp	\$ 3,974	22.1bp	\$ 3,751	21.6bp	6%	6%
Buy-up impairment	(38)	(0.2)	(49)	(0.3)	(36)	(0.2)	(22)	36
Guaranty fee income/average effective guaranty fee rate ⁽²⁾	\$ 4,174	21.8bp	\$ 3,925	21.8bp	\$ 3,715	21.4bp	6%	6%
Average outstanding Fannie Mae MBS and other guaranties ⁽³⁾	\$ 1,915,457		\$ 1,797,547		\$ 1,733,060		7%	4%
Fannie Mae MBS issues ⁽⁴⁾	481,704		510,138		552,482		(6)	(8)

(1) Presented in basis points and calculated based on guaranty fee income components divided by average outstanding Fannie Mae MBS and other guaranties for each respective year.

(2) Includes the effect of the reclassification from Guaranty fee income to Losses on certain guaranty contracts of \$146 million and \$111 million for 2005 and 2004, respectively.

(3) Other guaranties include \$19.7 billion, \$19.2 billion and \$14.7 billion as of December 31, 2006, 2005 and 2004, respectively, related to long-term standby commitments we have issued and credit enhancements we have provided.

(4) Reflects unpaid principal balance of MBS issued and guaranteed by us, including mortgage loans held in our portfolio that we securitized during the period and MBS issued during the period that we acquired for our portfolio.

The 6% increase in guaranty fee income in 2006 from 2005 was driven by a 7% increase in average outstanding Fannie Mae MBS and other guaranties, due principally to slower liquidations than experienced in prior periods. The 6% increase in guaranty fee income in 2005 from 2004 was largely due to a 4% increase in average outstanding Fannie Mae MBS and other guaranties. Our average effective guaranty fee rate, which includes the effect of buy-up impairment and excludes losses on certain guaranty contracts, remained steady during the three-year period at 21.8 basis points for 2006 and 2005 and 21.4 basis points for 2004.

Growth in outstanding Fannie Mae MBS depends largely on the volume of mortgage assets made available for securitization and our assessment of the credit risk and pricing dynamics of these mortgage assets. Our MBS issuances decreased in 2006; however, our outstanding Fannie Mae MBS grew because of the reduced level of liquidations in 2006. The decline in MBS issuances in 2006 continues the trend observed in 2005 and 2004. Originations of traditional mortgages, such as conventional fixed-rate loans, which historically have represented the majority of our business volume, began to decline during 2004. Originations of lower credit quality loans, loans with reduced documentation and loans to fund investor properties increased, resulting in a shift in the product mix in the primary mortgage market. Competition from private-label issuers, which have been a significant source of funding for these mortgage products, reduced our market share and level of MBS issuances. In 2006, we began to increase our participation in these product types where we concluded that it would be economically advantageous or that it would contribute to our mission objectives, a trend that has continued in 2007.

Our average effective guaranty fee rate, excluding the effect of buy-up impairments and losses on certain guaranty contracts, was 22.0 basis points in 2006, 22.1 basis points in 2005 and 21.6 basis points in 2004. The decrease in 2006 was primarily due to slower prepayments. As prepayment speeds decrease, we recognize deferred guaranty income at a slower rate.

Table of Contents**Losses on Certain Guaranty Contracts**

While our guaranty fees are subject to competitive pressure and we may enter into transactions with lower expected economic returns than our typical transactions to achieve our housing goals or to maintain our market share, we expect the vast majority of our MBS guaranty transactions to generate positive economic returns over the lives of the related MBS. We negotiate guaranty contracts with our customers based upon our view of the overall economics of the transaction; however, the accounting for our guaranty-related assets and liabilities is not determined at the contract level. Instead, it is determined separately for each individual MBS issuance. We recognize an immediate loss in earnings on new credit guaranteed Fannie Mae MBS issuances where our modeled expectation of returns is below what we believe a market participant would require for that credit risk inclusive of a reasonable profit margin. Although we determine losses at an individual MBS issuance level, we largely price our credit guaranty business on an overall contract basis and establish a single guaranty fee for all the loans included in the contract. Accordingly, a guaranty transaction may result in some loan pools for which we recognize a loss immediately in earnings and other loan pools for which we record deferred profits that are recognized as a component of guaranty fee income over the life of the loans underlying the MBS issuance. We expect that we will subsequently recover the losses recognized at inception on certain guaranty contracts in our consolidated statements of income over time in proportion to our receipt of contractual guaranty fees on those guaranties.

The losses on guaranty transactions that we were required to recognize immediately in earnings totaled \$439 million, \$146 million and \$111 million in 2006, 2005 and 2004, respectively. The increase in these losses in 2006 was driven primarily by the slowdown in home price appreciation in 2006, which resulted in an increase in our modeled expectation of credit risk and higher initial losses on some of our guaranty pools. In addition, our expanded efforts to increase the amount of mortgage financing that we make available to target populations and geographic areas to support our housing goals contributed to the increase in losses during 2006. Because of the likelihood that home prices will continue to decline in 2007, as well as our continued investment in loans that support our housing goals, we expect these losses to more than double in 2007 from 2006.

Fee and Other Income

Fee and other income includes transaction fees, technology fees, multifamily fees and foreign currency exchange gains and losses. Transaction, technology and multifamily fees are largely driven by business volume, while foreign currency exchange gains and losses are driven by fluctuations in exchange rates on our foreign-denominated debt. Table 7 displays the components of fee and other income.

Table 7: Fee and Other Income

	For the Year Ended December 31,		
	2006	2005	2004
	(Dollars in millions)		
Transaction fees	\$ 124	\$ 136	\$ 152
Technology fees	216	223	214
Multifamily fees	292	432	244
Foreign currency exchange gains (losses)	(230)	625	(304)
Other	457	110	98
Fee and other income	\$ 859	\$ 1,526	\$ 404

The \$667 million decrease in fee and other income in 2006 from 2005 was primarily due to a foreign currency exchange loss of \$230 million in 2006, compared with a foreign currency exchange gain of \$625 million in 2005. The \$625 million foreign currency gain recorded in 2005 stemmed from a strengthening of the U.S. dollar relative to the Japanese yen. In addition, we experienced a \$140 million decrease in multifamily fees due to a reduction in refinancing volumes, which were significantly higher in 2005 than in 2006 or 2004. These decreases were partially offset by a \$347 million increase in other fee income, of which \$191 million was due to the recognition of defeasance fees on consolidated multifamily loans and \$111 million was due to

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the reclassification of float income. Float income is income that we earn on cash we hold during the period between when payments are received by us on Fannie Mae MBS and when we remit these payments to certificateholders. We previously recorded float income as a component of interest income. In November 2006, we made operational changes to segregate these funds from our corporate funds, and we began recording float income as a component of Fee and other income, instead of as a component of Interest income.

The \$1.1 billion increase in fee and other income in 2005 over 2004 was primarily due to the foreign currency exchange gain of \$625 million recorded in 2005, compared with a foreign currency exchange loss of \$304 million recorded in 2004. In addition, we experienced a \$188 million increase in multifamily fees due to a significant increase in refinancing volumes during 2005.

Our foreign currency exchange gains (losses) are offset by corresponding net losses (gains) on foreign currency swaps, which are recognized in our consolidated statements of income as a component of Derivatives fair value gains (losses), net. We seek to eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps that effectively convert debt denominated in a foreign currency to debt denominated in U.S. dollars.

Investment Losses, Net

Investment losses, net includes other-than-temporary impairment on AFS securities, lower-of-cost-or-market adjustments on HFS loans, gains and losses recognized on the securitization of loans from our portfolio and the sale of securities, unrealized gains and losses on trading securities and other investment losses. Investment gains and losses may fluctuate significantly from period to period depending upon our portfolio investment and securitization activities, changes in market conditions that may result in fluctuations in the fair value of trading securities, and other-than-temporary impairment. We recorded investment losses of \$683 million, \$1.3 billion and \$362 million in 2006, 2005 and 2004, respectively. Table 8 details the components of investment gains and losses for each year.

Table 8: Investment Losses, Net

	For the Year Ended December 31,		
	2006	2005	2004
	(Dollars in millions)		
Other-than-temporary impairment on AFS securities ⁽¹⁾	\$ (853)	\$ (1,246)	\$ (389)
Lower-of-cost-or-market adjustments on HFS loans	(47)	(114)	(110)
Gains (losses) on Fannie Mae portfolio securitizations, net	152	259	(34)
Gains on sale of investment securities, net	106	225	185
Unrealized gains (losses) on trading securities, net	8	(415)	24
Other investment losses, net	(49)	(43)	(38)
Investment losses, net	\$ (683)	\$ (1,334)	\$ (362)

⁽¹⁾ Excludes other-than-temporary impairment on guaranty assets and buy-ups as these amounts are recognized as a component of guaranty fee income.

Other-than-temporary impairment occurs when we determine that it is probable we will be unable to collect all of the contractual principal and interest payments of a security or if we do not have the ability and intent to hold the security until it recovers to its carrying amount. We consider many factors in assessing other-than-temporary impairment, including the severity and duration of the impairment, recent events specific to the issuer and/or the industry to which the issuer belongs, external credit ratings and recent downgrades, as well as our ability and intent to hold such securities until recovery. We generally view changes in the fair value of our AFS securities caused by movements in interest rates to be temporary. When we either decide to sell a security in an unrealized loss position and do not expect the fair value of the security to fully recover prior to the expected time of sale or determine that a security in an unrealized loss position may be sold in future periods prior to recovery of the impairment, we identify the security as other-than-temporarily impaired in the period that the decision to sell or the determination that the security may be sold is made. For all other

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securities in an unrealized loss position resulting primarily from increases in interest rates, we have the positive intent and ability to hold such securities until the earlier of full recovery or maturity. We may subsequently recover other-than-temporary impairment amounts we record on securities if we collect all of the contractual principal and interest payments due or if we sell the security at an amount greater than its carrying value.

The \$651 million decrease in investment losses, net in 2006 from 2005 was attributable to the following:

A decrease of \$393 million in other-than-temporary impairment on AFS securities. We recognized other-than-temporary impairment of \$853 million in 2006, compared with \$1.2 billion in 2005. The other-than-temporary impairment of \$853 million in 2006 resulted from continued interest rate increases in the first half of 2006, which caused the fair value of certain securities to decline below carrying value. Because we previously recognized significant other-than-temporary amounts on certain securities in 2005 that reduced the carrying value of these securities, the amount of other-than-temporary impairment recognized in 2006 declined relative to 2005.

A \$423 million shift in unrealized amounts recognized on trading securities. We recorded unrealized gains of \$8 million in 2006, compared with unrealized losses of \$415 million in 2005. The unrealized gain in 2006 reflects an increase in the fair value of trading securities due to a decrease in implied volatility during the year. The vast majority of these unrealized gains, however, were offset by unrealized losses that resulted from the general increase in interest rates during the year. In 2005, we recorded an unrealized loss mainly due to fair value losses resulting from the increase in interest rates and the widening of option adjusted spreads.

The \$1.0 billion increase in investment losses, net in 2005 from 2004 was attributable to the combined effect of the following:

An increase of \$857 million in other-than-temporary impairment on AFS securities. We recognized other-than-temporary impairment of \$1.2 billion in 2005 versus \$389 million in 2004. The rising interest rate environment in 2005 caused an overall decline in the fair value of our mortgage-related securities below the carrying value. The increase in impairment was primarily due to the write down in 2005 of certain mortgage-related securities to fair value because we sold these securities before the interest rate impairments recovered.

An increase of \$439 million in unrealized losses on trading securities. We recorded net unrealized losses on trading securities of \$415 million in 2005, compared with net unrealized gains of \$24 million in 2004. The increase in medium- and long-term interest rates during 2005 caused the fair value of our trading securities to decline, resulting in significant unrealized losses for the year. We experienced unrealized gains on trading securities during 2004 due to the modest decrease in long-term interest rates during the year.

A net gain of \$259 million in 2005 on Fannie Mae portfolio securitizations, compared with a net loss of \$34 million in 2004. We experienced a significant increase in portfolio securitizations in 2005 relative to 2004. Cash proceeds from portfolio securitizations totaled \$55.0 billion in 2005, compared with \$12.3 billion in 2004.

On August 15, 2007, the Audit Committee of our Board of Directors reviewed and discussed, with our independent registered public accounting firm, the conclusion of our Chief Financial Officer and our Controller that we are required under GAAP to recognize the other-than-temporary impairment charges described in this 2006 Form 10-K for the year ended December 31, 2006. The Audit Committee affirmed that material impairments had occurred.

During the first six months of 2007, we increased our portfolio of trading securities to approximately \$50 billion and have recorded losses on these securities. Changes in the fair value of our trading securities generally move inversely to

changes in the fair value of our derivatives. Through the first half of the year, gains in the fair value of our derivatives more than offset the losses on our trading securities. In light of the market conditions as of the date of this filing and uncertainty about how long the markets will remain volatile, we may experience an increased level of volatility in the fair value of our trading securities for the remainder

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of 2007. Because the fair value of our trading securities is affected by market fluctuations that cannot be predicted, we cannot estimate the impact of changes in the fair value of our trading securities for the full year.

Derivatives Fair Value Losses, Net

Table 9 presents, by type of derivative instrument, the fair value gains and losses, net on our derivatives. Table 9 also includes an analysis of the components of derivatives fair value gains and losses attributable to net contractual interest expense accruals on our interest rate swaps, terminated derivative contracts and outstanding derivative contracts. The five-year interest rate swap rate is a key reference interest rate affecting the estimated fair value of our derivatives. We present this rate as of the end of each quarter of 2006, 2005 and 2004 in the table below.

Table 9: Derivatives Fair Value Gains (Losses), Net

	For the Year Ended December 31,		
	2006	2005	2004
	(Dollars in millions)		
Risk management derivatives:			
Swaps:			
Pay-fixed	\$ 2,181	\$ 549	\$ (10,640)
Receive-fixed	(390)	(1,118)	3,917
Basis swaps	26	(2)	51
Foreign currency swaps ⁽¹⁾	105	(673)	379
Swaptions:			
Pay-fixed	(1,148)	(1,393)	(3,841)
Receive-fixed	(2,480)	(2,071)	(1,913)
Interest rate caps	100	283	(140)
Other ⁽²⁾	6	8	(22)
Risk management derivatives fair value losses, net	(1,600)	(4,417)	(12,209)
Mortgage commitment derivatives fair value gains (losses), net ⁽³⁾	78	221	(47)
Total derivatives fair value losses, net	\$ (1,522)	\$ (4,196)	\$ (12,256)
Risk management derivatives fair value gains (losses) attributable to:			
Net contractual interest expense accruals on interest rate swaps	\$ (111)	\$ (1,325)	\$ (4,981)
Net change in fair value of terminated derivative contracts from end of prior year to date of termination	(176)	(1,434)	(4,096)
Net change in fair value of outstanding derivative contracts, including derivative contracts entered into during the period	(1,313)	(1,658)	(3,132)
Risk management derivatives fair value losses, net ⁽⁴⁾	\$ (1,600)	\$ (4,417)	\$ (12,209)
	2006	2005	2004

5-year swap rate:

Quarter ended March 31	5.31%	4.63%	3.17%
Quarter ended June 30	5.65	4.15	4.30
Quarter ended September 30	5.08	4.66	3.81
Quarter ended December 31	5.10	4.88	4.02

- (1) Includes the effect of net contractual interest expense of approximately \$71 million for 2006. The change in fair value of foreign currency swaps excluding this item resulted in a net gain of \$176 million.
- (2) Includes MBS options, forward starting debt, forward purchase and sale agreements, swap credit enhancements, mortgage insurance contracts and exchange-traded futures.

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- (3) The subsequent recognition in our consolidated statements of income associated with cost basis adjustments that we record upon the settlement of mortgage commitments accounted for as derivatives resulted in income of approximately \$14 million in 2006 and expense of \$870 million and \$541 million in 2005 and 2004, respectively. These amounts are reflected in our consolidated statements of income as a component of either Net interest income or Investment losses, net.
- (4) Reflects net derivatives fair value losses recognized in the consolidated statements of income, excluding mortgage commitments.

Because a significant portion of our derivatives consists of pay-fixed swaps, we expect the aggregate estimated fair value of our derivatives to decline and result in derivatives losses when interest rates decline because we are paying a higher fixed rate of interest relative to the current interest rate environment. Conversely, we expect the aggregate fair value to increase when interest rates rise. In addition, even when there is no change in interest rates or implied volatility, we generally would expect to record aggregate net fair value losses on our derivatives because we have a significant amount of purchased options where the time value of the upfront premium we pay for these options decreases due to the passage of time relative to the expiration date of these options.

As shown in Table 9 above, we recorded net contractual interest expense accruals on interest rate swaps totaling \$111 million, \$1.3 billion and \$5.0 billion in 2006, 2005 and 2004, respectively. These amounts, which we consider to be part of the cost of funding our mortgage investments, are included in the derivatives fair value losses recognized in the consolidated statements of income. If we had elected to fund our mortgage investments with long-term fixed-rate debt instead of a combination of short-term variable-rate debt and interest rate swaps, the expense related to our interest rate swap accruals would have been reflected as interest expense, resulting in a reduction in our net interest income and net interest yield, instead of as a component of our derivatives fair value losses.

Interest rates have generally trended up since the end of 2004 and remained at overall higher levels through July 2007. The \$2.7 billion and \$8.1 billion decrease in derivative losses in 2006 and 2005, respectively, was largely attributable to the upward trend in interest rates. As a result, the aggregate fair value of our interest rate swaps increased and we experienced a significant reduction in the net contractual interest expense recognized on our interest rate swaps. This increase in fair value was partially offset by decreases in the fair value of our option-based derivatives during each year due to the combined effect of time decay of these options and decreases in implied volatility in each of these years. While we recorded fair value gains on our derivatives for the first six months of 2007, the financial markets have exhibited extraordinary volatility since mid-July 2007. In light of the market conditions as of the date of this filing and uncertainty about how long the markets will remain volatile, we may experience an increased level of volatility in the fair value of our derivatives for the remainder of 2007. Because the fair value of our derivatives is affected by market fluctuations that cannot be predicted, we cannot estimate the impact of changes in the fair value of our derivatives for the full year.

While changes in the estimated fair value of our derivatives resulted in net expense in each reported period, we incurred this expense as part of our overall interest rate risk management strategy to economically hedge the prepayment and duration risk of our mortgage investments. The derivatives fair value gains and losses recognized in our consolidated statements of income should be examined in the context of our overall interest rate risk management objectives and strategy, including the economic objective of our use of various types of derivative instruments, the factors that drive changes in the fair value of our derivatives, how these factors affect changes in the fair value of other assets and liabilities, and the differences in accounting for our derivatives and other financial instruments. We provide additional information on our use of derivatives to manage interest rate risk and the effect on our consolidated financial statements in MD&A Consolidated Balance Sheet Analysis Derivative Instruments and MD&A Risk Management Interest Rate Risk Management and Other Market Risks.

Debt Extinguishment Gains (Losses), Net

We call debt securities in order to reduce future debt costs as a part of our integrated interest rate risk management strategy. We also repurchase debt in order to enhance the liquidity of our debt. Debt

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extinguishment losses (and gains) are affected by the level of debt extinguishment activity and the price performance of our debt securities. The gain or loss we recognize when we call or repurchase debt is based on the difference between the call price or fair value of the debt and the carrying value. Typically, the amount of debt repurchased has a greater impact on gains and losses recognized on debt extinguishments than the amount of debt called. Debt repurchases, unlike debt calls, may require the payment of a premium and therefore result in higher extinguishment costs. As a result, we historically have generally repurchased high interest rate debt at times (and in amounts) when we believed we had sufficient income available to absorb or offset those higher costs.

We recognized a net gain of \$201 million in 2006 from the repurchase of \$15.5 billion and the call of \$24.1 billion of outstanding debt. These gains resulted from our decision to take advantage of favorable funding spreads during 2006 relative to LIBOR to issue new debt and to repurchase outstanding debt trading at attractive prices. In comparison, we recognized a loss of \$68 million in 2005 from the repurchase of \$22.9 billion and the call of \$28.0 billion of outstanding debt and a loss of \$152 million in 2004 from the repurchase of \$4.3 billion and the call of \$155.6 billion of outstanding debt.

Losses from Partnership Investments

Our partnership investments totaled approximately \$10.6 billion and \$9.3 billion as of December 31, 2006 and 2005, respectively. In some cases, we consolidate these entities in our financial statements. In other cases, we account for these investments using the equity method and record our share of operating losses in the consolidated statements of income as Losses from partnership investments. Investments we accounted for under the equity method totaled \$4.9 billion and \$4.5 billion as of December 31, 2006 and 2005, respectively. We provide additional information about these investments and applicable accounting in Off-Balance Sheet Arrangements and Variable Interest Entities LIHTC Partnership Interests.

Losses from partnership investments, net totaled \$865 million, \$849 million and \$702 million in 2006, 2005 and 2004, respectively. These increased losses were primarily the result of continuing increases in the amount we invest in LIHTC partnerships. We consider these investments to be a significant channel for advancing our affordable housing mission. Accordingly, we expect to continue to invest in LIHTC partnerships, and we anticipate that these new investments will generate additional net operating losses and tax credits in the future. However, we recently sold two portfolios of LIHTC investments and expect that we may sell LIHTC investments in the future if we believe that the economic return from the sale will be greater than the benefit we would receive from continuing to hold these investments. In March 2007, we sold a portfolio of investments in LIHTC partnerships totaling approximately \$676 million in potential future tax credits. In July 2007, we sold a second portfolio of investments in LIHTC partnerships totaling approximately \$254 million in potential future tax credits. Together, these equity interests represented approximately 11% of our overall LIHTC portfolio. For more information on tax credits associated with our LIHTC investments, refer to Provision for Federal Income Taxes below.

Table of Contents**Administrative Expenses**

Administrative expenses include costs incurred to run our daily operations, such as salaries and employee benefits, professional services, occupancy costs and technology expenses. Administrative expenses also include costs associated with our efforts to return to timely financial reporting and restructuring costs. Expenses included in our efforts to return to timely financial reporting include costs of restatement and related regulatory examinations, investigations and litigation and also include remediation costs. The table below details the components of these costs.

Table 10: Administrative Expenses

	For the Year Ended December 31,			% Change	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
	(Dollars in millions)				
Ongoing daily operations costs	\$ 2,013	\$ 1,546	\$ 1,656	30%	(7)%
Restatement and related regulatory expenses ⁽¹⁾	1,063	569	(2)	87	
Total administrative expenses	\$ 3,076	\$ 2,115	\$ 1,656	45%	28%

(1) Includes costs of restatement and related regulatory examinations, investigations and litigation. Also includes remediation costs.

(2) Excludes the \$400 million civil penalty that we paid to the U.S. Treasury in 2006 pursuant to our settlements with OFHEO and the SEC that we recognized in our consolidated income statement in 2004 as a component of Other expenses. However, we include this amount in the line item Restatement and related regulatory expenses for business segment reporting purposes.

The increases in administrative expenses in 2006 and in 2005 were primarily due to costs associated with our efforts to return to timely financial reporting. In addition, we experienced an increase in our ongoing daily operations costs during 2006 due to an increase in our hiring efforts and staffing levels, as we redesigned our organizational structure to enhance our risk governance framework and strengthen our internal controls. We anticipate that the costs associated with the preparation of our audited consolidated financial statements and periodic SEC reports will continue to have a substantial impact on administrative expenses at least until we are current in filing our periodic financial reports with the SEC.

Beginning in January 2007, we undertook a thorough review of our costs as part of a broad reengineering initiative to increase productivity and lower administrative costs. We have previously disclosed that, while continuing to focus on core competencies and controls, we expect to reduce our administrative expenses by \$200 million in 2007 compared with 2006, primarily through a reduction in employee and contract resources. In June 2007, we introduced a voluntary early retirement program that allowed eligible employees to elect to retire early and receive a severance package that included retirement benefits. We estimate that the costs of this early retirement program and various involuntary severance initiatives we have implemented or expect to implement during 2007 will total approximately \$100 million in 2007. We continue to believe that we will be successful in reducing our total administrative expenses for 2007 by

\$200 million compared with 2006.

As we have previously disclosed, we expect the level of our ongoing daily operations costs to exceed the level of these expenses for 2006 and prior years because of the significant investment we have made to remediate material weaknesses in our internal controls by enhancing our organizational structure and systems. We expect, however, that our 2007 productivity and cost reduction reengineering initiative will reduce our ongoing daily operations costs to approximately \$2 billion in 2008. Our ongoing daily operations costs, or run rate, excludes costs associated with our efforts to return to current financial reporting and also excludes various costs, such as restructuring and litigation costs that we do not expect to incur on a regular basis. We, therefore, do not consider these expenses to be part of our run rate.

Administrative expenses totaled an estimated \$659 million and \$1.4 billion for the quarter and six months ended June 30, 2007, respectively, compared with \$780 million and \$1.5 billion for the quarter and six months ended June 30, 2006, respectively. Of these amounts, restatement and related regulatory expenses and restructuring costs totaled an estimated \$152 million and \$323 million for the quarter and six months ended

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June 30, 2007, respectively, compared with \$286 million and \$573 million for the quarter and six months ended June 30, 2006, respectively.

Credit-Related Expenses

Credit-related expenses include the provision for credit losses and foreclosed property expense (income). Our credit-related expenses increased to \$783 million in 2006, from \$428 million in 2005 and \$363 million in 2004. Following is a discussion of how changes in the provision for credit losses and foreclosed property expense (income) affected our credit-related expenses in each year.

Provision for Credit Losses

The level of the provision for loan losses in each period reflects our assessment of the combined allowance for loan losses and reserve for guaranty losses, taking into consideration factors such as loan product mix, current levels of non-performing loans, historical loss severity and default rate trends, and economic conditions as of the balance sheet date.

The provision for credit losses totaled \$589 million in 2006, an increase of \$148 million, or 34%, over 2005. This increase reflects the impact of a trend of higher charge-offs that began in the second half of 2006. We began to experience higher default rates and loan loss severities in 2006 due to the significant slowdown in home price appreciation and continued economic weakness in the Midwest.

The provision for credit losses totaled \$441 million in 2005, an increase of \$89 million, or 25%, from the provision in 2004. This increase primarily related to our recording a provision for credit losses of \$106 million in 2005 for single-family and multifamily properties affected by Hurricane Katrina. In addition, we increased our provision for credit losses in 2005 as a result of our adoption of Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). Under SOP 03-3, we are required to record loans we purchase from Fannie Mae MBS trusts due to default at fair value because these loans have deteriorated in credit quality since origination. The excess of the purchase price over the fair value, if any, increases our provision for credit losses because it is recorded as a charge to Reserve for guaranty losses in the consolidated balance sheet.

Based on the likelihood that home prices will continue to decline during 2007, we expect the level of foreclosures and the related expense to increase for 2007. As a result, we expect a significant increase in credit-related expenses and credit losses in 2007. We provide additional detail on credit losses and factors affecting our allowance for loan losses and reserve for guaranty losses in Risk Management Credit Risk Management Mortgage Credit Risk Management and Critical Accounting Policies and Estimates Allowance for Loan Losses and Reserve for Guaranty Losses.

Foreclosed Property Expense (Income)

Foreclosed property expense (income) is affected by the level of foreclosures and the effectiveness of our property management and sales operations, which employ strategies designed to shorten our holding time, maximize our recovery and mitigate credit losses. Home price appreciation trends and the level of credit enhancement on loans also have an impact on foreclosed property expense (income).

We recorded foreclosed property expense of \$194 million in 2006, income of \$13 million in 2005 and expense of \$11 million in 2004. The accelerated rate of home price appreciation during 2005 and 2004 helped to mitigate our foreclosure losses and resulted in gains on the sale of certain REO properties. As the housing market began to soften in 2006 and the rate of home price appreciation slowed, we experienced an increase in the level of foreclosures, as well as losses on foreclosed properties, particularly in the Midwest, which accounted for a majority of the increase in

foreclosed property expense in 2006. Based on the likelihood that home prices will continue to decline in 2007, we expect the level of foreclosures and the related expense to increase in 2007. As a result, we expect a significant increase in the amount of our credit losses in 2007.

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Other Non-Interest Expenses

Other Expenses

Other expenses include credit enhancement expenses that relate to the amortization of the credit enhancement asset we record at inception of certain guaranty contracts, costs associated with the purchase of additional mortgage insurance to protect against credit losses, regulatory penalties and other miscellaneous expenses. Other expenses totaled \$395 million, \$251 million and \$607 million in 2006, 2005 and 2004, respectively.

The \$144 million increase in other expenses in 2006 over 2005 was attributable to higher credit enhancement expense, due in part to our acquisition of insurance coverage related to our increased purchase of nontraditional mortgage products that we believe may present higher credit risk, such as Alt-A and subprime loans. In addition, we dissolved an MBS trust in 2006 for which we had a remaining unamortized credit enhancement asset as of the date of dissolution of \$126 million. We were required to recognize this unamortized amount as credit enhancement expense in 2006. The \$356 million decrease in other expenses in 2005 from 2004 was attributable to the \$400 million civil penalty that we accrued in 2004 and paid to the U.S. Treasury in 2006 pursuant to our settlements with OFHEO and the SEC.

Provision for Federal Income Taxes

Our effective income tax rate, excluding the provision or benefit for taxes related to extraordinary amounts, was reduced below the 35% statutory rate to 4%, 17% and 17% in 2006, 2005 and 2004, respectively. The difference between the statutory rate and our effective tax rate is primarily due to the tax benefits we receive from our investments in LIHTC partnerships that help to support our affordable housing mission. As disclosed in Notes to Consolidated Financial Statements Note 11, Income Taxes, our effective tax rate would have been 29%, 30% and 32% in 2006, 2005 and 2004, respectively, if we had not received the tax benefits from our investments in LIHTC partnerships.

The variance in our effective income tax rate over the past three years is primarily due to the combined effect of fluctuations in our pre-tax income, which affects the relative tax benefit of tax-exempt income and tax credits, and an increase in the actual dollar amount of tax credits.

The extent to which we are able to use all of the tax credits generated by existing or future investments in housing tax credit partnerships to reduce our federal income tax liability will depend on the amount of our future federal income tax liability, which we cannot predict with certainty. In addition, our ability to use tax credits in any given year may be limited by the corporate alternative minimum tax rules, which ensure that corporations pay at least a minimum amount of federal income tax annually. We were not able to use all the tax credits we received for 2006 and 2005 in the year the credits were generated because our income tax liability, after applying all such credits, would have been reduced below the minimum tax amount. We were able to apply a portion of the 2005 unused credits to reduce our income tax liability for 2004 and expect to use the remainder for 2006. We expect to use the remaining credits generated in 2006 in future years, to the extent permissible. Because we plan to continue investing in LIHTC partnerships, we expect tax credits related to these investments to grow in the future, which is likely to significantly reduce our effective tax rate below the 35% statutory rate assuming we are able to use all of the tax credits generated. If we are limited in our use of the tax credits related to these investments and we conclude that the economic return from selling the investment is likely to be greater than the benefit we would receive from continuing to hold these investments, we may also sell certain LIHTC investments, as we did in 2007.

We recorded a net deferred tax asset of \$8.5 billion and \$7.7 billion as of December 31, 2006 and 2005, respectively, arising principally from differences in the timing of the recognition of derivatives fair value gains and losses for

financial statement and income tax purposes. We have not recorded a valuation allowance against our net deferred tax asset as we anticipate it is more likely than not that the results of future operations will generate sufficient taxable income to allow us to realize the entire tax benefit.

Single-Family Business

Our Single-Family business generated net income of \$2.0 billion, \$2.6 billion and \$2.4 billion in 2006, 2005 and 2004, respectively. The primary source of net revenues for our Single-Family business is guaranty fee income. Other sources of revenue include technology and other fees and interest income. Expenses primarily include administrative expenses and credit-related expenses, including the provision for credit losses.

Net income for the Single-Family business segment decreased by \$579 million, or 22%, in 2006 from 2005 reflecting a \$488 million increase in net revenue during the period that was more than offset by a \$308 million increase in losses on certain guaranty contracts, a \$553 million increase in administrative expenses, a \$123 million increase in the provision for credit losses, and an increase of \$218 million of foreclosed property expense.

Net revenues increased in 2006 by 9% to \$6.1 billion from \$5.6 billion in 2005 primarily reflecting a \$288 million, or 6%, increase in guaranty fee income and a \$62 million increase in float income during the period. Guaranty fee income increased \$288 million, or 6%, from \$4.5 billion to \$4.8 billion due to a 4%

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growth in the average single-family mortgage credit book of business, and an increase in the average effective guaranty fee rate on the book. The average effective guaranty fee rate is calculated as guaranty fee income as a percentage of the average single-family mortgage credit book of business and excludes losses on certain guaranty contracts. Float income, the interest income that we earn on cash flows from the date of the remittance by servicers to us until the date of distribution by us to MBS certificate holders, increased by \$62 million, or 12%, in 2006 from 2005 due to an increase in short-term interest rates during the year.

In 2006, losses on certain guaranty contracts increased by \$308 million as compared to 2005. This loss is determined and recorded at an individual MBS issuance level and our credit guaranty business is largely priced on an overall contract basis where a single guaranty fee is established for all loans in a deal. The loans in that deal may be included in a single MBS issuance or in multiple MBS issuances. These losses are recorded on new credit guaranteed MBS issuances where our modeled expectation of returns is below what we believe a market participant would require for such credit risk inclusive of a reasonable profit margin. The increase in 2006 is attributable, in part, to our efforts to increase the amount of mortgage financing that we make available to target populations and geographic areas in support of housing goals. As home price appreciation slows, our modeled expectation of credit risk in such loans increases, resulting in higher losses.

Expenses increased by 76% in 2006 from 2005 due to an increase in the segment allocation of indirect corporate expenses during the period mostly driven by an increase in costs associated with our restatement and related matters, as well as an increase of \$218 million of foreclosed property expense.

The provision for credit losses of \$577 million in 2006, an increase of \$123 million from 2005, was primarily attributable to a \$221 million addition to the allowance for credit losses in the fourth quarter reflecting continued credit weakness in the Midwest region and a decline in home prices in some regions in the second half of the year which has an impact on the number of loans that will default and the amount of the charge off in the event of a default. The prior year provision for credit losses included the impact of Hurricane Katrina. While the credit environment was strong in the first half of 2006, the fundamentals that drive low credit losses, such as defaults and loss severity, began to weaken in the latter half of the year. This was evidenced by the steady growth in acquired properties and higher foreclosed property expense due to declining property values. Additionally, we recorded \$201 million of foreclosed property expense in 2006, compared to gains of \$17 million in 2005, due to the weakening home prices, particularly concentrated in the Midwest. We expect weakening home prices to continue to result in significantly higher credit losses in 2007.

Net income for the Single-Family business segment increased by \$227 million or 9% in 2005 from 2004, primarily due to a \$578 million increase in net revenues during the period that was offset by a \$129 million increase in administrative expenses and \$142 million increase in the provision for credit losses. Net revenues increased in 2005 by 12% to \$5.6 billion as a result of higher guaranty fee income and float income. Guaranty fee income for 2005 increased slightly from 2004 as the average single-family mortgage credit book of business increased 3%. The average effective guaranty fee rate remained essentially unchanged from year to year. Float income increased by \$282 million in 2005 due to an increase in short-term interest rates during the year. Expenses increased by 13% in 2005 due to the increase in administrative expenses resulting from costs associated with our restatement and related matters. The provision for credit losses increased by 46% to \$454 million in 2005, primarily attributable to our provision for credit losses related to Hurricane Katrina and our implementation of SOP 03-3.

During the period 2004 to 2006, there was intense competition for the purchase of mortgage assets by a growing number of mortgage investors through a variety of investment vehicles and structures. During these years, affordability issues, combined with a variety of new mortgage products being introduced and accepted by investors, encouraged consumers to take advantage of adjustable-rate mortgages, including nontraditional products such as interest-only ARMs, negative-amortizing ARMs and a variety of other product and risk combinations. The increased

demand for floating-rate and subprime mortgage loans accelerated the growth of competing securitization options in the form of private-label mortgage-related securities. The demand for these products slowed in 2007.

Single-family mortgage originations in the primary mortgage market totaled \$2.8 trillion, \$3.0 trillion and \$2.8 trillion in 2006, 2005 and 2004, respectively. The \$3.0 trillion in originations in 2005 represented the

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second strongest year in history. Based on our assessment of the underlying risk, we made a strategic decision to not pursue the guaranty of a significant portion of mortgage loan originations during 2004 and 2005, ceding market share of new single-family mortgage-related securities issuances to private-label issuers. While we maintained the same strategic approach in 2006, our market share did not decline significantly in 2006. Our estimated overall market share of new single-family mortgage-related securities issuance for 2006 was approximately 23.7% in 2006, compared with 23.5% in 2005 and 29.2% in 2004. We estimate that our market share will increase slightly in 2007 as the marketplace shifts towards more fixed-rate mortgage products. Our total single-family Fannie Mae MBS outstanding increased to \$2.1 trillion as of June 30, 2007, from \$1.9 trillion as of June 30, 2006. The market share estimates are based on publicly available data and exclude previously securitized mortgages.

Our conventional single-family mortgage credit book of business remained relatively strong from 2004 to 2006. We believe that our assessment and approach to the management of credit risk during these years allowed us to maintain a conventional single-family mortgage credit book of business with strong credit risk characteristics as evidenced by our credit losses, which remained low during the three-year period from 2004 to 2006.

We are focused on understanding and serving our customers' needs, strengthening our relationships with key partners, and helping lenders reach and serve new, emerging and nontraditional markets by providing more flexible mortgage options, including Alt-A and subprime products, which have represented an increased proportion of mortgage originations in recent years. We have increased our participation in these types of products where we have concluded that it would be economically advantageous and/or that it would contribute to our mission objectives. Our participation in these products reflects our assessment of anticipated guaranty fee income in light of our expectation for potentially higher credit losses. We continue to closely monitor credit risk and pricing dynamics across the full spectrum of mortgage product types. Our assessment of these dynamics will continue to determine the timing and level of our acquisitions of these types of mortgage products.

HCD Business

Our HCD business generated net income of \$338 million, \$503 million and \$425 million in 2006, 2005 and 2004, respectively. The primary sources of net revenues for our HCD business are guaranty fee income and fee and other income. Expenses primarily include administrative expenses, credit-related expenses and our share of net operating losses associated with LIHTC investments that are offset by the related tax benefits from these investments.

Net income for the HCD business segment decreased by \$165 million, or 33%, in 2006 from 2005 resulting from an increase in administrative expenses and credit enhancement expense and a decline in net revenues, which were partially offset by investment tax credits as HCD increased its investment activity. LIHTC investments, which comprise the largest proportion of investment activity for this segment, increased to \$8.8 billion in 2006, compared to \$7.7 billion in 2005, and generated tax benefits that were the primary driver in reducing our 2006 effective corporate tax rate to approximately 4%. Losses from partnership investments were \$865 million in 2006, a slight increase as compared to 2005. Guaranty fee income remained essentially unchanged in 2006 from 2005. Expenses increased 46% in 2006 from 2005 primarily due to an increase in the segment allocation of indirect corporate expenses during the period mostly driven by an increase in costs associated with our restatement and related matters, and higher credit enhancement expenses associated with a large multifamily transaction that liquidated in 2006.

Net income for the HCD business segment increased by \$78 million, or 18%, in 2005 from 2004 as a result of increased tax benefits from tax-advantaged investments and higher fee and other income, which were partially offset by an increase in administrative expenses. LIHTC investments totaled \$7.7 billion in 2005 compared to \$6.8 billion in 2004. Losses from partnership investments increased by \$147 million as HCD increased its investment activity but were more than offset by increased LIHTC tax benefits. Guaranty fee income was up due to the 5% increase in the average multifamily mortgage credit book of business in 2005. Fee and other income was up \$143 million in 2005 to

\$347 million primarily due to an increase in multifamily transaction

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fees caused by higher borrower refinancing activity in 2005 as compared to 2004. Expenses increased 28% in 2005 due to an increase in the segment's allocation of a portion of the costs associated with our restatement and related matters.

We expect to maintain our LIHTC partnership investments strategy in the future, which is likely to continue to result in an effective tax rate significantly below the statutory rate of 35%. We view these investments as a significant vehicle for advancing our affordable housing mission and expect to continue to invest in LIHTC partnerships. In March 2007, we sold a portfolio of investments in LIHTC partnerships totaling approximately \$676 million in LIHTC credits. In July 2007, we sold a second portfolio of investments in LIHTC partnerships totaling approximately \$254 million in LIHTC credits. Together, these equity interests represented approximately 11% of our overall LIHTC portfolio. We may sell additional LIHTC investments in the future if we believe that the economic return from the sale will be greater than the benefit we would receive from continuing to hold these investments.

HCD's Multifamily Group continued to benefit from the improvement in multifamily real estate fundamentals during 2006. Rental unit vacancies declined to an estimated 5.3% nationally at year-end 2006 for institutional-type multifamily properties, compared to an estimated vacancy rate of approximately 6.1% at the end of 2005. However, the multifamily real estate sector is beginning to experience the effects of the overall slowdown in the housing market. We expect the vacancy rate for multifamily rental properties to increase in 2007 as a result of an increasing supply of new condominiums reverting to rental units. As of March 31, 2007, estimated vacancy rates were approximately 5.8%.

We are one of the largest participants in the multifamily secondary market. HCD's multifamily business has been challenged in recent years. Competition has been fueled by private-label issuers of CMBS and aggressive bidding for multifamily debt among institutional investors, which reflects the high level of funds available for investment in the secondary mortgage market. We have responded to market challenges with an increased emphasis on serving partner needs with customized lending options and advanced a number of efficiency initiatives to make it quicker, easier and less expensive to do business with us.

HCD continues to grow and diversify its business into new areas that expand the supply of affordable housing, such as increased investment in rental and for-sale housing projects, including LIHTC investments. HCD further enables the expansion of affordable housing stock by participating in specialized debt financing, acquiring mortgage loans from a variety of new public and private partners, and increasing other community lending activities.

Capital Markets Group

Our Capital Markets group generated net income of \$1.7 billion, \$3.2 billion and \$2.1 billion in 2006, 2005 and 2004, respectively. The primary sources of net revenues for our Capital Markets group include net interest income and fee and other income. Derivatives fair value losses, investment gains and losses, and debt extinguishment gains and losses also have a significant impact on the financial performance of our Capital Markets group.

Net income for the Capital Markets group decreased by \$1.5 billion or 48%, in 2006 from 2005, primarily due to a significant decline in net interest income, which was partially offset by a reduction in derivatives fair value losses, lower impairment expense and lower income tax expense.

Net interest income was \$6.2 billion, \$10.9 billion, and \$17.8 billion in 2006, 2005 and 2004, respectively. The decrease in net interest income of \$4.7 billion, or 44%, in 2006 from 2005 was driven by lower average balances of asset in 2006 versus 2005 and by the compression of the spread between interest earned on our assets and interest expense on our debt. In addition, our product mix shifted as floating-rate securities and adjustable-rate mortgage products increased as a percentage of our total mortgage portfolio. Increasing interest rates had the effect of increasing

the cost of our debt, which further reduced net interest income. The decrease in fee and other income was primarily attributable to a foreign currency exchange loss of \$230 million in 2006 compared with a foreign currency exchange gain of \$625 million in 2005 on our foreign denominated debt. As discussed in Risk Management Interest Rate Risk Management and Other Market Risks, when we issue

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foreign-denominated debt, we swap out of the foreign currency completely at the time of the debt issue in order to minimize our exposure to currency risk. As a result, our foreign currency exchange losses are primarily offset by gains in fair value of the related derivatives.

Investment losses decreased by \$723 million or 48%, due to a decrease in the amount of impairments recognized on AFS securities in 2006 as compared to 2005, combined with a decline in unrealized losses recognized on our trading securities. We recognized other-than-temporary impairment of \$853 million in 2006 as compared to \$1.2 billion in 2005. The decrease in other-than-temporary impairment in 2006 was due to the level of the change in interest rates in 2006 relative to 2005, coupled with impairment amounts recognized on these securities in 2005. We recorded unrealized gains on trading securities of \$8 million in 2006, compared with unrealized losses of \$415 million in 2005. The unrealized gain in 2006 reflects favorable changes in fair value due to implied volatility, virtually offset by increasing interest rates during the year. In 2005, we recorded an unrealized loss mainly due to fair value losses resulting from the increase in interest rates and the widening of option adjusted spreads.

Derivatives fair value losses decreased 64% to \$1.5 billion in 2006 primarily due to the overall rise in interest rates in 2006 from 2005, which resulted in an increase in the fair value of our derivatives. In particular, the aggregate fair value of our interest rate swaps increased and we experienced a significant reduction in the net contractual interest expense recognized on our interest rate swaps. This increase in fair value was partially offset by decreases in the fair value of our option-based derivatives during each year due to the combined effect of time decay of these options and decreases in implied volatility in each of these years.

Expenses increased 30% in 2006 from 2005 primarily due to an increase in the segment allocation of indirect corporate expenses during the period, mostly driven by an increase in costs associated with our restatement and related matters. The provision for income taxes decreased by \$607 million as a result of lower segment net income in 2006.

Net income for the Capital Markets group increased by \$1.1 billion, or 50%, in 2005 from 2004. The reduction in net interest income and an increase in investment losses were offset by lower derivatives fair value losses. Net interest income decreased \$6.9 billion, or 39%, in 2005 from 2004 largely due to a 10% decline in the average mortgage portfolio balance resulting from a decrease in securities purchases and an increase in sales activity throughout 2005. The majority of the portfolio sales and a large portion of portfolio liquidations were comprised of fixed-rate Fannie Mae MBS, which caused the product mix of the portfolio to shift slightly as floating-rate securities and adjustable-rate mortgage products increased as a percentage of our total mortgage portfolio. In addition, significant increases in short-term interest rates had the effect of increasing the cost of our short-term debt, which further reduced net interest income. The significant increase in fee and other income was primarily attributable to foreign currency exchange gains on our foreign-denominated debt as the dollar strengthened against the Japanese yen in 2005 as compared to 2004. Derivatives fair value losses dropped 66% to \$4.2 billion in 2005, reflecting a rise in interest rates that resulted in (i) the fair value of our interest rate derivatives to increase relative to 2004 and (ii) the spread between our pay-fixed and receive-variable swap positions to narrow causing our interest accruals on our interest rate swaps to decrease by \$3.7 billion.

The Capital Markets group continues to seek ways to maximize long-term total returns while fulfilling our chartered liquidity function. Our total return management involves acquiring mortgage assets that allow us to achieve an acceptable spread over our cost of funding. In an effort to gain better returns, we have acquired new products for which we have been attractively compensated for the risk assumed. We will continue to seek out these beneficial opportunities in the future.

Changes to Business Segment Reporting in 2007

During 2007, we began to develop new metrics based on fair value changes, inclusive of fee income and costs incurred, and may use these measures in the future as an indicator of segment profitability. Refer to [Glossary of Terms Used in This Report](#) for additional information on option-adjusted spreads.

Additionally, we changed our methodology for the allocation of indirect administrative expenses, primarily our corporate overhead functions, to better align these expenses to the segment these functions serve. As a result,

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our Single-Family segment will absorb a higher amount of indirect costs resulting in an increase in their administrative expenses.

CONSOLIDATED BALANCE SHEET ANALYSIS

We seek to structure the composition of our balance sheet and manage its size to ensure compliance with our regulatory and internal capital requirements, to provide adequate liquidity to meet our needs, to mitigate our interest rate and credit risk exposure, and to maximize long-term stockholder value. Total assets grew to \$843.9 billion as of December 31, 2006, an increase of \$9.8 billion, or 1%, from December 31, 2005. Total liabilities were \$802.3 billion, an increase of \$7.5 billion, or less than 1%, from December 31, 2005. Stockholders' equity of \$41.5 billion reflected an increase of \$2.2 billion, or 6%, from December 31, 2005. The major asset components of our balance sheet include our mortgage-related assets and non-mortgage investments. We fund and manage the interest rate risk on these investments through the issuance of debt securities and the use of derivatives. Our debt securities and derivatives represent the major liability components of our balance sheet. Following is a discussion of the major components of our assets and liabilities.

Mortgage Investments

Table 12 shows the composition of our mortgage portfolio by product type and the carrying value, which reflects the net impact of our purchases, sales and liquidations, as of the end of each year of the five-year period ended December 31, 2006.

Table 12: Mortgage Portfolio Composition⁽¹⁾

	2006	2005	As of December 31, 2004	2003	2002
	(Dollars in millions)				
Mortgage loans: ⁽²⁾					
Single-family:					
Government insured or guaranteed	\$ 20,106	\$ 15,036	\$ 10,112	\$ 7,284	\$ 6,404
Conventional:					
Long-term, fixed-rate	202,339	199,917	230,585	250,915	223,794
Intermediate-term, fixed-rate ⁽³⁾	53,438	61,517	76,640	85,130	59,521
Adjustable-rate	46,820	38,331	38,350	19,155	12,142
Total conventional single-family	302,597	299,765	345,575	355,200	295,457
Total single-family	322,703	314,801	355,687	362,484	301,861
Multifamily:					
Government insured or guaranteed	968	1,148	1,074	1,204	1,898
Conventional:					
Long-term, fixed-rate	5,098	3,619	3,133	3,010	3,165
Intermediate-term, fixed-rate ⁽³⁾	50,847	45,961	39,009	29,717	15,213
Adjustable-rate	3,429	1,151	1,254	1,218	1,107
Total conventional multifamily	59,374	50,731	43,396	33,945	19,485

Total multifamily	60,342	51,879	44,470	35,149	21,383
Total mortgage loans	383,045	366,680	400,157	397,633	323,244
Unamortized premiums and other cost basis adjustments, net	943	1,254	1,647	1,768	1,358
Lower of cost or market adjustments on loans held for sale	(93)	(89)	(83)	(50)	(16)
Allowance for loan losses for loans held for investment	(340)	(302)	(349)	(290)	(216)
Total mortgage loans, net	383,555	367,543	401,372	399,061	324,370

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	2006	2005	As of December 31, 2004	2003	2002
	(Dollars in millions)				
Mortgage-related securities:					
Fannie Mae single-class MBS	124,383	160,322	272,665	337,463	292,611
Non-Fannie Mae single-class mortgage securities	27,980	27,162	35,656	33,367	38,731
Fannie Mae structured MBS	75,261	74,129	71,739	68,459	87,772
Non-Fannie Mae structured mortgage securities	97,399	86,129	109,455	45,065	28,188
Mortgage revenue bonds	16,924	18,802	22,076	20,359	19,650
Other mortgage-related securities	3,940	4,665	5,461	6,522	9,583
Total mortgage-related securities	345,887	371,209	517,052	511,235	476,535
Market value adjustments ⁽⁴⁾	(1,261)	(789)	6,680	7,973	17,868
Other-than-temporary impairments	(1,004)	(553)	(432)	(412)	(204)
Unamortized premiums (discounts) and other cost basis adjustments, net ⁽⁵⁾	(1,083)	(909)	173	1,442	1,842
Total mortgage-related securities, net	342,539	368,958	523,473	520,238	496,041
Mortgage portfolio, net ⁽⁶⁾	\$ 726,094	\$ 736,501	\$ 924,845	\$ 919,299	\$ 820,411

- (1) Mortgage loans and mortgage-related securities are reported at unpaid principal balance.
- (2) Mortgage loans include unpaid principal balance totaling \$105.5 billion, \$113.3 billion, \$152.7 billion, \$162.5 billion and \$135.8 billion as of December 31, 2006, 2005, 2004, 2003 and 2002, respectively, related to mortgage-related securities that were consolidated under FIN 46 and mortgage-related securities created from securitization transactions that did not meet the sales criteria under SFAS 140, which effectively resulted in these mortgage-related securities being accounted for as loans.
- (3) Intermediate-term, fixed-rate consists of mortgage loans with contractual maturities at purchase equal to or less than 15 years.
- (4) Includes unrealized gains and losses on mortgage-related securities and securities commitments classified as trading and available-for-sale.
- (5) Includes the impact of other-than-temporary impairments of cost basis adjustments.
- (6) Includes consolidated mortgage-related assets acquired through the assumption of debt.

Our portfolio activities may be constrained by certain operational limitations, tax classifications and our intent to hold certain temporarily impaired securities until recovery, as well as risk parameters applied to the mortgage portfolio. The OFHEO limit on our net mortgage portfolio assets, which excludes consolidated mortgage-related assets acquired

through the assumption of debt, to no more than \$727.75 billion and continued strong competition for mortgage assets, which compressed spreads and limited investment opportunities, resulted in a modest decline of 1% in the size of our net mortgage portfolio in 2006. The size of our net mortgage portfolio declined 20% during 2005, due to a significant increase in portfolio sales, normal liquidations and fewer portfolio purchases. Our mortgage investment activities during 2005 were conducted within the context of our capital restoration plan, which was approved by OFHEO in February 2005 and required that we achieve the OFHEO-directed minimum capital requirement by September 30, 2005 and that we maintain a 30% capital surplus over our statutory minimum capital requirement. Lowering our net mortgage portfolio enabled us to achieve our capital objective.

The OFHEO-directed minimum capital requirement remains in effect at OFHEO's discretion. We continue to manage the size of our balance sheet to meet the OFHEO-directed portfolio limit and minimum capital requirement. We estimate that our net mortgage portfolio assets totaled approximately \$714.9 billion and \$719.6 billion as of June 30, 2007 and December 31, 2006, respectively.

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Table 13 summarizes our mortgage portfolio activity for 2006, 2005 and 2004.

Table 13: Mortgage Portfolio Activity⁽¹⁾

	Purchases ⁽²⁾			Sales			Liquidations ⁽³⁾		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
	(Dollars in millions)								
loans:									
Fixed-rate term ⁽⁴⁾	\$ 65,680	\$ 60,267	\$ 53,305	\$ 1	\$ 9	\$ 35,336	\$ 55,427	\$ 38,603	\$ 23,470
Adjustable-rate loans	16,044	18,824	23,470				28,009	38,603	
Fixed-rate securities:									
Fixed-rate securities	81,724	79,091	76,775	42,538	106,027	18,151	41,608	90,531	47,515
Adjustable-rate securities	9,431	5,515	9,118	4,977	7,562	161	38,442	51,165	5,160
Mortgage securities	91,155	84,606	85,893	52,675	113,589	18,312	80,050	141,696	52,675
Mortgage portfolio	\$ 181,766	\$ 145,427	\$ 258,478	\$ 52,675	\$ 113,640	\$ 18,378	\$ 153,398	\$ 247,118	\$ 258,478
Liquidation rate							21.0%	30.7%	

(1) Excludes unamortized premiums, discounts and other cost basis adjustments.

(2) Excludes advances to lenders and mortgage-related securities acquired through the extinguishment of debt.

(3) Includes scheduled repayments, prepayments and foreclosures.

(4) Consists of mortgage loans with contractual maturities at purchase equal to or less than 15 years.

(5) Consists of mortgage securities with maturities of 15 years or less at issue date.

The changing product mix of originations in our underlying market had a pronounced effect on the composition of mortgage assets purchased for our portfolio during 2006, 2005 and 2004. Due to a higher percentage of adjustable-rate mortgage originations in the primary mortgage market during these years, a larger proportion of our purchases consisted of ARMs and floating-rate mortgage-related securities and a lower proportion of 30-year fixed-rate assets relative to historical norms.

As indicated above in Table 13, portfolio purchases were significantly lower in 2006 and 2005 than in 2004, due to narrowing mortgage-to-debt spreads, as well as our focus on managing the size of our balance sheet to achieve our capital plan objectives. We also experienced a considerable decline in the level of portfolio sales and liquidations for 2006 relative to 2005. During 2006, the timing of certain portfolio sales was affected by our portfolio limit. However, we believe that sales from our portfolio in 2006, consisting primarily of 30-year fixed-rate Fannie Mae MBS, were attractive economically and contributed to our total return objectives.

While portfolio liquidations in 2005 were comparable to 2004, we experienced a significant increase in portfolio sales in 2005. This increase was due in part to the intense competition for mortgage assets, which increased the number of economically attractive opportunities to sell certain mortgage assets, particularly 15-year and 30-year fixed-rate mortgage-related securities. These sales were aligned with our need to lower portfolio balances to achieve our capital plan objectives. The higher level of sales of fixed-rate securities in 2005 contributed to the shift in the product mix of our portfolio.

For the first six months of 2007, portfolio purchases decreased by approximately 14% from the same prior year period to \$85.2 billion. Portfolio sales increased by approximately 1% to \$25.1 billion, and portfolio liquidations decreased by approximately 12% to \$62.0 billion.

Table of Contents**Non-Mortgage Investments**

As discussed further in Liquidity and Capital Management, our Capital Markets group also purchases non-mortgage investments. Our non-mortgage investments consist primarily of high-quality securities that are readily marketable or have short-term maturities, such as commercial paper. Our liquid assets, net of any cash and cash equivalents pledged as collateral, totaled approximately \$69.4 billion and \$52.2 billion as of December 31, 2006 and 2005, respectively. Our investments in non-mortgage securities, which account for the majority of our liquid assets, totaled \$47.6 billion and \$37.1 billion of December 31, 2006 and 2005, respectively. Our non-mortgage investments, which are carried at fair value in our consolidated balance sheets, are presented below as of December 31, 2006, 2005 and 2004.

Table 14: Non-Mortgage Investments

	As of December 31,		
	2006	2005	2004
(Dollars in millions)			
Non-mortgage-related securities:			
Asset-backed securities	\$ 18,914	\$ 19,190	\$ 25,645
Corporate debt securities	17,594	11,840	15,098
Commercial paper	10,010	5,139	1,337
Other	1,055	947	1,829
Total non-mortgage-related securities	\$ 47,573	\$ 37,116	\$ 43,909

Table 15 shows the amortized cost, maturity and weighted average yield of our investments in mortgage and non-mortgage securities as of December 31, 2006.

Table 15: Amortized Cost, Maturity and Average Yield of Investments in Available-for-Sale Securities

	As of December 31, 2006								
	Total Amortized Cost ⁽¹⁾	Total Fair Value	One Year or Less Amortized Cost ⁽¹⁾	Fair Value	After One Year Through Five Years Amortized Cost ⁽¹⁾	Fair Value	After Five Years Through Ten Years Amortized Cost ⁽¹⁾	Fair Value	After Ten Years Amortized Cost ⁽¹⁾
(Dollars in millions)									
Securities	\$ 111,521	\$ 110,924	\$ 20	\$ 20	\$ 428	\$ 429	\$ 2,473	\$ 2,493	\$ 108,600
Mortgage	97,458	97,300					5,959	6,052	91,499
Structured	75,333	74,684	25	25	30	30	885	880	74,393
Other	27,239	27,146	3	3	83	81	235	236	26,918

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ue bonds -related	16,956	17,221	86	85	314	312	721	729	15,835
	3,504	3,750					1	1	3,503
curities ⁽²⁾	18,906	18,914	56	56	7,304	7,306	8,106	8,110	3,440
curities	17,573	17,594	2,294	2,295	15,279	15,299			
er	10,010	10,010	10,010	10,010					
related	986	1,055	953	1,022	33	33			
	\$ 379,486	\$ 378,598	\$ 13,447	\$ 13,516	\$ 23,471	\$ 23,490	\$ 18,380	\$ 18,501	\$ 324,188
	5.47%		6.42%		3.84%		3.72%		5.64%

(1) Amortized cost includes unamortized premiums, discounts and other cost basis adjustments, as well as other-than-temporary impairment write downs.

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- (2) Asset-backed securities, including mortgage-backed securities, are reported based on contractual maturities assuming no prepayments. The contractual maturity of asset-backed securities generally is not a reliable indicator of the expected life because borrowers typically have the right to repay these obligations at any time.
- (3) Includes commitments related to mortgage securities that are accounted for as securities.
- (4) Yields are determined by dividing interest income (including the amortization and accretion of premiums, discounts and other cost basis adjustments) by amortized cost balances as of year-end.

Debt Instruments

Table 16 shows the amount of our outstanding short-term borrowings and long-term debt as of December 31, 2006 and 2005.

Table 16: Outstanding Debt⁽¹⁾

	December 31, 2006		December 31, 2005	
	Outstanding	Weighted Average Interest Rate (Dollars in millions)	Outstanding	Weighted Average Interest Rate
Federal funds purchased and securities sold under agreements to repurchase	\$ 700	5.36%	\$ 705	3.90%
Short-term debt:				
Fixed rate	\$ 164,686	5.16%	\$ 168,953	4.07%
Floating rate			645	4.16
From consolidations	1,124	5.32	3,588	4.25
Total short-term debt	\$ 165,810	5.16%	\$ 173,186	4.07%
Long-term debt:				
Senior fixed rate	\$ 576,099	4.98%	\$ 546,516	4.50%
Senior floating-rate	5,522	5.06	23,257	4.34
Subordinated fixed-rate	12,852	5.91	14,244	5.85
From consolidations	6,763	5.98	6,807	5.85
Total long-term debt ⁽²⁾	\$ 601,236	5.01%	\$ 590,824	4.54%

- (1) Outstanding debt amounts and weighted average interest rate reported in this table include the effect of unamortized discounts, premiums and other cost basis adjustments. The unpaid principal balance of outstanding debt, which excludes unamortized discounts, premiums and other cost basis adjustments, totaled \$789.4 billion as June 30, 2007, compared with \$773.4 billion as of December 31, 2006.

- (2) Reported amounts include a net premium and cost basis adjustments of \$11.9 billion and \$10.7 billion as of December 31, 2006 and 2005, respectively.

In 2006, we experienced a continuation of a trend that began in 2004, as our long-term debt securities have continued to increase as a percentage of our total debt outstanding. Much of this increase can be attributed to a relatively flat yield curve in 2006 that enabled us to refinance short-term debt with various forms of long-term debt and allowed us to take advantage of historically low funding costs for a longer period, reducing our debt rollover risk. In addition, a significant amount of our long-term debt matured or was redeemed. As a result, despite our portfolio limit, we have been an active issuer of both short-and long-term debt for refunding and rebalancing purposes. We present our debt activity in Table 24 in Liquidity and Capital Management Liquidity.

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Table 17 below presents additional information for each category of our short-term borrowings.

Table 17: Outstanding Short-Term Borrowings

	As of December 31,		2006 Average During the Year		Maximum Outstanding ⁽³⁾
	Outstanding	Weighted Average Interest Rate ⁽¹⁾	Outstanding ⁽²⁾ (Dollars in millions)	Weighted Average Interest Rate ⁽¹⁾	
Federal funds purchased and securities sold under agreements to repurchase	\$ 700	5.36%	\$ 485	2.00%	\$ 2,096
Fixed-rate short-term debt:					
Discount notes	\$ 158,785	5.16%	\$ 155,548	4.86%	\$ 170,268
Foreign exchange discount notes	194	4.09	959	3.50	2,009
Other fixed-rate short-term debt	5,707	5.24	1,236	4.57	5,704
Floating-rate short-term debt			220	1.95	645
Debt from consolidations	1,124	5.32	2,483	4.73	3,485
Total short-term debt	\$ 165,810	5.16%			

	As of December 31,		2005 Average During the Year		Maximum Outstanding ⁽³⁾
	Outstanding	Weighted Average Interest Rate ⁽¹⁾	Outstanding ⁽²⁾ (Dollars in millions)	Weighted Average Interest Rate ⁽¹⁾	
Federal funds purchased and securities sold under agreements to repurchase	\$ 705	3.90%	\$ 2,202	2.88%	\$ 6,143
Fixed-rate short-term debt:					
Discount notes	\$ 166,645	4.08%	\$ 205,152	3.15%	\$ 281,117
Foreign exchange discount notes	1,367	2.66	3,931	2.00	8,191
Other fixed-rate short-term debt	941	3.75	1,429	3.03	3,570
Floating-rate short-term debt	645	4.16	3,383	3.26	6,250
Debt from consolidations	3,588	4.25	4,394	3.25	4,891

Total short-term debt	\$ 173,186	4.07%
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	As of December 31,		2004 Average During the Year		Maximum Outstanding ⁽³⁾
	Outstanding	Weighted Average Interest Rate ⁽¹⁾	Outstanding ⁽²⁾ (Dollars in millions)	Weighted Average Interest Rate ⁽¹⁾	
Federal funds purchased and securities sold under agreements to repurchase	\$ 2,400	1.90%	\$ 2,704	0.80%	\$ 10,455
Fixed-rate short-term debt:					
Discount notes	\$ 299,728	2.14%	\$ 306,539	1.42%	\$ 323,289
Foreign exchange discount notes	6,591	0.84	3,064	1.10	7,089
Other fixed-rate short-term debt	3,724	1.59	3,236	1.43	3,779
Floating-rate short-term debt	6,250	2.19	7,548	1.41	9,135
Debt from consolidations	3,987	2.20	2,989	1.54	3,987
Total short-term debt	\$ 320,280	2.11%			

(1) Includes unamortized discounts, premiums and other cost basis adjustments.

(2) Average amount outstanding during the year has been calculated using month-end balances.

(3) Maximum outstanding represents the highest month-end outstanding balance during the year.

Derivative Instruments

While we use debt instruments as the primary means to fund our mortgage investments and manage our interest rate risk exposure, we supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. As an example, by combining a pay-fixed swap with short-term variable-rate debt, we can achieve the economic effect of converting short-term variable-rate debt into long-term fixed-rate debt. By combining a pay-fixed swaption with short-term variable-rate debt, we can achieve the economic effect of converting short-term variable-rate debt into long-term callable debt. The cost of derivatives used in our management of interest rate risk is an inherent part of the cost of funding and hedging our mortgage investments and is economically similar to the interest expense that we recognize on the debt we issue to fund our mortgage investments. However, because we do not apply hedge accounting to our derivatives, the fair value gains or losses on our derivatives, including the periodic net contractual interest expense accruals on our swaps, are reported as

Derivatives fair value losses, net in our consolidated statements of income rather than as interest expense.

Our derivatives consist primarily of OTC contracts and commitments to purchase and sell mortgage assets that are valued using a variety of valuation models. The primary factors affecting changes in the fair value of our derivatives include the following:

Changes in the level of interest rates: Because our derivatives portfolio as of December 31, 2006, 2005 and 2004 predominately consisted of pay-fixed swaps, we typically reported declines in fair value as interest rates decreased and increases in fair value as interest rates increased. As part of our economic hedging strategy, these derivatives, in combination with our debt issuances, are intended to offset changes in the fair value of our mortgage assets, which tend to increase in value when interest rates decrease and, conversely, decrease in value when interest rates rise.

Implied interest rate volatility: We purchase option-based derivatives to economically hedge the embedded prepayment option in our mortgage investments. A key variable in estimating the fair value of option-based derivatives is implied volatility, which reflects the market's expectation about the future volatility of interest rates. Assuming all other factors are held equal, including interest rates, a decrease in implied volatility would reduce the fair value of our derivatives and an increase in implied volatility would increase the fair value.

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Changes in our derivative activity: As interest rates change, we are likely to take actions to rebalance our portfolio to manage our interest rate exposure. As interest rates decrease, expected mortgage prepayments are likely to increase, which reduces the duration of our mortgage investments. In this scenario, we generally will rebalance our existing portfolio to manage this risk by terminating pay-fixed swaps or adding receive-fixed swaps, which shortens the duration of our liabilities. Conversely, when interest rates increase and the duration of our mortgage assets increases, we are likely to rebalance our existing portfolio by adding pay-fixed swaps that have the effect of extending the duration of our liabilities. We also add derivatives in various interest rate environments to hedge the risk of incremental mortgage purchases that we are not able to accomplish solely through our issuance of debt securities.

Time value of purchased options: Intrinsic value and time value are the two primary components of an option price. The intrinsic value is the amount that can be immediately realized by exercising the option the amount by which the market rate exceeds or is below the strike rate, such that the option is in-the-money. The time value of an option is the amount by which the price of an option exceeds its intrinsic value. As the remaining life of an option shortens due to the passage of time, the time value of the option declines. We generally have recorded aggregate net fair value losses on our derivatives due to the effect of the passage of time on the fair value of our purchased options.

Table 18 presents, by derivative instrument type, the estimated fair value of derivatives recorded in our condensed consolidated balance sheets and the related outstanding notional amount as of December 31, 2006 and 2005.

Table 18: Notional and Fair Value of Derivatives

	As of December 31,			
	2006	2005		
	Notional Amount	Estimated Fair Value ⁽¹⁾ (Dollars in millions)	Notional Amount	Estimated Fair Value ⁽¹⁾
Risk management derivatives:				
Swaps:				
Pay-fixed	\$ 268,068	\$ (1,447)	\$ 188,787	\$ (2,954)
Receive-fixed	247,084	(615)	123,907	(1,301)
Basis swaps	950	(2)	4,000	(2)
Foreign currency swaps	4,551	371	5,645	200
Swaptions:				
Pay-fixed	95,350	1,102	149,405	2,270
Receive-fixed	114,921	3,721	138,595	6,202
Interest rate caps	14,000	124	33,000	436
Other ⁽²⁾	469	65	776	69
Risk management derivatives excluding accrued interest	745,393	3,319	644,115	4,920
Accrued interest receivable (payable)		406		(548)
Total risk management derivatives	\$ 745,393	\$ 3,725	\$ 644,115	\$ 4,372
Mortgage commitment derivatives:				

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Mortgage commitments to purchase whole loans	\$ 1,741	\$ (6)	\$ 2,081	\$ 6
Forward contracts to purchase mortgage-related securities	16,556	(25)	17,993	62
Forward contracts to sell mortgage-related securities	21,631	53	19,120	(66)
Total mortgage commitment derivatives	\$ 39,928	\$ 22	\$ 39,194	\$ 2

(1) Represents the net amount of Derivative assets at fair value and Derivative liabilities at fair value in the consolidated balance sheets.

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- (2) Includes MBS options, swap credit enhancements, forward starting debt and the fair value of mortgage insurance contracts that are accounted for as derivatives. These mortgage insurance contracts have payment provisions that are not based on a notional amount.

Table 19 provides an analysis of items affecting the estimated fair value of the net derivative asset (liability) amounts, excluding mortgage commitments, that were recorded in our consolidated balance sheets as of December 31, 2006, 2005 and 2004. As indicated in Table 19, we recorded a net derivative asset, excluding mortgage commitments, of \$3.7 billion and \$4.4 billion in our consolidated balance sheets as of December 31, 2006 and 2005, respectively. The general effects on our consolidated financial statements of the changes in the estimated fair value of our derivatives shown in this table are described following the table.

Table 19: Changes in Risk Management Derivative Assets (Liabilities) at Fair Value, Net⁽¹⁾

	As of December 31,		
	2006	2005	2004
	(Dollars in millions)		
Beginning net derivative asset ⁽²⁾	\$ 4,372	\$ 5,432	\$ 3,988
Effect of cash payments:			
Fair value at inception of contracts entered into during the period ⁽³⁾	(7)	846	2,998
Fair value at date of termination of contracts settled during the period ⁽⁴⁾	(106)	879	4,129
Periodic net cash contractual interest payments	1,066	1,632	6,526
Total cash payments	953	3,357	13,653
Income statement impact of recognized amounts:			
Periodic net contractual interest expense accruals on interest rate swaps	(111)	(1,325)	(4,981)
Net change in fair value during the period	(1,489)	(3,092)	(7,228)
Derivatives fair value losses, net ⁽⁵⁾	(1,600)	(4,417)	(12,209)
Ending net derivative asset ⁽²⁾	\$ 3,725	\$ 4,372	\$ 5,432

(1) Excludes mortgage commitments.

(2) Represents the net of Derivative assets at fair value and Derivative liabilities at fair value recorded in our consolidated balance sheets, excluding mortgage commitments.

(3) Primarily includes upfront premiums paid or received on option contracts. Our net upfront premium payments on option contracts were less than \$1 million in 2006 and totaled \$853 million and \$3.0 billion in 2005 and 2004, respectively. Also includes upfront cash paid or received on other derivative contracts. Additional detail on option premium payments provided below in Table 20.

(4) Primarily represents cash paid (received) upon termination of derivative contracts. The original fair value at termination and related weighted average life in years at termination for those contracts with original scheduled

maturities during or after 2006, 2005 and 2004 were \$13.9 billion and 9.7 years; \$14.9 billion and 7.6 years; and \$15.3 billion and 6.6 years, respectively.

- (5) Reflects net derivatives fair value losses recognized in the consolidated statements of income, excluding mortgage commitments.

Amounts presented in Table 19 have the following effects on our consolidated financial statements:

Cash payments made to purchase derivative option contracts (purchased options premiums) increase the derivative asset recorded in the consolidated balance sheets.

Cash payments to terminate and/or sell derivative contracts reduce the derivative liability recorded in the consolidated balance sheets.

We accrue interest on our interest rate swap contracts based on the contractual terms and recognize the accrual as an increase to the net derivative liability recorded in the consolidated balance sheets. The corresponding offsetting amount is recorded as an expense and included as a component of derivatives fair value losses in the consolidated statements of income. Periodic interest payments on our interest rate swap contracts reduce the derivative liability.

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Changes in the estimated fair value that increase the derivative liability or decrease the derivative asset are recorded as losses in the consolidated statements of income.

Changes in the estimated fair value that decrease the derivative liability or increase the derivative asset are recorded as gains in the consolidated statements of income.

The upfront premiums we pay to enter into option contracts primarily relate to swaption agreements, which give us the right to enter into a specific swap for a defined period of time at a specified rate. We can exercise the option up to the designated date. Table 20 provides information on our option activity during 2006 and 2005 and the amount of outstanding options as of the end of each year based on the original premiums paid.

Table 20: Purchased Options Premiums⁽¹⁾

	Original Premium Payments	Original Weighted Average Life to Expiration (Dollars in millions)	Remaining Weighted Average Life
Outstanding options as of December 31, 2002	\$ 9,363	3.3 years	2.8 years
Outstanding options as of December 31, 2003	\$ 12,463	4.8 years	3.7 years
Outstanding options as of December 31, 2004	\$ 13,230	5.6 years	4.0 years
Purchases ⁽¹⁾	853		
Exercises	(1,027)		
Expirations	(1,398)		
Outstanding options as of December 31, 2005	\$ 11,658	6.5 years	4.3 years
Purchases ⁽¹⁾			
Exercises	(1,811)		
Terminations	(278)		
Expirations	(800)		
Outstanding options as of December 31, 2006	\$ 8,769	9.2 years	5.7 years

⁽¹⁾ Amount of purchases is included in Table 19 as a component of the line item Fair value at inception of contracts entered into during the period. Purchases for 2004 are included in Footnote 3 of Table 19.

As more fully described in Risk Management Interest Rate Risk Management and Other Market Risks, we believe our duration gap, which is a measure of the difference between the estimated durations of our interest rate sensitive assets and liabilities, and the interest rate sensitivity of our net asset fair value are useful tools in assessing our interest rate exposure and our management of that exposure, as these measures show the extent to which changes in the fair value

of our mortgage investments are offset by changes in the fair value of our debt and derivatives.

SUPPLEMENTAL NON-GAAP INFORMATION FAIR VALUE BALANCE SHEET

Because our assets and liabilities consist predominately of financial instruments, we routinely use fair value measures to make investment decisions and to measure, monitor and manage our risk. The balance sheets presented in our consolidated financial statements reflect some financial assets measured and reported at fair value while other financial assets, along with most of our financial liabilities, are measured and reported at historical cost.

Each of the non-GAAP supplemental consolidated fair value balance sheets presented below in Table 21 reflects all of our assets and liabilities at estimated fair value. Estimated fair value is the amount at which an asset or liability could be exchanged between willing parties, other than in a forced or liquidation sale.

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The non-GAAP estimated fair value of our net assets (net of tax effect) is derived from our non-GAAP fair value balance sheet. This measure is not a defined term within GAAP and may not be comparable to similarly titled measures reported by other companies. The estimated fair value of our net assets (net of tax effect) presented in the non-GAAP supplemental consolidated fair value balance sheets is not intended as a substitute for amounts reported in our consolidated financial statements prepared in accordance with GAAP. We believe, however, that the non-GAAP supplemental consolidated fair value balance sheets and the fair value of our net assets, when used in conjunction with our consolidated financial statements prepared in accordance with GAAP, can serve as valuable incremental tools for investors to assess changes in our overall value over time relative to changes in market conditions. In addition, we believe that the non-GAAP supplemental consolidated fair value balance sheets are useful to investors because they provide consistency in the measurement and reporting of all of our assets and liabilities. Management, particularly our Capital Markets group, uses this information to gain a clearer picture of changes in our assets and liabilities from period to period, to understand how the overall value of the company is changing from period to period and to measure the performance of our Capital Markets investment activities.

Cautionary Language Relating to Supplemental Non-GAAP Financial Measures

In reviewing our non-GAAP supplemental consolidated fair value balance sheets, there are a number of important factors and limitations to consider. The estimated fair value of our net assets is calculated as of a particular point in time based on our existing assets and liabilities and does not incorporate other factors that may have a significant impact on that value, most notably any value from future business activities in which we expect to engage. As a result, the estimated fair value of our net assets presented in our non-GAAP supplemental consolidated fair value balance sheets does not represent an estimate of our net realizable value, liquidation value or our market value as a whole. Amounts we ultimately realize from the disposition of assets or settlement of liabilities may vary significantly from the estimated fair values presented in our non-GAAP supplemental consolidated fair value balance sheets. Because temporary changes in market conditions can substantially affect the fair value of our net assets, we do not believe that short-term fluctuations in the fair value of our net assets attributable to mortgage-to-debt OAS or changes in the fair value of our net guaranty assets are necessarily representative of the effectiveness of our investment strategy or the long-term underlying value of our business. We believe the long-term value of our business depends primarily on our ability to acquire new assets and funding at attractive prices and to effectively manage the risks of these assets and liabilities over time. However, we believe that focusing on the factors that affect near-term changes in the estimated fair value of our net assets helps us evaluate our long-term value and assess whether temporary market factors have caused our net assets to become overvalued or undervalued relative to the level of risk and expected long-term fundamentals of our business.

In addition, as discussed in *Critical Accounting Policies and Estimates Fair Value of Financial Instruments*, when quoted market prices or observable market data are not available, we rely on internally developed models that may require management judgment and assumptions to estimate fair value. Differences in assumptions used in our models could result in significant changes in our estimates of fair value.

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	As of December 31, 2006			As of December 31, 2005		
	GAAP	Fair	Estimated	GAAP	Fair	Estimated
	Carrying	Value	Fair	Carrying	Value	Fair
	Value	Adjustment ⁽²⁾	Value	Value	Adjustment ⁽²⁾	Value
	(Dollars in millions)					
Assets:						
Cash and cash equivalents	\$ 3,972	\$	\$ 3,972 ⁽³⁾	\$ 3,575	\$	\$ 3,575 ⁽³⁾
Federal funds sold and securities purchased under agreements to resell	12,681		12,681 ⁽³⁾	8,900		8,900 ⁽³⁾
Trading securities	11,514		11,514 ⁽³⁾	15,110		15,110 ⁽³⁾
Available-for-sale securities	378,598		378,598 ⁽³⁾	390,964		390,964 ⁽³⁾
Mortgage loans:						
Mortgage loans held for sale	4,868	(88)	4,780 ⁽³⁾⁽⁴⁾	5,064	17	5,081 ⁽³⁾⁽⁴⁾
Mortgage loans held for investment, net of allowance for loan losses	378,687	(2,821)	375,866 ⁽⁴⁾	362,479	(1,463)	361,016 ⁽⁴⁾
Guaranty assets of mortgage loans held in portfolio		3,669	3,669 ⁽⁴⁾⁽⁵⁾		3,609	3,609 ⁽⁴⁾⁽⁵⁾
Guaranty obligations of mortgage loans held in portfolio		(2,831)	(2,831) ⁽⁴⁾⁽⁵⁾		(2,477)	(2,477) ⁽⁴⁾⁽⁵⁾
Total mortgage loans	383,555	(2,071)	381,484 ⁽³⁾⁽⁴⁾	367,543	(314)	367,229 ⁽³⁾⁽⁴⁾
Advances to lenders ⁽⁶⁾	6,163	(152)	6,011 ⁽³⁾	4,086		4,086 ⁽³⁾
Derivative assets at fair value	4,931		4,931 ⁽³⁾	5,803		5,803 ⁽³⁾
Guaranty assets and buy-ups	8,523	3,737	12,260 ⁽³⁾⁽⁵⁾	7,629	3,077	10,706 ⁽³⁾⁽⁵⁾
Total financial assets	809,937	1,514	811,451 ⁽³⁾	803,610	2,763	806,373 ⁽³⁾
Master servicing assets and credit enhancements	1,624	1,063	2,687 ⁽⁵⁾⁽⁷⁾	1,471	861	2,332 ⁽⁵⁾⁽⁷⁾
Other assets	32,375	(948)	31,427 ⁽⁷⁾	29,087	(1,722)	27,365 ⁽⁷⁾
Total assets	\$ 843,936	\$ 1,629	\$ 845,565	\$ 834,168	\$ 1,902	\$ 836,070
Liabilities:						
Federal funds purchased and securities sold under agreements to repurchase	\$ 700	\$	\$ 700 ⁽³⁾	\$ 705	\$	\$ 705 ⁽³⁾
Short-term debt	165,810	(63)	165,747 ⁽³⁾	173,186	(209)	172,977 ⁽³⁾

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Long-term debt	601,236	5,358	606,594 ⁽³⁾	590,824	5,978	596,802 ⁽³⁾
Derivative liabilities at fair value	1,184		1,184 ⁽³⁾	1,429		1,429 ⁽³⁾
Guaranty obligations	11,145	(2,960)	8,185 ⁽³⁾	10,016	(4,848)	5,168 ⁽³⁾
Total financial liabilities	780,075	2,335	782,410 ⁽³⁾	776,160	921	777,081 ⁽³⁾
Other liabilities	22,219	(2,101)	20,118 ⁽⁸⁾	18,585	(1,916)	16,669 ⁽⁸⁾
Total liabilities	802,294	234	802,528	794,745	(995)	793,750
Minority interests in consolidated subsidiaries	136		136	121		121
Stockholders' Equity:						
Preferred	9,108	(90)	9,018 ⁽⁹⁾	9,108	(330)	8,778 ⁽⁹⁾
Common	32,398	1,485	33,883 ⁽¹⁰⁾	30,194	3,227	33,421 ⁽¹⁰⁾
Total stockholders equity/non-GAAP fair value of net assets	\$ 41,506	\$ 1,395	\$ 42,901	\$ 39,302	\$ 2,897	\$ 42,199
Total liabilities and stockholders equity/non-GAAP fair value of net assets	\$ 843,936	\$ 1,629	\$ 845,565	\$ 834,168	\$ 1,902	\$ 836,070

Explanation and Reconciliation of Non-GAAP Measures to GAAP Measures

- (1) Certain prior year amounts have been reclassified to conform with the current year presentation.
- (2) Each of the amounts listed as a fair value adjustment represents the difference between the carrying value included in our GAAP consolidated balance sheets and our best judgment of the estimated fair value of the listed asset or liability.
- (3) We determined the estimated fair value of these financial instruments in accordance with the fair value guidelines outlined in SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* (SFAS 107), as described in Notes to Consolidated Financial Statements Note 19, Fair Value of Financial Instruments. In Note 19, we also disclose the carrying value and estimated fair value of our total financial assets and total financial liabilities as well as discuss the methodologies and assumptions we use in estimating the fair value of our financial instruments.

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- (4) We have separately presented the estimated fair value of Mortgage loans held for sale, Mortgage loans held for investment, net of allowance for loan losses, Guaranty assets of mortgage loans held in portfolio, and Guaranty obligations of mortgage loans held in portfolio. These combined line items together represent total mortgage loans reported in our GAAP consolidated balance sheets. This presentation provides transparency into the components of the fair value of our mortgage loans associated with our guaranty business activities and the components of our capital markets business activities, which is consistent with the way we manage risks and allocate revenues and expenses for segment reporting purposes. While the carrying values and estimated fair values of the individual line items may differ from the amounts presented in Note 19, the combined amounts together equal the carrying value and estimated fair value amounts of total mortgage loans in Note 19.
- (5) In our GAAP consolidated balance sheets, we report the guaranty assets associated with our outstanding Fannie Mae MBS and other guaranties as a separate line item and include buy-ups, master servicing assets and credit enhancements associated with our guaranty assets in Other assets. The GAAP carrying value of our guaranty assets reflects only those guaranty arrangements entered into subsequent to our adoption of FIN 45 on January 1, 2003. On a GAAP basis, our guaranty assets totaled \$7.7 billion and \$6.8 billion as of December 31, 2006 and 2005, respectively. The associated buy-ups totaled \$831 million and \$781 million as of December 31, 2006 and 2005, respectively. In our non-GAAP consolidated fair value balance sheets, we also disclose the estimated guaranty assets and obligations related to mortgage loans held in our portfolio. The sum of Guaranty assets of mortgage loans held in portfolio, Guaranty obligations of mortgage loans held in portfolio, Guaranty assets and buy-ups, and Master servicing assets and credit enhancements together represent the guaranty asset-related components associated with our total mortgage credit book of business for which our Single-Family and HCD guaranty businesses assume the credit risk. The aggregate carrying value and estimated fair value of the guaranty asset-related components associated with our total mortgage credit book of business totaled \$10.1 billion and \$15.8 billion, respectively, as of December 31, 2006 and \$9.1 billion and \$14.2 billion, respectively, as of December 31, 2005.
- (6) We previously included Advances to lenders in Other assets. In 2006, we have disclosed advances to lenders as a separate line item in our GAAP consolidated balance sheets and as a SFAS 107 financial asset. We have reclassified the prior year to conform with the current year presentation.
- (7) The line items Master servicing assets and credit enhancements and Other assets together consist of the assets presented on the following five line items in our GAAP consolidated balance sheets: (i) accrued interest receivable; (ii) acquired property, net; (iii) deferred tax assets; (iv) partnership investments; and (v) other assets. The carrying value of these items in our GAAP consolidated balance sheets together totaled \$34.8 billion and \$31.3 billion as of December 31, 2006 and 2005, respectively. We deduct the carrying value of the buy-ups associated with our guaranty obligation, which totaled \$831 million and \$781 million as of December 31, 2006 and 2005, respectively, from Other assets reported in our GAAP consolidated balance sheets because buy-ups are a financial instrument that we combine with guaranty assets in our SFAS 107 disclosure in Note 19. We have estimated the fair value of master servicing assets and credit enhancements based on our fair value methodologies discussed in Note 19. With the exception of partnership investments and deferred tax assets, the GAAP carrying values of other assets generally approximate fair value. While we have included partnership investments at their carrying value in each of the non-GAAP fair value balance sheets, the fair values of these items are generally different from their GAAP carrying values, potentially materially. For example, our LIHTC partnership investments had a carrying value of \$8.8 billion and an estimated fair value of \$10.0 billion as of December 31, 2006. We assume that other deferred assets, consisting primarily of prepaid expenses, have no fair value. We adjust the GAAP-basis deferred income taxes for purposes of each of our non-GAAP supplemental consolidated fair value balance sheets to include estimated income taxes on the difference between our non-GAAP supplemental consolidated fair value balance sheets net assets, including

deferred taxes from the GAAP consolidated balance sheets, and our GAAP consolidated balance sheets stockholders' equity. Because our adjusted deferred income taxes are a net asset in each year, the amounts are included in our non-GAAP fair value balance sheets as a component of other assets.

- (8) The line item "Other liabilities" consists of the liabilities presented on the following four line items in our GAAP consolidated balance sheets: (i) accrued interest payable; (ii) reserve for guaranty losses; (iii) partnership liabilities; and (iv) other liabilities. The carrying value of these items in our GAAP consolidated balance sheets together totaled \$22.2 billion and \$18.6 billion as of December 31, 2006 and 2005, respectively. With the exception of partnership liabilities, the GAAP carrying values of these other liabilities generally approximate fair value. We assume that deferred liabilities, such as deferred debt issuance costs, have no fair value.
- (9) Preferred stockholders' equity is reflected in our non-GAAP fair value balance sheets at the estimated fair value amount.
- (10) The line item "Common stockholders' equity" consists of the stockholders' equity components presented on the following five line items in our GAAP consolidated balance sheets: (i) Common stock; (ii) Additional paid-in capital; (iii) Retained earnings; (iv) Accumulated other comprehensive loss and (v) Treasury stock, at cost. Common stockholders' equity is reflected in our non-GAAP fair value balance sheets at the estimated fair value amount.

Key Drivers of Changes in the Estimated Fair Value of Net Assets (Non-GAAP)

We expect periodic fluctuations in the estimated fair value of our net assets due to our business activities, as well as due to changes in market conditions, including changes in interest rates, changes in relative spreads

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between our mortgage assets and debt, and changes in implied volatility. Following is a discussion of the effects these market conditions generally have on the fair value of our net assets and the factors we consider to be the principal drivers of changes in the estimated fair value of our net assets. We also disclose the sensitivity of the estimated fair value of our net assets to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks.

Capital Transactions, Net. Capital transactions include our issuances of common and preferred stock, our repurchases of stock and our payment of dividends. Cash we receive from the issuance of preferred and common stock results in an increase in the fair value of our net assets, while repurchases of stock and dividends we pay on our stock reduce the fair value of our net assets.

Estimated Net Interest Income from OAS. OAS income represents the estimated net interest income generated during the current period that is attributable to the market spread between the yields on our mortgage-related assets and the yields on our debt during the period, calculated on an option-adjusted basis.

Guaranty Fees, Net. Guaranty fees, net, represent the net cash receipts during the reported period related to our guaranty business, and are generally calculated as the difference between the contractual guaranty fees we receive during the period and the expenses we incur during the period that are associated with our guaranty business. Changes in guaranty fees, net, result from changes in portfolio size and composition, changes in home price appreciation and changes in the market spreads for similar instruments.

Fee and Other Income and Other Expenses, Net. Fee and other income includes miscellaneous fees, such as securitization transaction fees and technology-related fees. Other expenses primarily include costs incurred during the period that are associated with the Capital Markets group.

Return on Risk Positions. Our investment activities expose us to market risks, including duration and convexity risks, yield curve risk, OAS risk and volatility risk. The return on risk positions represents the estimated net increase or decrease in the fair value of our net assets resulting from net exposures related to the market risks we actively manage. We actively manage, or hedge, interest rate risk related to our mortgage investments in order to maintain our interest rate risk exposure within prescribed limits. However, we do not actively manage certain other market risks. Specifically, we do not attempt to actively manage or hedge changes in mortgage-to-debt OAS after we purchase mortgage assets or the interest rate risk related to our guaranty business. Additional information about credit, market and operational risks and our strategies for managing these types of risks is included in Risk Management.

Mortgage-to-debt OAS. Funding mortgage investments with debt exposes us to mortgage-to-debt OAS risk, which represents basis risk. Basis risk is the risk that interest rates in different market sectors will not move in the same direction or amount at the same time. We generally hold our mortgage investments to generate a spread over our debt on a long-term basis. The fair value of our assets and liabilities can be significantly affected by periodic changes in the net OAS between the mortgage and agency debt sectors. The fair value impact of changes in mortgage-to-debt OAS for a given period represents an estimate of the net unrealized increase or decrease in the fair value of our net assets resulting from fluctuations during the reported period in the net OAS between our mortgage assets and our outstanding debt securities. When the mortgage-to-debt OAS on a given mortgage asset increases, or widens, the fair value of the asset will typically decline relative to the debt. The level of OAS and changes in OAS are model-dependent and differ among market participants depending on the prepayment and interest rate models used to measure OAS.

We work to manage the OAS risk that exists at the time we purchase mortgage assets through our asset selection process. We use our proprietary models to evaluate mortgage assets on the basis of yield-to-maturity, option-adjusted

yield spread, historical valuations and embedded options. Our models also take into account risk factors such as credit quality, price volatility and prepayment experience. We purchase mortgage assets that appear economically attractive to us in the context of current market conditions and that fall within our OAS targets. Although a widening of mortgage-to-debt OAS during a period generally results in lower fair values of the mortgage assets relative to the debt during that period, it can provide us

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with better investment opportunities to purchase mortgage assets because a wider OAS is indicative of higher expected returns. We generally purchase mortgage assets when mortgage-to-debt OAS is relatively wide and restrict our purchase activity or sell mortgage assets when mortgage-to-debt OAS is relatively narrow. We do not, however, attempt to actively manage or hedge the impact of changes in mortgage-to-debt OAS after we purchase mortgage assets, other than through asset monitoring and disposition.

Change in the Fair Value of Net Guaranty Assets. As described more fully in Notes to Consolidated Financial Statements Note 19, Fair Value of Financial Instruments, we calculate the estimated fair value of our existing guaranty business based on the difference between the estimated fair value of the guaranty fees we expect to receive and the estimated fair value of the guaranty obligations we assume. The fair value of both our guaranty assets and our guaranty obligations is highly sensitive to changes in interest rates and home price assumptions. Changes in interest rates can result in significant periodic fluctuations in the fair value of our net assets. For example, as interest rates decline, the expected prepayment rate on fixed-rate mortgages increases, which lowers the fair value of our existing guaranty business. We do not believe, however, that periodic changes in fair value due to movements in interest rates are the best indication of the long-term value of our guaranty business because they do not take into account future guaranty business activity. Based on our historical experience, we expect that the guaranty fee income generated from future business activity will largely replace any guaranty fee income lost as a result of mortgage prepayments. To assess the value of our underlying guaranty business, we focus primarily on changes in the fair value of our net guaranty assets resulting from business growth, changes in the credit quality of existing guaranty arrangements and changes in anticipated future credit performance.

Market Drivers of Changes in Fair Value

Selected relevant market information is shown below in Table 22. Our goal is to minimize the risk associated with changes in interest rates for our investments in mortgage assets. Accordingly, we do not expect changes in interest rates to have a significant impact on the fair value of our net mortgage assets. The market conditions that we expect to have the most significant impact on the fair value of our net assets include changes in implied volatility and relative changes between mortgage OAS and debt OAS. A decrease in implied volatility generally increases the estimated fair value of our mortgage assets and decreases the estimated fair value of our debt and derivatives, while an increase in implied volatility generally has the opposite effect. A tighter, or lower, mortgage OAS generally increases the estimated fair value of our mortgage assets, and a tighter debt OAS generally increases the fair value of our liabilities. Changes in interest rates, however, may have a significant impact on our guaranty business because we do not actively manage or hedge expected changes in the fair value of our net guaranty assets related to changes in interest rates.

Table 22: Selected Market Information⁽¹⁾

	As of December 31,			Change	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
10-year U.S. Treasury note yield	4.70%	4.39%	4.22%	0.31%	0.17%
Implied volatility ⁽²⁾	15.7%	19.5%	20.1%	(3.8)%	(0.6)
30-year Fannie Mae MBS par coupon rate	5.79%	5.75%	5.21%	0.04%	0.54%
Lehman U.S. MBS Index OAS (in basis points) over LIBOR yield curve	(2.7)bp	4.2bp	(11.5)bp	(6.9)bp	15.7bp
Lehman U.S. Agency Debt Index OAS (in basis points) over LIBOR yield curve	(13.8)bp	(11.0)bp	(6.3)bp	(2.8)bp	(4.7)bp

House price appreciation ⁽³⁾	9.1%	13.1%	10.7%	(4.0)%	2.4%
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- (1) Information obtained from Lehman Live, Lehman POINT, Bloomberg and OFHEO.
- (2) Implied volatility for an interest rate swaption with a 3-year option on a 10-year final maturity.
- (3) OFHEO publishes a House Price Index (HPI) quarterly using data provided by Fannie Mae and Freddie Mac. The HPI is a truncated measure because it is based solely on loans from Fannie Mae and Freddie Mac. As a result, it excludes loans in excess of conventional loan amounts, or jumbo loans, and includes only a portion of total subprime and Alt-A

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loans outstanding in the overall market. The HPI is a weighted repeat transactions index, meaning that it measures average price changes in repeat sales or refinancings on the same properties. House price appreciation reported above reflects the annual average HPI of the reported year compared with the annual average HPI of the prior year.

Changes in Non-GAAP Estimated Fair Value of Net Assets

The effects of our investment strategy, including our interest rate risk management which we discuss in Risk Management Interest Rate Risk Management, are reflected in changes in the estimated fair value of our net assets over time. The following table summarizes the change in the fair value of our net assets for 2006 and 2005.

Table 23: Non-GAAP Estimated Fair Value of Net Assets (Net of Tax Effect)

	2006	2005
Balance as of January 1	\$ 42,199	\$ 40,094
Capital transactions: ⁽¹⁾		
Common dividends, common share repurchases and issuances, net	(1,030)	(943)
Preferred dividends	(511)	(486)
Capital transactions, net	(1,541)	(1,429)
Change in estimated fair value of net assets, excluding capital transactions	2,243	3,534
Increase in estimated fair value of net assets, net	702	2,105
Balance as of December 31 ⁽²⁾	\$ 42,901	\$ 42,199

(1) Represents net capital transactions, which are reflected in the Consolidated Statements of Changes in Stockholders' Equity.

(2) Represents estimated fair value of net assets (net of tax effect) presented in Table 21: Non-GAAP Supplemental Consolidated Fair Value Balance Sheets.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

The estimated fair value of our net assets increased by \$702 million in 2006, which included the effect of a reduction of \$1.5 billion attributable to capital transactions consisting primarily of the payment of \$1.7 billion of dividends to holders of our common and preferred stock. We experienced a \$2.2 billion increase in the estimated fair value of net assets excluding the effect of capital transactions. We discuss below how the activities of our guaranty and capital markets businesses contributed to this net increase in fair value.

Guaranty Business Activities

The estimated fair value of our net guaranty assets decreased by approximately \$1.4 billion, which includes the impact of a \$1.6 billion increase in the estimated fair value of our guaranty assets due to growth in our guaranty book of business and a \$355 million increase in the estimated fair value of master servicing assets and credit enhancements.

The increases in the fair value of our guaranty assets and related master servicing assets and credit enhancements were more than offset by a \$3.4 billion increase in our guaranty obligations, which reflects the significant slowdown in home price appreciation that occurred during the second half of 2006. We estimate the fair value of our guaranty obligations using simulation models that project our potential future credit losses under various economic scenarios, which incorporate assumptions about default and severity rates and a market rate of return. The slowdown in home price appreciation increased the probability of higher projected credit losses in our simulation models, resulting in an increase in the estimated fair value of our guaranty obligations. However, our actual future credit losses are likely to be significantly less than the estimated increase in the fair value of our guaranty obligations, as the fair value of our guaranty obligations includes not only future expected credit losses but also the economic carrying costs we would expect a market participant to require to assume such obligations. Our combined allowance for loan losses and reserve for guaranty losses reflects our estimate of the probable credit losses inherent in our mortgage credit book of business.

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Capital Markets Business Activities

As indicated in Table 22 above, the Lehman U.S. MBS index, which primarily includes 30-year and 15-year mortgages, reflected a decrease in OAS during 2006. However, during 2006, the OAS on securities held by us that are not in the index, such as hybrid ARMs and REMICs, widened and resulted in an overall widening of the OAS for mortgage assets held in our portfolio during 2006 and a decrease in the fair value of our mortgage assets. In addition, debt OAS based on the Lehman U.S. Agency Debt Index to LIBOR decreased by 2.8 basis points to minus 13.8 basis points as of year-end 2006, resulting in an increase in the fair value of our liabilities that further decreased the overall fair value of our net assets. More than offsetting the decline in the fair value of our net assets due to movements in spreads was an increase in fair value due to the decrease in implied volatility during 2006. The combined effect of these market changes and net cash inflows resulted in a modest increase in the fair value of our capital markets business.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

The estimated fair value of our net assets increased by \$2.1 billion in 2005, which included the effect of the payment of \$1.4 billion of dividends to holders of our common and preferred stock. We experienced a \$3.5 billion increase in the estimated fair value of net assets excluding the effect of capital transactions. We discuss below how the activities of our guaranty and capital markets businesses contributed to this net increase in fair value.

Guaranty Business Activities

The estimated fair value of our net guaranty assets increased by approximately \$1.5 billion. This increase in fair value was primarily due to higher interest rates and a significant increase in home price appreciation during the year. The 30-year Fannie Mae MBS par coupon rate and the 10-year U.S. Treasury note yield increased in 2005, which slowed the rate of expected prepayments and increased the fair value of our net guaranty assets.

Capital Markets Business Activities

Mortgage OAS based on the Lehman U.S. MBS Index to LIBOR increased by 15.7 basis points to 4.2 basis points as of year-end 2005, from minus 11.5 basis points as of year-end 2004. Debt OAS based on the Lehman U.S. Agency Debt Index to LIBOR decreased by 4.7 basis points to minus 11.0 basis points as of year-end 2005, from minus 6.3 basis points as of year-end 2004. This net increase in mortgage-to-debt OAS, a slight decline in interest rates and the flattening of the yield curve resulted in a decline in the fair value of our net mortgage assets. More than offsetting this decline were the cash inflows from our net mortgage assets and a slight decrease in implied volatility.

LIQUIDITY AND CAPITAL MANAGEMENT

Liquidity is essential to our business. We actively manage our liquidity and capital position with the objective of preserving stable, reliable and cost-effective sources of cash to meet all of our current and future operating financial commitments and regulatory capital requirements. We obtain the funds we need to operate our business primarily from the proceeds we receive from the issuance of debt. We seek to maintain sufficient excess liquidity in the event that factors, whether internal or external to our business, temporarily prevent us from issuing debt in the capital markets.

Liquidity

We manage our cash position on a daily basis. Our primary source of cash is proceeds from the issuance of our debt securities, especially short-term debt securities. Our uses of cash currently consist primarily of: the repayment of

matured, redeemed and repurchased debt; the purchase of mortgage loans, mortgage-related securities and other investments; and the payment of interest payments on outstanding debt.

Table of Contents**Debt Funding**

Because our primary source of cash is proceeds from the issuance of our debt securities, we depend on our continuing ability to issue debt securities in the capital markets to meet our cash requirements. We issue a variety of non-callable and callable debt securities in the domestic and international capital markets in a wide range of maturities to meet our large and continuous funding needs. Our Capital Markets group is responsible for the issuance of debt securities to meet our funding needs. Table 24 below provides a summary of our debt activity for the years ended December 31, 2006, 2005 and 2004.

Table 24: Debt Activity

	For the Year Ended December 31,		
	2006	2005	2004
	(Dollars in millions)		
Issued during the year: ⁽¹⁾			
Short-term: ⁽²⁾			
Amount: ⁽³⁾	\$ 2,107,737	\$ 2,795,854	\$ 2,055,759
Weighted average interest rate:	4.85%	3.20%	1.50%
Long-term:			
Amount: ⁽³⁾	\$ 181,427	\$ 156,437	\$ 252,658
Weighted average interest rate:	5.49%	4.41%	2.90%
Total issued:			
Amount: ⁽³⁾	\$ 2,289,164	\$ 2,952,291	\$ 2,308,417
Weighted average interest rate:	4.90%	3.26%	1.66%
Redeemed during the year: ⁽¹⁾⁽⁴⁾			
Short-term: ⁽²⁾			
Amount: ⁽³⁾	\$ 2,112,364	\$ 2,944,027	\$ 2,081,726
Weighted average interest rate:	4.44%	3.03%	1.34%
Long-term:			
Amount: ⁽³⁾	\$ 169,397	\$ 196,957	\$ 238,686
Weighted average interest rate:	3.97%	3.51%	3.26%
Total redeemed:			
Amount: ⁽³⁾	\$ 2,281,761	\$ 3,140,984	\$ 2,320,412
Weighted average interest rate:	4.41%	3.06%	1.54%

(1) Excludes debt activity resulting from consolidations and intraday loans.

(2) Includes Federal funds purchased and securities sold under agreements to repurchase.

(3) Represents the face amount at issuance or redemption.

(4) Represents all payments on debt, including regularly scheduled principal payments, payments at maturity, payments as the result of a call and payments for any other repurchases.

We are one of the world's largest issuers of unsecured debt securities. We issue debt on a regular basis in significant amounts in the capital markets and have a diversified funding base of domestic and international investors. Purchasers

of our debt securities include fund managers, commercial banks, pension funds, insurance companies, foreign central banks, state and local governments, and retail investors. Purchasers of our debt securities are also geographically diversified, with a significant portion of our investors located in the U.S., Europe and Asia. The diversity of our debt investors enhances our financial flexibility and limits our dependence on any one source of funding. Our status as a GSE and our current AAA (or its equivalent) senior long-term unsecured debt credit ratings are critical to our ability to continuously access the debt capital markets to borrow at attractive rates. The U.S. government does not guarantee our debt, directly or indirectly, and our debt does not constitute a debt or obligation of the U.S. government.

We require regular access to the capital markets because we rely primarily on the issuance of our short-term debt to fund our operations. Our sources of liquidity have consistently been adequate to meet both our short-

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term and long-term funding needs, and we anticipate that they will remain adequate. Due to the reduction in the size of our mortgage portfolio after December 31, 2004 pursuant to our capital restoration plan, our debt funding requirements have been lower in 2005, 2006 and in 2007 to date than in 2003 and 2004. However, we remain an active issuer of short-term and long-term debt securities. During 2006, we issued \$2.1 trillion in short-term debt, and \$181 million in long-term debt. Our short-term and long-term funding needs during 2007 and 2008 are generally expected to be consistent with our needs during 2006, and with the uses of cash described above under Liquidity.

As described in Item 1 Business Our Charter and Regulation of Our Activities Regulation and Oversight of Our Activities OFHEO Regulation OFHEO Consent Order, pursuant to the OFHEO consent order, we are currently not permitted to increase our net mortgage portfolio assets above the amount shown in our minimum capital report to OFHEO as of December 31, 2005 (\$727.75 billion). We expect that, over the long term, our funding needs and sources of liquidity will remain relatively consistent with current needs and sources. We may increase our issuance of debt in future years if we decide to increase our purchase of mortgage assets following any modification or expiration of the current limitation on the size of our mortgage portfolio.

On June 13, 2006, the U.S. Department of the Treasury announced that it would undertake a review of its process for approving our issuances of debt, which could adversely impact our flexibility in issuing debt securities in the future. We cannot predict whether the outcome of this review will materially impact our current debt issuance activities.

Change in the Federal Reserve Board's Payments System Risk Policy

On July 20, 2006, the Federal Reserve Banks implemented changes to the Federal Reserve Board's Policy Statement on Payments System Risk. The changes pertain to the processing of principal and interest payments, via the Fedwire system, for securities issued by GSEs and certain international organizations, including us.

Prior to July 2006, the Federal Reserve Bank had exempted us from overdraft fees relating to the processing of interest and redemption payments on our debt and Fannie Mae MBS. We were permitted to overdraw our account at the Federal Reserve Bank for these payments and would make periodic payments throughout the business day until our account balance was zero. Since July 2006, we have been required to fund interest and redemption payments on our debt and Fannie Mae MBS before the Federal Reserve Banks, acting as our fiscal agent, will execute the payments on our behalf. We compensate the Federal Reserve Banks for this service.

Because we receive funds and make payments throughout each business day, we have implemented actions, including revising our funding strategies, to ensure that we will have access to funds to meet our payment obligations in a timely manner. We have established and periodically may use secured and unsecured intraday funding lines of credit with several large financial institutions. In 2006, we opened six intraday lines of credit with financial institutions in connection with the revised Federal Reserve policy. Certain of these lines of credit require that we post collateral which, in certain limited circumstances, the secured party has the right to repledge to third parties, including the Federal Reserve Bank. As of December 31, 2006, we have approximately \$30 billion of securities available for pledge to these parties. These lines of credit are uncommitted intraday loan facilities. As a result, while we expect to continue to use these facilities, we may not be able to draw on them if and when needed. We are currently funding security holder payments on a daily basis and are fully compliant with the revised Federal Reserve policy.

Credit Ratings and Risk Ratings

Our ability to borrow at attractive rates is highly dependent upon our credit ratings. Our senior unsecured debt (both long-term and short-term), benchmark subordinated debt and preferred stock are rated and continuously monitored by Standard & Poor's, a division of The McGraw Hill Companies (Standard & Poor's), Moody's Investor Service (Moody's), and Fitch Ratings (Fitch), each of which is a nationally recognized statistical rating organization. Table 25

below sets forth the credit ratings issued by each of these rating agencies of our

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long-term and short-term senior unsecured debt, qualifying benchmark subordinated debt and preferred stock as of August 15, 2007.

Table 25: Fannie Mae Debt Credit Ratings

	Senior Long-Term Unsecured Debt	Senior Short-Term Unsecured Debt	Qualifying Benchmark Subordinated Debt	Preferred Stock
Standard & Poor's	AAA	A-1+	AA-(1)	AA-(1)
Moody's	Aaa	P-1	Aa2(2)	Aa3(2)
Fitch	AAA	F1+	AA-(3)	AA-(4)

- (1) On December 7, 2006, Standard & Poor's removed our AA- preferred stock and subordinated debt ratings from CreditWatch with negative implications. The ratings were affirmed and the outlook is negative.
- (2) On December 15, 2005, Moody's confirmed our preferred stock and subordinated debt ratings with a stable outlook.
- (3) On December 7, 2006, Fitch removed our subordinated debt rating from Rating Watch Negative and affirmed the AA- rating. The outlook is stable.
- (4) On December 7, 2006, Fitch upgraded our preferred stock rating to AA- from A+ and removed the Rating Watch Negative. The outlook is stable.

Pursuant to our September 1, 2005 agreement with OFHEO, we agreed to seek to obtain a rating, which will be continuously monitored by at least one nationally recognized statistical rating organization, that assesses, among other things, the independent financial strength or risk to the government of Fannie Mae operating under its authorizing legislation but without assuming a cash infusion or extraordinary support of the government in the event of a financial crisis. We also agreed to provide periodic public disclosure of this rating.

Our risk to the government rating by Standard & Poor's as of August 15, 2007 is AA- with a negative outlook. On December 7, 2006, Standard & Poor's removed this rating from CreditWatch with negative implications and placed the rating on a negative outlook. Our Bank Financial Strength Rating by Moody's as of August 15, 2007 is B+ with a stable outlook.

We do not have any covenants in our existing debt agreements that would be violated by a downgrade in our credit ratings. To date, we have not experienced any limitations in our ability to access the capital markets due to a credit ratings downgrade. See Item 1A Risk Factors for a discussion of the potential risks associated with a downgrade of our credit ratings.

Contractual Obligations

Table 26 summarizes our expectation as to the effect on our liquidity and cash flows in future periods of our minimum debt payments and other material noncancelable contractual obligations as of December 31, 2006. Our current contractual obligations as of the date of this report are different than the contractual obligations as of December 31,

2006 presented in the table below, primarily with respect to our debt obligations. We had total outstanding debt of \$767.7 billion and \$764.7 billion as of December 31, 2006 and 2005, respectively.

Table 26: Contractual Obligations

	Payments Due by Period as of December 31, 2006				
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
	(Dollars in millions)				
Long-term debt obligations ⁽¹⁾	\$ 594,473	\$ 134,560	\$ 187,050	\$ 105,508	\$ 167,355
Contractual interest on long-term debt obligations ⁽²⁾	154,166	27,430	39,310	24,812	62,614
Operating lease obligations ⁽³⁾	181	36	47	40	58
Purchase obligations:					
Mortgage commitments ⁽⁴⁾	21,799	21,681	118		
Other purchase obligations ⁽⁵⁾	85	74	11		
Other long-term liabilities reflected in the consolidated balance sheet ⁽⁶⁾	5,433	3,882	1,145	182	224
Total contractual obligations	\$ 776,137	\$ 187,663	\$ 227,681	\$ 130,542	\$ 230,251

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- (1) Represents the carrying amount of our long-term debt assuming payments are made in full at maturity. Amounts exclude approximately \$6.8 billion in long-term debt from consolidations. Amounts include unamortized net premium and other cost basis adjustments of approximately \$11.9 billion.
- (2) Excludes contractual interest on long-term debt from consolidations.
- (3) Includes certain premises and equipment leases.
- (4) Includes on- and off-balance sheet commitments to purchase loans and mortgage-related securities.
- (5) Includes only unconditional purchase obligations that are subject to a cancellation penalty for certain telecom services, software and computer services, and agreements. Excludes arrangements that may be cancelled without penalty.
- (6) Excludes risk management derivative transactions that may require cash settlement in future periods and our obligations to stand ready to perform under our guaranties relating to Fannie Mae MBS and other financial guaranties, because the amount and timing of payments under these arrangements are generally contingent upon the occurrence of future events. For a description of the amount of our on- and off-balance sheet Fannie Mae MBS and other financial guaranties as of December 31, 2006, see *Off-Balance Sheet Arrangements and Variable Interest Entities*. Includes future cash payments due under our contractual obligations to fund LIHTC and other partnerships that are unconditional and legally binding, as well as cash received as collateral from derivative counterparties, which are included in the consolidated balance sheets under *Partnership liabilities* and *Other liabilities*, respectively. Amounts also include our obligation to fund partnerships that have been consolidated.

Cash Flows

Cash Flows for the Year Ended December 31, 2006

Cash and cash equivalents increased by \$419 million, or 15%, to \$3.2 billion as of December 31, 2006 from \$2.8 billion as of the end of the prior year.

We generated net cash of \$31.7 billion in operating activities in 2006, primarily due to net income and a net decrease in trading securities. Our cash generated by operating activities was partially offset by purchases of HFS loans.

We used net cash of \$13.8 billion in investing activities during 2006, primarily due to purchases of AFS securities, held-for-investment (HFI) loans and advances to lenders. Our cash used by investing activities was partially offset by maturities and sales of AFS securities and repayments of HFI loans.

We used net cash of \$17.5 billion in financing activities during 2006, primarily due to reduced proceeds from issuances of short term debt, offset by decreased payments for redemptions of short-term debt.

Cash Flows for the Year Ended December 31, 2005

Cash and cash equivalents increased by \$165 million, or 6%, to \$2.8 billion as of December 31, 2005 from \$2.7 billion as of the end of the prior year.

We generated net cash of \$78.1 billion in operating activities in 2005, primarily due to net income and a net decrease in trading securities. Our cash generated by operating activities was partially offset by purchases of HFS loans.

We generated net cash of \$139.4 billion in investing activities in 2005, primarily due to proceeds we received from sales and maturities of AFS securities and proceeds from the sale of HFI loans as we reduced our portfolio. The cash increases were partially offset by advances to lenders and purchases of AFS securities and HFI loans.

We used net cash of \$217.4 billion in financing activities in 2005, primarily for the net redemption of short-term and long-term debt.

Cash Flows for the Year Ended December 31, 2004

Cash and cash equivalents decreased by \$740 million, or 22%, to \$2.7 billion as of December 31, 2004 from \$3.4 billion as of the end of the prior year.

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We generated net cash of \$41.6 billion in operating activities in 2004, primarily due to net income and a net decrease in trading securities. Our cash generated by operating activities was partially offset by purchases of HFS loans.

We used net cash of \$16.8 billion in investing activities in 2004, primarily due to advances to lenders and purchases of AFS securities and HFI loans. The cash we used in investing activities was partially offset by proceeds we received from maturities of AFS securities and repayments of HFI loans.

We used net cash of \$25.5 billion in financing activities in 2004, primarily for the redemption of short-term and long-term debt. The cash we used in financing activities was offset primarily by issuances of our short-term and long-term debt.

Capital Management

Our objective in managing capital is to maximize long-term stockholder value through the pursuit of business opportunities that provide attractive returns while maintaining capital at levels sufficient to ensure compliance with both our regulatory and internal capital requirements.

Capital Management Framework

As part of its responsibilities under the 1992 Act, OFHEO has regulatory authority as to the capital requirements established by the 1992 Act, issuing regulations on capital adequacy and enforcing capital standards. The 1992 Act capital standards include minimum and critical capital requirements calculated as specified percentages of our assets and our off-balance sheet obligations, such as outstanding guaranties. In addition, the 1992 Act capital requirements include a risk-based capital requirement that is calculated as the amount of capital needed to withstand a severe ten-year stress period characterized by extreme movements in interest rates and simultaneous severe credit losses. Moreover, to allow for management and operations risks, an additional 30% is added to the amount necessary to withstand the ten-year stress period. A detailed description of our regulatory capital requirements can be found in Item 1 Business Our Charter and Regulation of Our Activities OFHEO Regulation Capital Adequacy Requirements.

Our internal economic capital requirements represent management's view of the capital required to support our risk posture and are used to guide capital deployment decisions to maximize long-term stockholder value. Our economic capital framework relies upon both stress test and value-at-risk analyses that measure capital solvency using long-term financial simulations and near-term market value shocks. We currently target a combined corporate economic capital requirement that is less than our regulatory capital requirements.

To ensure compliance with each of our regulatory capital requirements, we maintain different levels of capital surplus for each capital requirement. The optimal surplus amount for each capital measure is directly tied to the volatility of the capital requirement and related core capital base. Because it is explicitly tied to risk, the statutory risk-based capital requirement tends to be more volatile than the ratio-based minimum capital requirement. Quarterly changes in economic conditions (such as interest rates, spreads and home prices) can materially impact the calculated risk-based capital requirement, as was the case in 2006. As a consequence, we generally seek to maintain a larger surplus over the risk-based capital requirement to ensure continued compliance.

While we are able to reasonably estimate the size of our book of business and therefore our minimum capital requirement, the amount of our reported core capital holdings at each period end is less certain without hedge accounting treatment. Changes in the fair value of our derivatives may result in significant fluctuations in our capital holdings from period to period. Accordingly, we target a surplus above the statutory minimum capital requirement and OFHEO-directed minimum capital requirement to accommodate a wide range of possible valuation changes that

might adversely impact our core capital base.

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The table below shows our core capital, total capital and other capital classification measures as of December 31, 2006 and 2005.

Table 27: Regulatory Capital Surplus

	As of December 31,	
	2006⁽¹⁾	2005
	(Dollars in millions)	
Core capital ⁽²⁾	\$ 41,950	\$ 39,433
Statutory minimum capital ⁽³⁾	29,359	28,233
Surplus of core capital over required minimum capital	12,591	11,200
Surplus of core capital percentage over required minimum capital ⁽⁴⁾	42.9%	39.7%
Core capital ⁽²⁾	\$ 41,950	\$ 39,433
OFHEO-directed minimum capital ⁽⁵⁾	38,166	36,703
Surplus of core capital over OFHEO-directed minimum capital	3,784	2,730
Surplus of core capital percentage over OFHEO-directed minimum capital ⁽⁶⁾	9.9%	7.4%
Total capital ⁽⁷⁾	\$ 42,703	\$ 40,091
Statutory risk-based capital ⁽⁸⁾	26,870	12,636
Surplus of total capital over required risk-based capital	\$ 15,833	\$ 27,455
Surplus of total capital percentage over required risk-based capital ⁽⁹⁾	58.9%	217.3%
Core capital ⁽²⁾	\$ 41,950	\$ 39,433
Statutory critical capital ⁽¹⁰⁾	15,149	14,536
Surplus of core capital over required critical capital	\$ 26,801	\$ 24,897
Surplus of core capital percentage over required critical capital ⁽¹¹⁾	176.9%	171.3%

(1) Except for statutory risk-based capital amounts, all amounts represent estimates that will be resubmitted to OFHEO for their certification. Statutory risk-based capital amounts represent previously announced results by OFHEO. OFHEO may determine that results require restatement in the future based upon analysis provided by us.

(2) The sum of (a) the stated value of our outstanding common stock (common stock less treasury stock); (b) the stated value of our outstanding non-cumulative perpetual preferred stock; (c) our paid-in capital; and (d) our retained earnings. Core capital excludes AOCI.

(3) Generally, the sum of (a) 2.50% of on-balance sheet assets; (b) 0.45% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and (c) up to 0.45% of other off-balance sheet obligations,

which may be adjusted by the Director of OFHEO under certain circumstances (See 12 CFR 1750.4 for existing adjustments made by the Director of OFHEO).

- (4) Defined as the surplus of core capital over statutory minimum capital expressed as a percentage of statutory minimum capital.
- (5) This requirement was effective as of September 30, 2005, and is defined as a 30% surplus over the statutory minimum capital requirement. We are currently required to maintain this surplus under the OFHEO consent order until such time as the Director of OFHEO determines that the requirement should be modified or allowed to expire, taking into account factors such as the resolution of accounting and internal control issues.
- (6) Defined as the surplus of core capital over the OFHEO-directed minimum capital expressed as a percentage of the OFHEO-directed minimum capital.
- (7) The sum of (a) core capital and (b) the total allowance for loan losses and reserve for guaranty losses, less (c) the specific loss allowance (that is, the allowance required on individually-impaired loans). The specific loss allowance totaled \$106 million and \$66 million as of December 31, 2006 and 2005, respectively.
- (8) Defined as the amount of total capital required to be held to absorb projected losses flowing from future adverse interest rate and credit risk conditions specified by statute (see 12 CFR 1750.13 for conditions), plus 30% mandated by statute to cover management and operations risk.
- (9) Defined as the surplus of total capital over statutory risk-based capital expressed as a percentage of statutory risk-based capital.

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- (10) Generally, the sum of (a) 1.25% of on-balance sheet assets; (b) 0.25% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and (c) up to 0.25% of other off-balance sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances.
- (11) Defined as the surplus of core capital over statutory critical capital, expressed as a percentage of statutory critical capital.

For each quarter of 2005 and 2006, we have been classified by OFHEO as adequately capitalized. On June 28, 2007, OFHEO announced that we were classified as adequately capitalized as of March 31, 2007 (the most recent quarter for which OFHEO has published its capital classification). Our adjusted core capital of \$42.3 billion as of March 31, 2007 exceeded our adjusted statutory minimum capital requirement by \$12.8 billion, and our adjusted OFHEO-directed minimum capital requirement by \$3.9 billion. Because we have not yet prepared audited consolidated financial statements for any periods after December 31, 2006, OFHEO's capital classifications for periods after December 31, 2006 are based on our estimates of our financial condition as of those periods and remain subject to revision.

Common Stock

Shares of common stock outstanding, net of shares held in treasury, totaled approximately 972 million and 971 million as of December 31, 2006 and 2005, respectively. We issued 1.6 million and 1.5 million shares of common stock from treasury for our employee benefit plans during 2006 and 2005, respectively. We did not issue any common stock during 2006 and 2005 other than in accordance with these plans. Our ability to issue common stock will be limited until we have returned to timely financial reporting.

In January 2003, our Board of Directors approved a stock repurchase program (the General Repurchase Authority) authorizing us to repurchase up to 5% of our shares of common stock outstanding as of December 31, 2002, as well as additional shares to offset stock issued, or expected to be issued, under our employee benefit plans. Under this General Repurchase Authority, which does not have a specified expiration date, we repurchased 7.2 million shares of common stock at a weighted average cost per share of \$73.67 in 2004. We have not repurchased any shares from the open market pursuant to this General Repurchase Authority since July 2004.

In November 2004, OFHEO agreed that our September 27, 2004 agreement with OFHEO did not impair our ability to repurchase shares from employees under certain employee benefit plan transactions, including reacquiring shares for: payment of withholding taxes on the vesting of restricted stock; payment of withholding taxes due upon the exercise of employee stock options; and payment of the exercise price on stock options. OFHEO also approved our request to repurchase shares from employees in limited circumstances relating to financial hardship.

Since April 2005, we have prohibited all of our employees from engaging in purchases or sales of our securities except in limited circumstances relating to financial hardship. In November 2005, our Board of Directors authorized the creation of a stock repurchase program that permits us to repurchase up to \$100 million of our shares from our non-officer employees, who are employees below the level of vice president. Under the program, we may repurchase shares weekly at fair market value only during the 30-trading day period following our quarterly filings on Form 12b-25 with the SEC. Officers and members of our Board of Directors are not permitted to participate in the program. On March 22, 2006, OFHEO advised us that it had no objection to our proceeding with the program on the terms described to OFHEO. We implemented the program in May 2006. From May 31, 2006 to June 30, 2007, we purchased an aggregate of 82,321 shares of common stock from our employees under the program. The employee stock repurchase program does not have a specified expiration date.

Non-Cumulative Preferred Stock

We have not issued preferred stock since December 31, 2004. We did not redeem any preferred stock during 2006 and 2005. We redeemed our Series J Preferred stock on February 28, 2007, and our Series K Preferred Stock on April 2, 2007.

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Subordinated Debt

On September 1, 2005, we agreed with OFHEO to make specific commitments relating to the issuance of qualifying subordinated debt. These commitments replaced our October 2000 voluntary initiatives relating to the maintenance of qualifying subordinated debt. We agreed to issue qualifying subordinated debt, rated by at least two nationally recognized statistical rating organizations, in a quantity such that the sum of our total capital plus the outstanding balance of our qualifying subordinated debt equals or exceeds the sum of (1) outstanding Fannie Mae MBS held by third parties times 0.45% and (2) total on-balance sheet assets times 4%, which we refer to as our subordinated debt requirement. We must also take reasonable steps to maintain sufficient outstanding subordinated debt to promote liquidity and reliable market quotes on market values. We also agreed to provide periodic public disclosure of our compliance with these commitments, including a comparison of the quantities of qualifying subordinated debt and total capital to the levels required by our agreement with OFHEO.

Every six months, commencing January 1, 2006, we are required to submit to OFHEO a subordinated debt management plan that includes any issuance plans for the upcoming six months. Although it is not a component of core capital, qualifying subordinated debt supplements our equity capital. It is designed to provide a risk-absorbing layer to supplement core capital for the benefit of senior debt holders. In addition, the spread between the trading prices of our qualifying subordinated debt and our senior debt serves as a market indicator to investors of the relative credit risk of our debt. A narrow spread between the trading prices of our qualifying subordinated debt and senior debt implies that the market perceives the credit risk of our debt to be relatively low. A wider spread between these prices implies that the market perceives our debt to have a higher relative credit risk.

Our total capital plus the outstanding balance of our qualifying subordinated debt was approximately \$50.2 billion and exceeded our subordinated debt requirement by an estimated \$8.2 billion as of March 31, 2007 (the most recent date for which results have been published by OFHEO). The sum of our total capital plus the outstanding balance of our qualifying subordinated debt exceeded our subordinated debt requirement by an estimated \$8.6 billion, or 20.7%, as of December 31, 2006, and by \$8.3 billion, or 20.4%, as of December 31, 2005. Because we have not yet prepared audited consolidated financial statements for any periods after December 31, 2006, determinations for periods after December 31, 2006 are based on our estimates of our financial condition as of those periods and remain subject to revision. Qualifying subordinated debt with a remaining maturity of less than five years receives only partial credit in this calculation. One-fifth of the outstanding amount is excluded each year during the instrument's last five years before maturity and, when the remaining maturity is less than one year, the instrument is entirely excluded.

Qualifying subordinated debt is defined as subordinated debt that contains an interest deferral feature that requires us to defer the payment of interest for up to five years if either:

our core capital is below 125% of our critical capital requirement; or

our core capital is below our minimum capital requirement, and the U.S. Secretary of the Treasury, acting on our request, exercises his or her discretionary authority pursuant to Section 304(c) of the Charter Act to purchase our debt obligations.

Core capital is defined by OFHEO and represents the sum of the stated value of our outstanding common stock (common stock less treasury stock), the stated value of our outstanding non-cumulative perpetual preferred stock, our paid-in capital and our retained earnings, as determined in accordance with GAAP.

During any period in which we defer payment of interest on qualifying subordinated debt, we may not declare or pay dividends on, or redeem, purchase or acquire, our common stock or preferred stock. To date, no triggering events have occurred that would require us to defer interest payments on our qualifying subordinated debt.

Prior to our September 1, 2005 agreement with OFHEO, pursuant to our voluntary initiatives, we sought to maintain sufficient qualifying subordinated debt to bring the sum of total capital and outstanding qualifying subordinated debt to at least 4% of on-balance sheet assets, after providing adequate capital to support Fannie

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Mae MBS held by third parties that is not included in the consolidated balance sheets. We had qualifying subordinated debt with a carrying amount of \$12.5 billion as of both December 31, 2004 and 2003, which, together with our total capital, constituted 4.0% and 3.3% of our on-balance sheet assets as of December 31, 2004 and 2003, respectively. Under the voluntary initiatives, qualifying subordinated debt with a remaining maturity of less than five years did not receive a partial credit in this calculation.

We have not issued any subordinated debt securities since 2003. We had qualifying subordinated debt totaling \$2.0 billion and \$1.5 billion, based on redemption value, that matured in January 2007 and May 2006, respectively. As of the date of this filing, we have \$9.0 billion in outstanding qualifying subordinated debt.

Dividends

In January 2005, our Board of Directors reduced our quarterly dividend rate by 50%, from \$0.52 per share of common stock to \$0.26 per share of common stock. We reduced our common stock dividend rate in order to increase our capital surplus, which was a component of our capital restoration plan. In December 2006, the Board of Directors increased our dividend rate to \$0.40 per share of common stock, beginning in the fourth quarter of 2006, and increased our dividend rate again to \$0.50 per share of common stock, beginning in the second quarter of 2007.

We paid common stock dividends of:

\$0.26 per share for each quarter of 2005 and for the first, second and third quarters of 2006;

\$0.40 per share for the fourth quarter of 2006 and first quarter of 2007; and

\$0.50 per share for the second quarter of 2007.

On July 17, 2007, our Board of Directors declared common stock dividends of \$0.50 per share for the third quarter of 2007, payable on August 27, 2007. Our Board of Directors has approved preferred stock dividends for periods commencing December 31, 2004, up to but excluding September 30, 2007. See Notes to Consolidated Financial Statements Note 17, Preferred Stock for detailed information on our preferred stock dividends.

OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES

We enter into certain business arrangements to facilitate our statutory purpose of providing liquidity to the secondary mortgage market and to reduce our exposure to interest rate fluctuations. We form arrangements to meet the financial needs of our customers and manage our credit, market or liquidity risks. Some of these arrangements are not recorded in the consolidated balance sheets or may be recorded in amounts different from the full contract or notional amount of the transaction, depending on the nature or structure of, and accounting required to be applied to, the arrangement. These arrangements are commonly referred to as off-balance sheet arrangements, and expose us to potential losses in excess of the amounts recorded in the consolidated balance sheets.

The most significant off-balance sheet arrangements that we engage in result from the mortgage loan securitization and resecuritization transactions that we routinely enter into as part of the normal course of our business operations. Our Single-Family business generates most of its revenues through the guaranty fees earned from these securitization transactions. In addition, our HCD business generates a significant amount of its revenues through the guaranty fees earned from these securitization transactions. We also enter into other guaranty transactions and hold LIHTC partnership interests that may involve off-balance sheet arrangements.

Fannie Mae MBS Transactions and Other Financial Guaranties

As described in Item 1 Business, both our Single-Family business and our HCD business generate revenues through guaranty fees earned in connection with the issuance of Fannie Mae MBS. In connection with our guaranties issued or modified on or after January 1, 2003, we record in the consolidated balance sheets a guaranty obligation based on an estimate of our non-contingent obligation to stand ready to perform

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under these guaranties. We also record in the consolidated balance sheets a reserve for guaranty losses based on an estimate of our incurred credit losses on all of our guaranties, irrespective of the issuance date.

While we hold some Fannie Mae MBS in our mortgage portfolio, the substantial majority of outstanding Fannie Mae MBS is held by third parties and therefore is generally not reflected in the consolidated balance sheets. Of the \$2.0 trillion and \$1.9 trillion in total outstanding Fannie Mae MBS as of December 31, 2006 and 2005, respectively, we held \$199.6 billion and \$234.5 billion, respectively, in our portfolio. Fannie Mae MBS held in our portfolio is reflected in the consolidated balance sheets as Investments in securities. We consolidate certain Fannie Mae MBS trusts depending on the significance of our interest in those MBS trusts. Upon consolidation, we recognize the assets of the consolidated trust. As of December 31, 2006 and 2005, we recognized \$105.6 billion and \$111.3 billion, respectively, of assets from the consolidation of certain MBS trusts. As of December 31, 2006 and 2005, there was approximately \$1.8 trillion and \$1.6 trillion, respectively, in outstanding and unconsolidated Fannie Mae MBS held by third parties, which is not reflected in the consolidated balance sheets.

While our guaranties relating to Fannie Mae MBS represent the substantial majority of our guaranty activity, we also provide other financial guaranties. Our HCD business provides credit enhancements primarily for taxable and tax-exempt bonds issued by state and local governmental entities to finance multifamily housing for low- and moderate-income families. Under these credit enhancement arrangements, we guarantee to the trust that we will supplement proceeds as required to permit timely payment on the related bonds, which improves the bond ratings and thereby results in lower-cost financing for multifamily housing. Our HCD business generates revenue from the fees earned on these transactions. These transactions also contribute to our housing goals and help us meet other mission-related objectives.

Our maximum potential exposure to credit losses relating to our outstanding and unconsolidated Fannie Mae MBS held by third parties and our other financial guaranties is significantly higher than the carrying amount of the guaranty obligations and reserve for guaranty losses that are reflected in the consolidated balance sheets. In the case of outstanding and unconsolidated Fannie Mae MBS held by third parties, our maximum potential exposure arising from these guaranties is primarily represented by the unpaid principal balance of the mortgage loans underlying these Fannie Mae MBS, which was \$1.8 trillion and \$1.6 trillion as of December 31, 2006 and 2005, respectively. In the case of our other financial guaranties, our maximum potential exposure is primarily represented by the unpaid principal balance of the underlying bonds and loans, which totaled \$19.7 billion and \$19.2 billion as of December 31, 2006 and 2005, respectively.

Based on our historical credit losses, which represent less than 0.03% of our mortgage credit book of business for each year from 2004 to 2006, we do not believe that the maximum exposure on our Fannie Mae MBS and other credit-related guaranties is representative of our actual credit exposure relating to these guaranties. In the event that we were required to make payments under these guaranties, we would pursue recovery of these payments by exercising our rights to the collateral backing the underlying loans or through available credit enhancements (which includes all recourse with third parties and mortgage insurance).

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The table below presents a summary of our on- and off-balance sheet Fannie Mae MBS and other guaranty obligations as of December 31, 2006 and 2005.

Table 28: On- and Off-Balance Sheet MBS and Other Guaranty Arrangements

	As of December 31,	
	2006	2005
	(Dollars in millions)	
Fannie Mae MBS and other guaranties outstanding ⁽¹⁾	\$ 1,996,941	\$ 1,852,521
Less: Fannie Mae MBS held in portfolio ⁽²⁾	199,644	234,451
Fannie Mae MBS held by third parties and other guaranties	\$ 1,797,297	\$ 1,618,070

(1) Includes \$19.7 billion and \$19.2 billion in unpaid principal balance of other guaranties as of December 31, 2006 and 2005, respectively. Excludes \$105.6 billion and \$111.3 billion in unpaid principal balance of consolidated Fannie Mae MBS as of December 31, 2006 and 2005, respectively.

(2) Amounts represent unpaid principal balance and are recorded in Investments in securities in the consolidated balance sheets.

For more information on our securitization transactions, including the interests we retain in these transactions, cash flows from these transactions, and our accounting for these transactions, see Notes to Consolidated Financial Statements Note 6, Portfolio Securitizations, Notes to Consolidated Financial Statements Note 8, Financial Guaranties and Master Servicing and Notes to Consolidated Financial Statements Note 18, Concentrations of Credit Risk. For information on the revenues and expenses associated with our Single-Family and HCD businesses, refer to Business Segment Results.

LIHTC Partnership Interests

In most instances, we are not the primary beneficiary of our LIHTC partnership investments, and therefore our consolidated balance sheets reflect only our investment in the partnership, rather than the full amount of the partnership's assets and liabilities. In certain instances, we have been determined to be the primary beneficiary of the investments, and therefore all of the partnership assets and liabilities have been recorded in the consolidated balance sheets, and the portion of these investments owned by third parties is recorded in the consolidated balance sheets as an offsetting minority interest. Our investments in LIHTC partnerships are recorded in the consolidated balance sheets as Partnership investments.

In cases where we are not the primary beneficiary of these investments, we account for our investments in LIHTC partnerships by using the equity method of accounting or the effective yield method of accounting, as appropriate. In each case, we record in the consolidated financial statements our share of the income and losses of the partnerships, as well as our share of the tax credits and tax benefits of the partnerships. Our share of the operating losses generated by our LIHTC partnerships is recorded in the consolidated statements of income under Loss from partnership investments. The tax credits and benefits associated with any operating losses incurred by these LIHTC partnerships are recorded in the consolidated statements of income within our Provision for federal income taxes.

As of December 31, 2006, we had a recorded investment in these LIHTC partnerships of \$8.8 billion. Our risk exposure relating to these LIHTC partnerships is limited to the amount of our investment and the possible recapture of the tax benefits we have received from the partnership. Neither creditors of, nor equity investors in, these partnerships have any recourse to our general credit. To manage the risks associated with a partnership, we track compliance with the LIHTC requirements, as well as the property condition and financial performance of the underlying investment throughout the life of the investment. In addition, we evaluate the strength of the partnership's sponsor through periodic financial and operating assessments. Further, in some of our LIHTC partnership investments, our exposure to loss is further mitigated by our having a guaranteed economic return from an investment grade counterparty.

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The table below provides information regarding our LIHTC partnership investments as of and for the years ended December 31, 2006 and 2005.

Table 29: LIHTC Partnership Investments

	2006		2005	
	Consolidated	Unconsolidated	Consolidated	Unconsolidated
	(Dollars in millions)			
As of December 31:				
Obligation to fund LIHTC partnerships	\$ 1,101	\$ 1,538	\$ 833	\$ 1,698
For the year ended December 31:				
Tax credits from investments in LIHTC partnerships	\$ 419	\$ 531	\$ 366	\$ 467
Losses from investments in LIHTC partnerships	288	553	275	518
Tax benefits on credits and losses from investments in LIHTC partnerships	520	725	462	649
Contributions to LIHTC partnerships	690	1,053	484	743
Distributions from LIHTC partnerships	1	8	2	1

For more information on our off-balance sheet transactions, see Notes to Consolidated Financial Statements Note 18, Concentrations of Credit Risk.

2006 QUARTERLY REVIEW

We provide certain selected unaudited quarterly financial statement information for the years ended December 31, 2006 and 2005 in Notes to Consolidated Financial Statements Note 21, Selected Quarterly Financial Information (Unaudited). The selected financial information includes the following:

Consolidated statements of income for the quarters ended March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006.

Consolidated statements of income for the quarters ended March 31, 2005, June 30, 2005, September 30, 2005 and December 31, 2005.

Condensed consolidated balance sheets as of March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006.

Condensed business segment results of operations for the quarters ended March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006.

Table of Contents**Table 30: 2006 Quarterly Consolidated Statements of Income**

	For the 2006 Quarter Ended			
	March 31	June 30	September 30	December 31
	(Dollars and shares in millions, except per share amounts)			
Interest income:				
Investments in securities	\$ 5,422	\$ 5,791	\$ 5,976	\$ 5,634
Mortgage loans	5,082	5,204	5,209	5,309
Total interest income	10,504	10,995	11,185	10,943
Interest expense:				
Short-term debt	1,650	1,907	2,124	2,055
Long-term debt	6,842	7,221	7,533	7,543
Total interest expense	8,492	9,128	9,657	9,598
Net interest income	2,012	1,867	1,528	1,345
Guaranty fee income	930	917	1,063	1,264
Losses on certain guaranty contracts	(27)	(51)	(103)	(258)
Investment gains (losses), net	(675)	(633)	550	75
Derivatives fair value gains (losses), net	906	1,621	(3,381)	(668)
Debt extinguishment gains, net	17	69	72	43
Losses from partnership investments	(194)	(188)	(197)	(286)
Fee and other income	308	62	255	234
Non-interest income (loss)	1,265	1,797	(1,741)	404
Administrative expenses:				
Salaries and employee benefits	265	311	307	336
Professional services	347	362	333	351
Occupancy expenses	61	67	64	71
Other administrative expenses	35	40	57	69
Total administrative expenses	708	780	761	827
Minority interest in losses of consolidated subsidiaries	2	3	2	3
Provision for credit losses	79	144	145	221
Foreclosed property expense	23	14	52	105
Other expenses	31	61	99	204
Total expenses	843	1,002	1,059	1,360
	2,434	2,662	(1,272)	389

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Income (loss) before federal income taxes and extraordinary gains (losses)				
Provision for federal income tax expense (benefit)	409	610	(639)	(214)
Income (loss) before extraordinary gains (losses)	2,025	2,052	(633)	603
Extraordinary gains (losses), net of tax effect	1	6	4	1
Net income (loss)	\$ 2,026	\$ 2,058	\$ (629)	\$ 604
Preferred stock dividends	(122)	(127)	(131)	(131)
Net income (loss) available to common stockholders	\$ 1,904	\$ 1,931	\$ (760)	\$ 473
Basic earnings (loss) per share:				
Earnings (losses) before extraordinary gains (losses)	\$ 1.96	\$ 1.98	\$ (0.79)	\$ 0.49
Extraordinary gains (losses), net of tax effect		0.01		
Basic earnings (loss) per share	\$ 1.96	\$ 1.99	\$ (0.79)	\$ 0.49
Diluted earnings (loss) per share:				
Earnings (losses) before extraordinary gains (losses)	\$ 1.94	\$ 1.96	\$ (0.79)	\$ 0.49
Extraordinary gains (losses), net of tax effect		0.01		
Diluted earnings (loss) per share	\$ 1.94	\$ 1.97	\$ (0.79)	\$ 0.49
Cash dividends per common share	0.26	0.26	0.26	0.40
Weighted-average common shares outstanding:				
Basic	971	971	972	972
Diluted ⁽¹⁾	998	999	972	974

(1) For the quarters ended September 30, 2006 and December 31, 2006, diluted shares outstanding exclude the effect of our convertible preferred stock as inclusion would be anti-dilutive for the periods.

Table of Contents**Table 31: 2005 Quarterly Consolidated Statements of Income**

	For the 2005 Quarter Ended			
	March 31	June 30	September 30	December 31
(Dollars and shares in millions, except per share amounts)				
Interest income:				
Investments in securities	\$ 6,613	\$ 6,288	\$ 5,884	\$ 5,371
Mortgage loans	5,449	5,128	5,133	4,978
Total interest income	12,062	11,416	11,017	10,349
Interest expense:				
Short-term debt	1,766	1,791	1,525	1,480
Long-term debt	6,509	6,728	6,828	6,712
Total interest expense	8,275	8,519	8,353	8,192
Net interest income	3,787	2,897	2,664	2,157
Guaranty fee income	903	1,239	872	911
Losses on certain guaranty contracts ⁽¹⁾	(33)	(31)	(40)	(42)
Investment gains (losses), net	(1,454)	596	(169)	(307)
Derivatives fair value gains (losses), net	(749)	(2,641)	(539)	(267)
Debt extinguishment gains (losses), net	(142)	18	86	(30)
Losses from partnership investments	(200)	(210)	(211)	(228)
Fee and other income	353	459	298	416
Non-interest income (loss)	(1,322)	(570)	297	453
Administrative expenses:				
Salaries and employee benefits	174	253	259	273
Professional services	105	166	219	302
Occupancy expenses	53	54	56	58
Other administrative expenses	31	34	33	45
Total administrative expenses	363	507	567	678
Minority interest in (earnings) losses of consolidated subsidiaries	(4)	1		1
Provision for credit losses	57	125	172	87
Foreclosed property expense (income)	4	(28)	(8)	19
Other expenses	53	49	76	73
Total expenses	473	654	807	858

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Income (loss) before federal income taxes and extraordinary gains (losses)	1,992	1,673	2,154	1,752
Provision for federal income taxes	217	333	406	321
Income before extraordinary gains (losses)	1,775	1,340	1,748	1,431
Extraordinary gains (losses), net of tax effect	65	(2)	(3)	(7)
Net income	\$ 1,840	\$ 1,338	\$ 1,745	\$ 1,424
Preferred stock dividends	(121)	(122)	(122)	(121)
Net income available to common stockholders	\$ 1,719	\$ 1,216	\$ 1,623	\$ 1,303
Basic earnings (loss) per share:				
Earnings before extraordinary gains (losses)	\$ 1.71	\$ 1.25	\$ 1.68	\$ 1.35
Extraordinary gains (losses), net of tax effect	.06			(0.01)
Basic earnings per share	\$ 1.77	\$ 1.25	\$ 1.68	\$ 1.34
Diluted earnings (loss) per share:				
Earnings before extraordinary gains (losses)	\$ 1.70	\$ 1.25	\$ 1.66	\$ 1.35
Extraordinary gains (losses), net of tax effect	0.06			(0.01)
Diluted earnings per share	\$ 1.76	\$ 1.25	\$ 1.66	\$ 1.34
Cash dividends per common share	0.26	0.26	0.26	0.26
Weighted-average common shares outstanding:				
Basic	969	970	970	970
Diluted ⁽²⁾	998	971	998	998

(1) Reclassified from guaranty fee income to conform to current year presentation.

(2) For the quarter ended June 30, 2005, diluted shares outstanding exclude the effect of our convertible preferred stock as inclusion would be anti-dilutive for that period.

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	March 31, 2006	June 30, 2006	As of September 30, 2006	December 31, 2006
	(Dollars in millions)			
Assets:				
Cash and cash equivalents	\$ 4,675	\$ 18,899	\$ 3,079	\$ 3,239
Fed funds sold and securities purchased under agreements to resell	10,650	17,844	16,803	12,681
Investments in securities:				
Trading, at fair value	14,077	13,307	12,034	11,514
Available-for-sale, at fair value	383,423	383,233	372,300	378,598
Total investments in securities	397,500	396,540	384,334	390,112
Mortgage loans:				
Loans held for sale, at lower of cost or market	5,422	5,253	10,158	4,868
Loans held for investment, at amortized cost	364,003	370,451	372,507	379,027
Allowance for loan losses	(306)	(314)	(315)	(340)
Total mortgage loans	369,119	375,390	382,350	383,555
Advances to lenders	5,026	5,493	6,054	6,163
Derivative assets at fair value	6,728	8,338	4,604	4,931
Guaranty assets	7,200	7,645	7,800	7,692
Deferred tax assets	7,685	7,685	7,685	8,505
Other assets	25,481	27,305	25,817	27,058
Total assets	\$ 834,064	\$ 865,139	\$ 838,526	\$ 843,936
Liabilities and Stockholders Equity:				
Liabilities:				
Fed funds purchased and securities sold under agreements to repurchase	\$	\$	\$ 196	\$ 700
Short-term debt	157,382	175,858	150,592	165,810
Long-term debt	608,596	612,449	609,670	601,236
Derivative liabilities at fair value	1,105	1,052	1,093	1,184
Reserve for guaranty losses	378	407	447	519
Guaranty obligations	10,396	10,975	11,295	11,145
Other liabilities	17,420	25,626	23,771	21,700
Total liabilities	795,277	826,367	797,064	802,294
Minority interests in consolidated subsidiaries	118	121	124	136
Stockholders Equity:				
Retained earnings	37,214	38,885	37,872	37,955

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Accumulated other comprehensive loss	(2,430)	(4,152)	(487)	(445)
Other stockholders' equity	3,885	3,918	3,953	3,996
Total stockholders' equity	38,669	38,651	41,338	41,506
Total liabilities and stockholders' equity	\$ 834,064	\$ 865,139	\$ 838,526	\$ 843,936

Table of Contents**Table 33: 2006 Quarterly Condensed Business Segment Results**

	For the Quarter Ended March 31, 2006			
	Single-Family Credit	Capital		Total
	Guaranty	HCD	Markets	
(Dollars in millions)				
Net interest income (expense) ⁽¹⁾	\$ 245	\$ (75)	\$ 1,842	\$ 2,012
Guaranty fee income (expense) ⁽²⁾	1,079	119	(268)	930
Losses on certain guaranty contracts	(26)	(1)		(27)
Investment gains (losses), net	22		(697)	(675)
Derivatives fair value gains, net			906	906
Debt extinguishment gains, net			17	17
Losses from partnership investments		(194)		(194)
Fee and other income	63	70	175	308
Administrative expenses	(339)	(129)	(240)	(708)
(Provision) benefit for credit losses	(84)	5		(79)
Other income (expense)	(78)	23	(1)	(56)
Income (loss) before federal income taxes and extraordinary gains	882	(182)	1,734	2,434
Provision (benefit) for federal income taxes	307	(328)	430	409
Income before extraordinary gains	575	146	1,304	2,025
Extraordinary gains, net of tax effect			1	1
Net income	\$ 575	\$ 146	\$ 1,305	\$ 2,026

(1) Includes cost of capital charge.

(2) Includes intercompany guaranty fee income (expense) allocated to Single-Family and HCD from Capital Markets for absorbing the credit risk on mortgage loans held in our portfolio.

	For the Quarter Ended June 30, 2006			
	Single-Family Credit	Capital		Total
	Guaranty	HCD	Markets	
(Dollars in millions)				
Net interest income (expense) ⁽¹⁾	\$ 263	\$ (81)	\$ 1,685	\$ 1,867
Guaranty fee income (expense) ⁽²⁾	1,085	105	(273)	917
Losses on certain guaranty contracts	(48)	(3)		(51)

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Investment gains (losses), net	30		(663)	(633)
Derivatives fair value gains, net			1,621	1,621
Debt extinguishment gains, net			69	69
Losses from partnership investments		(188)		(188)
Fee and other income (expense)	62	73	(73)	62
Administrative expenses	(383)	(150)	(247)	(780)
Provision for credit losses	(130)	(14)		(144)
Other expenses	(66)	(10)	(2)	(78)
Income (loss) before federal income taxes and extraordinary gains	813	(268)	2,117	2,662
Provision (benefit) for federal income taxes	281	(357)	686	610
Income before extraordinary gains	532	89	1,431	2,052
Extraordinary gains, net of tax effect			6	6
Net income	\$ 532	\$ 89	\$ 1,437	\$ 2,058

(1) Includes cost of capital charge.

(2) Includes intercompany guaranty fee income (expense) allocated to Single-Family and HCD from Capital Markets for absorbing the credit risk on mortgage loans held in our portfolio.

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	For the Quarter Ended September 30, 2006			
	Single-Family	Capital		
	Credit Guaranty	HCD	Markets	Total
	(Dollars in millions)			
Net interest income (expense) ⁽¹⁾	\$ 257	\$ (81)	\$ 1,352	\$ 1,528
Guaranty fee income (expense) ⁽²⁾	1,242	99	(278)	1,063
Losses on certain guaranty contracts	(101)	(2)		(103)
Investment gains, net	21		529	550
Derivatives fair value losses, net			(3,381)	(3,381)
Debt extinguishment gains, net			72	72
Losses from partnership investments		(197)		(197)
Fee and other income	67	71	117	255
Administrative expenses	(391)	(144)	(226)	(761)
Provision for credit losses	(142)	(3)		(145)
Other income (expense)	(141)	(14)	2	(153)
Income (loss) before federal income taxes and extraordinary gains	812	(271)	(1,813)	(1,272)
Provision (benefit) for federal income taxes	283	(360)	(562)	(639)
Income (loss) before extraordinary gains	529	89	(1,251)	(633)
Extraordinary gains, net of tax effect			4	4
Net income (loss)	\$ 529	\$ 89	\$ (1,247)	\$ (629)

(1) Includes cost of capital charge.

(2) Includes intercompany guaranty fee income (expense) allocated to Single-Family and HCD from Capital Markets for absorbing the credit risk on mortgage loans and held in our portfolio.

	For the Quarter Ended December 31, 2006			
	Single-Family	Capital		
	Credit Guaranty	HCD	Markets	Total
	(Dollars in millions)			
Net interest income (expense) ⁽¹⁾	\$ 161	\$ (94)	\$ 1,278	\$ 1,345
Guaranty fee income (expense) ⁽²⁾	1,379	163	(278)	1,264
Losses on certain guaranty contracts	(256)	(2)		(258)
Investment gains, net	24		51	75
Derivatives fair value losses, net			(668)	(668)
Debt extinguishment gains, net			43	43
Losses from partnership investments		(286)		(286)

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Fee and other income (expense)	170	141	(77)	234
Administrative expenses	(453)	(173)	(201)	(827)
Provision for credit losses	(221)			(221)
Other expenses	(178)	(133)	(1)	(312)
Income (loss) before federal income taxes and extraordinary gains	626	(384)	147	389
Provision (benefit) for federal income taxes	218	(398)	(34)	(214)
Income before extraordinary gains	408	14	181	603
Extraordinary gains, net of tax effect			1	1
Net income	\$ 408	\$ 14	\$ 182	\$ 604

(1) Includes cost of capital charge.

(2) Includes intercompany guaranty fee income (expense) allocated to Single-Family and HCD from Capital Markets for absorbing the credit risk on mortgage loans held in our portfolio.

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During the year ended December 31, 2006, our earnings fluctuated from quarter to quarter and included net income of \$2.0 billion for the quarter ended March 31, 2006, net income of \$2.1 billion for the quarter ended June 30, 2006, a net loss of \$629 million for the quarter ended September 30, 2006 and net income of \$604 million for the quarter ended December 31, 2006. As discussed in the Consolidated Results of Operations section above, we expect that our annual and quarterly results will be volatile, primarily due to changes in market conditions that result in periodic fluctuations in the estimated fair value of our derivative instruments. This is reflected in the consolidated statements of income as Derivatives fair value losses, net. The following is a review of our results for the quarterly interim periods in 2006 as compared to the same quarterly interim periods in 2005.

First Quarter Ended March 31, 2006 versus First Quarter Ended March 31, 2005

We recorded net income of \$2.0 billion for the first quarter of 2006 compared to net income of \$1.8 billion for the first quarter of 2005. The increase in net income was due to a lower level of net investment losses and recognition of net derivatives fair value gains in the first quarter of 2006 as compared to net derivatives fair value losses in the first quarter of 2005, which were offset by a lower level of net interest income and higher administrative expenses.

Net interest income totaled \$2.0 billion for the first quarter of 2006 as compared to \$3.8 billion for the first quarter of 2005. The reduction in net interest income was due primarily to lower average balances in our mortgage portfolio for the first quarter of 2006 as a result of our 2005 portfolio sales as well as to liquidations and to continued compression of our net interest yield.

Net investment losses totaled \$675 million for the first quarter of 2006 as compared to \$1.5 billion for the first quarter of 2005. The lower level of net losses resulted from lower other-than-temporary impairment charges on available-for-sale securities as well as lower net unrealized holding losses on trading securities.

We recorded net derivatives fair value gains of \$906 million for the first quarter of 2006 as compared to net derivatives fair value losses of \$749 million for the first quarter of 2005. The net gains recorded in the first quarter of 2006 were due to an increase in the fair value of open derivative positions as of March 31, 2006 resulting from an increase in interest rates combined with lower net interest costs on interest rate swaps due to the rising rates and lower termination costs. The net losses recorded in the first quarter of 2005 were the result of higher net interest costs on interest rate swaps, termination costs and declines in the fair value of open derivative positions as of March 31, 2005.

We recorded debt extinguishment gains of \$17 million for the first quarter of 2006 as compared to debt extinguishment losses of \$142 million for the first quarter of 2005. The gains in 2006 were the result of our decision to take advantage of favorable funding spreads relative to LIBOR on new debt issuances and repurchase outstanding debt trading at attractive prices.

Administrative expenses totaled \$708 million for the first quarter of 2006 as compared to \$363 million for the first quarter of 2005. The increase in administrative expenses was due to higher professional service fees as a result of the restatement and reaudit of our financial results, which were \$242 million higher in the first quarter of 2006 as compared to the first quarter of 2005, as well as to higher salaries and employee benefit expenses as a result of increasing our staffing to address the restatement and remediation efforts.

We recorded a provision for federal income tax expense of \$409 million for the first quarter of 2006 as compared to \$217 million for the first quarter 2005. The increase in provision for income taxes in the first quarter of 2006 as compared to the first quarter of 2005 primarily relates to a \$442 million increase in income before taxes. The provision includes taxes accrued on income at the federal statutory rate of 35% adjusted for tax credits recognized for our equity investments in affordable housing projects and tax benefits resulting from our holdings of tax-exempt

investments.

Second Quarter Ended June 30, 2006 versus Second Quarter Ended June 30, 2005

We recorded net income of \$2.1 billion in the second quarter of 2006 compared to net income of \$1.3 billion in the second quarter of 2005. The increase in net income was due to recognition of net derivatives fair value

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gains in the second quarter of 2006 as compared to net derivatives fair value losses in the second quarter of 2005. The increase was offset primarily by a lower level of net interest income and recognition of net investment losses in the second quarter of 2006 as compared to net investment gains in the second quarter of 2005.

Net interest income totaled \$1.9 billion for the second quarter of 2006 as compared to \$2.9 billion for the second quarter of 2005. The reduction in net interest income was due primarily to lower average balances in our mortgage portfolio for the second quarter of 2006 as a result of our 2005 portfolio sales as well as to liquidations and to continued compression of our net interest yield.

Guaranty fee income totaled \$917 million for the second quarter of 2006 as compared to \$1.2 billion for the second quarter of 2005. The decrease in guaranty fee income was due to an increase in interest rates in the second quarter of 2006 resulting in the deceleration of amortization of deferred fees net of impairment charges for guaranty assets as opposed to a decline in interest rates in the second quarter of 2005 resulting in the acceleration of amortization of deferred fees net of impairment charges. An increase in mortgage rates reduces the rate of expected mortgage loan prepayments thereby increasing the average expected life of the guaranty assets and slowing the rate of amortization of deferred fees.

Net investment losses totaled \$633 million for the second quarter of 2006 as compared to net investment gains of \$596 million for the second quarter of 2005. The net losses recorded in the second quarter of 2006 reflected net unrealized holding losses on trading securities as interest rates rose during the second quarter of 2006 and other-than-temporary impairment charges on available-for-sale securities due to rising rates and an intent to sell the securities. Net gains recorded in the second quarter of 2005 reflected net unrealized holding gains on trading securities as interest rates declined during the second quarter of 2005.

We recorded net derivatives fair value gains of \$1.6 billion for the second quarter of 2006 as compared to net derivatives fair value losses of \$2.6 billion for the second quarter of 2005. The net gains recorded in the second quarter of 2006 were due to an increase in the fair value of open derivative positions as of June 30, 2006 resulting from an increase in interest rates combined with lower net interest costs on interest rate swaps. The net losses recorded in the second quarter of 2005 were the result of losses in the fair value of open derivative positions as of June 30, 2005 caused by a decrease in interest rates during the second quarter of 2005 and higher net interest costs on interest rate swaps.

Fee and other income totaled \$62 million for the second quarter of 2006 as compared to \$459 million for the second quarter of 2005. The decrease in fee and other income was primarily the result of recognition of foreign exchange losses on foreign-denominated debt in the second quarter of 2006 of \$161 million as compared to the recognition of foreign exchange gains in the second quarter of 2005 of \$226 million. These gains (losses) were offset by corresponding gains (losses) on foreign currency swaps recorded as a component of Derivatives fair value gains (losses), net in the consolidated statements of income as we eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps to convert foreign-denominated debt to U.S. dollars.

Administrative expenses totaled \$780 million for the second quarter of 2006 as compared to \$507 million for the second quarter of 2005. The increase in administrative expenses was due to higher professional service fees as a result of the restatement and reaudit of our financial results, which were \$196 million higher in the second quarter of 2006 as compared to the second quarter of 2005, as well as to higher salaries and employee benefit expenses as a result of increasing our staffing to address the restatement and remediation efforts.

We recorded a provision for federal income tax expense of \$610 million for the second quarter of 2006 as compared to \$333 million for the second quarter of 2005. The increase in provision for income taxes in the second quarter of 2006 as compared to the second quarter of 2005 primarily relates to a \$989 million increase in income before taxes. The

provision includes taxes accrued on income at the federal statutory rate of 35% adjusted for tax credits recognized for our equity investments in affordable housing projects and tax benefits resulting from our holdings of tax-exempt investments.

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Third Quarter Ended September 30, 2006 versus Third Quarter Ended September 30, 2005

We recorded a net loss of \$629 million for the third quarter of 2006 compared to net income of \$1.7 billion for the third quarter of 2005. The decrease in net income was due to recognition of a higher level of net derivatives fair value losses and a lower level of net interest income offset by recognition of net investment gains in the third quarter of 2006 compared to net investment losses in the third quarter of 2005.

Net interest income totaled \$1.5 billion for the third quarter of 2006 as compared to \$2.7 billion for the third quarter of 2005. The reduction in net interest income was due primarily to lower average balances in our mortgage portfolio for the third quarter of 2006 as a result of our 2005 portfolio sales as well as to liquidations and to continued compression of our net interest yield.

Guaranty fee income totaled \$1.1 billion for the third quarter of 2006 as compared to \$872 million for the third quarter of 2005. The increase in guaranty fee income was due to the acceleration of amortization of deferred fees net of impairment charges for guaranty assets resulting from a decline in interest rates in the third quarter of 2006.

Net investment gains in the third quarter of 2006 totaled \$550 million as compared to net investment losses of \$169 million for the third quarter of 2005. The net gains recorded in the third quarter of 2006 reflected net unrealized holding gains on trading securities as interest rates declined during the quarter. The net investment losses recorded in the third quarter of 2005 were attributable to net unrealized holding losses on trading securities due to rising interest rates during the quarter.

We recorded net derivatives fair value losses of \$3.4 billion for the third quarter of 2006 as compared to \$539 million for the third quarter of 2005. The net losses recorded in the third quarter of 2006 were due to a decrease in the fair value of open derivative positions as of September 30, 2006 resulting from a decline in interest rates. The net losses recorded in the third quarter of 2005 were attributable to a decline in the fair value of open derivative positions as of September 30, 2005 and net interest costs on interest rate swaps.

Administrative expenses totaled \$761 million for the third quarter of 2006 as compared to \$567 million for the third quarter of 2005. The increase in administrative expenses was due to higher professional service fees as a result of the restatement and reaudit of our financial results, which were \$114 million higher in the third quarter of 2006 as compared to the third quarter of 2005, as well as to higher salaries and employee benefit expenses as a result of increasing our staffing to address the restatement and remediation efforts.

The provision for credit losses totaled \$145 million for the third quarter of 2006 as compared to \$172 million for the third quarter of 2005. The provision for credit losses for the third quarter of 2006 increased sequentially from the second quarter of 2006 as we began to observe an increase in default rates. However, the provision for credit losses in the third quarter of 2006 was slightly lower than the third quarter of 2005 as the third quarter of 2005 included \$106 million for our estimate of incurred losses related to Hurricane Katrina.

We recorded a provision for federal income tax benefit of \$639 million for the third quarter of 2006 as compared to a provision for federal income tax expense of \$406 million for the third quarter of 2005. The federal income tax benefit in the third quarter of 2006 relates to a loss before taxes for the third quarter of 2006 as compared to income before taxes for the third quarter of 2005 at the federal statutory rate of 35% adjusted for tax credits recognized for our equity investments in affordable housing projects and tax benefits resulting from our holdings of tax-exempt investments.

Fourth Quarter Ended December 31, 2006 versus Fourth Quarter Ended December 31, 2005

We recorded net income of \$604 million for the fourth quarter of 2006 compared to net income of \$1.4 billion for the fourth quarter of 2005. The decrease in net income was due to a lower level of net interest income and recognition of a higher level of net derivatives fair value losses.

Net interest income totaled \$1.3 billion for the fourth quarter of 2006 as compared to \$2.2 billion for the fourth quarter 2005. The reduction in net interest income was due primarily to a higher cost of funds in the fourth quarter of 2006 resulting in a compressed net interest yield as compared to the fourth quarter of 2005.

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Guaranty fee income totaled \$1.3 billion for the fourth quarter of 2006 as compared to \$911 million for the fourth quarter of 2005. The increase in guaranty fee income was due to the acceleration of amortization of deferred fees net of impairment charges for guaranty assets resulting from a decline in interest rates in the fourth quarter of 2006 as well as the early liquidation of an HCD guaranty contract that accelerated amortization of the remaining associated guaranty fee income.

Losses on certain guaranty contracts totaled \$258 million for the fourth quarter of 2006 as compared to \$42 million for the fourth quarter of 2005. The increased loss during the fourth quarter of 2006 relates primarily to the slowdown in home appreciation in the latter half of 2006, which resulted in an increase in our modeled expectation of credit risk and higher initial losses on some of our MBS issuances.

Net investment gains in the fourth quarter of 2006 totaled \$75 million as compared to net investment losses of \$307 million for the fourth quarter of 2005. The net losses recorded in the fourth quarter of 2005 were attributable to other-than-temporary impairment charges on available-for-sale securities due to rising rates and an intent to sell the securities and unrealized holding losses on trading securities as a result of rising interest rates.

We recorded net derivatives fair value losses of \$668 million for the fourth quarter of 2006 as compared to \$267 million for the fourth quarter of 2005. The net losses in 2006 were due to a decrease in the fair value of open derivative positions as of December 31, 2006 resulting from a small decline in interest rates. The net losses in 2005 were due to a decrease in fair value of open derivative positions as of December 31, 2005 and net interest costs on interest rate swaps.

Fee and other income totaled \$234 million for the fourth quarter of 2006 as compared to \$416 million for the fourth quarter of 2005. The decrease in fee and other income was primarily the result of recognition of foreign exchange losses on foreign-denominated debt in the fourth quarter of 2006 of \$107 million as compared to the recognition of foreign exchange gains in the fourth quarter of 2005 of \$138 million. These gains (losses) were offset by corresponding gains (losses) on foreign currency swaps recorded as a component of Derivatives fair value gains (losses), net in the consolidated statements of income as we eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps to convert foreign-denominated debt to U.S. dollars. Additionally, in the fourth quarter of 2006, we recorded float income of \$111 million as fee and other income, which prior to November 2006 was recorded as net interest income.

Administrative expenses totaled \$827 million for the fourth quarter of 2006 as compared to \$678 million for the fourth quarter of 2005. The increase in administrative expenses was due to higher professional service fees as a result of the restatement and reaudit of our financial results, which were \$49 million higher in the fourth quarter of 2006 as compared to the fourth quarter of 2005, as well as to higher salaries and employee benefit expenses as a result of increasing our staffing to address the restatement and remediation efforts.

The provision for credit losses totaled \$221 million for the fourth quarter of 2006 as compared to \$87 million for the fourth quarter of 2005. The provision for credit losses for the fourth quarter of 2006 increased as compared to the fourth quarter of 2005 as a result of an observable trend of increasing defaults that began in the third quarter of 2006.

Other expenses totaled \$204 million for the fourth quarter of 2006 as compared to \$73 million for the fourth quarter of 2005. Other expenses for the fourth quarter of 2006 increased as compared to the fourth quarter of 2005 as a result of the early liquidation of an HCD guaranty contract that accelerated amortization of the remaining credit enhancement asset as well as accelerated amortization of the remaining associated guaranty fee income.

We recorded a provision for a federal income tax benefit of \$214 million for the fourth quarter of 2006 as compared to a provision for federal income tax expense of \$321 million for the fourth quarter of 2005. The federal income tax

benefit for the fourth quarter of 2006 relates to a reduction in our effective tax rate from the projected income tax rate applied during the first nine months of 2006 upon completion of our annual calculation of provision for income taxes. In the fourth quarter of 2005, higher net income before income taxes offset any differences between the actual and projected income tax rate resulting in income tax expense. These amounts reflect the federal statutory rate of 35% adjusted for tax credits recognized for our equity

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investments in affordable housing projects and tax benefits resulting from our holdings of tax-exempt investments.

RISK MANAGEMENT

As discussed in Item 1 Business Risk Management, our businesses expose us to the following four major categories of risks that often overlap: credit risk, market risk, operational risk and liquidity risk. We also are subject to a number of other risks that could adversely impact our business, financial condition, results of operations and cash flows, including legal and reputational risks that may arise due to a failure to comply with laws, regulations or ethical standards and codes of conduct applicable to our business activities and functions. See Item 1A Risk Factors.

Effective management of risks is an integral part of our business and critical to our safety and soundness. In the following sections, we provide an overview of our corporate risk governance structure and risk management processes, which are intended to identify, measure, monitor and control the principal risks we assume in conducting our business activities in accordance with defined policies and procedures. Following the risk governance overview, we provide additional information on how we manage each of our four major categories of risk.

Risk Governance

Our corporate risk framework is intended to ensure that people and processes are organized in a way that promotes a cross-functional approach to risk management and that controls are in place to better manage our risks. Basic tenets of our corporate risk framework include:

establishing corporate-wide policies for risk management,

delegating to business units primary responsibility for the management of the day-to-day risks inherent in the activities of the business unit,

enacting policies and procedures designed to ensure that we have an independent risk oversight function with appropriate checks and balances throughout our company, and

monitoring aggregate risks and compliance with risk policies at a corporate level.

As shown in the following chart, our corporate risk framework is supported by a governance structure encompassing the Board of Directors, an independent corporate risk oversight organization, business units, management-level risk committees and Internal Audit.

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Board of Directors

The Board of Directors is responsible for approving our risk governance framework and providing capital and risk management oversight. The Board exercises its oversight of credit risk, market risk, operational risk and liquidity risk through the Board's Risk Policy and Capital Committee. The responsibilities of the Risk Policy and Capital Committee include recommending for Board approval enterprise risk governance policy and limits consistent with our mission, safety and soundness; overseeing the development of risk policies and procedures; overseeing compliance with all enterprise-wide risk management policies; overseeing the Chief Risk Office; and reviewing the sufficiency of personnel, systems and other risk management capabilities.

Chief Risk Office

The Chief Risk Office is an independent risk oversight organization with responsibility for oversight of credit risk, market risk, operational risk and liquidity risk. The Chief Risk Officer is responsible for establishing our overall risk governance structure and providing independent evaluation and oversight of our risk management activities. In 2006 and 2007, we centralized oversight of our business continuity efforts, information security programs, corporate insurance program and SOX Finance Team under our Operational Risk Oversight function within the Chief Risk Office to further strengthen our existing operational risk programs.

Corporate Risk Management Committees

As depicted in the above chart, we have three management-level risk committees that focus on our major categories of credit, market, liquidity and operational risks. Our two additional management-level risk committees, the Capital Structure Committee and the Compliance Coordination Committee, focus on capital management activities and our compliance with legal and regulatory requirements, respectively. Our Compliance Coordination Committee also is responsible for coordinating the legal and regulatory compliance risk governance functions with other control functions, such as Legal, Internal Audit and the Chief Risk Office.

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The Management Executive Committee, which is chaired by the Chief Executive Officer and composed of principal executive officers of the company, has responsibility for reviewing and providing oversight of our enterprise-wide risk tolerance policies and our enterprise-wide risk framework, addressing issues referred to it by our risk committees, addressing matters that involve multiple types of risks and addressing other significant business and reputational risks.

Business Units

Each business unit is responsible for identifying, measuring and managing key credit risks within its business consistent with corporate policies. In addition, each business unit has business unit risk managers who are responsible for ensuring that there are clear delineations of responsibility for managing credit risk, adequate systems for measuring credit risk, appropriately structured limits on risk taking, effective internal controls and a comprehensive risk reporting process. As part of our risk governance structure, we have established within each business unit risk committees that are responsible for decisions relating to risk strategy, policies and controls.

Internal Audit and Office of Compliance and Ethics

Our Internal Audit group, under the direction of the Chief Audit Executive, provides an objective assessment of the design and execution of our internal control system, including our management systems, our risk governance, and our policies and procedures. Internal Audit activities are designed to provide reasonable assurance that resources are safeguarded; significant financial, managerial and operating information is complete, accurate and reliable; and employee actions comply with our policies and applicable laws and regulations.

Our Office of Compliance and Ethics, under the direction of the Chief Compliance Officer, is responsible for developing corporate policies related to compliance, ethics and investigations; overseeing our compliance activities and coordinating our OFHEO and HUD regulatory reporting and examinations; developing and promoting a code of ethical conduct; anti-fraud management; and evaluating and investigating any allegations of misconduct.

Credit Risk Management

We are generally subject to two types of credit risk: mortgage credit risk and institutional counterparty credit risk. The degree of credit risk to which we are exposed will vary based on many factors, including the risk profile of the borrower or counterparty, the contractual terms of the agreement, the amount of the transaction, repayment sources, the availability and quality of collateral and other factors relevant to current market conditions, events and expectations. We evaluate these factors and actively manage, on an aggregate basis, the extent and nature of the credit risk we bear, with the objective of ensuring that we are adequately compensated for the credit risk we take, consistent with our mission goals. We discuss how we manage mortgage credit risk in the section below, and we discuss how we manage institutional counterparty risk beginning on page 137. We also discuss measures that we use to assess our credit risk exposure.

Mortgage Credit Risk Management

Mortgage credit risk is the risk that a borrower will fail to make required mortgage payments. We are exposed to credit risk on our mortgage credit book of business because we either hold the mortgage assets or have issued a guaranty in connection with the creation of Fannie Mae MBS backed by mortgage assets. Our mortgage credit book of business consists of the following on-and off-balance sheet arrangements:

single-family and multifamily mortgage loans held in our portfolio;

Fannie Mae MBS and non-Fannie Mae mortgage-related securities held in our portfolio;

Fannie Mae MBS held by third-party investors; and
credit enhancements that we provide on mortgage assets.

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We provide additional information regarding our off-balance sheet arrangements in Off-Balance Sheet Arrangements and Variable Interest Entities above.

Factors affecting credit risk on loans in our single-family mortgage credit book of business include the borrower's financial strength and credit profile; the type of mortgage; the value and characteristics of the property securing the mortgage; and economic conditions, such as changes in employment and home prices. Factors that affect credit risk on a multifamily loan include the structure of the financing; the type and location of the property; the condition and value of the property; the financial strength of the borrower and lender; market and sub-market trends and growth; and the current and anticipated cash flows from the property. These and other factors affect both the amount of expected credit loss on a given loan and the sensitivity of that loss to changes in the economic environment.

Table 34 displays the composition of our entire mortgage credit book of business as of December 31, 2006, 2005 and 2004. Our single-family mortgage credit book of business accounted for approximately 94%, 94% and 95% of our entire mortgage credit book of business as of December 31, 2006, 2005 and 2004, respectively.

Table 34: Composition of Mortgage Credit Book of Business

	As of December 31, 2006					
	Single-Family ⁽¹⁾		Multifamily ⁽²⁾		Total	
	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾
	(Dollars in millions)					
Mortgage portfolio: ⁽⁵⁾						
Mortgage loans ⁽⁶⁾	\$ 302,597	\$ 20,106	\$ 59,374	\$ 968	\$ 361,971	\$ 21,074
Fannie Mae MBS ⁽⁶⁾	198,335	709	277	323	198,612	1,032
Agency mortgage-related securities ⁽⁶⁾⁽⁷⁾	29,987	1,995		56	29,987	2,051
Mortgage revenue bonds	3,394	3,284	7,897	2,349	11,291	5,633
Other mortgage-related securities ⁽⁸⁾	85,339	2,084	9,681	177	95,020	2,261
Total mortgage portfolio	619,652	28,178	77,229	3,873	696,881	32,051
Fannie Mae MBS held by third parties ⁽⁹⁾	1,714,815	19,069	42,184	1,482	1,756,999	20,551
Other ⁽¹⁰⁾	3,049		16,602	96	19,651	96
Mortgage credit book of business	\$ 2,337,516	\$ 47,247	\$ 136,015	\$ 5,451	\$ 2,473,531	\$ 52,698

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	As of December 31, 2005					
	Single-Family ⁽¹⁾		Multifamily ⁽²⁾		Total	
	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾
	(Dollars in millions)					
Mortgage portfolio: ⁽⁵⁾						
Mortgage loans ⁽⁶⁾	\$ 299,765	\$ 15,036	\$ 50,731	\$ 1,148	\$ 350,496	\$ 16,184
Fannie Mae MBS ⁽⁶⁾	232,574	1,001	404	472	232,978	1,473
Agency mortgage-related securities ⁽⁶⁾⁽⁷⁾	28,604	2,380		57	28,604	2,437
Mortgage revenue bonds	4,000	3,965	8,375	2,462	12,375	6,427
Other mortgage-related securities ⁽⁸⁾	85,698	1,174		43	85,698	1,217
Total mortgage portfolio	650,641	23,556	59,510	4,182	710,151	27,738
Fannie Mae MBS held by third parties ⁽⁹⁾	1,523,043	23,734	50,345	1,796	1,573,388	25,530
Other ⁽¹⁰⁾	3,291		15,718	143	19,009	143
Mortgage credit book of business	\$ 2,176,975	\$ 47,290	\$ 125,573	\$ 6,121	\$ 2,302,548	\$ 53,411

	As of December 31, 2004					
	Single-Family ⁽¹⁾		Multifamily ⁽²⁾		Total	
	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾	Conventional ⁽³⁾	Government ⁽⁴⁾
	(Dollars in millions)					
Mortgage portfolio: ⁽⁵⁾						
Mortgage loans ⁽⁶⁾	\$ 345,575	\$ 10,112	\$ 43,396	\$ 1,074	\$ 388,971	\$ 11,186
Fannie Mae MBS ⁽⁶⁾	341,768	1,239	505	892	342,273	2,131
Agency mortgage-related securities ⁽⁶⁾⁽⁷⁾	37,422	4,273		68	37,422	4,341
Mortgage revenue bonds	6,344	4,951	8,037	2,744	14,381	7,695
Other mortgage-related securities ⁽⁸⁾	108,082	669	12	46	108,094	715
Total mortgage portfolio	839,191	21,244	51,950	4,824	891,141	26,068
Fannie Mae MBS held by third parties ⁽⁹⁾	1,319,066	32,337	54,639	2,005	1,373,705	34,342
Other ⁽¹⁰⁾	346		14,111	368	14,457	368
Mortgage credit book of business	\$ 2,158,603	\$ 53,581	\$ 120,700	\$ 7,197	\$ 2,279,303	\$ 60,778

- (1) The amounts reported above reflect our total single-family mortgage credit book of business. Of these amounts, the portion of our single-family mortgage credit book of business for which we have access to detailed loan-level information represented approximately 95%, 94% and 92% of our total conventional single-family mortgage credit book of business as of December 31, 2006, 2005 and 2004, respectively. Unless otherwise noted, the credit statistics we provide in the Credit Risk discussion that follows relate only to this specific portion of our conventional single-family mortgage credit book of business. The remaining portion of our conventional single-family mortgage credit book of business consists of non-Fannie Mae mortgage-related securities backed by single-family mortgage loans and credit enhancements that we provide on single-family mortgage assets. Non-Fannie Mae mortgage-related securities held in our portfolio include Freddie Mac securities, Ginnie Mae securities, private-label mortgage-related securities, Fannie Mae MBS backed by private-label mortgage-related securities, and housing-related municipal revenue bonds. Our Capital Markets group prices and manages credit risk related to this specific portion of our conventional single-family mortgage credit book of business. We may not have access to detailed loan-level data on these particular mortgage-related assets and therefore may not manage the credit performance of individual loans. However, a substantial majority of these securities benefit from significant forms of credit enhancement, including guarantees from Ginnie Mae or Freddie Mac, insurance policies, structured subordination and similar sources of credit protection. All non-Fannie Mae agency securities held in our portfolio as of December 31, 2006 were rated AAA/Aaa by Standard & Poor's and Moody's. Over 90% of non-agency mortgage-related securities held in our portfolio as of December 31, 2006 and June 30, 2007 were rated AAA/Aaa by Standard & Poor's and Moody's.

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- (2) The amounts reported above reflect our total multifamily mortgage credit book of business. Of these amounts, the portion of our multifamily mortgage credit book of business for which we have access to detailed loan-level information represented approximately 84% of our total multifamily mortgage credit book as of December 31, 2006 and approximately 90% as of December 31, 2005 and 2004. Unless otherwise noted, the credit statistics we provide in the Credit Risk discussion that follows relate only to this specific portion of our multifamily mortgage credit book of business.
- (3) Refers to mortgage loans and mortgage-related securities that are not guaranteed or insured by the U.S. government or any of its agencies.
- (4) Refers to mortgage loans and mortgage-related securities guaranteed or insured by the U.S. government or one of its agencies.
- (5) Mortgage portfolio data is reported based on unpaid principal balance.
- (6) Includes unpaid principal balance totaling \$105.5 billion, \$113.3 billion, \$152.7 billion, \$162.5 billion and \$135.8 billion as of December 31, 2006, 2005, 2004, 2003 and 2002, respectively, related to mortgage-related securities that were consolidated under FIN 46 and mortgage-related securities created from securitization transactions that did not meet the sales criteria under SFAS 140, which effectively resulted in these mortgage-related securities being accounted for as loans.
- (7) Includes mortgage-related securities issued by Freddie Mac and Ginnie Mae. As of December 31, 2006, we held mortgage-related securities issued by Freddie Mac with a carrying value and fair value of \$29.5 billion, which exceeded 10% of our stockholders' equity.
- (8) Includes mortgage-related securities issued by entities other than Fannie Mae, Freddie Mac or Ginnie Mae.
- (9) Includes Fannie Mae MBS held by third-party investors. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.
- (10) Includes single-family and multifamily credit enhancements that we have provided and that are not otherwise reflected in the table.

Our strategy in managing mortgage credit risk consists of three primary components: (1) acquisition policy and standards; (2) portfolio monitoring and diversification; and (3) credit loss management. We use various metrics to evaluate credit performance in our mortgage credit book of business. We estimate incurred credit losses inherent in our mortgage credit book of business as of each balance sheet date and maintain a combined balance of allowance for loan losses and reserve for guaranty losses at a level we believe reflects these losses.

Acquisition Policy and Standards

We use proprietary models and analytical tools to price and measure credit risk at acquisition. Our loan underwriting and eligibility guidelines are intended to provide a comprehensive analysis of borrowers and mortgage loans based upon known risk characteristics. The underwriting of single-family mortgage loans primarily focuses on an evaluation of the borrower's creditworthiness and ability to repay the loan based on the value of the property and LTV ratio, the loan purpose and the loan product features. The underwriting of multifamily mortgage loans primarily focuses on an evaluation of expected cash flows from the property for repayment, the historical and projected performance of the property, and the property's physical condition and third-party reports, including appraisals and engineering and

environmental reports. Our guidelines for both types of loans require a comprehensive analysis of the property value, the LTV ratio, the local market, and the borrower and their investment in the property. For multifamily equity investments, such as LIHTC investments and investments in other rental or for sale housing developments, we also evaluate the strength of our investment sponsors and third-party asset managers.

Lenders generally represent and warrant that they have complied with both our underwriting and asset acquisition requirements when they sell us mortgage loans, when they request securitization of their loans into Fannie Mae MBS or when they request that we provide credit enhancement in connection with an affordable housing bond transaction. We have policies and various quality assurance procedures that we use to review a sample of loans to assess compliance with our underwriting and eligibility criteria. After completion of a transaction, we assess the characteristics and quality of the lender's loans and processes through a post-purchase review of selected loans based on the product type or risk profile of the loans, the lender's historical underwriting practices, the market and submarket conditions. We also conduct on-site reviews of lender operations and periodically review comparisons of actual loan performance to expected performance. If we identify underwriting or eligibility deficiencies, we may take a variety of actions, including increasing the

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lender credit loss sharing or requiring the lender to repurchase a loan, depending on the severity of the issues identified.

The use of credit enhancements is an important part of our acquisition policy and standards, although it also exposes us to institutional counterparty risk. The amount of credit enhancement we obtain on any mortgage loan depends on our charter requirements and our assessment of risk. In addition to the credit enhancement required by our charter, we may obtain supplemental credit enhancement for some mortgage loans, typically those with higher credit risk. Our use of discretionary credit enhancements depends on our view of the inherent credit risk, the price of the credit enhancement, and our risk versus return objective.

Single-Family

Our Single-Family business is responsible for pricing and managing credit risk relating to the portion of our single-family mortgage credit book of business consisting of single-family mortgage loans and Fannie Mae MBS backed by single-family mortgage loans (whether held in our portfolio or held by third parties).

We have developed a proprietary automated underwriting system, Desktop Underwriter[®], which measures default risk by assessing the primary risk factors of a mortgage, including the LTV ratio, the borrower's credit profile, the type of mortgage, the loan purpose, and other mortgage and borrower characteristics. Subject to our review and approval, we also purchase and securitize mortgage loans that have been underwritten using other automated underwriting systems, as well as mortgage loans underwritten to agreed-upon standards that differ from our standard underwriting and eligibility criteria.

Based on our current acquisition policy and standards, we may accept single-family loans originated with LTV ratios of up to 100%. Our charter requires that conventional single-family mortgage loans that we purchase or that back Fannie Mae MBS with LTV ratios above 80% at acquisition be covered by one or more of the following: (i) primary mortgage insurance; (ii) a seller's agreement to repurchase or replace any mortgage loan in default (for such period and under such circumstances as we may require); or (iii) retention by the seller of at least a 10% participation interest in the mortgage loans.

Primary mortgage insurance is the most common type of credit enhancement in our single-family mortgage credit book of business and is typically provided on a loan-level basis. Primary mortgage insurance transfers varying portions of the credit risk associated with a mortgage loan to a third-party insurer. Mortgage insurers may also provide pool mortgage insurance, which is insurance that applies to a defined group of loans. Pool mortgage insurance benefits typically are based on actual loss incurred and are subject to an aggregate loss limit. The percentage of our conventional single-family mortgage credit book of business with credit enhancement, including primary mortgage, pool mortgage insurance, lender recourse and shared risk, was 19%, 18% and 19% as of December 31, 2006, 2005 and 2004, respectively. The percentage of our conventional single-family mortgage credit book of business with credit enhancement has not changed significantly since the end of 2006.

Housing and Community Development

Our HCD business is responsible for pricing and managing the credit risk on multifamily mortgage loans we purchase and on Fannie Mae MBS backed by multifamily loans (whether held in our portfolio or held by third parties).

Multifamily loans we purchase or that back Fannie Mae MBS are either underwritten by a Fannie Mae-approved lender or subject to our underwriting review prior to closing. Many of our agreements delegate the underwriting decisions to the lender, principally through our Delegated Underwriting and Servicing, or DUS[®], program. Loans delivered to us by DUS lenders represented approximately 94%, 87% and 89% of our multifamily mortgage credit

book of business as of December 31, 2006, 2005 and 2004, respectively.

We use various types of credit enhancement arrangements for our multifamily loans, including lender risk sharing, lender repurchase agreements, pool insurance, subordinated participations in mortgage loans or structured pools, cash and letter of credit collateral agreements, and cross-collateralization/cross-default provisions. The most prevalent form of credit enhancement is lender risk sharing. Lenders in the DUS

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program typically share in loan-level credit losses in one of two ways: either (i) they bear losses up to the first 5% of unpaid principal balance of the loan and share in remaining losses up to a prescribed limit or (ii) they agree to share with us up to one-third of the credit losses on an equal basis. The percentage of our multifamily credit book of business with credit enhancement was 96% as of December 31, 2006 and 95% as of December 31, 2005 and 2004.

Monitoring and Portfolio Diversification

Single-Family

Our single-family mortgage credit book of business is diversified based on several factors that influence credit quality, including the following:

LTV ratio. LTV ratio is a strong predictor of credit performance. The likelihood of default and the gross severity of a loss in the event of default are typically lower as the LTV ratio decreases.

Product type. Certain loan product types have features that may result in increased risk. Intermediate-term, fixed-rate mortgages generally exhibit the lowest default rates, followed by long-term, fixed-rate mortgages. ARMs and balloon/reset mortgages typically exhibit higher default rates than fixed-rate mortgages, partly because the borrower's future payments may rise or fall, within limits, as interest rates change. Negative-amortizing and interest-only loans also default more often than traditional fixed-rate mortgage loans.

Number of units. Mortgages on one-unit properties tend to have lower credit risk than mortgages on multiple-unit properties.

Property type. Certain property types have a higher risk of default. For example, condominiums generally are considered to have higher credit risk than single-family detached properties.

Occupancy type. Mortgages on properties occupied by the borrower as a primary or secondary residence tend to have lower credit risk than mortgages on investment properties.

Credit score. Credit score is a measure often used by the financial services industry, including our company, to assess borrower credit quality. Credit scores are generated by credit repositories and calculated based on proprietary statistical models that evaluate many types of information on a borrower's credit report and predict the likelihood that a borrower will repay future obligations as expected. A higher credit score typically indicates a lower degree of credit risk.

Loan purpose. Loan purpose indicates how the borrower intends to use the funds from a mortgage loan. Cash-out refinancings have a higher risk of default than either mortgage loans used for the purchase of a property or other refinancings that restrict the amount of cash back to the borrower.

Geographic concentration. Local economic conditions affect borrowers' ability to repay loans and the value of collateral underlying loans. Geographic diversification reduces mortgage credit risk.

Loan age. We monitor year of origination and loan age, which is defined as the number of years since origination. Statistically, the peak ages for default are currently from two to six years after origination.

Table 35 presents our conventional single-family business volumes, based on the key risk characteristics above, for 2006, 2005 and 2004 and our conventional single-family mortgage credit book of business as of the end of each respective year.

Table of Contents**Table 35: Risk Characteristics of Conventional Single-Family Business Volume and Mortgage Credit Book of Business⁽¹⁾**

	Percent of Business Volume ⁽²⁾ For the Year Ended December 31,			Percent of Book of Business ⁽³⁾ As of December 31,		
	2006	2005	2004	2006	2005	2004
Original LTV ratio: ⁽⁴⁾						
<= 60%	18%	22%	23%	25%	26%	26%
60.01% to 70%	15	16	16	17	17	17
70.01% to 80%	50	46	43	43	41	40
80.01% to 90%	7	7	8	7	8	9
90.01% to 100%	10	9	10	8	8	8
Greater than 100%						
Total	100%	100%	100%	100%	100%	100%
Weighted average	73%	72%	71%	70%	70%	70%
Average loan amount	\$ 184,411	\$ 171,761	\$ 158,759	\$ 135,379	\$ 129,657	\$ 125,812
Estimated						
mark-to-market LTV						
ratio: ⁽⁵⁾						
<= 60%				55%	60%	53%
60.01% to 70%				17	17	20
70.01% to 80%				18	16	18
80.01% to 90%				7	5	6
90.01% to 100%				3	2	3
Greater than 100%						
Total				100%	100%	100%
Weighted average				55%	53%	57%
Product type: ⁽⁶⁾						
Fixed-rate:						
Long-term	71%	69%	62%	68%	65%	64%
Intermediate-term	6	9	16	18	21	24
Interest-only	6	1		1		
Total fixed-rate	83	79	78	87	86	88
Adjustable-rate:						
Interest-only	9	9	5	4	4	2
Negative-amortizing	3	3	2	2	2	1
Other ARMs	5	9	15	7	8	9
Total adjustable-rate	17	21	22	13	14	12

Total	100%	100%	100%	100%	100%	100%
Number of property units:						
1 unit	96%	96%	96%	96%	96%	96%
2-4 units	4	4	4	4	4	4
Total	100%	100%	100%	100%	100%	100%
Property type:						
Single-family homes	89%	90%	91%	92%	92%	93%
Condo/Co-op	11	10	9	8	8	7
Total	100%	100%	100%	100%	100%	100%

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	Percent of Business Volume⁽²⁾			Percent of Book of Business⁽³⁾		
	For the Year Ended			As of December 31,		
	2006	2005	2004	2006	2005	2004
Occupancy type:						
Primary residence	87%	89%	91%	90%	91%	92%
Second/vacation home	6	5	4	4	4	3
Investor	7	6	5	6	5	5
Total	100%	100%	100%	100%	100%	100%
FICO credit score:⁽⁷⁾						
< 620	6%	5%	6%	5%	5%	5%
620 to < 660	11	11	12	10	10	11
660 to < 700	20	19	19	18	18	18
700 to < 740	23	23	24	23	23	23
>= 740	40	42	39	43	43	41
Not available				1	1	2
Total	100%	100%	100%	100%	100%	100%
Weighted average	716	719	715	721	721	719
Loan purpose:						
Purchase	52%	47%	43%	38%	34%	31%
Cash-out refinance	34	35	29	32	31	30
Other refinance	14	18	28	30	35	39
Total	100%	100%	100%	100%	100%	100%
Geographic concentration:⁽⁸⁾						
Midwest	15%	16%	17%	17%	17%	17%
Northeast	17	18	19	19	19	19
Southeast	27	25	22	24	23	22
Southwest	17	16	14	16	16	16
West	24	25	28	24	25	26
Total	100%	100%	100%	100%	100%	100%
Origination year:						
<=1996				2%	2%	2%
1997						1
1998				1	2	2
1999				1	1	2
2000					1	1
2001				3	4	6
2002				9	12	17
2003				29	36	46

2004	16	21	23
2005	20	21	
2006	19		
Total	100%	100%	100%

(1) We typically obtain the data for the statistics presented in this table from the sellers or servicers of the mortgage loans and receive representations and warranties from them as to the accuracy of the information. While we perform various quality assurance checks by sampling loans to assess compliance with our underwriting and eligibility criteria, we do not independently verify all reported information. As noted in Table 34 above, we generally have access to detailed

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loan-level statistics only on conventional single-family mortgage loans held in our portfolio and backing Fannie MBS (whether held in our portfolio or held by third parties).

- (2) Percentages calculated based on unpaid principal balance of loans at time of acquisition.
- (3) Percentages calculated based on unpaid principal balance of loans as of the end of each period.
- (4) The original LTV ratio generally is based on the appraised property value reported to us at the time of acquisition of the loan and the original unpaid principal balance of the loan. Excludes loans for which this information is not readily available.
- (5) The aggregate estimated mark-to-market LTV ratio is based on the estimated current value of the property, calculated using an internal valuation model that estimates periodic changes in home value, and the unpaid principal balance of the loan as of the date of each reported period. Excludes loans for which this information is not readily available.
- (6) Long-term fixed-rate consists of mortgage loans with maturities greater than 15 years, while intermediate-term fixed-rate have maturities equal to or less than 15 years. Fixed-rate mortgage loans and ARMs represented an estimated 90% and 10%, respectively, of our single-family business volume for the first six months of 2007.
- (7) Reflects Fair Isaac Corporation credit score, referred to as FICO® score, which is a commonly used credit score that ranges from a low of 300 to a high of 850. We obtain borrower credit scores on the majority of single-family mortgage loans that we purchase or that back Fannie Mae MBS.
- (8) Midwest consists of IL, IN, IA, MI, MN, NE, ND, OH, SD and WI. Northeast includes CT, DE, ME, MA, NH, NJ, NY, PA, PR, RI, VT and VI. Southeast consists of AL, DC, FL, GA, KY, MD, MS, NC, SC, TN, VA and WV. Southwest consists of AZ, AR, CO, KS, LA, MO, NM, OK, TX and UT. West consists of AK, CA, GU, HI, ID, MT, NV, OR, WA and WY.

While we expect the substantial slowdown in the housing market to increase our future credit losses, we believe the overall credit quality of the mortgage loans in our conventional single-family mortgage credit book of business continued to remain strong as of December 31, 2006, as evidenced by the risk characteristics presented above in Table 35. Our mortgage credit book of business continues to consist mostly of traditional fixed-rate mortgage loans. Over 95% of our conventional single-family mortgage credit book of business consists of loans secured by one-unit properties. The weighted average credit score within our single-family mortgage credit book of business remained high and the estimated mark-to-market LTV ratio remained below 60%. Approximately 10% of our conventional single-family mortgage credit book of business had an estimated mark-to-market LTV ratio greater than 80% as of December 31, 2006. Of that 10% portion, over 76% of the loans were covered by credit enhancement. The remainder of these loans, which would have required credit enhancement at acquisition if the original LTV ratios had been above 80%, were not covered by credit enhancement as of December 31, 2006. While the LTV ratios of these loans were at or below 80% at the time of acquisition, they increased above 80% subsequent to acquisition due to declines in home price appreciation over time, partially offset by loan principal payments. In examining the geographic concentration of these high LTV loans, there was no metropolitan statistical area with more than 5% of this segment of our conventional single-family mortgage credit book of business. The three largest metropolitan statistical area concentrations were in Atlanta, Chicago and Detroit.

As of June 30, 2007, the weighted average credit score, the original LTV ratio and the weighted average estimated mark-to-market LTV ratio for our conventional single-family book of business were 722, 71% and 57%, respectively. Approximately 13% of our conventional single-family mortgage credit book of business had an estimated

mark-to-market LTV ratio greater than 80% as of June 30, 2007. The portion of our conventional single-family mortgage credit book of business for which we have access to detailed loan-level information represented approximately 95% of our total conventional single-family mortgage credit book of business as of June 30, 2007.

The acquisition of mortgage loans with features that make it easier for borrowers to obtain a mortgage loan has produced the most notable change in the overall risk profile of our single-family mortgage credit book of business in recent years. We have worked closely with our lender customers to provide liquidity for loans with these features, including the following:

Interest-Only and Negative Amortization Loans: Interest-only mortgage loans (that are available with both fixed-rate and adjustable-rate terms) and ARMs that have the potential for negative amortization offer lower initial monthly payments by allowing borrowers to defer repayment of principal or interest. As a result of the shift in the product profile of new business, interest-only ARMs and negative-amortizing ARMs increased to approximately 12% of our conventional single-family business volume in 2006 and 2005, compared with approximately 7% in 2004. Interest-only ARMs and negative amortizing ARMs together represented

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approximately 6% of our conventional single-family mortgage credit book of business as of December 31, 2006 and 2005. Interest-only ARMs and negative-amortizing ARMs represented approximately 7% of our conventional single-family business volume for the first six months of 2007 and accounted for approximately 6% of our conventional single-family mortgage credit book of business as of June 30, 2007.

Alt-A Loans: There has been an increasing industry trend towards streamlining the mortgage loan underwriting process by reducing the documentation requirements and accepting alternative or nontraditional documentation. The industry generally refers to these loans as Alt-A. We usually acquire mortgage loans originated as Alt-A from our traditional lenders that generally specialize in originating prime mortgage loans. These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process. The majority of our Alt-A mortgage loans are fixed-rate, and the weighted average credit score of borrowers under our Alt-A mortgage loans is comparable to that of our overall single-family mortgage credit book of business. We estimate that approximately 11% of our total single-family mortgage credit book of business as of December 31, 2006 consisted of Alt-A mortgage loans or structured Fannie Mae MBS backed by Alt-A mortgage loans. This percentage increased to approximately 12% as of June 30, 2007.

Subprime Loans: In recent years, we have increased our acquisitions of loans to borrowers with riskier credit profiles, referred to as subprime loans by the industry. Subprime mortgage loans that we acquire are generally originated by lenders specializing in this type of business, using processes unique to subprime loans. Based on data published by National Mortgage News and our internal economic analysis of the mortgage market, subprime mortgage loan originations have increased sharply in recent years, rising to a record high of approximately 24% of single-family mortgage loan originations in the first quarter of 2006, from approximately 9% in the first quarter of 2002. Subprime mortgage loans represented approximately 13% of single-family mortgage debt outstanding as of the end of 2006, compared with approximately 9% as of the end of 2002. Our acquisitions of subprime mortgage loans have been significantly less than the overall market's share. We estimate that approximately 0.2% of our total single-family mortgage credit book of business as of December 31, 2006 consisted of subprime mortgage loans or structured Fannie Mae MBS backed by subprime mortgage loans. This percentage remained unchanged as of June 30, 2007.

Our acquisitions of Alt-A and subprime mortgage loans generally have been accompanied by the purchase of credit enhancements that materially reduce our exposure to credit losses on these mortgages. We closely monitor credit risk and pricing dynamics across the full spectrum of mortgage product types. We will determine the timing and level of our acquisitions of these types of mortgages in the future based on our continued assessment of these dynamics.

We also have invested in highly rated private-label mortgage-related securities that are backed by Alt-A or subprime mortgage loans. We believe our credit exposure to the Alt-A and subprime mortgage loans underlying the private-label mortgage-related securities in our portfolio is limited because, to date, we have focused our purchases on the highest-rated tranches of these securities available at the time of acquisition. In 2007, we began to acquire a limited amount of private-label mortgage-related securities of other investment grades. We estimate that private-label mortgage-related securities backed by Alt-A loans and private-label mortgage-related securities backed by subprime mortgage loans, including resecuritizations, accounted for approximately 1% and 2%, respectively, of our single-family mortgage credit book of business as of June 30, 2007.

Housing and Community Development

Diversification within our multifamily mortgage credit book of business and equity investments business by geographic concentration, term-to-maturity, interest rate structure, borrower concentration and credit enhancement arrangements is an important factor that influences credit quality and performance and helps reduce our credit risk.

We monitor the performance and risk concentrations of our multifamily debt and equity investments and the underlying properties on an ongoing basis throughout the lifecycle of the investment at the loan, equity investment, fund, property and portfolio level. We closely track the physical condition of the property, the historical performance of the investment, loan or property, the relevant local market and economic conditions that may signal changing risk or return profiles and other risk factors. For example, we closely monitor the

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rental payment trends and vacancy levels in local markets to identify loans or investments that merit closer attention or loss mitigation actions. We also monitor our LIHTC investments for program compliance.

For our investments in multifamily loans, the primary asset management responsibilities are performed by our DUS lenders. Similarly, for many of our equity investments, the primary asset management is performed by our syndicators, our fund advisors, our joint venture partners or other third parties. We periodically evaluate the performance of our third-party service providers for compliance with our asset management criteria.

*Credit Loss Management***Single-Family**

We manage problem loans to mitigate credit losses. In our experience, early intervention is critical to controlling credit losses. If a mortgage loan does not perform, we work in partnership with the servicers of our loans to minimize the frequency of foreclosure as well as the severity of loss. Our loan management strategy begins with payment collection and work-out guidelines designed to minimize the number of borrowers who fall behind on their obligations and to help borrowers who are delinquent from falling further behind on their payments.

We require our single-family servicers to pursue various resolutions of problem loans as an alternative to foreclosure, including:

repayment plans in which borrowers repay past due principal and interest over a reasonable period of time through a temporarily higher monthly payment;

loan modifications in which past due interest amounts are added to the loan principal amount and recovered over the remaining life of the loan, and other loan adjustments;

forbearances in which the lender agrees to suspend or reduce borrower payments for a period of time;

accepting deeds in lieu of foreclosure whereby the borrower signs over title to the property without the added expense of a foreclosure proceeding; and

preforeclosure sales in which the borrower, working with the servicer, sells the home and pays off all or part of the outstanding loan, accrued interest and other expenses from the sale proceeds.

The table below presents statistics on the resolution of conventional single-family problem loans for the years ended December 31, 2006, 2005 and 2004.

Table 36: Statistics on Conventional Single-Family Problem Loan Workouts

	2006		As of December 31, 2005		2004	
	Unpaid Principal Balance	Number of Loans	Unpaid Principal Balance (Dollars in millions)	Number of Loans	Unpaid Principal Balance	Number of Loans
Modifications ⁽¹⁾	\$ 3,173	27,607	\$ 2,292	20,732	\$ 2,519	22,591

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Repayment plans and forbearances completed	1,908	17,324	1,470	13,540	1,226	11,573
Pre-foreclosure sales	238	1,960	300	2,478	311	2,575
Deeds in lieu of foreclosure	52	496	38	384	35	330
Total problem loan workouts	\$ 5,371	47,387	\$ 4,100	37,134	\$ 4,091	37,069
Percent of conventional single-family mortgage credit book of business	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%

(1) Modifications include troubled debt restructurings, which result in concessions to borrowers, and other modifications to the contractual terms of the loan that do not result in concessions to the borrower.

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Of the conventional single-family problem loans that are resolved through modification, long-term forbearance or repayment plans, our performance experience after 36 months following the inception of these types of plans, based on the period 1999 to 2003, has been that approximately 66% of these loans remain current or have been paid in full. Approximately 12% of these loans were terminated through foreclosure. The remaining loans continue in a delinquent status.

Housing and Community Development

When a multifamily loan does not perform, we work with our loan servicers to minimize the severity of loss by taking appropriate loss mitigation steps. We permit our multifamily servicers to pursue various options as an alternative to foreclosure, including modifying the terms of the loan, selling the loan, and preforeclosure sales. The resolution strategy depends in part on the borrower's level of cooperation, the performance of the market or submarket, the value of the property, the condition of the property, any remaining equity in the property and the borrower's ability to provide additional equity for the property. The unpaid principal balance of modified multifamily loans totaled \$84 million, \$165 million and \$224 million for the years ended December 31, 2006, 2005, and 2004, respectively, which represented 0.06%, 0.13% and 0.18% of our total multifamily mortgage credit book of business as of the end of each respective period.

Our risk exposure related to our LIHTC investments is limited to the amount of our investment and the possible recapture of the tax benefits we have received from the partnership. When a non-guaranteed LIHTC investment does not perform, we work with our syndicator partner. The resolution strategy depends on:

- the local general partner's ability to meet obligations;
- the value of the property;
- the ability to restructure the debt;
- the financial and workout capacity of the syndicator partner; and
- the strength of the market or submarket.

If a guaranteed LIHTC investment does not perform, the guarantor remits funds to us in an amount that provides us with the return provided for in the guaranty contract. Our risk in this situation is that the guarantor will not perform. Refer to Institutional Counterparty Credit Risk Management below for a discussion of how we manage the credit risk associated with our counterparties.

Mortgage Credit Book Performance

Key metrics used to measure credit risk in our mortgage credit book of business and evaluate credit performance include (i) the serious delinquency rate, (ii) nonperforming loans, (iii) foreclosure activity, and (iv) credit losses.

Serious Delinquency

The serious delinquency rate is an indicator of potential future foreclosures, although most loans that become seriously delinquent do not result in foreclosure. The rate at which new loans become seriously delinquent and the rate at which existing seriously delinquent loans are resolved significantly affect the level of future credit losses. Home price appreciation decreases the risk of default because a borrower with enough equity in a home generally can sell the

home or draw on equity in the home to avoid foreclosure. The presence of credit enhancements mitigates credit losses caused by defaults.

We classify single-family loans as seriously delinquent when a borrower has missed three or more consecutive monthly payments, and the loan has not been brought current or extinguished through foreclosure, payoff or other resolution. A loan referred to foreclosure but not yet foreclosed is also considered seriously delinquent. Loans that are subject to a repayment plan are classified as seriously delinquent until the borrower has missed fewer than three consecutive monthly payments. We classify multifamily loans as seriously delinquent when payment is 60 days or more past due.

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The table below presents by geographic region the serious delinquency rates for all conventional single-family loans. We also provide a comparison of the serious delinquency rates, with credit enhancements and without credit enhancements, for all conventional single-family loans and for multifamily loans.

Table 37: Serious Delinquency Rates

	As of December 31,					
	2006		2005		2004	
	Book	Serious	Book	Serious	Book	Serious
	Outstanding ⁽¹⁾	Delinquency	Outstanding ⁽¹⁾	Delinquency	Outstanding ⁽¹⁾	Delinquency
		Rate ⁽²⁾		Rate ⁽²⁾		Rate ⁽²⁾
Conventional single-family delinquency rates by geographic region: ⁽³⁾						
Midwest	17%	1.01%	17%	0.99%	17%	0.88%
Northeast	19	0.67	19	0.62	19	0.63
Southeast	24	0.68	23	0.83	22	0.75
Southwest	16	0.69	16	1.32	16	0.67
West	24	0.20	25	0.19	26	0.24
Total conventional single-family loans	100%	0.65%	100%	0.79%	100%	0.63%
Conventional single-family loans:						
Credit enhanced	19%	1.81%	18%	2.14%	19%	1.84%
Non-credit enhanced	81	0.37	82	0.47	81	0.33
Total conventional single-family loans	100%	0.65%	100%	0.79%	100%	0.63%
Multifamily loans:						
Credit enhanced	96%	0.07%	95%	0.34%	95%	0.11%
Non-credit enhanced	4	0.35	5	0.02	5	0.13
Total multifamily loans	100%	0.08%	100%	0.32%	100%	0.11%

(1) Reported based on unpaid principal balance of loans, where we have detailed loan-level information.

(2) Calculated based on number of loans for single-family and unpaid principal balance for multifamily. We include all of the conventional single-family loans that we own and that back Fannie Mae MBS in the calculation of the single-family delinquency rate. We include the unpaid principal balance of all multifamily loans that we own or that back Fannie Mae MBS and any housing bonds for which we provide credit enhancement in the calculation of the multifamily serious delinquency rate.

(3) See footnote 8 to Table 35 for states included in each geographic region.

We experienced a decline in our overall serious delinquency rates during 2006, primarily due to payoffs and the resolution of problem associated with loans secured by properties in the Southwest region affected by Hurricane Katrina. However, the serious delinquency rate for the Midwest region increased due to continued economic weakness in this region, particularly in the Midwestern states of Ohio, Michigan and Indiana. The aftermath of Hurricane Katrina during the fourth quarter of 2005 resulted in an increase in our single-family and multifamily serious delinquency rates as of the end of 2005. Our serious delinquency rate for single-family and multifamily, excluding the effect of loans impacted by Hurricane Katrina, was 0.64% and 0.12%, respectively, as of December 31, 2005. These serious delinquency rates were comparable to our serious delinquency rates as of December 31, 2004.

We expect our overall serious delinquency rates to increase in 2007 due to the likely continued decline in national home prices and the continued impact of weak economic conditions in the Midwest. In addition, California and Florida, which represent the two largest states in our single-family mortgage credit book of business, have experienced notable reversals in home price appreciation. The serious delinquency rates for California and Florida remained relatively flat during 2006 and ended the year at 0.15% and 0.43%, respectively. However, the serious delinquency rates for California and Florida climbed to 0.20% and 0.65%, respectively, as of June 30, 2007, from 0.10% and 0.34%, respectively, as of the end of June 2006. Our overall

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serious delinquency rates for conventional single-family loans and multifamily loans were 0.64% and 0.09%, respectively, as of June 30, 2007.

Nonperforming Loans

We classify conventional single-family loans, including delinquent loans purchased from an MBS trust pursuant to the terms of the related trust indenture or trust agreement, as nonperforming and place them on nonaccrual status at the earlier of when payment of principal and interest is three months or more past due according to the loan's contractual terms or when, in our opinion, collectibility of interest or principal on the loan is not reasonably assured. We classify conventional multifamily loans as nonperforming and place them on nonaccrual status at the earlier of when payment of principal and interest is three months or more past due according to the loan's contractual terms or when we determine that collectibility of all principal or interest is not reasonably assured based on an individual loan level assessment. We continue to accrue interest on nonperforming loans that are federally insured or guaranteed by the U.S. government. Table 38 provides statistics on nonperforming single-family and multifamily loans as of the end of each year of the five-year period ending December 31, 2006.

Table 38: Nonperforming Single-Family and Multifamily Loans

	2006	As of December 31,			2002
		2005	2004	2003	
		(Dollars in millions)			
Nonperforming loans:					
Nonaccrual loans	\$ 5,961	\$ 8,356	\$ 7,987	\$ 7,742	\$ 6,303
Troubled debt restructurings ⁽¹⁾	1,086	661	816	673	580
Total nonperforming loans	\$ 7,047	\$ 9,017	\$ 8,803	\$ 8,415	\$ 6,883
Interest on nonperforming loans:					
Interest income forgone ⁽²⁾	\$ 163	\$ 184	\$ 188	\$ 192	\$ 149
Interest income recognized during year ⁽³⁾	295	405	381	376	331
Accruing loans past due 90 days or more ⁽⁴⁾	\$ 147	\$ 185	\$ 187	\$ 225	\$ 251

- (1) Troubled debt restructurings include loans whereby the contractual terms have been modified that result in concessions to borrowers experiencing financial difficulties.
- (2) Forgone interest income represents the amount of interest income that would have been recorded during the year on nonperforming loans as of December 31 had the loans performed according to their contractual terms.
- (3) Represents interest income recognized during the year on loans classified as nonperforming as of December 31.
- (4) Recorded investment of loans as of December 31 that are 90 days or more past due and continuing to accrue interest include loans insured or guaranteed by the government and loans where we have recourse against the seller of the loan in the event of a default.

Table of Contents**Foreclosure and REO Activity**

Foreclosure and real estate owned (REO) activity affect the level of credit losses. The table below provides information, by region, on our foreclosure activity for the years ended December 31, 2006, 2005 and 2004. Regional REO acquisition and charge-off trends generally follow a pattern that is similar to, but lags, that of regional delinquency trends.

Table 39: Single-Family and Multifamily Foreclosed Properties

	For the Year Ended December 31,		
	2006	2005	2004
Single-family foreclosed properties (number of properties):			
Beginning inventory of single-family foreclosed properties (REO) ⁽¹⁾	20,943	18,361	13,749
Acquisitions by geographic area: ⁽²⁾			
Midwest	16,128	11,777	10,149
Northeast	2,638	2,405	2,318
Southeast	9,280	9,470	10,275
Southwest	7,958	8,099	8,422
West	576	809	1,739
Total properties acquired through foreclosure	36,580	32,560	32,903
Dispositions of REO	(32,398)	(29,978)	(28,291)
Ending inventory of single-family foreclosed properties (REO) ⁽¹⁾	25,125	20,943	18,361
Carrying value of single-family foreclosed properties (dollars in millions) ⁽³⁾	\$ 1,999	\$ 1,642	\$ 1,493
Single-family foreclosure rate ⁽⁴⁾	0.2%	0.2%	0.2%
Multifamily foreclosed properties:			
Ending inventory of multifamily foreclosed properties (REO)	8	8	18
Carrying value of multifamily foreclosed properties (dollars in millions) ⁽³⁾	\$ 49	\$ 51	\$ 131

(1) Includes deeds in lieu of foreclosure.

(2) See footnote 8 to Table 35 for states included in each geographic region.

(3) Excludes foreclosed property claims receivables, which are reported in our consolidated balance sheets as a component of Acquired property, net.

(4)

Estimated based on the total number of properties acquired through foreclosure as a percentage of the total number of loans in our conventional single-family mortgage credit book as of the end of each respective year.

While our single-family foreclosure rate remained relatively stable over the period 2004 to 2006, averaging approximately 0.2% of our conventional single-family mortgage credit book of business, the number of single-family properties acquired through foreclosure rose by 12% in 2006, following a decline of 1% in 2005. The increase in foreclosures in 2006 was driven partly by the general overall slowing of the housing market, as well as weak economic conditions in the Midwest, particularly Ohio, Indiana and Michigan. The Midwest accounted for approximately 20% of the loans in our conventional single-family mortgage credit book of business during the three-year period ended December 31, 2006; however, this region accounted for approximately 44%, 36% and 31% of the single-family properties acquired through foreclosure in 2006, 2005 and 2004, respectively.

In light of the continued weakness of economic fundamentals in the Midwest, such as employment levels and lack of home price appreciation, we expect an increase in foreclosure and REO incidence and credit losses in that region in 2007 for both our single-family and multifamily mortgage credit book of business. In addition, the disruption in the subprime market, the overall erosion of property values and near record levels of unsold properties, together are likely to slow the sale of and reduce the sales price of our foreclosed properties. As a result, we expect an increase in our overall level of foreclosures and credit losses for 2007.

Table of Contents**Credit Losses**

Credit loss performance is a significant indicator of the effectiveness of our credit risk management strategies. Credit losses include charge-offs plus foreclosed property expense (income). Credit losses for the years ended December 31, 2006, 2005 and 2004 are presented in Table 40.

Table 40: Single-Family and Multifamily Credit Loss Performance

	For the Year Ended December 31,								
	2006			2005			2004		
	Single-Family	Multifamily	Total	Single-Family	Multifamily	Total	Single-Family	Multifamily	Total
	(Dollars in millions)								
Charge-offs, net of recoveries	\$ 440	\$ 14	\$ 454	\$ 437	\$ 25	\$ 462	\$ 189	\$ 21	\$ 210
Foreclosed property expense (income)	201	(7)	194	(17)	4	(13)	(17)	28	11
Credit losses ⁽¹⁾	\$ 641	\$ 7	\$ 648	\$ 420	\$ 29	\$ 449	\$ 172	\$ 49	\$ 221
Charge-off ratio (basis points) ⁽²⁾	1.9bp	1.0bp	1.9bp	2.0bp	1.9bp	2.0bp	0.9bp	1.7bp	0.9 bp
Credit loss ratio (basis points) ⁽³⁾	2.8bp	0.5bp	2.7bp	1.9bp	2.2bp	1.9bp	0.8bp	4.0bp	1.0 bp

(1) Interest forgone on nonperforming loans in our mortgage portfolio, which is presented in Table 38, reduces our net interest income but is not reflected in our credit losses total. In addition, other-than-temporary impairment resulting from deterioration in credit quality of our mortgage-related securities is not included in our credit losses.

(2) Represents charge-offs, net of recoveries, divided by average total mortgage credit book of business.

(3) Represents credit losses divided by average total mortgage credit book of business.

During the period 2004 to 2006, our credit losses trended upward but still remained at what we consider to be low levels, not exceeding 0.03% of our mortgage credit book of business during any given year. While there was a rapid acceleration of home price appreciation during the period from 1999 to mid-2006, there was a significant slowdown in home price appreciation during the second half 2006, which fueled higher loan loss severities and default rates and contributed to an increase in charge-offs. As a result of economic indicators that suggest home prices are likely to continue to decline in 2007, we expect our credit losses for 2007 to increase significantly over 2006 as our credit loss ratio moves back to what we believe represents our more normal historical average range of 4 to 6 basis points. In certain periods, however, our credit loss ratio may move outside of this historical average range depending on market factors and the risk profile of our mortgage credit book of business.

Losses from Hurricane Katrina increased our credit losses in 2005. Our exposure to losses as a result of Hurricane Katrina arose primarily from Fannie Mae MBS backed by loans secured by properties in the affected areas, our portfolio holdings of mortgage loans and mortgage-related securities backed by loans secured by properties in the affected areas, and real estate that we own in the affected areas. We recorded a provision for credit losses of \$106 million (after-tax loss of \$69 million) in the third quarter of 2005 for estimated losses related to both single-family and multifamily properties affected by Hurricane Katrina.

We use internally developed models to assess our sensitivity to credit losses based on current data on home values, borrower payment patterns, non-mortgage consumer credit history and management's economic outlook. We examine a range of potential economic scenarios to monitor the sensitivity of credit losses. Our models indicate that home price movements are an important predictor of credit performance. We disclose on a quarterly basis the estimated impact on our expected credit losses from an immediate 5% decline in single-family home prices for the entire United States, which we believe is a stressful scenario based on housing data from OFHEO. Historical statistics from OFHEO's house price index reports indicate the national average rate of home price appreciation over the last 20 years has been about 5.3%, while the lowest national average annual appreciation rate in any single year has been 0.3%. However, we believe that the decline in home prices in 2007 is likely to continue.

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Table 41 shows our single-family credit loss sensitivity, before and after consideration of the effect of projected credit risk sharing proceeds, such as private mortgage insurance claims and other credit enhancement, as of December 31, 2006 and 2005. These estimated credit loss sensitivities are generated using the same models that we use to estimate fair value and impairment. We have made certain modifications to our models from those used to report previous credit loss sensitivities. The increase in the net credit loss sensitivity of \$818 million, or 72%, to \$2.0 billion as of December 31, 2006, was attributable to the significant slowing of home price appreciation during the second half of 2006.

Table 41: Single-Family Credit Loss Sensitivity⁽¹⁾

	As of December 31,	
	2006	2005
	(Dollars in millions)	
Gross credit loss sensitivity ⁽²⁾	\$ 3,887	\$ 2,310
Less: Projected credit risk sharing proceeds	(1,926)	(1,167)
Net credit loss sensitivity	\$ 1,961	\$ 1,143
Single-family whole loans and Fannie Mae MBS	\$ 2,203,246	\$ 2,035,704
Single-family net credit loss sensitivity as a percentage of single-family whole loans and Fannie Mae MBS	0.09%	0.06%

- (1) Represents total economic credit losses, which include net charge-offs/recoveries, foreclosed property expenses, forgone interest and the cost of carrying foreclosed properties. Calculations based on approximately 92% of our total single-family mortgage credit book of business as of December 31, 2006 and 2005. The mortgage loans and mortgage-related securities that are included in these estimates consist of single-family single-class Fannie Mae MBS (whether held in our portfolio or held by third parties) and single-family mortgage loans, excluding mortgages secured only by second liens and reverse mortgages. We expect the inclusion in our estimates of these excluded products may impact the estimated sensitivities set forth in the preceding paragraphs.
- (2) Reflects the gross sensitivity of our expected future credit losses to an immediate 5% decline in home values for first lien single-family whole loans we own or that back Fannie Mae MBS. After the initial shock, we estimate home price growth rates return to the rate projected by our credit pricing models.

Allowance for Loan Losses and Reserve for Guaranty Losses

We maintain a separate allowance for loan losses for single-family and multifamily loans classified as held for investment in our mortgage portfolio and a reserve for guaranty losses for credit losses associated with certain mortgage loans that back Fannie Mae MBS held in our portfolio and held by other investors. The allowance for loan losses and reserve for guaranty losses represent our estimate of incurred credit losses inherent in our loans held for investment and loans underlying Fannie Mae MBS, respectively, as of each balance sheet date. We use the same methodology to determine our allowance for loan losses and our reserve for guaranty losses because the relevant factors affecting credit risk are the same. For a discussion of the methodology used in developing our allowance for loan losses and reserve for guaranty losses, see Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies.

We report the allowance for loan losses and reserve for guaranty losses as separate line items in the consolidated balance sheets. The provision for credit losses is reported in the consolidated statements of income. Table 42 summarizes changes in our allowance for loan losses and reserve for guaranty losses for the five-year period ended December 31, 2006.

Table of Contents**Table 42: Allowance for Loan Losses and Reserve for Guaranty Losses**

	2006	2005	As of December 31,		2002
			2004	2003	
	(Dollars in millions)				
Allowance for loan losses:					
Beginning balance	\$ 302	\$ 349	\$ 290	\$ 216	\$ 168
Provision	174	124	174	187	128
Charge-offs ⁽¹⁾	(206)	(267)	(321)	(270)	(175)
Recoveries	70	96	131	72	27
Increase from the reserve for guaranty losses ⁽²⁾			75	85	68
Ending balance ⁽³⁾	\$ 340	\$ 302	\$ 349	\$ 290	\$ 216
Reserve for guaranty losses:					
Beginning balance	\$ 422	\$ 396	\$ 313	\$ 223	\$ 138
Provision	415	317	178	178	156
Charge-offs ⁽⁴⁾	(336)	(302)	(24)	(7)	(11)
Recoveries	18	11	4	4	8
Decrease to the allowance for loan losses ⁽²⁾			(75)	(85)	(68)
Ending balance	\$ 519	\$ 422	\$ 396	\$ 313	\$ 223
Combined allowance for loan losses and reserve for guaranty losses:					
Beginning balance	\$ 724	\$ 745	\$ 603	\$ 439	\$ 306
Provision	589	441	352	365	284
Charge-offs ⁽¹⁾	(542)	(569)	(345)	(277)	(186)
Recoveries	88	107	135	76	35
Ending balance	\$ 859	\$ 724	\$ 745	\$ 603	\$ 439
Balance at end of each period attributable to:					
Single-family	\$ 785	\$ 647	\$ 644	\$ 516	\$ 374
Multifamily	74	77	101	87	65
Total	\$ 859	\$ 724	\$ 745	\$ 603	\$ 439
Percent of combined allowance and reserve in each category to related mortgage credit book of business: ⁽⁵⁾					
Single-family	0.03%	0.03%	0.03%	0.02%	0.02%
Multifamily	0.05	0.06	0.08	0.07	0.07
Total	0.03	0.03	0.03	0.03	0.02

- (1) Includes accrued interest of \$39 million, \$24 million, \$29 million and \$29 million and \$24 million for the years ended December 31, 2006, 2005, 2004, 2003 and 2002, respectively.
- (2) Includes decrease in reserve for guaranty losses and increase in allowance for loan losses due to the purchase of delinquent loans from MBS pools. Effective with our adoption of SOP 03-3 on January 1, 2005, we record delinquent loans purchased from Fannie Mae MBS pools at fair value upon acquisition. We no longer record an increase in the allowance for loan losses and reduction in the reserve for guaranty losses when we purchase these loans.
- (3) Includes \$28 million and \$22 million as of December 31, 2006 and 2005, respectively, for acquired loans subject to the application of SOP 03-3.
- (4) Includes charge of \$204 million and \$251 million in 2006 and 2005, respectively, for acquired loans subject to the application of SOP 03-3 where the acquisition price exceeded the fair value of the acquired loan.
- (5) Represents ratio of combined allowance and reserve balance by loan type to total mortgage credit book of business by loan type.

Our combined allowance for loan losses and reserve for guaranty losses totaled \$859 million as of December 31, 2006, compared with \$724 million, \$745 million, \$603 million and \$439 million as of December 31, 2005, 2004, 2003 and 2002, respectively. The combined allowance for loan losses and reserve

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for guaranty losses as a percentage of our total mortgage credit book of business has remained relatively stable, averaging between 0.02% and 0.03%.

The increase of \$135 million in 2006 was attributable to an increase in the provision for credit losses due to higher charge-offs, which were driven by an observed trend of higher loan loss severities and default rates that we began to experience during the second half of 2006. In 2005, we increased our combined allowance for loan losses and reserve for guaranty losses by \$67 million for estimated losses related to Hurricane Katrina. This increase was more than offset by a decrease in the allowance for loan losses and reserve for guaranty losses due to the significant increase in home prices during 2005.

The increase in our combined allowance for loan losses and reserve for guaranty losses from 2002 to 2004 was primarily due to significant growth in our mortgage credit book of business during this period, combined with a reduction in subsequent recourse proceeds from lenders on certain charged-off loans and an increase in loans with higher risk characteristics. In the fourth quarter of 2004, we recorded an increase of \$142 million in our combined allowance for loan losses and reserve for guaranty losses due to the observed reduction in lender recourse proceeds.

Based on prevailing housing and economic conditions, which have resulted in higher defaults, foreclosures and loss severities, we expect our combined allowance for loan losses and reserve for guaranty losses to increase in 2007, both in absolute terms and as a percentage of our mortgage credit book of business. However, we believe that our acquisition criteria have provided us with a high quality mortgage credit book of business. While we expect our credit loss ratio to significantly increase in 2007 from the historically low levels of the past several years, we anticipate that it will move back to what we believe represents our more normal historical average range of 4 to 6 basis points. In certain periods, however, our credit loss ratio may move outside of this historical average range depending on market factors and the risk profile of our mortgage credit book of business.

Institutional Counterparty Credit Risk Management

Institutional counterparty risk is the risk that institutional counterparties may be unable to fulfill their contractual obligations to us. Our primary exposure to institutional counterparty risk exists with our lending partners and servicers, mortgage insurers, dealers who distribute our debt securities or who commit to sell mortgage pools or loans, issuers of investments included in our liquid investment portfolio, and derivatives counterparties.

Lenders with Risk Sharing

The primary risk associated with lenders providing risk sharing agreements is that they will fail to reimburse us for losses as required under these agreements. We had recourse to lenders for losses on single-family loans totaling an estimated \$53.7 billion and \$55.0 billion as of December 31, 2006 and 2005, respectively. The credit quality of these counterparties is generally high. Investment grade counterparties, based on the lower of Standard & Poor's, Moody's and Fitch ratings, accounted for 53% and 55% of lender recourse obligations as of December 31, 2006 and 2005, respectively. Only 2% of these counterparties were rated by either Standard & Poor's, Moody's or Fitch as below investment grade as of December 31, 2006 and 2005. The remaining counterparties were not rated by rating agencies, but were rated internally. In addition, we require some lenders to pledge collateral to secure their recourse obligations. We held \$112 million and \$61 million in collateral as of December 31, 2006 and 2005, respectively, to secure single-family recourse transactions. In addition, a portion of servicing fees on loans includes recourse to certain lenders, and the credit support for such lender recourse considers the value of the mortgage servicing assets for these counterparties.

We had full or partial recourse to lenders on multifamily loans totaling \$112.5 billion and \$111.1 billion as of December 31, 2006 and 2005, respectively. Our multifamily recourse obligations generally were partially or fully

secured by reserves held in custodial accounts, insurance policies, letters of credit from investment grade counterparties rated A or better, or investment agreements.

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Mortgage Servicers

The primary risk associated with mortgage servicers is that they will fail to fulfill their servicing obligations. Mortgage servicers collect mortgage and escrow payments from borrowers, pay taxes and insurance costs from escrow accounts, monitor and report delinquencies, and perform other required activities on our behalf. A servicing contract breach could result in credit losses for us or could cause us to incur the cost of finding a replacement servicer. We have minimum standards and financial requirements for mortgage servicers, including requiring servicers to maintain a minimum level of servicing fees that would be available to compensate a replacement servicer in the event of a servicing contract breach.

Our ten largest single-family mortgage servicers serviced 73% and 72% of our single-family mortgage credit book of business, and the largest single-family mortgage servicer serviced 22% of our single-family mortgage credit book of business as of December 31, 2006 and 2005. Our ten largest multifamily servicers serviced 73% and 69% of our multifamily mortgage credit book of business as of December 31, 2006 and 2005, respectively. The largest multifamily mortgage servicer serviced 14% and 10% of our multifamily mortgage credit book of business as of December 31, 2006 and 2005, respectively.

Custodial Depository Institutions

The primary risk associated with custodial depository institutions is that they may fail while holding remittances of borrower payments of principal and interest due to us, in which case we may be required to replace the funds to make payments that are due to Fannie Mae MBS holders. We mitigate this risk by establishing qualifying standards for depository custodial institutions, including minimum credit ratings, and limiting depositories to federally regulated or insured institutions that are classified as well capitalized by their regulator. In addition, we have the right to withdraw custodial funds at any time upon written demand or establish other controls, including requiring more frequent remittances or setting limits on aggregate deposits with a custodian.

A total of \$34.5 billion and \$38.4 billion in deposits for scheduled MBS payments were held by 347 and 371 custodial institutions as of December 31, 2006 and 2005, respectively. Of this amount, 96% and 91% were held by institutions rated as investment grade by Standard & Poor's, Moody's and Fitch as of December 31, 2006 and 2005, respectively. Our ten largest depository counterparties held 88% and 86% of these deposits as of December 31, 2006 and 2005, respectively.

Mortgage Insurers

The primary risk associated with mortgage insurers is that they will fail to fulfill their obligations to reimburse us for claims under insurance policies. We manage this risk by maintaining a certification process that establishes eligibility requirements that an insurer must meet to become and remain a qualified mortgage insurer. Qualified mortgage insurers generally must obtain and maintain external ratings of claims paying ability, with a minimum acceptable level of Aa3 from Moody's and AA- from Standard & Poor's and Fitch. We perform periodic on-site reviews of mortgage insurers to confirm compliance with eligibility requirements and to evaluate their management and control practices.

We were the beneficiary of primary mortgage insurance coverage on \$272.1 billion of single-family loans in our portfolio or underlying Fannie Mae MBS as of December 31, 2006, which represented approximately 12% of our single-family mortgage credit book of business, compared with \$263.1 billion, or approximately 13%, of our single-family mortgage credit book of business as of December 31, 2005. As of December 31, 2006, we were the beneficiary of pool mortgage insurance coverage on \$106.6 billion of single-family loans, including conventional and government loans, in our portfolio or underlying Fannie Mae MBS, compared with \$71.7 billion as of December 31, 2005. Seven mortgage insurance companies, all rated AA (or its equivalent) or higher by Standard & Poor's, Moody's

or Fitch, provided over 99% of the total coverage as of December 31, 2006 and 2005.

On February 6, 2007, two major mortgage insurers, MGIC Investment Corporation and Radian Group Inc. announced an agreement to merge. If this merger is completed or any similar future consolidations within the

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mortgage industry occur, it will increase further our concentration risk to individual companies and may require us to take additional steps to mitigate this risk.

Debt Security and Mortgage Dealers

The primary credit risk associated with dealers who commit to place our debt securities is that they will fail to honor their contracts to take delivery of the debt, which could result in delayed issuance of the debt through another dealer. The primary credit risk associated with dealers who make forward commitments to deliver mortgage pools to us is that they may fail to deliver the agreed-upon loans to us at the agreed-upon date, which could result in our having to replace the mortgage pools at higher cost to meet a forward commitment to sell the MBS. We manage these risks by establishing approval standards and limits on exposure and monitoring both our exposure positions and changes in the credit quality of dealers.

Mortgage Originators and Investors

We are routinely exposed to pre-settlement risk through the purchase, sale and financing of mortgage loans and mortgage-related securities with mortgage originators and mortgage investors. The risk is the possibility that the market moves against us at the same time the counterparty is unable or unwilling to either deliver mortgage assets or pay a pair-off fee. On average, the time between trade and settlement is about 35 days. We manage this risk by determining position limits with these counterparties, based upon our assessment of their creditworthiness, and we monitor and manage these exposures. Based upon this assessment, we may, in some cases, require counterparties to post collateral.

Derivatives Counterparties

The primary credit exposure that we have on a derivative transaction is that a counterparty will default on payments due, which could result in us having to acquire a replacement derivative from a different counterparty at a higher cost. Our derivative credit exposure relates principally to interest rate and foreign currency derivative contracts. Typically, we manage this exposure by contracting with experienced counterparties that are rated A (or its equivalent) or better. These counterparties consist of large banks, broker-dealers and other financial institutions that have a significant presence in the derivatives market, most of which are based in the United States. To date, we have never experienced a loss on a derivative transaction due to credit default by a counterparty.

We estimate our exposure to credit loss on derivative instruments by calculating the replacement cost, on a present value basis, to settle at current market prices all outstanding derivative contracts in a net gain position by counterparty where the right of legal offset exists, such as master netting agreements. Derivatives in a gain position are reported in the consolidated balance sheet as Derivative assets at fair value. Table 43 presents our assessment of our credit loss exposure by counterparty credit rating on outstanding risk management derivative contracts as of December 31, 2006 and 2005. We present the outstanding notional amount and activity for our risk management derivatives in Table 18 in MD&A Consolidated Balance Sheet Analysis Derivative Instruments.

Table 43: Credit Loss Exposure of Risk Management Derivative Instruments

As of December 31, 2006					
Credit Rating ⁽¹⁾					
AAA	AA	A	Subtotal	Other ⁽²⁾	Total
(Dollars in millions)					

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Credit loss exposure ⁽³⁾	\$	\$ 3,219	\$ 1,552	\$ 4,771	\$ 65	\$ 4,836
Less: Collateral held ⁽⁴⁾		2,598	1,510	4,108		4,108
Exposure net of collateral	\$	\$ 621	\$ 42	\$ 663	\$ 65	\$ 728
Additional information:						
Notional amount	\$ 750	\$ 537,293	\$ 206,881	\$ 744,924	\$ 469	\$ 745,393
Number of counterparties	1	17	3	21		

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As of December 31, 2005

	Credit Rating ⁽¹⁾			Subtotal (Dollars in millions)	Other ⁽²⁾	Total
	AAA	AA	A			
Credit loss exposure ⁽³⁾	\$	\$ 3,012	\$ 2,641	\$ 5,653	\$ 72	\$ 5,725
Less: Collateral held ⁽⁴⁾		2,515	2,476	4,991		4,991
Exposure net of collateral	\$	\$ 497	\$ 165	\$ 662	\$ 72	\$ 734
Additional information:						
Notional amount	\$ 775	\$ 323,141	\$ 319,423	\$ 643,339	\$ 776	\$ 644,115
Number of counterparties	1	14	6	21		

- (1) We manage collateral requirements based on the lower credit rating, as issued by Standard & Poor's and Moody's, of the legal entity. The credit rating reflects the equivalent Standard & Poor's rating for any ratings based on Moody's scale.
- (2) Includes MBS options, defined benefit mortgage insurance contracts, forward starting debt and swap credit enhancements accounted for as derivatives.
- (3) Represents the exposure to credit loss on derivative instruments, which is estimated by calculating the cost, on a present value basis, to replace all outstanding contracts in a gain position. Derivative gains and losses with the same counterparty are presented net where a legal right of offset exists under an enforceable master settlement agreement. This table excludes mortgage commitments accounted for as derivatives.
- (4) Represents the collateral amount held as of December 31, 2006 and 2005, adjusted for any collateral transferred subsequent to December 31, based on credit loss exposure limits on derivative instruments as of December 31, 2006 and 2005. The actual collateral settlement dates, which vary by counterparty, ranged from one to three business days after the December 31, 2006 and 2005 credit loss exposure valuation dates. The value of the collateral is reduced in accordance with counterparty agreements to help ensure recovery of any loss through the disposition of the collateral. We posted \$303 million and \$476 million of collateral related to our counterparties credit exposure to us as of December 31, 2006 and 2005, respectively.

We expect the credit exposure on derivative contracts to fluctuate with changes in interest rates, implied volatility and the collateral thresholds of the counterparties. To reduce our credit risk concentration, we diversify our derivative contracts among different counterparties. Of the 21 risk management derivatives counterparties that we had outstanding transactions with as of December 31, 2006, seven of these counterparties accounted for approximately 78% of the total outstanding notional amount, and each of these seven counterparties accounted for between approximately 6% and 16% of the total outstanding notional amount. Each of the remaining counterparties accounted for less than 5% of the total outstanding notional amount as of December 31, 2006.

Approximately 85% of our net derivatives exposure of \$728 million as of December 31, 2006 was with 13 interest rate and foreign currency derivative counterparties rated AA- or better by Standard & Poor's and Aa3 or better by Moody's. The percentage of our net exposure with these counterparties ranged from approximately 2% to 10%, or approximately \$12 million to \$74 million, as of December 31, 2006.

We mitigate our net exposure on our risk management derivative transactions through a collateral management policy, which consists of four primary components.

Minimum Collateral Threshold. Our derivatives counterparties are obligated to post collateral when exposure to credit losses exceeds agreed-upon thresholds that are based on credit ratings. The amount of collateral generally must equal the excess of exposure over the threshold amount.

Collateral Valuation Percentages. We require counterparties to post specific types of collateral to meet their collateral requirements. The collateral posted by our counterparties as of December 31, 2006 consisted of cash, U.S. Treasury securities, agency debt and agency mortgage-related securities. We assign each type of collateral a specific valuation percentage based on its relative risk. In cases where the valuation percentage for a certain type of collateral is less than 100%, we require counterparties to post an additional amount of collateral to meet their requirements.

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Over-collateralization Based on Low Credit Ratings. We further reduce our net exposure on derivatives by generally requiring over-collateralization from counterparties whose credit ratings have dropped below predetermined levels. Counterparties with credit ratings falling below these levels must post collateral beyond the amounts previously noted to meet their overall requirements.

Daily Monitoring Procedures. On a daily basis, we value our derivative collateral positions for each counterparty using both internal and external pricing models, compare the exposure to counterparty limits, and determine whether additional collateral is required. We evaluate any additional exposure to a counterparty beyond our model tolerance level based on our corporate credit policy framework for managing counterparty risk. We also enter into master agreements that provide for netting of amounts due to us and amounts due to counterparties under those agreements.

Issuers of Securities in our Liquid Investment Portfolio

The primary credit exposure associated with issuers of investments held in our liquid investment portfolio is that the issuer will not repay principal and interest in accordance with the contractual terms. We mitigate this risk by restricting these investments to high credit quality short- and medium-term instruments, such as commercial paper, asset-backed securities and corporate floating rate notes, which are broadly traded in the financial markets. Approximately 99% and 98% of our non-mortgage securities as of December 31, 2006 and 2005, respectively, had a credit rating of A (or its equivalent) or higher, based on the lowest of Standard & Poor's, Moody's or Fitch ratings. We have a duration policy that limits the effective maturity on these investments to five years and limits the credit spread and interest rate durations to three years.

Interest Rate Risk Management and Other Market Risks

Our most significant market risks are interest rate risk and spread risk, which primarily arise from the prepayment uncertainty associated with investing in mortgage-related assets with prepayment options and from the changing supply and demand for mortgage assets. The majority of our mortgage assets are intermediate-term or long-term fixed-rate loans that borrowers have the option to pay at any time before the scheduled maturity date or continue paying until the stated maturity. An inverse relationship exists between changes in interest rates and the value of fixed-rate investments, including mortgages. As interest rates decline, the value or price of fixed-rate mortgages held in our portfolio will generally increase because mortgage assets originated at the prevailing interest rates are likely to have lower yields and prices than the assets we currently hold in our portfolio. Conversely, an increase in interest rates tends to result in a reduction in the value of our assets. As interest rates decline prepayment rates tend to increase because more favorable financing is available to the borrower, which shortens the duration of our mortgage assets. The opposite effect occurs as interest rates increase.

One way of reducing the interest rate risk associated with investing in long-term, fixed-rate mortgages is to fund these investments with long-term debt with similar offsetting characteristics. This strategy is complicated by the fact that most borrowers have the option of prepaying their mortgages at any time, a factor that is beyond our control and driven to a large extent by changes in interest rates. In addition, funding mortgage investments with debt results in mortgage-to-debt OAS risk, or basis risk, which is the risk that interest rates in different market sectors will not move in the same direction or amount at the same time.

Our Capital Markets group is responsible for managing interest rate risk subject to our strategic objectives and corporate risk policies and limits. As discussed in Supplemental Non-GAAP Information Fair Value Balance Sheet, we do not attempt to actively manage or hedge the impact of changes in mortgage-to-debt OAS after we purchase mortgage assets, other than through asset monitoring and disposition. We accept period-to-period volatility in our

financial performance due to mortgage-to-debt OAS consistent with our corporate risk principles. The following discussion explains our interest rate risk management process, including the actions we take to manage interest rate risk and the measures we use to monitor interest rate risk.

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Interest Rate Risk Management Strategies

Our portfolio of interest rate-sensitive instruments includes our investments in mortgage loans and securities, the debt issued to fund those assets, and the derivatives we use to manage interest rate risk. These assets and liabilities have a variety of risk profiles and sensitivities. We employ an integrated interest rate risk management strategy that includes asset selection and structuring of our liabilities to match and offset the interest rate characteristics of our balance sheet assets and liabilities as much as possible. Our strategy consists of the following principal elements:

Debt Instruments: We issue a broad range of both callable and non-callable debt instruments to manage the duration and prepayment risk of expected cash flows of the mortgage assets we own.

Derivative Instruments: We supplement our issuance of debt with derivative instruments to further reduce duration and prepayment risks.

Monitoring and Active Portfolio Rebalancing: We continually monitor our risk positions and actively rebalance our portfolio of interest rate-sensitive financial instruments to maintain a close match between the duration of our assets and liabilities.

Debt Instruments

The primary tool we use to manage the interest rate risk implicit in our mortgage assets is the variety of debt instruments we issue. We fund the purchase of mortgage assets with a combination of equity and debt. The debt we issue is a mix that typically consists of short- and long-term, non-callable debt and callable debt. The varied maturities and flexibility of these debt combinations help us in reducing the mismatch of cash flows between assets and liabilities in order to manage the duration risk associated with an investment in long-term fixed-rate assets. Callable debt helps us manage the prepayment risk associated with fixed-rate mortgage assets because the duration of callable debt changes when interest rates change in a manner similar to changes in the duration of mortgage assets.

Derivative Instruments

Derivative instruments also are an integral part of our strategy in managing interest rate risk. Derivative instruments may be privately negotiated contracts, which are often referred to as OTC derivatives, or they may be listed and traded on an exchange. When deciding whether to use derivatives instead of issuing debt securities to reach the same goal, we consider a number of factors, such as cost, efficiency, the effect on our liquidity and capital, and our overall interest rate risk management strategy. We choose to use derivatives when we believe they will provide greater relative value or more efficient execution of our strategy than debt securities. The derivatives we use for interest rate risk management purposes consist primarily of OTC contracts that fall into three broad categories:

Interest rate swap contracts. An interest rate swap is a transaction between two parties in which each agrees to exchange payments tied to different interest rates or indices for a specified period of time, generally based on a notional amount of principal. The types of interest rate swaps we use include pay-fixed, receive variable swaps; receive-fixed, pay variable swaps; and basis swaps.

Interest rate option contracts. These contracts primarily include pay-fixed swaptions, receive-fixed swaptions, cancelable swaps and interest rate caps.

Foreign currency swaps. These swaps convert debt that we issue in foreign-denominated currencies into U.S. dollars. We enter into foreign currency swaps only to the extent that we issue foreign currency debt.

We provide additional descriptions of the specific types of derivatives we use, including the typical effect on the fair value of each instrument as interest rates change, in Glossary of Terms Used in This Report.

We use interest rate swaps and interest rate options, in combination with our issuance of debt securities, to better match both the duration and prepayment risk of our mortgages. We are generally an end user of

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derivatives and our principal purpose in using derivatives is to manage our aggregate interest rate risk profile within prescribed risk parameters. We generally only use derivatives that are highly liquid and relatively straightforward to value. We use derivatives for four primary purposes:

(1) As a substitute for notes and bonds that we issue in the debt markets.

We can use a mix of debt issuances and derivatives to achieve the same duration matching that would be achieved by issuing only debt securities. The primary types of derivatives used for this purpose include pay-fixed and receive-fixed interest rate swaps (used as substitutes for non-callable debt) and pay-fixed and receive-fixed swaptions (used as substitutes for callable debt).

(2) To achieve risk management objectives not obtainable with debt market securities.

As an example, we can use the derivative markets to purchase swaptions to add characteristics not obtainable in the debt markets. Some of the characteristics of the option embedded in a callable bond are dependent on the market environment at issuance and the par issuance price of the bond. Thus, in a callable bond we can not specify certain characteristics, such as specifying an out-of-the-money option, which could allow us to more closely match the interest rate risk being hedged. We use option-based derivatives, such as swaptions, because they provide the added flexibility to fully specify the terms of the option, thereby allowing us to more closely match the interest rate risk being hedged.

(3) To quickly and efficiently rebalance our portfolio.

While we have a number of rebalancing tools available to us, it is often most efficient for us to rebalance our portfolio by adding new derivatives or by terminating existing derivative positions. For example, when interest rates fall and mortgage durations shorten, we can shorten the duration of our debt by entering into receive-fixed interest rate swaps that convert longer-duration, fixed-term debt into shorter-duration, floating-rate debt or by terminating existing pay-fixed interest rate swaps. This use of derivatives helps increase our funding flexibility while helping us maintain our interest rate risk within policy limits. The types of derivative instruments we use most often to rebalance our portfolio include pay-fixed and receive-fixed interest rate swaps.

(4) To hedge foreign currency exposure.

We occasionally issue debt in a foreign currency. Our foreign-denominated debt represents less than 1% of our total debt outstanding. Because all of our assets are denominated in U.S. dollars, we enter into currency swaps to effectively convert the foreign-denominated debt into U.S. dollar-denominated debt. We are able to minimize our exposure to currency risk by swapping out of foreign currencies completely at the time of the debt issue.

Decisions regarding the repositioning of our derivatives portfolio are based upon current assessments of our interest rate risk profile and economic conditions, including the composition of our consolidated balance sheets and relative mix of our debt and derivative positions, the interest rate environment and expected trends. Table 44 presents, by derivative instrument type, our risk management derivative activity for the years ended December 31, 2006 and 2005, along with the stated maturities of derivatives outstanding as of December 31, 2006.

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Table 44: Activity and Maturity Data for Risk Management Derivatives⁽¹⁾

	Interest Rate Swaps			Interest Rate Swaptions			Interest Rate Caps	Other ⁽⁵⁾	Total
	Pay-Fixed ⁽²⁾	Receive-Fixed ⁽³⁾	Basis ⁽⁴⁾	Foreign Currency	Pay-Fixed	Receive-Fixed			
(Dollars in millions)									
Balance									
As of December 31,									
Balance	\$ 142,017	\$ 81,193	\$ 32,273	\$ 11,453	\$ 170,705	\$ 147,570	\$ 104,150	\$ 733	\$ 600,000
Changes	141,775	156,475	1,300	9,147	14,750	25,250		7,409	3,000
Net change	(95,005)	(113,761)	(29,573)	(14,955)	(36,050)	(34,225)	(71,150)	(7,366)	(4,000)
Balance									
As of December 31,									
Balance	\$ 188,787	\$ 123,907	\$ 4,000	\$ 5,645	\$ 149,405	\$ 138,595	\$ 33,000	\$ 776	\$ 600,000
Changes	132,411	176,870	3,350	3,870	783	255		2,852	3,000
Net change	(53,130)	(53,693)	(6,400)	(4,964)	(54,838)	(23,929)	(19,000)	(3,159)	(2,000)
Balance									
As of December 31,									
Balance	\$ 268,068	\$ 247,084	\$ 950	\$ 4,551	\$ 95,350	\$ 114,921	\$ 14,000	\$ 469	\$ 700,000
Changes									
Net change									
Balance	\$ 15,950	\$ 36,430	\$ 200	\$ 2,390	\$ 2,000	\$ 7,300	\$ 11,750	\$ 40	\$ 100,000
Changes	107,981	149,789		1,329	45,050	20,876	1,500	69	3,000
Net change	112,835	53,325	100		43,250	74,245	750	360	2,000
Balance	31,302	7,540	650	832	5,050	12,500			
Net change	\$ 268,068	\$ 247,084	\$ 950	\$ 4,551	\$ 95,350	\$ 114,921	\$ 14,000	\$ 469	\$ 700,000
Weighted-average rate as of December 31,									
Rate	5.10%	5.35%	5.29%		6.18%				
Rate	5.36%	5.01%	6.58%			4.92%			
Weighted-average rate as of							3.55%		

er 31,

rate

5.02%	4.36%	4.04%	5.94%	
4.37%	4.38%	4.13%		5.03%
				2.97%

- (1) Excludes mortgage commitments accounted for as derivatives. Dollars represent notional amounts that indicate only the amount on which payments are being calculated and do not represent the amount at risk of loss.
- (2) Notional amounts include swaps callable by Fannie Mae of \$10.8 billion and \$14.3 billion as of December 31, 2006 and 2005, respectively.
- (3) Notional amounts include swaps callable by derivatives counterparties of \$6.7 billion and \$3.6 billion as of December 31, 2006 and 2005, respectively.
- (4) Notional amounts include swaps callable by derivatives counterparties of \$600 million as of December 31, 2006.
- (5) Includes MBS options, forward starting debt and swap credit enhancements.
- (6) Includes matured, called, exercised, assigned and terminated amounts. Also includes changes due to foreign exchange rate movements.
- (7) Based on contractual maturities.

The outstanding notional balance of our risk management derivatives increased to \$745.4 billion as of December 31, 2006. The \$101.3 billion increase during 2006 reflects higher balances of both pay-fixed and receive-fixed swaps, partially offset by a reduction in interest rate swaptions. In response to the general increase in interest rates during the first half of 2006, which lengthened the duration of our mortgage assets, we generally added to our net pay-fixed swap position to extend the duration of our liabilities to more closely match the expected duration of our assets. During the second half of the year, when interest rates generally declined and the duration of our mortgage assets shortened, we added to our net receive-fixed swap position to shorten the duration of our liabilities. During 2005, we decreased the outstanding notional balance of our risk management derivatives by \$46.0 billion to \$644.1 billion as of December 31, 2005. The key driver of this decline was the termination of derivatives in connection with the elimination of debt that was used to fund mortgage assets that we sold.

Since December 31, 2006, the outstanding notional balance of our risk management derivatives has increased by \$40.6 billion to \$786.0 billion as of June 30, 2007. This increase was mainly due to an increase in our pay-

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fixed swaps to extend the duration of our liabilities in response to the general increase in interest rates during the first half of 2007, which lengthened the duration of our mortgage assets.

Monitoring and Active Portfolio Rebalancing

Because single-family borrowers typically can prepay a mortgage at any time prior to maturity, the borrower's mortgage is economically similar to callable debt. By investing in mortgage assets, we assume this inherent prepayment risk. As described above, we attempt to offset the prepayment risk and cover our short position either by issuing callable debt that we can redeem at our option or by purchasing option-based derivatives that we can exercise at our option. We also manage the prepayment risk of our assets relative to our funding through active portfolio rebalancing. We develop rebalancing actions based on a number of factors, including an assessment of current market conditions and various interest rate risk measures, which we describe below.

Measuring Interest Rate Risk

We are subject to Board and management market risk limits, which are monitored by our Capital Markets group and the Chief Risk Office and reviewed regularly by senior management and the appropriate risk committee. Our interest rate risk measurement framework is based on the fair value of our assets, liabilities and derivative instruments and the sensitivity of these fair values to changes in market factors. Because no single measure can reflect all aspects of the interest rate risk inherent in our mortgage portfolio, we utilize various risk metrics that together provide a more complete assessment of interest rate risk. We measure and monitor the fair value sensitivity to both small and large changes in the level of interest rates, changes in the slope and shape of the yield curve, and changes in interest rate volatility. We also calculate and monitor industry standard risk metrics that are based on fair value measures, such as duration and convexity, as well as value at-risk. In addition, we perform a range of stress test analyses that measure the sensitivity of the portfolio to severe hypothetical changes in market conditions. We produce a series of daily, weekly, monthly, and quarterly analyses that are used by the company to manage and monitor our interest rate risk position. Below we discuss three measures that we use to quantify our interest rate risk: (i) fair value sensitivity to interest rate level and slope shock, (ii) duration gap and (iii) net asset fair value sensitivity.

Fair Value Sensitivity to Changes in Level and Slope of Yield Curve

In July 2007, we disclosed in our Monthly Summary Report, which is submitted to the SEC in a Current Report on Form 8-K and made available on our Web site, the estimated impact on our financial condition of changes in the level and slope of the yield curve. Our disclosure presents the estimated pre-tax losses expressed as a percentage of the estimated after-tax fair value of our net assets resulting from an immediate adverse 50 basis point parallel shift in the level of LIBOR rates and an immediate adverse 25 basis point change in the slope of the LIBOR yield curve. We believe these changes represent moderate movements in interest rates. As of June 30, 2007, we estimated our exposure to a 50 basis point shift in the level of interest rates and a 25 basis point change in the slope of the yield curve was (1)% and 0%, respectively. We intend to publish these two new interest rate risk measures each month in our Monthly Summary Report.

Assets included in these interest rate sensitivity measures consist of our existing mortgage portfolio, non-mortgage investments and priced asset commitments. Liabilities consist of our existing debt instruments, derivative instruments and priced debt and derivative commitments. The calculation excludes the interest rate sensitivity of our guaranty business because we expect that the guaranty fee income generated from future business activity will largely replace any guaranty fee income lost as a result of mortgage prepayments due to movements in interest rates.

Duration Gap

Duration measures the price sensitivity of our assets and liabilities to changes in interest rates by quantifying the difference between the estimated durations of our assets and liabilities. Duration gap summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time and across

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interest rate scenarios. A positive duration gap signals a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities.

Our effective duration gap, which we report on a monthly basis in our Monthly Summary Report, reflects the estimate used contemporaneously by management as of the reported date to manage the interest rate risk of our portfolio. Our effective duration gap calculation includes the same assets and liabilities that we include in calculating the above interest rate level and slope fair value sensitivity measures. We seek to keep our assets and liabilities matched within a duration tolerance of plus or minus six months. When interest rates are volatile, we often need to lengthen or shorten the average duration of our liabilities to keep them closely matched with our mortgage durations, which change as expected mortgage prepayments change.

Beginning with June 2007 and for future months, we prospectively changed the methodology we use to calculate our monthly effective duration gap. The revised calculation reflects the difference between the proportional fair value weightings of our assets and liabilities. In prior months, the duration gap was not calculated on a weighted basis and was simply the daily average of the difference between the duration of our assets and the duration of our liabilities. Our revised methodology presents our effective duration gap on a basis that is consistent with the fair value sensitivity measures of changes in the level and slope of the yield curve discussed above. Based on the revised methodology, our duration gap was plus 1 month for the month of June 2007. Under the previous methodology, our duration gap for June 2007 would have measured minus 1 month, or approximately 2 months less than the effective duration gap under the revised methodology. Our monthly duration gap, based on our previous methodology, did not exceed plus or minus one month from October 2004 through June 2007.

Fair Value Sensitivity of Net Assets

Table 45 discloses the estimated fair value of our net assets as of December 31, 2006 and 2005, and the impact on the estimated fair value from a hypothetical instantaneous shock in interest rates of a 50 basis points decrease and a 100 basis points increase. We selected these interest rate changes because we believe they reflect reasonably possible near-term outcomes within a 12-month period. We discuss how we derive the estimated fair value of our net assets, which serves as the base case for our sensitivity analysis, in Supplemental Non-GAAP Information Fair Value Balance Sheet.

Table 45: Interest Rate Sensitivity of Fair Value of Net Assets

	As of December 31, 2006 ⁽⁶⁾					
	Carrying Value	Estimated Fair Value	Effect on Estimated Fair Value			
			-50 Basis Points		+100 Basis Points	
			\$	%	\$	%
			(Dollars in millions)			
Trading financial instruments ⁽¹⁾	\$ 11,514	\$ 11,514	\$ 210	1.82%	\$ (499)	(4.33)%
Non-trading mortgage assets and consolidated debt ⁽²⁾	777,084	774,012	9,515	1.23	(23,431)	(3.03)
Debt ⁽²⁾	(759,860)	(765,144)	(8,351)	1.09	17,737	(2.32)
Subtotal before derivatives	28,738	20,382	1,374	6.74	(6,193)	(30.38)
Derivative assets and liabilities, net	3,747	3,747	(1,866)	(49.80)	4,130	110.22

Subtotal after derivatives	32,485	24,129	(492)	(2.04)	(2,063)	(8.55)
Guaranty assets and guaranty obligations, net ⁽²⁾	(2,445)	7,593	(1,309)	(17.24)	1,664	21.91
Net market sensitive assets ⁽²⁾⁽³⁾	30,040	31,722	(1,801)	(5.68)	(399)	(1.26)
Other non-financial assets and liabilities, net ⁽⁴⁾	11,466	11,179	636	5.69	146	1.31
Net assets ⁽⁵⁾	\$ 41,506	\$ 42,901	\$ (1,165)	(2.72)%	\$ (253)	(0.59)%

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	As of December 31, 2005					
	Carrying Value	Estimated Fair Value	Effect on Estimated Fair Value			
			-50 Basis Points		+100 Basis Points	
			\$	%	\$	%
(Dollars in millions)						
Trading financial instruments ⁽¹⁾	\$ 15,110	\$ 15,110	\$ 262	1.73%	\$ (641)	(4.24)%
Non-trading mortgage assets and consolidated debt ⁽²⁾	760,586	759,054	9,544	1.26	(24,059)	(3.17)
Debt ⁽²⁾	(754,320)	(760,002)	(8,617)	1.13	17,640	(2.32)
Subtotal before derivatives	21,376	14,162	1,189	8.40	(7,060)	(49.85)
Derivative assets and liabilities, net	4,374	4,374	(1,577)	(36.05)	5,696	130.22
Subtotal after derivatives	25,750	18,536	(388)	(2.09)	(1,364)	(7.36)
Guaranty assets and guaranty obligations, net ⁽²⁾	(2,274)	8,993	(1,392)	(15.48)	2,116	23.53
Net market sensitive assets ⁽²⁾⁽³⁾	23,476	27,529	(1,780)	(6.47)	752	2.73
Other non-financial assets and liabilities, net ⁽⁴⁾	15,826	14,670	489	3.33	(397)	(2.71)
Net assets ⁽⁵⁾	\$ 39,302	\$ 42,199	\$ (1,291)	(3.06)%	\$ 355	0.84%

- (1) Consists of securities classified in the consolidated balance sheets as trading and carried at estimated fair value.
- (2) Non-trading mortgage assets and consolidated debt includes the line item Advances to lenders reported in our consolidated GAAP balance sheets and the reclassification of consolidated debt with a carrying value and estimated fair value of \$7.9 billion as of December 31, 2006, respectively, and a carrying value of \$10.4 billion and estimated fair value of \$10.5 billion as of December 31, 2005, respectively. In addition, certain amounts have been reclassified from securities to Guaranty assets and guaranty obligations, net to reflect how the risk of these securities is managed by the business.
- (3) Includes net financial assets and financial liabilities reported in Notes to Consolidated Financial Statements Note 19, Fair Value of Financial Instruments and additional market sensitive instruments that consist of master servicing assets, master servicing liabilities and credit enhancements.
- (4) The sensitivity changes related to other non-financial assets and liabilities represent the tax effect on net assets under these scenarios and do not include any interest rate sensitivity related to these items.
- (5) The carrying value for net assets equals total stockholders equity as reported in the consolidated balance sheets.
- (6) Certain prior period amounts have been reclassified to conform with the current year presentation, which resulted in changes in the reported sensitivities of selected categories of market-sensitive assets and liabilities but did not change the reported sensitivities of either our net market sensitive assets or net assets.

The net asset sensitivities (excluding the sensitivity of the Guaranty assets and guaranty obligations, net), net of tax was (0.7)% for a -50 basis point shock and (3.1)% for a +100 basis point shock as of December 31, 2006, compared with (0.9)% for a -50 basis point shock and (2.4)% for a +100 basis point shock as of December 31, 2005. We evaluate the sensitivity of the fair value of our net assets, excluding the sensitivity of our guaranty assets and guaranty obligations, because, as previously discussed, we expect that the guaranty fee income generated from future business activity will largely replace any guaranty fee income lost as a result of mortgage prepayments due to movements in interest rates. As discussed above, we structure our debt and derivatives to match and offset the interest rate risk of our mortgage investments as much as possible. We believe the results of these sensitivity analyses are indicative of a relatively low level of interest rate risk.

Our interest rate risk measures are based on industry standard financial modeling techniques that depend on our internally developed proprietary mortgage prepayment models and interest rate models. Our prepayment models contain many assumptions, including those regarding borrower behavior in certain interest rate environments and borrower relocation rates. Other market inputs, such as interest rates, mortgage prices and interest rate volatility, are also critical components of our interest rate risk measures. We maintain a research program to constantly evaluate, update and enhance these assumptions, models and analytical tools as appropriate to reflect our best assessment of the environment.

Although we perform a wide range of sensitivity analyses using industry standard methodologies, there are inherent limitations in any methodology used to estimate the exposure to changes in market interest rates. It is not possible to fully model the market risk in instruments with option or prepayment risks. Our sensitivity

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analysis contemplate only certain movements in interest rates and are performed at a particular point in time based on the estimated fair value of our existing portfolio. These sensitivity analyses do not incorporate other factors that may have a significant effect, most notably the value from expected future business activities and strategic actions that management may take to manage interest rate risk. As such, these analyses are not intended to provide precise forecasts of the effect a change in market interest rates would have on us.

Operational Risk Management

Operational risk can manifest itself in many ways, including accounting or operational errors, business disruptions, fraud, technological failures and other operational challenges resulting from failed or inadequate internal controls. These events may potentially result in financial losses and other damage to our business, including reputational harm. In 2006, we implemented a new operational risk management framework that includes policies designed to identify, measure, monitor and manage operational risks across the company. In November 2006, we submitted a detailed three-year plan on the design and implementation of this framework to OFHEO as required by our consent order with OFHEO. Our operational risk management framework is based on the Basel Committee guidance on sound practices for the management of operational risk broadly adopted by U.S. commercial banks comparable in size to Fannie Mae. The framework incorporates elements such as the monitoring of operational loss events, tracking of key risk indicators, use of common terminology to describe risks and self-assessments of risks and controls in place to mitigate operational risks. We have recently hired several new senior officers with significant expertise in operational risk management to implement this new framework.

In addition to the corporate operational risk oversight function, we also maintain programs for the management of our exposure to other key operational risks, such as mortgage fraud, breaches in information security and external disruptions to business continuity. These risks are not unique to us and are inherent in the financial services industry.

Liquidity Risk Management

Liquidity risk is the risk to our earnings and capital that would arise from an inability to meet our cash obligations in a timely manner. Because liquidity is essential to our business, we have adopted a comprehensive liquidity risk policy that is designed to provide us with sufficient flexibility to address both liquidity events specific to our business and market-wide liquidity events. Our liquidity risk policy governs our management of liquidity risk and outlines our methods for measuring and monitoring liquidity risk. Our liquidity risk policy, which has been approved by our Board of Directors, outlines the roles and responsibilities for managing liquidity risk within the company.

We conduct daily liquidity management activities to achieve the goals of our liquidity risk policy. The primary tools that we employ for liquidity management include the following:

- daily monitoring and reporting of our liquidity position;

- daily forecasting of our ability to meet our liquidity needs over a 90-day period without relying upon the issuance of unsecured debt;

- daily monitoring of market and economic factors that may impact our liquidity;

- a defined escalation process for bringing any liquidity issues or concerns that may arise to the attention of higher levels of our management;

- routine testing of our ability to rely upon identified sources of liquidity;

periodic reporting of our liquidity position to management and oversight by the Market Risk Committee and Board of Directors;

periodic review and testing of our liquidity management controls by our Internal Audit department;

maintaining unencumbered mortgage assets that are available as collateral for secured borrowings pursuant to repurchase agreements or for sale; and

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maintaining an investment portfolio of liquid non-mortgage assets that are readily marketable or have short-term maturities so that we can quickly and easily convert these assets into cash.

Liquidity Contingency Plan

Our liquidity risk policy includes a contingency plan in the event that factors, whether internal or external to our business, temporarily compromise our ability to access capital through normal channels. Our contingency plan provides for alternative sources of liquidity that would allow us to meet all of our cash obligations for 90 days without relying upon the issuance of unsecured debt. If our access to the capital markets becomes impaired, our contingency plan designates our unencumbered mortgage portfolio as our primary source of liquidity. Our unencumbered mortgage portfolio consists of unencumbered mortgage loans and mortgage-related securities that could be pledged as collateral for borrowing in the market for mortgage repurchase agreements or sold to generate additional funds. Substantially all of our mortgage portfolio would have been eligible to be pledged as collateral under repurchase agreements as of December 31, 2006 and 2005. We did not have any outstanding securities sold under agreements to repurchase as of December 31, 2006 and 2005, and we did not pledge any mortgage loans held in our portfolio as collateral under repurchase agreements as of each of these dates. However, we have pledged mortgage-related securities and mortgage-related securities that were consolidated as loans under FIN 46R and under other agreements, including pledged collateral required to facilitate our trading activities. For further information on collateral pledged, see Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies Collateral.

Our liquid investment portfolio is also a source of liquidity in the event that we cannot access the capital markets. Our liquid investment portfolio consists primarily of high-quality non-mortgage investments that are readily marketable or have short-term maturities. We had approximately \$69.4 billion and \$52.2 billion in liquid assets, net of any cash and cash equivalents pledged as collateral, as of December 31, 2006 and 2005, respectively.

OFHEO Supervision

Pursuant to its role as our safety and soundness regulator, OFHEO monitors our liquidity management practices and audits our liquidity position on a continuous basis. On September 1, 2005, we entered into an agreement with OFHEO that formalized and updated the voluntary initiatives that we announced in October 2000 to enhance market discipline, liquidity and capital. Pursuant to this agreement, we agreed to certain commitments pertaining to management of our liquidity, including:

complying with principles of sound liquidity management consistent with industry practice;

maintenance of a portfolio of highly liquid assets;

maintenance of a functional contingency plan providing for at least three months liquidity without relying upon the issuance of unsecured debt; and

periodic testing of our contingency plan in consultation with an OFHEO examiner.

Each of these commitments is addressed in our liquidity risk policy. We further agreed to periodic public disclosure regarding our compliance with the plan for maintaining three months liquidity and meeting the commitment for periodic testing. We believe we were in compliance with our commitment to maintain and test our functional contingency plan as of December 31, 2006 and June 30, 2007. We are currently in the process of revising our liquidity management policies in consultation with OFHEO. We expect that OFHEO will finalize its review of our proposed changes to our liquidity risk policy during the third quarter of 2007.

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IMPACT OF FUTURE ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 155, Accounting for Certain Hybrid Financial Instruments and DIG Issue No. B40, Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS 133 and SFAS 140. This statement: (i) clarifies which interest-only strips and principal-only strips are not subject to SFAS 133; (ii) establishes a requirement to evaluate interests in securitized financial instruments that contain an embedded derivative requiring bifurcation; (iii) clarifies that concentration of credit risks in the form of subordination are not embedded derivatives; and (iv) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation.

In January 2007, FASB issued Derivatives Implementation Group (DIG) Issue No. B40 (DIG B40). The objective of DIG B40 is to provide a narrow scope exception to certain provisions of SFAS 133 for securitized interests that contain only an embedded derivative that is tied to the prepayment risk of the underlying financial assets. SFAS 155 and DIG B40 are effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. We adopted SFAS 155 effective January 1, 2007 and elected fair value measurement for hybrid financial instruments that contain embedded derivatives that otherwise require bifurcation, which includes buy-ups and guaranty assets arising from portfolio securitization transactions. We also elected to classify investment securities that may contain embedded derivatives as trading securities under SFAS 115. SFAS 155 is a prospective standard and had no impact on the consolidated financial statements on the date of adoption.

SFAS No. 156, Accounting for Servicing of Financial Assets

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140* (SFAS 156). SFAS 156 modifies SFAS 140 by requiring that mortgage servicing rights (MSR) be initially recognized at fair value and by providing the option to either (i) carry MSRs at fair value with changes in fair value recognized in earnings or (ii) continue recognizing periodic amortization expense and assess the MSRs for impairment as was originally required by SFAS 140. This option is available by class of servicing asset or liability. This statement also changes the calculation of the gain from the sale of financial assets by requiring that the fair value of servicing rights be considered part of the proceeds received in exchange for the sale of the assets.

SFAS 156 is effective for all separately recognized servicing assets and liabilities acquired or issued after the beginning of a fiscal year that begins after September 15, 2006, with early adoption permitted. We adopted SFAS 156 effective January 1, 2007, with no material impact to the consolidated financial statements because we are not electing to measure MSRs at fair value subsequent to their initial recognition.

FIN 48, Accounting for Uncertainty in Income Taxes and FSP FIN 48-1 Definition of Settlement in FASB Interpretation 48

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 supplements SFAS 109 by defining a threshold for recognizing tax benefits in the consolidated financial statements. FIN 48 provides a two-step approach to recognizing and measuring tax benefits when a benefit's realization is uncertain. First, we must determine whether the benefit is to be recognized and then the amount to be recognized. Income tax benefits should be recognized when, based on the technical merits of a tax position, we believe that if upon examination, including resolution of any appeals or litigation process, it is more likely than not (a probability of greater than 50%) that the tax position would be sustained as filed. The benefit recognized for a tax position that meets the

more-likely-than-not criterion is measured based on the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement with the taxing authority, taking into consideration the amounts and probabilities of the outcomes upon settlement.

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In May 2007, the FASB issued FSP FIN 48-1, *Definition of Settlement in FASB Interpretation 48* (FSP FIN 48-1) to provide guidance on determining whether or not a tax position has been effectively settled for the purpose of recognizing previously unrecognized tax benefits. FIN 48 and FSP FIN 48-1 are effective for consolidated financial statements beginning in the first quarter of 2007. The cumulative effect of applying the provisions of FIN 48 upon adoption will be reported as an adjustment to beginning retained earnings. We are evaluating the impact of the adoption of FIN 48 and FSP FIN 48-1 on the consolidated financial statements.

SFAS No. 157, Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities and requires companies to provide expanded information about assets and liabilities measured at fair value, including the effect of fair value measurements on earnings. This statement applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, but does not expand the use of fair value in any new circumstances.

Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. This statement clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, this standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data (for example, a company's own data). Under this statement, fair value measurements would be separately disclosed by level within the fair value hierarchy.

SFAS 157 is effective for consolidated financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We intend to adopt SFAS 157 effective January 1, 2008 and are evaluating the impact of its adoption on the consolidated financial statements.

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits companies to make a one-time election to report certain financial instruments at fair value with the changes in fair value included in earnings. SFAS 159 is effective for consolidated financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We intend to adopt SFAS 159 effective January 1, 2008. We are still evaluating which, if any, financial instruments we will elect to report at fair value. Accordingly, we have not yet determined the impact, if any, on the consolidated financial statements of adopting this standard.

FSP FIN 39-1, Amendment of FASB Interpretation No. 39

In April 2007, the FASB issued FASB Staff Position No. FIN 39-1, *Amendment of FASB Interpretation No. 39* (FSP FIN 39-1). This FSP amends FIN 39 to allow an entity to offset cash collateral receivables and payables reported at fair value against derivative instruments (as defined by SFAS 133) for contracts executed with the same counterparty under master netting arrangements. The decision to offset cash collateral under this FSP must be applied consistently to all derivatives counterparties where the entity has master netting arrangements. If an entity nets derivative positions as permitted under FIN 39, this FSP requires the entity to also offset the cash collateral receivables and payables with the same counterparty under a master netting arrangement. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007. As we have elected to net derivative positions under FIN 39, we will adopt FSP FIN 39-1 on January 1, 2008 and are evaluating the impact of its adoption on the consolidated financial statements.

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GLOSSARY OF TERMS USED IN THIS REPORT

Terms used in this report have the following meanings, unless the context indicates otherwise.

Agency issuers refers to the government-sponsored enterprises Fannie Mae and Freddie Mac, as well as Ginnie Mae.

Alt-A mortgage generally refers to a loan that can be underwritten with lower or alternative documentation than a full documentation mortgage loan but may also include other alternative product features. As a result, Alt-A mortgage loans generally have a higher risk of default than non-Alt-A mortgage loans. In reporting our Alt-A exposure, we have classified mortgage loans as Alt-A if the lenders that deliver the mortgage loans to us have classified the loans as Alt-A based on documentation or other product features, or, for the original or resecuritized private-label, mortgage-related securities that we hold in our portfolio, if the securities were labeled as Alt-A when sold.

ARM or adjustable-rate mortgage refers to a mortgage loan with an interest rate that adjusts periodically over the life of the mortgage based on changes in a specified index.

Basis swap contract refers to an agreement that provides for the exchange of variable interest payments, based on notional amounts, tied to two different underlying interest rate indices.

Business volume or new business acquisitions refers to the sum in any given period of the unpaid principal balance of: (1) the mortgage loans and mortgage-related securities we purchase for our investment portfolio; and (2) the mortgage loans we securitize into Fannie Mae MBS that are acquired by third parties. It excludes mortgage loans we securitize from our portfolio.

Cancelable swaps generally refers to a swap in which one or both parties have the right to cancel the swap under certain circumstances at some point in the future and without incurring a cost for canceling the swap. Ordinarily, the rates exchanged in the swap will reflect the value of a cancellation option. These contracts generally increase in value as implied volatility increases.

Charter Act or our charter refers to the Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 *et seq.*

Conforming mortgage refers to a conventional single-family mortgage loan with an original principal balance that is equal to or less than the applicable conforming loan limit, which is the applicable maximum original principal balance for a mortgage loan that we are permitted by our charter to purchase or securitize. The conforming loan limit is established each year by OFHEO based on the national average price of a one-family residence. The current conforming loan limit for a one-family residence in most geographic areas is \$417,000.

Conventional mortgage refers to a mortgage loan that is not guaranteed or insured by the U.S. government or its agencies, such as the VA, FHA or RHS.

Conventional single-family mortgage credit book of business refers to the sum of the unpaid principal balance of: (1) the conventional single-family mortgage loans we hold in our investment portfolio; (2) the Fannie Mae MBS and non-Fannie Mae mortgage-related securities backed by conventional single-family mortgage loans we hold in our investment portfolio; (3) Fannie Mae MBS backed by conventional single-family mortgage loans that are held by third parties; and (4) credit enhancements that we provide on conventional single-family mortgage assets.

Core capital refers to a statutory measure of our capital that is the sum of the stated value of our outstanding common stock (common stock less treasury stock), the stated value of our outstanding non-cumulative perpetual preferred stock, our paid-in capital and our retained earnings, as determined in accordance with GAAP.

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Credit enhancement refers to a method to reduce credit risk by requiring collateral, letters of credit, mortgage insurance, corporate guaranties, or other agreements to provide an entity with some assurance that it will be recompensed to some degree in the event of a financial loss.

Critical capital requirement refers to the amount of core capital below which we would be classified by OFHEO as critically undercapitalized and generally would be required to be placed in conservatorship. Our critical capital requirement is generally equal to the sum of: (1) 1.25% of on-balance sheet assets; (2) 0.25% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and (3) up to 0.25% of other off-balance sheet obligations.

Delinquency refers to an instance in which a principal or interest payment on a mortgage loan has not been made in full by the due date.

Derivative refers to a financial instrument that derives its value based on changes in an underlying asset, such as security or commodity prices, interest rates, currency rates or other financial indices. Examples of derivatives include futures, options and swaps.

Duration refers to the sensitivity of the value of a security to changes in interest rates. The duration of a financial instrument is the expected percentage change in its value in the event of a change in interest rates of 100 basis points.

DUS refers to our Delegated Underwriting and Servicing Program. Under this program, we delegate the underwriting of loans to lenders that we approve for the program, and these lenders are not required to obtain loan-by-loan approval before we acquire the loans from them.

Fannie Mae mortgage-backed securities or *Fannie Mae MBS* generally refer to those mortgage-related securities that we issue and with respect to which we guarantee to the related trusts that we will supplement amounts received by the MBS trust as required to permit timely payment of principal and interest on the related Fannie Mae MBS. We also issue some forms of mortgage-related securities for which we do not provide this guaranty. The term *Fannie Mae MBS* refers to all forms of mortgage-related securities that we issue, including single-class Fannie Mae MBS and multi-class Fannie Mae MBS.

Fixed-rate mortgage refers to a mortgage loan with an interest rate that does not change during the entire term of the loan.

GAAP refers to generally accepted accounting principles in the U.S.

GSEs refers to government-sponsored enterprises such as Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

HUD refers to the Department of Housing and Urban Development.

Implied volatility refers to the market's expectation of potential changes in interest rates.

Interest-only loan refers to a mortgage loan that allows the borrower to pay only the monthly interest due, and none of the principal, for a fixed term. After the end of that term the borrower can choose to refinance, pay the principal balance in a lump sum, or begin paying the monthly scheduled principal due on the loan, which results in a higher monthly payment at that time. Interest-only loans can be adjustable-rate or fixed-rate mortgage loans.

Interest rate cap refers to a contract in which we receive money when a reference interest rate, typically LIBOR, exceeds an agreed-upon referenced strike price. The value generally increases as reference interest rates rise. Although an interest rate cap is not an option it has option-like characteristics.

Interest rate swap refers to a transaction between two parties in which each agrees to exchange payments tied to different interest rates or indices for a specified period of time, generally based on a notional principal amount. An interest rate swap is a type of derivative.

Intermediate-term mortgage refers to a mortgage loan with a contractual maturity at the time of purchase equal to or less than 15 years.

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LIHTC partnerships refer to low-income housing tax credit limited partnerships or limited liability companies. For a description of these partnerships, refer to Business Segments Housing and Community Development Community Investment Group above.

Liquid assets refers to our holdings of non-mortgage investments, cash and cash equivalents, and funding agreements with our lenders, including advances to lenders and repurchase agreements.

Loans, mortgage loans and mortgages refer to both whole loans and loan participations, secured by residential real estate, cooperative shares or by manufactured housing units.

Loan-to-value ratio or *LTV ratio* refers to the ratio, at any point in time, of the unpaid principal amount of a borrower's mortgage loan to the value of the property that serves as collateral for the loan (expressed as a percentage).

Minimum capital requirement refers to the amount of core capital below which we would be classified by OFHEO as undercapitalized. Our minimum capital requirement is generally equal to the sum of: (1) 2.50% of on-balance sheet assets; (2) 0.45% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and (3) up to 0.45% of other off-balance sheet obligations.

Mortgage assets, when referring to our assets, refers to both mortgage loans and mortgage-related securities we hold in our portfolio.

Mortgage credit book of business or book of business refers to the sum of the unpaid principal balance of: (1) the mortgage loans we hold in our investment portfolio; (2) the Fannie Mae MBS and non-Fannie Mae mortgage-related securities we hold in our investment portfolio; (3) Fannie Mae MBS that are held by third parties; and (4) credit enhancements that we provide on mortgage assets.

Mortgage-related securities or mortgage-backed securities refer generally to securities that represent beneficial interests in pools of mortgage loans or other mortgage-related securities. These securities may be issued by Fannie Mae or by others.

Multi-class Fannie Mae MBS refers to Fannie Mae MBS, including REMICs, where the cash flows on the underlying single-class and/or multi-class Fannie Mae MBS, other mortgage-related securities or mortgage loans are divided creating several classes of securities, each of which represents a beneficial ownership interest in a separate portion of cash flows. By separating the cash flows, the resulting classes may consist of: (1) interest-only payments; (2) principal-only payments; (3) different portions of the principal and interest payments; or (4) combinations of each of these. Terms to maturity of some multi-class Fannie Mae MBS, particularly REMIC classes, may match or be shorter than the maturity of the underlying mortgage loans and/or mortgage-related securities. As a result, each of the classes in a multi-class Fannie Mae MBS may have a different coupon rate, average life, repayment sensitivity or final maturity.

Multifamily mortgage loan refers to a mortgage loan secured by a property containing five or more residential dwelling units.

Multifamily business volume refers to the sum in any given period of the unpaid principal balance of: (1) the multifamily mortgage loans we purchase for our investment portfolio; (2) the multifamily mortgage loans we securitize into Fannie Mae MBS; and (3) credit enhancements that we provide on our multifamily mortgage assets.

Multifamily mortgage credit book of business refers to the sum of the unpaid principal balance of: (1) the multifamily mortgage loans we hold in our investment portfolio; (2) the Fannie Mae MBS and non-Fannie Mae mortgage-related

securities backed by multifamily mortgage loans we hold in our investment portfolio; (3) Fannie Mae MBS backed by multifamily mortgage loans that are held by third parties; and (4) credit enhancements that we provide on multifamily mortgage assets.

Negative-amortizing loan refers to a mortgage loan that allows the borrower to make monthly payments that are less than the interest actually accrued for the period. The unpaid interest is added to the principal balance of the loan, which increases the outstanding loan balance. Negative-amortizing loans are typically adjustable-rate mortgage loans.

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Net mortgage portfolio assets refers to the amount reported to OFHEO for purposes of computing the portfolio limit and is defined as the unpaid principal balance of our mortgage assets, net of market valuation adjustments, allowance for loan losses, impairments, and unamortized premiums and discounts, excluding consolidated mortgage-related assets acquired through the assumption of debt.

Nontraditional mortgages generally refer to mortgage products that allow borrowers to defer payment of principal and/or interest, such as interest-only mortgages, negative-amortizing mortgages, and payment option ARMs.

Notional principal amount refers to the hypothetical dollar amount in an interest rate swap transaction on which exchanged payments are based. The notional principal amount in an interest rate swap transaction generally is not paid or received by either party to the transaction and is typically significantly greater than the potential market or credit loss that could result from such transaction.

OFHEO refers to the Office of Federal Housing Enterprise Oversight, our safety and soundness regulator.

OFHEO-directed minimum capital requirement refers to a 30% capital surplus over our minimum capital requirement.

Option-adjusted spread or *OAS* refers to the incremental expected return between a security, loan or derivative contract and a benchmark yield curve (typically, U.S. Treasury securities, LIBOR and swaps, or agency debt securities). The OAS provides explicit consideration of the variability in the security's cash flows across multiple interest rate scenarios resulting from any options embedded in the security, such as prepayment options. For example, the OAS of a mortgage that can be prepaid by the homeowner without penalty is typically lower than a nominal yield spread to the same benchmark because the OAS reflects the exercise of the prepayment option by the homeowner, which lowers the expected return of the mortgage investor. In other words, OAS for mortgage loans is a risk-adjusted spread after consideration of the prepayment risk in mortgage loans. The market convention for mortgages is typically to quote their OAS to swaps. The OAS of our debt and derivative instruments are also frequently quoted to swaps. The OAS of our net mortgage assets is therefore the combination of these two spreads to swaps and is the option-adjusted spread between our assets and our funding and hedging instruments.

Outstanding Fannie Mae MBS refers to the total unpaid principal balance of Fannie Mae MBS that is held by third-party investors and held in our mortgage portfolio.

Pay-fixed, receive variable swap contract refers to an agreement under which we pay a predetermined fixed rate of interest based upon a set notional amount and receive a variable interest payment based upon a stated index, with the index resetting at regular intervals over a specified period of time. These contracts generally increase in value as interest rates rise.

Pay-fixed swaption refers to an option that allows us to enter into a pay-fixed, receive variable interest rate swap at some point in the future. These contracts generally increase in value as interest rates rise.

Private-label issuers or *non-agency issuers* refers to issuers of mortgage-related securities other than agency issuers Fannie Mae, Freddie Mac and Ginnie Mae.

Private-label securities or *non-agency securities* refers to mortgage-related securities issued by entities other than agency issuers Fannie Mae, Freddie Mac or Ginnie Mae.

Qualifying subordinated debt refers to our subordinated debt that contains an interest deferral feature that requires us to defer the payment of interest for up to five years if either: (1) our core capital is below 125% of our critical capital requirement; or (2) our core capital is below our minimum capital requirement and the U.S. Secretary of the Treasury,

acting on our request, exercises his or her discretionary authority pursuant to Section 304(c) of the Charter Act to purchase our debt obligations.

Receive-fixed swaption refers to an option that allows us to enter into a receive-fixed, pay variable interest rate swap at some point in the future. These contracts generally increase in value as interest rates fall.

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Receive-fixed, pay variable swap contract refers to an agreement under which we make a variable interest payment based upon a stated index, with the index resetting at regular intervals, and receive a predetermined fixed rate of interest based upon a set notional amount and over a specified period of time. These contracts generally increase in value as interest rates fall.

REMIC or *Real Estate Mortgage Investment Conduit* refers to a type of multi-class mortgage-related security in which interest and principal payments from mortgages or mortgage-related securities are structured into separately traded securities.

REO refers to real-estate owned by Fannie Mae, generally because we have foreclosed on the property or obtained the property through a deed in lieu of foreclosure.

Risk-based capital requirement refers to the amount of capital necessary to absorb losses throughout a hypothetical ten-year period marked by severely adverse circumstances. Refer to Item 1 Business Our Charter and Regulation of Our Activities OFHEO Regulation Capital Adequacy Requirements Statutory Risk-Based Capital Requirement for a detailed definition of our statutory risk-based capital requirement.

Secondary mortgage market refers to the financial market in which residential mortgages and mortgage-related securities are bought and sold.

Single-class Fannie Mae MBS refers to Fannie Mae MBS where the certificate holders receives principal and interest payments in proportion to their percentage ownership of the MBS issue.

Single-family mortgage loan refers to a mortgage loan secured by a property containing four or fewer residential dwelling units.

Single-family business volume refers to the sum in any given period of the unpaid principal balance of: (1) the single-family mortgage loans that we purchase for our investment portfolio; and (2) the single-family mortgage loans that we securitize into Fannie Mae MBS.

Single-family mortgage credit book of business refers to the sum of the unpaid principal balance of: (1) the single-family mortgage loans we hold in our investment portfolio; (2) the Fannie Mae MBS and non-Fannie Mae mortgage-related securities backed by single-family mortgage loans we hold in our investment portfolio; (3) Fannie Mae MBS backed by single-family mortgage loans that are held by third parties; and (4) credit enhancements that we provide on single-family mortgage assets.

Structured Fannie Mae MBS refers to multi-class Fannie Mae MBS and single-class Fannie Mae MBS that are securitizations of other single-class Fannie Mae MBS.

Subprime mortgage generally refers to a mortgage loan made to a borrower with a weaker credit profile than that of a prime borrower. As a result of the weaker credit profile, subprime borrowers have a higher likelihood of default than prime borrowers. Subprime mortgage loans are often originated by lenders specializing in this type of business, using processes unique to subprime loans. In reporting our subprime exposure, we have classified mortgage loans as subprime if the mortgage loans are originated by one of these specialty lenders or, for the original or res securitized private-label, mortgage-related securities that we hold in our portfolio, if the securities were labeled as subprime when sold.

Swaptions refers to options on interest rate swaps in the form of contracts granting an option to one party and creating a corresponding commitment from the counterparty to enter into specified interest rate swaps in the future. Swaptions

are usually traded in the over-the-counter market and not through an exchange.

Total capital refers to a statutory measure of our capital that is the sum of core capital plus the total allowance for loan losses and reserve for guaranty losses in connection with Fannie Mae MBS, less the specific loss allowance (that is, the allowance required on individually-impaired loans).

Yield curve or *shape of the yield curve* refers to a graph showing the relationship between the yields on bonds of the same credit quality with different maturities. For example, a normal or positive sloping yield curve exists when long-term bonds have higher yields than short-term bonds. A flat yield curve exists when yields are relatively the same for short-term and long-term bonds. A steep yield curve exists when yields on

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long-term bonds are significantly higher than on short-term bonds. An inverted yield curve exists when yields on long-term bonds are lower than yields on short-term bonds.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and qualitative disclosure about market risk is set forth on pages 141 through 148 of this Annual Report on Form 10-K under the caption Item 7 MD&A Risk Management Interest Rate Risk Management and Other Market Risks.

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements and notes thereto are included elsewhere in this Annual Report on Form 10-K as described below in Item 15 Exhibits and Financial Statement Schedules.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Table of Contents**Item 9A. Controls and Procedures****OVERVIEW**

This section discusses management's identification of, and efforts to remediate, material weaknesses in internal control over financial reporting over the period from December 31, 2005 to the date of this filing. It begins with an overview of remediation status of each of the material weaknesses reported as of December 31, 2005, as of December 31, 2006, and through the date of this filing. This overview is followed by a discussion of management's evaluation of disclosure controls and procedures, management's report on internal control over financial reporting, and management's progress in remediating the material weaknesses, as set forth in the table below.

As shown in the following table, a number of the material weaknesses reported as of December 31, 2005 were remediated as of December 31, 2006, while others continued to be material weaknesses at such date but have been remediated as of the date of this filing. The description of the material weaknesses identified in the table is attached as Exhibit 99.3 hereto and is incorporated by reference herein.

Material Weakness Reported as of December 31, 2005	Status as of December 31, 2006	Status as of the date of this Filing
<i>Control Environment:</i>		
Accounting Policy	Remediated	*
Enterprise-Wide Risk Oversight	Remediated	*
Internal Audit	Remediated	*
Human Resources	Remediated	*
Information Technology Policy	Remediated	*
Policies and Procedures	Remediated	*
Application of GAAP	Remediation in process	Remediation in process
<i>Financial Reporting Process:</i>		
Financial Statement Preparation and Reporting	Remediation in process	Remediation in process
Disclosure Controls	Remediation in process	Remediation in process
General Ledger Controls	Remediated	*
Journal Entry Controls	Remediation in process	Remediated
Reconciliation Controls	Remediation in process	Remediated
<i>Information Technology and Infrastructure:</i>		
Access Control	Remediation in process	Remediation in process
Change Management	Remediated	*
End User Computing	Remediated	*
Independent Model Review Process	Remediated	*
Treasury and Trading Operations	Remediated	*
Pricing and Independent Price Verification Processes		

	Pricing Controls - Remediation in process	Remediated
	Independent Price Verification Process	*
	-	
Wire Transfer Controls	Remediated	
Multifamily Lender Loan Loss Sharing Modifications	Remediated Remediation in process	* Remediation in Process

* Since remediation as of December 31, 2006 of the material weakness that existed as of December 31, 2005, these controls have continued to be effective.

In our 2005 Form 10-K, we identified 12 material weaknesses in our internal control over financial reporting as of December 31, 2005 relating to accounting policy, our enterprise-wide risk program, our internal audit program, human resources, IT policies, policies and procedures, general ledger controls, IT change management, end user computing tools, our independent model review process, treasury and trading operations, and wire transfer controls. These material weaknesses are not described below because they were remediated as of December 31, 2006. We describe the actions that we took during 2005 and 2006 to remediate

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these material weaknesses under the heading **Description of Remediation Actions** **Actions Relating to Material Weaknesses Remediated as of December 31, 2006**. This section then describes the remediation activities undertaken in 2005, 2006 and 2007 through the date of this filing with respect to material weaknesses in internal control over financial reporting that were remediated as of the date of this filing before concluding with the remaining remediation activities underway as of the date of this filing.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As required by Rule 13a-15 under the Securities Exchange Act of 1934, or the Exchange Act, management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. In addition, management has performed this same evaluation as of the date of filing this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

Management identified material weaknesses in our internal control over financial reporting, which management considers an integral component of our disclosure controls and procedures. The Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The PCAOB has revised the definition of material weakness for audits of fiscal years ending on or after November 15, 2007. The revised definition, under the PCAOB's Auditing Standard No. 5, changes the standard from more than a remote likelihood, to a reasonable possibility, that a material misstatement of annual or interim financial statements will not be prevented or detected on a timely basis. Although we use the Auditing Standard No. 2 definition of material weakness for this Item 9A, we do not expect that the revised definition would have affected management's assessment of internal control over financial reporting in this report. We have not filed periodic reports on a timely basis, as required by the rules of the SEC and the NYSE, since June 30, 2004. Our review of our accounting policies and practices in 2005 and 2006, and the restatement of our consolidated financial statements for the years ended December 31, 2003 and 2002, has resulted in an inability to timely file our Annual Reports on Form 10-K for the years ended December 31, 2004, 2005 and 2006, and our Quarterly Reports on Form 10-Q for the quarters ended September 30, 2004, March 31, 2005, June 30, 2005, September 30, 2005, March 31, 2006, June 30, 2006, September 30, 2006, March 31, 2007 and June 30, 2007. We filed our 2005 Form 10-K on May 2, 2007. As a result of these material weaknesses, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at a reasonable assurance level as of December 31, 2006 or as of the date of filing this report.

We have made progress toward achieving effectiveness at a reasonable assurance level in our internal control over financial reporting. Specifically, we have taken, and are taking, the actions described below under **Remediation Activities and Changes in Internal Control Over Financial Reporting** to remediate the material weaknesses in our internal control over financial reporting. In addition, during 2006, we made enhancements to other disclosure controls, which include:

revision and adoption of a new charter by the Disclosure Committee;

an annual review of the Disclosure Committee charter;

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clarification of authority and role of the Disclosure Committee;

formal training for Disclosure Committee members;

preparation of and maintenance of agendas for Disclosure Committee meetings;

implementation of a Disclosure Committee voting process; and

implementation of new disclosure policies and procedures covering, among other things, the relevant documents reviewed by the Disclosure Committee and the process for raising and resolving disclosure questions in a timely manner.

We continue to strive to improve our disclosure controls and procedures to enable us to provide complete and accurate public disclosure on a timely basis. Management believes that the material weakness relating to our disclosure controls will be remediated when we are able to file required reports with the SEC and the NYSE on a timely basis and we have remediated all other material weaknesses.

To address the material weaknesses described in this Item 9A, management performed additional analyses and other post-closing procedures designed to ensure that our consolidated financial statements were prepared in accordance with GAAP. These procedures included data validation and certification procedures from the source systems through the general ledger, testing and documentation of systems, validation of results, disclosure review, and pre- and post-closing analytics. As a result, management believes that the consolidated financial statements included in this report fairly present in all material respects the company's financial position, results of operations and cash flows for the periods presented.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Overview

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting, as defined in rules promulgated under the Exchange Act, is a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer and effected by our Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Internal control over financial reporting includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our Board of Directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control

over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making its assessment, management used the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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Management's assessment of our internal control over financial reporting as of December 31, 2006 identified the continuation of material weaknesses in our application of GAAP, our financial reporting process, information technology applications and infrastructure access controls, pricing controls, and multifamily lender loss sharing modifications.

Because of the material weaknesses described below, management has concluded that our internal control over financial reporting was not effective as of December 31, 2006 or as of the date of filing this report. Our independent registered public accounting firm, Deloitte & Touche LLP, has issued an audit report on management's assessment of our internal control over financial reporting, expressing an unqualified opinion on management's assessment and an adverse opinion on the effectiveness of our internal control over financial reporting as of December 31, 2006. This report is included on page 168 below.

Description of Material Weaknesses as of December 31, 2006

We identified the following material weaknesses as of December 31, 2006:

Application of GAAP

We did not maintain effective internal control over financial reporting relating to designing our process and information technology applications to comply with GAAP as specified in Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3) which affects our accounting conclusions related to loans purchased from trusts under our default call option. Although we did not have the process and information technology applications in place to comply with SOP 03-3 as of December 31, 2006, our financial statements for 2005 and 2006 appropriately reflect our adoption of SOP 03-03 for loans acquired out of trusts on or after January 1, 2005.

We did not maintain effective internal control over financial reporting relating to our accounting for certain 2006 securities sold under agreements to repurchase and certain 2006 securities purchased under agreements to resell to comply with GAAP as specified in SFAS No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125)* (SFAS 140). Our evaluation of these transactions was insufficient, and, as a result, we incorrectly recorded these 2006 transactions as purchases and sales although they did not qualify for such treatment under SFAS 140. These transactions are appropriately recorded as financings in this Annual Report on Form 10-K and do not affect prior periods as the agreements were entered into after January 1, 2006.

We have remediated all other previously reported control deficiencies relating to the design of our process and information technology applications to comply with GAAP.

Financial Reporting Process

We did not maintain an effective, timely and accurate financial reporting process. Given the pervasive nature of these material weaknesses, they could materially impact our financial statement accounts and disclosures. Specifically, we identified the following material weaknesses in our financial reporting process:

Financial Statement Preparation and Reporting

We identified errors in the processes and systems developed to prepare our financial information. Specifically, we identified design errors in these processes and systems which resulted in extensive process and system design changes as well as correcting journal entries. These errors were corrected prior to issuance of our financial statements.

However, based upon the nature and extent of these errors, our financial reporting processes and systems did not have adequate controls to ensure that they may be executed on a routine, repeatable basis.

Disclosure Controls and Procedures

We did not maintain effective disclosure controls and procedures. Specifically, we have not filed periodic reports on a timely basis as required by the rules of the SEC and the NYSE.

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Journal Entry Controls

We did not maintain effective internal control over financial reporting relating to the recording of journal entries, both recurring and non-recurring. Specifically, the design and operation of this control was inadequate for ensuring that journal entries were prepared by personnel with adequate knowledge of the activity being posted. The entries were not supported by appropriate documentation and were not reviewed at the appropriate level to ensure the accuracy and completeness of the entries recorded.

Reconciliation Controls

We did not maintain effective internal control over financial reporting relating to the reconciliation of many of our financial statement accounts and other data records that served as inputs to those accounts. Specifically, the design and operation of this control was inadequate for ensuring that our accounts were complete, accurate and in agreement with detailed supporting documentation. In addition, this control did not ensure proper review and approval of reconciliations by appropriate personnel.

Information Technology Applications and Infrastructure Access Control

We did not maintain effective internal control over financial reporting relating to the design of controls over access to financial reporting applications and data. Specifically, ineffective controls included inappropriate access to programs and data, lack of periodic review and monitoring of such access, and lack of clearly communicated policies and procedures governing information technology security and access. Furthermore, we did not maintain effective logging and monitoring of servers and databases to ensure that access was both appropriate and authorized. Given the pervasive nature of this material weakness, it could materially impact our financial statement accounts and disclosures.

Pricing Controls

We did not maintain effective internal control over financial reporting with respect to the design of our controls related to our pricing processes for securities. As a result, our accounting conclusions, including certain conclusions related to the fair value of our securities and unrealized gains and losses, could have been materially affected.

Multifamily Lender Loss Sharing Modifications

We did not maintain effective internal control over financial reporting with respect to the design of our controls related to maintaining and recording accurate multifamily lender loss sharing information in our information systems. As a result, our accounting conclusions, including certain conclusions related to consolidation, could have been materially affected.

REMEDIATION ACTIVITIES AND CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Overview

Management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, whether any changes in our internal control over financial reporting that occurred during the period from January 1, 2005 through the date of this filing have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation management conducted, substantial changes were

implemented and tested during the period from January 1, 2005 through the date of this filing to remediate our material weaknesses in internal control over financial reporting.

With respect to the remaining material weaknesses described above, we are implementing new internal controls and testing to assess their effectiveness. Management will not make a final determination that we have completed our remediation of these remaining material weaknesses until we have completed testing of our newly implemented internal controls. We currently estimate that we will not complete implementing and testing of all of these new controls until the filing of our Annual Report on Form 10-K for the year ended December 31, 2007; however, we

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anticipate that we may complete testing with respect to some of our remaining material weaknesses prior to that time. Further, we believe that we will not have remediated the material weakness relating to our disclosure controls and procedures until we are able to file required reports with the SEC and the NYSE on a timely basis. Deloitte & Touche LLP will independently assess the effectiveness of our internal control over financial reporting, but will make that assessment only in connection with its audit of our consolidated financial statements for the year ended December 31, 2007. In addition, our internal control environment will continue to be modified and enhanced in order to enable us to file periodic reports with the SEC on a current basis in the future.

Management believes the measures that we have implemented to remediate the material weaknesses in internal control over financial reporting have had a material impact on our internal control over financial reporting since December 31, 2004. Changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting are described below.

Description of Remediation Actions

Actions Relating to Material Weaknesses Remediated as of December 31, 2006

The discussion below describes the actions that management took during 2005 and 2006 to remediate material weaknesses in internal control over financial reporting that were identified as of December 31, 2005.

Control Environment

Accounting Policy

In September 2006, we completed a full assessment of all our accounting policies designed to ensure their compliance with GAAP, which required us to revise substantially all of these accounting policies. As part of this process, we engaged accounting experts to advise on our accounting policies. We currently maintain a written, comprehensive set of GAAP-compliant financial accounting policies. All of these accounting policies have been communicated to the appropriate accounting functions.

Staff in the accounting policy function works closely with each of the business units and financial reporting to facilitate accurate accounting policy interpretation and to address new or emerging accounting policy issues. Accounting standard-setting developments are actively monitored, with implementation impacts researched in coordination with the Controller's department, business unit personnel and other divisions that would be impacted. Additionally, accounting policy is actively engaged in new product and process approval designed to ensure that the correct accounting policy decisions are reached and implemented.

In addition, in order to provide a segregation of duties between those who develop our accounting policies and those who implement them, as part of our organizational redesign, reporting responsibility for the accounting policy function was moved from the Controller to the CFO. Since May 2005, we have changed leadership and significantly augmented the numbers and quality of staff in the accounting policy function.

Enterprise-Wide Risk Oversight

We completed the establishment of an enterprise-wide risk organization with oversight of credit risk, market risk, operational risk, and independent model review in 2006. In June 2006, we hired a Chief Risk Officer, and new senior officers responsible for credit risk oversight and operational risk oversight reporting to the new Chief Risk Officer. In September 2006, we also hired a senior officer responsible for market risk oversight, capital methodology and model review. We developed and communicated corporate-wide risk policies and enhanced our business unit risk

management processes. We implemented a new organizational risk structure that includes risk management personnel within each business unit. Those individuals report to business unit leadership and have responsibility for implementing the corporate-wide risk policies in their respective business units. We also enhanced Board monitoring and communication regarding credit risk and market risk through adoption of a new charter for the Risk

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Policy and Capital Committee of the Board of Directors in July 2006. The Chief Risk Officer reports independently to the Risk Policy and Capital Committee, and also reports directly to the Chief Executive Officer.

Internal Audit

In July 2005, management and the Audit Committee of the Board appointed a new Chief Audit Executive from outside the company. The Chief Audit Executive reports directly to the Audit Committee with indirect reporting to the Chief Executive Officer. The Chief Audit Executive enhanced the level of communication with the Audit Committee, which includes increased communication with the Chairman of the Audit Committee and enhanced detail within the formal reports to the Audit Committee. Additionally, the Internal Audit function completed a comprehensive review and analysis of its organizational design and audit processes, including organizational structure, staffing levels, skill assessments, audit planning, audit execution and reporting. Internal Audit has filled its key management positions and continues to reassess and enhance its staffing. The Internal Audit management team was expanded in 2006 from one officer to four, three of whom were external hires. All officers in the Internal Audit department hold one or more of the following professional credentials: certified public accountant, certified internal auditor, certified fraud examiner, certified information systems auditor or certified bank auditor. As of January 2006, Internal Audit developed and communicated a risk-based audit plan, which it reports upon regularly to the Audit Committee.

Human Resources

As part of our organizational redesign, we repositioned and redefined the role of our human resources function. In October 2006, this included implementation of a new performance assessment process, enhancement of job descriptions, and clearly communicated policies and procedures regarding human resources. We also hired additional personnel into HR functions to assist in strengthening the role of human resources within the company. Additionally, we completed a comprehensive corporate review of delegations of authority and developed and communicated a corporate-wide policy.

Information Technology Policy

We implemented an information technology standard setting board in 2005 that governs the development and communication of information technology policies, corporate technology standards and, in September 2006, implemented detailed technology operating procedures throughout the company. In addition, in November 2006, we hired a new Chief Information Officer responsible for oversight of all of our technology efforts.

Policies and Procedures

In September 2006, we implemented corporate-wide standards for policies and procedures for use throughout our business to support a uniform approach to the documentation of current policies, procedures and delegated authority in most areas of the company. Concurrent with our corporate policy and procedures initiative, each of our business units identified and corrected deficient policies and procedures documentation for processes relevant to internal control over financial reporting. As noted above, we also completed a comprehensive corporate review of delegations of authority and developed and communicated a corporate-wide policy.

Financial Reporting Process

General Ledger Controls

We implemented additional review and approval controls to manage the addition and deletion of general ledger accounts. We also strengthened supervisory review controls over account management and the periodic close process.

These controls were implemented in the second quarter of 2006.

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Information Technology Applications and Infrastructure

Change Management

We implemented additional procedures in September 2006 to control changes to all of the applications that are material to our financial reporting process. Such procedures include standard request, approval and review controls over any system or data change. Significant changes are managed through a governance committee of corporate representatives from technology and business unit management. In addition, we have implemented reconciliation or user controls designed to ensure that the desired change was implemented as intended.

End User Computing

We implemented procedures to control changes to our end user computing (EUC) applications, such as spreadsheets. These procedures included:

ongoing identification of EUCs used in all significant financial reporting processes;

protecting EUCs through maintenance on a controlled platform, implemented in August 2006, within our IT infrastructure where EUC access can be controlled using a process similar to the corporate application access provision process;

version control for a significant portion of EUCs; and

data change control for a significant portion of EUCs.

Independent Model Review Process

A corporate model policy approved in September 2005 established an independent model review process that assesses and validates on a regular basis whether the models and assumptions are reasonable for their intended use. We established an independent model review function under the Chief Risk Officer. As of December 31, 2006, we applied this process to our most critical financial models pursuant to our new independent model review process.

Treasury and Trading Operations

We redesigned our process for authorizing, approving, validating and settling trades, including segregating duties among trading, settlement and valuation activities within both our treasury and trading operations. In addition, with the assistance of an independent consulting firm, we assessed the organizational design of our treasury and trading operations, and completed changes in those functions in December 2006.

Wire Transfer Controls

We completed the implementation of redesigned controls related to our wire transfer activity in September 2006. Specifically, we implemented system changes, developed multiple department policies and created a cross functional team to develop enhancements to our wire transfer process and controls. As a result, we enhanced our access controls by segregating the wire initiation and wire system access functions, implemented a periodic access review process and strengthened our access approval procedures. Additionally, we eliminated the use of paper manual wire transfers from our standard processes and have reduced our list of inactive counterparty wire instructions in our database. Lastly, we also increased business unit staffing levels and hired an external consultant to provide best practice and industry

standards guidance.

Independent Price Verification Process

In 2006 we established an independent price verification process with appropriate segregation of duties from our pricing function. This function implemented independent validation controls to provide verification of fair value prices through comparisons with external market sources and analytical procedures for prices.

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Actions Relating to Material Weaknesses Remediated as of the Date of this Filing

The discussion below describes the actions that management took during 2005, 2006 and 2007 through the date of this filing to remediate the material weaknesses in internal control over financial reporting that were remediated as of the date of this filing.

Application of GAAP

We assessed the impact of SOP 03-3, and modified our process and information technology applications in the first quarter of 2007 to ensure the appropriate application of GAAP in accordance with the recently issued standard.

Financial Reporting Process

Journal Entry Controls

We completed implementation of enhanced processes and controls in our journal entry creation and approval process in the second quarter of 2007. The new process includes additional training on the creation of journal entries, required journal entry support and the required review and approval of journal entries. Additional controls were added to specify thresholds for journal entry approval while creating a separate function for the ongoing monitoring of journal entry generation and compliance.

Reconciliation Controls

We completed the implementation of a redesigned process in the third quarter of 2007. These process changes ensure that all of our general ledger accounts are reconciled on a timely basis. We assigned primary and supervisory account management responsibility for all of our general ledger accounts, and review this information on a quarterly basis. We have also provided detailed training on account reconciliations. Reconciliation completion, review and issue management is monitored each month to ensure compliance with our policies.

Pricing Controls

We completed improvements to our control processes for pricing securities during the third quarter of 2007 which included supervisory review over data inputs, model outputs and computational accuracy. During 2006 we also redesigned our processes for the pricing of our liabilities and derivatives to include additional supervisory review and additional controls over data inputs and model outputs.

Remediation Actions Relating to Remaining Material Weaknesses

The discussion below describes the actions that management has taken and is in the process of taking to remediate our remaining material weaknesses in internal control over financial reporting.

Application of GAAP

Although we have not yet remediated the material weakness relating to our accounting for certain securities sold under agreements to repurchase and certain securities purchased under agreements to resell to comply with GAAP as specified in SFAS 140, we are updating our procedures for the evaluation and recordation of these transactions in our accounting records to ensure that transactions are recorded appropriately under SFAS 140.

Financial Reporting Process

Financial Statement Preparation and Reporting

Although we have not yet remediated this material weakness, as of the date of this filing, we have redesigned our financial reporting processes and implemented technological changes which have resulted in generating the consolidated financial statements included in this Annual Report on Form 10-K. This redesigned process also includes requirements for appropriate review and approval of the consolidated financial statements by qualified accounting personnel.

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Further, during 2007, we continue to enhance the financial statement preparation and reporting by developing enhanced data sourcing and business processes to enable a sustainable, repeatable financial close and reporting process. We continue to identify and communicate requirements earlier, while ensuring that our systems have adequate controls and documentation prior to implementation. We have also provided detailed training on cash flow statement and disclosure preparation. Additionally, we are implementing additional analytics to facilitate a more thorough and timely review of the results of operations.

Disclosure Controls and Procedures

While we have made progress toward achieving effectiveness at a reasonable assurance level in our disclosure controls and procedures, as discussed under *Evaluation of Disclosure Controls and Procedures* above, management believes that this material weakness will not be remediated until we are able to file required reports with the SEC and the NYSE on a timely basis and have remediated all material weaknesses.

Access Controls for Information Technology Applications and Infrastructure

Although we have not yet remediated this material weakness, as of the date of this filing, we designed and implemented procedures and technology to control access to all of the applications that are within all significant financial reporting processes in August 2006. Such procedures include standard request, review and approval controls over any addition or deletion to system access. In addition, we perform regular, periodic monitoring of authorized users designed to ensure that only authorized users have access to systems and that such access is commensurate with current job responsibilities. We also implemented additional procedures to monitor our platforms and databases, with corresponding escalation and review of potential incidents.

We are further standardizing and automating the process to add or remove a user's access to applications that are material to our financial reporting process. In addition, we are improving automation of the workflow for requesting, approving, granting, revoking and reviewing access privileges on technology platforms that support applications that are material to our financial reporting process.

Multifamily Lender Loss Sharing Modifications

Although we have not yet remediated this material weakness, as of the date of this filing, we are implementing independent validation controls during 2007 to provide verification of recourse data associated with multifamily loans and deals with product characteristics and lender agreements. Further, we have redesigned our processes and controls for monitoring changes to contractual arrangements, and updating and validating such changes in our systems.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Fannie Mae
Washington, DC

We have audited management's assessment, included in the accompanying *Management's Report on Internal Control over Financial Reporting*, that Fannie Mae and consolidated entities (the Company) did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of the material weaknesses identified in management's assessment based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment:

Application of Accounting Principles Generally Accepted in the United States of America The Company did not maintain effective internal control relating to designing its process and information technology applications to comply with accounting principles generally accepted in the United States of America as specified in Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer (SOP 03-3)* which affects

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the Company's accounting conclusions related to loans purchased from trusts under the default call option.

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Additionally, the Company did not maintain effective internal control over financial reporting relating to its accounting for certain 2006 securities sold under agreements to repurchase and certain 2006 securities purchased under agreements to resell to comply with GAAP as specified in Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125) (SFAS 140)*. The Company's evaluation of these transactions was insufficient, and, as a result, the Company incorrectly recorded these 2006 transactions as purchases and sales although they did not qualify for such treatment under SFAS 140.

Financial Reporting Process The Company did not maintain an effective, timely and accurate financial reporting process, including a lack of timely and complete financial statement reviews, effective disclosure controls and procedures, and journal entry controls, and appropriate reconciliation processes. Given the pervasive nature of these material weaknesses, they could materially impact the Company's financial statement accounts and disclosures.

Information Technology Applications and Infrastructure Access Control The design of internal control was inadequate with respect to access to financial reporting applications and data. Given the pervasive nature of this material weakness, it could materially impact the Company's financial statement accounts and disclosures.

Pricing Control The design of internal control over financial reporting was inadequate with respect to the process related to the pricing process for securities. As a result, the Company's accounting conclusions, including certain conclusions related to the fair value of its securities and unrealized gains and losses, could have been materially affected.

Multifamily Lender Loan Loss Sharing Modifications The design of internal control was inadequate with respect to maintaining and recording accurate multifamily lender loss sharing information in the Company's information systems. As a result, the accounting conclusions, including certain conclusions related to consolidation, could have been materially affected.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended December 31, 2006, of the Company and this report does not affect our report on such financial statements.

In our opinion, management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2006, of the Company and our report dated August 15, 2007 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Washington, DC
August 15, 2007

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

Directors

Our current directors are listed below. They have provided the following information about their principal occupation, business experience and other matters.

Stephen B. Ashley, 67, has been Chairman and Chief Executive Officer of The Ashley Group, a group of commercial and multifamily real estate, brokerage and investment companies, since 1995. The Ashley Group is comprised of S.B. Ashley Management Corporation, S.B. Ashley Brokerage Corporation and S.B. Ashley & Associates Venture Company, LLC. From 1991 to 1995, Mr. Ashley served as Chairman and Chief Executive Officer of Sibley Mortgage Corporation, a commercial, multifamily, and single-family mortgage banking firm, and Sibley Real Estate Services, Inc. Mr. Ashley is a past President of the Mortgage Bankers Association of America and has over 40 years of experience in the real estate and real estate financing industries. Mr. Ashley also serves as a director of Manning & Napier Fund, Inc. In addition, Mr. Ashley serves as a trustee of Cornell University. Mr. Ashley has been a Fannie Mae director since May 1995 and Chairman of Fannie Mae's Board since December 2004.

Dennis R. Beresford, 68, has served as Ernst & Young Executive Professor of Accounting at the J.M. Tull School of Accounting, Terry College of Business, University of Georgia since 1997. From 1987 to 1997, Mr. Beresford served as Chairman of the Financial Accounting Standards Board, or FASB, the designated organization in the private sector for establishing standards of financial accounting and reporting in the U.S. From 1961 to 1986, Mr. Beresford was with Ernst & Young LLP, including ten years as a Senior Partner and National Director of Accounting. Mr. Beresford is a member of the Board of Directors and Chairman of the Audit Committee of Kimberly-Clark Corporation and Legg Mason, Inc. In addition, Mr. Beresford was recently appointed to the SEC Advisory Committee on Improvements to Financial Reporting. Mr. Beresford is a certified public accountant. Mr. Beresford has been a Fannie Mae director since May 2006.

Louis J. Freeh, 57, is President of Freeh Group International, LLC, a practice of former federal judges and former senior FBI leaders who provide legal, governance, investigative, litigation, and risk management services. He previously served as General Counsel, Corporate Secretary and Ethics Officer at MBNA Corporation, as well as Vice Chairman of MBNA America Bank N.A., from 2001 to January 2006. Mr. Freeh served as the Director of the FBI from 1993 to 2001 and as U.S. District Judge, Southern District of New York from 1991 to 1993. Mr. Freeh is a director of Bristol-Myers Squibb Company and L-1 Identity Solutions, Inc. Mr. Freeh has been a director since May 2007.

Brenda J. Gaines, 58, served as President and Chief Executive Officer of Diners Club North America, a subsidiary of Citigroup, from October 2002 until her retirement in April 2004. She served as President, Diners Club North America, from February 1999 to September 2002. From 1988 until her appointment as President, she held various positions within Diners Club North America, Citigroup and Citigroup's predecessor corporations. She also served as Deputy Chief of Staff for the Mayor of the City of Chicago from 1985 to 1987 and as Chicago Commissioner of Housing from 1983 to 1985. In addition, Ms. Gaines serves as a director of Office Depot, NICOR, Inc. and Tenet Healthcare Corporation. Ms. Gaines has been a Fannie Mae director since September 2006.

Karen N. Horn, Ph.D., 63, is a Senior Managing Director of Brock Capital Group LLC, an advisory and investment firm, a position she has held since 2003. She served as Managing Director, Private Client Services of Marsh Inc., a

subsidiary of Marsh & McLennan Companies, Inc., from 1999 until her retirement in 2003. She served as Senior Managing Director and Head of International Private Banking at Bankers Trust Company from 1996 to 1999, as Chairman and Chief Executive Officer, Bank One, Cleveland, from 1987 to 1996 and as President of the Federal Reserve Bank of Cleveland from 1982 to 1987. Ms. Horn is a director of Eli Lilly and Company and Simon Property Group, Inc. and a director or trustee of all T. Rowe Price funds and trusts. She also serves as a vice-chairman of the U.S. Russia Investment Fund, a presidential appointment. Ms. Horn has been a Fannie Mae director since September 2006.

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Bridget A. Macaskill, 59, is the Principal of BAM Consulting LLC, an independent financial services consulting firm, which she founded in 2003. Ms. Macaskill has been providing consulting services to the financial services industry since 2001. Ms. Macaskill previously held several positions at Oppenheimer Funds, Inc. including serving as Chairman of the Board from 2000 to 2001, Chief Executive Officer from 1995 to 2001 and President from 1991 to 2000. Ms. Macaskill is a director of Prudential plc and Scottish & Newcastle plc. She also serves on the Board of Trustees of the College Retirement Equities Fund (CREF) and the TIAA-CREF Funds. Ms. Macaskill has been a Fannie Mae director since December 2005.

Daniel H. Mudd, 48, has served as President and Chief Executive Officer of Fannie Mae since June 2005. Mr. Mudd previously served as Vice Chairman of Fannie Mae's Board of Directors and interim Chief Executive Officer, from December 2004 to June 2005, and as Vice Chairman and Chief Operating Officer from February 2000 to December 2004. Prior to his employment with Fannie Mae, Mr. Mudd was President and Chief Executive Officer of GE Capital, Japan, a diversified financial services company and a wholly-owned subsidiary of the General Electric Company, from April 1999 to February 2000. He also served as President of GE Capital, Asia Pacific, from May 1996 to June 1999. Mr. Mudd has served as a director of the Fannie Mae Foundation since March 2000, serving as Vice Chairman from September 2003 to December 2004, interim Chairman from December 2004 to June 2005, and Chairman since June 2005. Mr. Mudd serves as a director of Fortress Investment Group LLC. Until May 2007, Mr. Mudd also served as a director of Ryder System, Inc. Mr. Mudd has been a Fannie Mae director since February 2000.

Joe K. Pickett, 62, retired from HomeSide International, Inc. in 2001, where he had served as Chairman since 1996. He also served as Chief Executive Officer of HomeSide International, Inc. from 1996 to 2001. HomeSide International was the parent of HomeSide Lending, Inc., a mortgage banking company that was previously known as BancBoston Mortgage Corporation. Mr. Pickett also served as Chairman and Chief Executive Officer of HomeSide Lending from 1990 to 1999. Mr. Pickett is a past President of the Mortgage Bankers Association of America. Mr. Pickett has been a Fannie Mae director since May 1996.

Leslie Rahl, 57, is the founder of and has been President of Capital Market Risk Advisors, Inc., a financial advisory firm specializing in risk management, hedge funds and capital market strategy, since 1994. Previously, Ms. Rahl spent 19 years at Citibank, including nine years as Vice President and Division Head, Derivatives Group North America. She is currently a director of Canadian Imperial Bank of Commerce, or CIBC, the International Association of Financial Engineers and the Fischer Black Memorial Foundation. She is a former director of the International Swaps Dealers Association. Ms. Rahl has been a Fannie Mae director since February 2004.

Greg C. Smith, 55, retired in March 2006 from Ford Motor Company, or Ford, where he had served as Vice Chairman since October 2005. Mr. Smith held several positions at Ford including serving as the Executive Vice President and President, The Americas, from 2004 to 2005. He was Group Vice President of Ford and Chairman and Chief Executive Officer of Ford Motor Credit Company, or Ford Credit, an indirect, wholly-owned subsidiary of Ford, from 2002 to 2004. He also served as the Chief Operating Officer of Ford Credit from 2001 to 2002, and President, Ford Credit North America from 1997 to 2001. Mr. Smith is a former Chairman of the American Financial Services Association. Mr. Smith currently serves as a director of Penske Corp. He has been a Fannie Mae director since April 2005.

H. Patrick Swygert, 64, has been President of Howard University since 1995. He also serves as a director of Hartford Financial Services Group, Inc. and United Technologies Corporation. In addition, Mr. Swygert is a member of the Central Intelligence Agency External Advisory Board. Mr. Swygert has been a Fannie Mae director since January 2000.

John K. Wulff, 58, has been the non-executive Chairman of the Board of Hercules Incorporated, a manufacturer and supplier of specialty chemical products, since December 2003. Mr. Wulff was first elected as a director of Hercules in

July 2003, and served as interim Chairman from October 2003 to December 2003. Mr. Wulff also served as a member of the FASB from July 2001 until June 2003. From 1996 until 2001, Mr. Wulff was Chief Financial Officer of Union Carbide Corporation, a chemicals and polymers company. In addition to serving as a director of Hercules Incorporated, Mr. Wulff is a director of Sunoco, Inc., Celanese Corporation and Moody's Corporation. Mr. Wulff has been a Fannie Mae director since December 2004.

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Corporate Governance

Under the Charter Act, our Board of Directors consists of 18 directors, 5 of whom are appointed by the U.S. President. The terms of the most recent Presidential appointees to Fannie Mae's Board expired on May 25, 2004 and the President declined to reappoint or replace them. Pursuant to the Charter Act, those five Board positions will remain open unless and until the President names new appointees. There is currently one additional vacancy on our Board.

Fannie Mae's bylaws provide that each director holds office for the term to which he or she was elected or appointed and until his or her successor is chosen and qualified or until he or she dies, resigns, retires or is removed from office in accordance with the law, whichever occurs first. Under the Charter Act, each director is elected or appointed for a term ending on the date of our next stockholders' meeting.

Corporate Governance Information, Committee Charters and Codes of Conduct

Our Corporate Governance Guidelines, as well as the charters for standing Board committees, including our Board's Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee, are posted on our Web site, www.fanniemae.com, under Corporate Governance.

We have a Code of Conduct that is applicable to all officers and employees and a Code of Conduct and Conflicts of Interest Policy for Members of the Board of Directors. Our Code of Conduct also serves as the code of ethics for our Chief Executive Officer and senior financial officers required by the Sarbanes-Oxley Act of 2002 and implementing regulations of the SEC. These codes have been posted on our Web site, www.fanniemae.com, under Corporate Governance. We will make disclosures by posting on our Web site any change to or waiver from these codes for any of our executive officers or directors.

Copies of these documents also are available in print to any stockholder who requests them.

Audit Committee Membership

Our Board has a standing Audit Committee consisting of Dennis Beresford, who is the Chair, Stephen Ashley, Karen Horn, Greg Smith and John Wulff, all of whom are independent under the NYSE listing standards, Fannie Mae's Corporate Governance Guidelines and other SEC rules and regulations applicable to audit committees. The Board has determined that Mr. Beresford, Ms. Horn, Mr. Smith and Mr. Wulff have the requisite experience to qualify as audit committee financial experts under the rules and regulations of the SEC and has designated each of them as such.

Annual Certifications

The NYSE listing standards require each listed company's chief executive officer to certify annually that he or she is not aware of any violation by the company of the NYSE's corporate governance listing standards, qualifying the certification to the extent necessary. In December 2006, we submitted to the NYSE our Chief Executive Officer's certificate without qualification. With the filing of this 2006 Form 10-K, we are filing our annual consolidated financial statements for 2006 and related certifications by our Chief Executive Officer and Chief Financial Officer required by the Sarbanes-Oxley Act of 2002.

Executive Sessions

Our non-management directors meet regularly in executive session without management present. Time for an executive session is reserved at every regularly scheduled Board meeting. The non-executive Chairman of the Board, Mr. Ashley, typically presides over these sessions.

Communications with Directors

Interested parties wishing to communicate any concerns or questions about us to the non-executive Chairman of the Board or to our non-management directors as a group may do so by electronic mail addressed to board@fanniemae.com, or by U.S. mail addressed to Fannie Mae Directors, c/o Office of the Corporate

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Secretary, Fannie Mae, Mail Stop 1H-2S/05, 3900 Wisconsin Avenue NW, Washington, DC 20016-2892. Communications may be addressed to a specific director or directors, including Mr. Ashley, the Chairman of the Board, or to groups of directors, such as the independent or non-management directors.

The Office of the Corporate Secretary is responsible for processing all communications received through these procedures and for forwarding communications as appropriate.

Any stockholder who wishes to submit a candidate for director for consideration by the Nominating and Corporate Governance Committee should submit a written notice to Fannie Mae Director Nominees, c/o Office of the Corporate Secretary, Fannie Mae, Mail Stop 1H-2S/05, 3900 Wisconsin Avenue, NW, Washington, DC 20016-2892.

Executive Officers

Our current executive officers who are not also members of the Board of Directors are listed below. They have provided the following information about their principal occupation, business experience and other matters.

Kenneth J. Bacon, 52, has been Executive Vice President Housing and Community Development since July 2005. He was interim head of Housing and Community Development from January 2005 to July 2005. He was Senior Vice President Multifamily Lending and Investment from May 2000 to January 2005, and Senior Vice President American Communities Fund from October 1999 to May 2000. From August 1998 to October 1999 he was Senior Vice President of the Community Development Capital Corporation. He was Senior Vice President of Fannie Mae's Northeastern Regional Office in Philadelphia from May 1993 to August 1998. Mr. Bacon has served as a director of the Fannie Mae Foundation since January 1995 and as Vice Chairman since January 2005. Mr. Bacon is also a director of Comcast Corporation, Corporation for Supportive Housing and Maret School. He is a member of the Executive Leadership Council and the Real Estate Round Table.

Robert T. Blakely, 65, has been Executive Vice President and Chief Financial Officer since January 2006. Prior to joining Fannie Mae, Mr. Blakely was Executive Vice President, Chief Financial Officer and Chief Accounting Officer of MCI, Inc. since April 2005, and Executive Vice President and Chief Financial Officer of MCI from April 2003 to April 2005. Prior to that date, he was President of Performance Enhancement Group, Inc., a business development services firm, from July 2002 to April 2003, Executive Vice President and Chief Financial Officer of Lyondell Chemical Company from November 1999 to June 2002, and Executive Vice President of Tenneco, Inc. from 1996 to November 1999 and Chief Financial Officer from 1981 to November 1999. Mr. Blakely is also a Trustee of the Financial Accounting Foundation, which oversees the FASB. Mr. Blakely is a director of Natural Resources Partners L.P. and Westlake Chemicals Corporation. Mr. Blakely joined Fannie Mae in January 2006. Mr. Blakely has advised us of his intention to step down as Fannie Mae's Chief Financial Officer during 2007 following a transition period. Information about Fannie Mae's Chief Financial Officer Designate, Stephen M. Swad, appears below.

Enrico Dallavecchia, 45, has been Executive Vice President and Chief Risk Officer since June 2006. Prior to joining Fannie Mae, Mr. Dallavecchia was with JP Morgan Chase, where he served as Head of Market Risk for Retail Financial Services, Chief Investment Office and Asset Wealth Management from April 2005 to May 2006 and as Market Risk Officer for Global Treasury, Retail Financial Services, Credit Cards and Proprietary Positioning Division and Co-head of Market Risk Technology, the group responsible for developing, implementing and maintaining the firm-wide market risk measurement systems, from December 1998 to March 2005.

Linda K. Knight, 57, has been Executive Vice President Enterprise Operations since April 2007. Prior to her present appointment, Ms. Knight served as Executive Vice President Capital Markets from March 2006 to April 2007. Before that, Ms. Knight served as Senior Vice President and Treasurer from February 1993 to March 2006, and Vice President and Assistant Treasurer from November 1986 to February 1993. Ms. Knight held the position of Director,

Treasurer's Office from November 1984 to November 1986. Ms. Knight joined Fannie Mae in August 1982 as a senior market analyst.

Robert J. Levin, 51, has been Executive Vice President and Chief Business Officer since November 2005. Mr. Levin was Fannie Mae's interim Chief Financial Officer from December 2004 to January 2006. Prior to

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that position, Mr. Levin was the Executive Vice President of Housing and Community Development from June 1998 to December 2004. From June 1990 to June 1998, he was Executive Vice President Marketing. Mr. Levin has previously served as a director and as treasurer of the Fannie Mae Foundation. Mr. Levin joined Fannie Mae in 1981.

Thomas A. Lund, 48, has been Executive Vice President Single-Family Mortgage Business since July 2005. He was interim head of Single-Family Mortgage Business from January 2005 to July 2005 and Senior Vice President Chief Acquisitions Office from January 2004 to January 2005. Mr. Lund served as Senior Vice President Investor Channel from August 2000 to January 2004; Senior Vice President Southwestern Regional Office, Dallas, Texas from July 1996 to July 2000; and Vice President for marketing from January 1995 to July 1996.

Rahul N. Merchant, 51, has been Executive Vice President and Chief Information Officer since November 2006. Prior to joining Fannie Mae, Mr. Merchant was with Merrill Lynch & Co., where he served as Head of Technology from 2004 to 2006 and as Head of Global Business Technology for Merrill Lynch's Global Markets and Investment Banking division from 2000 to 2004. Before joining Merrill, he served as Executive Vice President at Dresdner, Kleinwort and Benson, a global investment bank, from 1998 to 2000. He also previously served as Senior Vice President at Sanwa Financial Products and First Vice President at Lehman Brothers, Inc. Mr. Merchant serves on the board of advisors of the American India Foundation.

Peter S. Niculescu, 47, has been Executive Vice President Capital Markets (previously Mortgage Portfolio) since November 2002. Mr. Niculescu joined Fannie Mae in March 1999 as Senior Vice President Portfolio Strategy and served in that position until November 2002.

William B. Senhauser, 44, has been Senior Vice President and Chief Compliance Officer since December 2005. Prior to his present appointment, Mr. Senhauser was Vice President for Regulatory Agreements and Restatement from October 2004 to December 2005 and Vice President for Operating Initiatives from January 2003 to September 2004. Mr. Senhauser joined Fannie Mae in 2000 as Vice President for Fair Lending.

Stephen M. Swad, 46, has been serving as our Executive Vice President and Chief Financial Officer Designate since May 2007. We expect Mr. Swad to become the Chief Financial Officer when Mr. Blakely steps down from that role. As Chief Financial Officer, Mr. Swad will be Fannie Mae's principal financial officer. Mr. Swad was previously Executive Vice President and Chief Financial Officer at AOL, LLC, from February 2003 to February 2007. Before joining AOL, Mr. Swad served as Executive Vice President of Finance and Administration at Turner Broadcasting System Inc.'s Turner Entertainment Group, from April 2002 to February 2003. From 1998 through 2002, he was with Time Warner, where he served in various corporate finance roles. Prior to that Mr. Swad was a partner in KPMG's national office and also worked as the Deputy Chief Accountant at the Securities and Exchange Commission.

Beth A. Wilkinson, 44, has been Executive Vice President General Counsel and Corporate Secretary since February 2006. Prior to joining Fannie Mae, Ms. Wilkinson was a partner and co-chair, White Collar Practice Group for Latham & Watkins LLP, from 1998 to 2006. Before joining Latham, she served as a prosecutor and special counsel for *U.S. v. McVeigh and Nichols* from 1996 to 1998. During her tenure at the Department of Justice, Ms. Wilkinson was appointed principal deputy of the Terrorism & Violent Crime Section in 1995, and served as Special Counsel to the Deputy Attorney General from 1995 to 1996. Ms. Wilkinson also served as an Assistant U.S. Attorney in the Eastern District of New York from 1991 to 1995. Prior to that time, Ms. Wilkinson was a Captain in the U.S. Army serving as an assistant to the general counsel of the Army for Intelligence & Special Operations from 1987 to 1991.

Michael J. Williams, 49, has been Executive Vice President and Chief Operating Officer since November 2005. Mr. Williams was Fannie Mae's Executive Vice President for Regulatory Agreements and Restatement from February 2005 to November 2005. Mr. Williams also served as President Fannie Mae eBusiness from July 2000 to February 2005 and as Senior Vice President e-commerce from July 1999 to July 2000. Prior to this, Mr. Williams served in

various roles in the Single-Family and Corporate Information Systems divisions of the company. Mr. Williams joined Fannie Mae in 1991.

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Under our bylaws, each executive officer holds office until his or her successor is chosen and qualified or until he or she resigns, retires or is removed from office.

Section 16(a) Beneficial Ownership Reporting Compliance

Our directors and officers file with the SEC reports on their ownership of our stock and on changes in their stock ownership. Based on a review of forms filed during 2006 or with respect to 2006 and on written representations from our directors and officers, we believe that all of our directors and officers filed all required reports and reported all transactions reportable during 2006, except that Julie St. John, our former Chief Information Officer, reported one transaction late.

Item 11. Executive Compensation

Compensation Discussion and Analysis

This section discusses the principles underlying our compensation policies and decisions relating to our Chief Executive Officer, our Chief Financial Officer and our Chief Business Officer, who served as our Chief Financial Officer during part of 2006, and our next four most highly compensated executive officers during 2006. We refer to these individuals below as the named executives. For 2006, our named executives were:

Daniel Mudd, President and Chief Executive Officer

Robert Blakely, Executive Vice President and Chief Financial Officer

Robert Levin, Executive Vice President and Chief Business Officer

Peter Niculescu, Executive Vice President Capital Markets

Beth Wilkinson, Executive Vice President, General Counsel and Corporate Secretary

Michael Williams, Executive Vice President and Chief Operating Officer

Julie St. John, former Executive Vice President and Chief Information Officer.

What are the goals of our compensation program?

Our compensation philosophy provides that our compensation program should attract, retain, and reward the skilled talent needed to successfully manage a leading financial services company. Compensation must also be consistent with our charter, which requires that compensation be reasonable and comparable with the compensation of executives performing similar duties in similar businesses.

Consistent with our compensation philosophy and our charter, our compensation program is designed to:

drive a pay for performance perspective that rewards company and individual performance, while supporting our mission to help more families achieve homeownership;

promote a long-term focus and align management's and shareholders' interests by providing a greater portion of compensation that is stock-based for more senior members of management;

foster compliance with legal and regulatory requirements; and

provide compensation that is straightforward and easy to understand.

Our company goals for our cash bonuses under our annual incentive plan for 2006 are set forth below under *How did we determine the amount of each element of 2006 cash and stock compensation?*

How does comparability factor into our executive compensation decisions?

Both our charter and our compensation philosophy require that we consider comparability in setting executive compensation. We determine comparability by reviewing executive compensation practices of a group of high-quality, diversified financial services companies, which we refer to as our comparator group. Among this group, our earning assets are substantially larger than the median, but in many cases our operations are less

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diverse. These companies have pay practices similar to ours and we compete with them for executive talent. The members of the comparator group are initially selected by management with the assistance of its outside executive compensation consultant, Johnson Associates, Inc. The composition of the comparator group is then reviewed with the Compensation Committee. In 2006, we used the same comparator group as we did in 2005.

The members of our comparator group for 2006 were:

Allstate	American Express	American International Group
Bank of America	Capital One	CitiGroup
Countrywide	Freddie Mac	JP Morgan Chase
MetLife	National City	Prudential
SunTrust Banks	U.S. Bancorp	Wachovia
Washington Mutual	Wells Fargo	

For 2006 compensation, we used as a guideline the median, or 50th percentile, of the total of salary, bonus and equity compensation paid at companies in our comparator group. In determining an executive's compensation, the Compensation Committee and Board were free to vary above or below the median if they determined it was appropriate as a result of factors such as the experience and expertise of the executive, our need for specific skill sets, and the executive's performance. For particular positions, data from companies outside our comparator group were used to provide a broader perspective and ensure that we had a comprehensive view of the market for executives with certain specific skills or experience.

How do we use outside executive compensation consultants?

Management receives advice on executive compensation matters from the executive compensation consulting firm of Johnson Associates, Inc. Johnson Associates provides no other services to Fannie Mae.

The Board of Directors retains the executive compensation consulting firm of Semler Brossy Consulting Group to provide independent executive and board compensation information and advice. Semler Brossy provides no other services to Fannie Mae.

What were the elements of compensation for our named executives for 2006, and why did we pay those elements?

Compensation for our named executives for 2006 consisted of salaries, cash incentive bonuses, long-term incentive awards, employee benefits and perquisites. We provided this compensation mix in order to maintain a competitive compensation program and to reinforce our corporate objectives. Salary was paid on a bi-weekly basis throughout the year, while annual bonuses and long-term incentive awards relating to 2006 performance were paid or granted in January 2007.

Salary, Bonuses, and Long-Term Incentive Awards.

Salary is the basic cash compensation for the executive's performance of his or her job responsibilities. It is intended to reflect the executive's level of responsibility and individual performance over time.

Annual incentive cash bonuses reward executives based on a combination of corporate and individual performance during the year measured against pre-established corporate goals and individual goals designed to align with the corporate goals. We also use sign-on bonuses or guaranteed first-year bonus minimums from time to time to recruit executives with critical skills.

Long-term incentive awards are stock-based awards that vest over a period of years. For 2006 performance, these awards were delivered in the form of restricted stock or restricted stock units with a four-year vesting schedule. We believe that providing a significant portion of senior management compensation through long-term incentive awards based on our common stock and with a multi-year vesting schedule aligns the long-term interests of our senior management with those of our other shareholders, reinforcing a shared interest in company performance. Long-term incentive awards may also be used as sign-on bonuses to recruit executives.

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Employee Benefits.

Our employee benefits are a fundamental part of our compensation program and serve as an important tool in recruiting and retaining executives.

Pension Benefits. Our named executives participate in our Executive Pension Plan. This plan is a non-qualified, defined benefit plan that supplements the pension benefits payable to the named executive under our tax-qualified pension plan, which is the Retirement Plan discussed below under Pension Benefits Fannie Mae Retirement Plan. The annual pension benefit (when combined with our Retirement Plan) for our executive vice presidents equals 40%, and for our chief executive officer equals 50%, of the executive's highest average covered compensation earned during any 36 consecutive months within the last 120 months of employment. Covered compensation under the plan is limited to 150% of base salary for our executive vice presidents and 200% of base salary for our chief executive officer.

A named executive is not entitled to receive a pension benefit under the Executive Pension Plan until the executive has completed five years of service as a plan participant, at which point the pension benefit becomes 50% vested and continues vesting at the rate of 10% per year during the next five years. We consider the Executive Pension Plan an important component of our executives' total compensation and believe requiring ten years of service as a participant before full vesting serves as a significant retention tool. Our Executive Pension Plan is discussed in more detail below under Pension Benefits.

Other Employee Benefits and Plans. In general, named executives are eligible for the employee benefits available to our employee population as a whole, including our medical insurance plans, our 401(k) plan, and our matching gifts program. Named executives also are eligible to participate in programs we make available only to management employees at varying levels, including our elective deferred compensation plan.

Severance benefits. Our chief executive officer and our chief business officer are entitled to receive severance benefits under agreements we entered into with them. During 2006, our named executives other than Mr. Mudd were eligible to receive severance benefits under certain circumstances pursuant to a severance program no longer available to them. See Potential Payments Upon Termination or Change-in-Control.

Perquisites.

In 2006, we provided our named executives relatively limited perquisites not available to our general employee population, based primarily on business needs. We also provided perquisites to the extent appropriate and reasonable for retaining and attracting executives. These perquisites, and recent changes we have made to eliminate or require reimbursement of certain perquisites, are discussed below under *How and why have we changed our policy on perquisites?*

How do we look at total compensation for 2006?

The following chart shows information about the salary, bonuses, and long-term incentive awards that were paid or granted for 2006.

Compensation Paid or Granted for 2006

2006 Long-Term	Total of Base Salary,
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Named Executive⁽¹⁾	Base Salary as of 12/31/06	2006 Bonus (Paid in 2007)	Incentive Award (Granted in 2007)⁽²⁾	Bonus, Long-Term Incentive Award
Daniel Mudd	\$ 950,000	\$ 3,500,000	\$ 9,999,947	\$ 14,449,947
Robert Blakely	650,000	1,290,575	3,299,361	5,239,936
Robert Levin	750,000	2,087,250	6,667,104	9,504,354
Peter Niculescu	539,977	1,029,060	2,839,945	4,408,982
Beth Wilkinson	575,000	1,947,988 ⁽³⁾	2,770,316	5,293,304
Michael Williams	650,000	1,630,200	5,247,443	7,527,643

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- (1) This table reflects compensation decisions made for our named executives who were still employed by Fannie Mae in January 2007. Ms. St. John entered into a separation agreement with us in July 2006, and she retired from Fannie Mae in December 2006. Information regarding Ms. St. John's 2006 compensation appears below in the Summary Compensation Table.
- (2) These awards consist of restricted stock or restricted stock units. The dollar amounts are based on the average of the high and low trading prices of our common stock of \$56.66 on January 25, 2007, the date of grant. Mr. Mudd is required to hold one-fifth of his grant (net of shares withheld to pay withholding taxes) until his employment with Fannie Mae is terminated. This is in addition to Mr. Mudd's obligation to hold shares under Fannie Mae's stock ownership guidelines.
- (3) Includes a sign-on bonus of \$800,000 paid in 2006 to Ms. Wilkinson when she joined us.

How did we determine the amount of each element of 2006 cash and stock compensation?

Overview of the Process for Determining Compensation. The Board (or, in the case of Mr. Mudd, the independent members of the Board), based on the recommendations of the Compensation Committee, determines compensation for our named executives. In making recommendations to the Board for 2006 compensation, the Compensation Committee considered our chief executive officer's assessment of our other named executives' performance and his compensation recommendation for these executives. In making a recommendation to the Board for Mr. Mudd, the Compensation Committee considered an assessment of his performance by the Chairman of our Board, Mr. Mudd's self-evaluation, and the results of a 360-degree survey of his leadership qualities. In making decisions and recommendations, the Compensation Committee also considered the market data provided by the compensation consultants for management and the Board, the importance of each executive's role in the company, competition for individuals with the experience and skill sets of each executive and related market factors, retention considerations, and the executive's experience and contributions to the company as a whole during the preceding year. In addition, the Compensation Committee considered the entire compensation package for each named executive, taking into account through review of a summary sheet the named executive's outstanding stock options, restricted shares, and performance share balances; existing severance arrangements with the executive, if any; and other benefits (such as life insurance, pension plan participation and health benefits) available to the executive.

Determination of Salaries, Bonus and Long-Term Incentive Awards.

Salaries. The Board established salaries for Mr. Mudd, Mr. Williams, and Mr. Levin in November 2005 in connection with their appointments to their current positions. None of these three named executives received any increase in salary for 2006. Salaries for Mr. Blakely and Ms. Wilkinson were determined by the Board in connection with their hires. Mr. Niculescu's and Ms. St. John's salaries were increased based on their performance, our company-wide budget for salary increases, and market-based information regarding compensation paid for executives with similar roles and responsibilities.

Annual Incentive Plan Cash Bonuses. The amount of an annual incentive plan cash bonus paid to a named executive depends on the company's and the named executive's performance measured against pre-established corporate and individual performance goals. During 2006, we engaged in a significant restatement of prior period financial statements and made an extensive effort to comply with the terms of our agreement with OFHEO and to address a number of operational, policy and infrastructure issues. As a result of the need to restate prior period financial statements, we had no reliable GAAP-compliant financial statements for recent periods. In light of these circumstances, our Board established the following set of performance goals, which focused on successfully operating the business while undertaking significant initiatives to address our financial reporting and compliance

issues:

Regulation and Restatement: Stabilize the company by (a) building strong and productive relationships with regulators; (b) restating prior period financial statements; (c) managing capital surplus; and (d) building relationships with investors;

Business Results: Optimize the company's business model and generate shareholder value through key initiatives;

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Mission Results: Fulfill Fannie Mae's affordable housing mission goals by increasing liquidity to make U.S. housing more affordable and making an impact in highly disadvantaged communities;

Operations and Controls: Instill operational discipline into all functions, resulting in stronger processes, reduced risk, and compliance with Sarbanes-Oxley requirements; and

Customers and Employees: Renew the company's culture to achieve the company's objectives by (a) demonstrating service, engagement, accountability, and good management; (b) reenergizing diversity programs; and (c) renewing our people strategy.

Achievement of these corporate performance goals affected cash bonuses for management-level employees throughout Fannie Mae, except for employees in our internal audit and compliance and ethics departments. These employees' bonuses were subject to the achievement of goals tailored to their departments' unique roles.

In conjunction with the establishment of corporate performance goals, in April 2006 the Compensation Committee approved individual bonus award targets for each named executive. Award targets for Mr. Mudd, Mr. Williams, and Mr. Levin were unchanged from those set in November 2005. The potential bonus that could have been paid to each named executive at the target level of achievement against the corporate and individual goals for 2006 is shown in the Grants of Plan-Based Awards table below. Payment significantly above target would occur only in a year in which both the company and the individual performed exceptionally well against goals.

In 2006, management provided the Compensation Committee with a mid-year update on progress against the corporate performance goals. In January 2007, the Compensation Committee, with input from other Board committees, evaluated corporate performance against the corporate performance goals and determined that corporate performance for 2006 was at 110% of target.

For 2006, the Compensation Committee considered that Fannie Mae, among other achievements, made progress toward our stability goal by resolving outstanding investigations by governmental agencies; achieved our restatement goal by filing our 2004 Form 10-K and restating prior period financials; successfully launched several major strategic business initiatives; restructured several business functions, including technology and operations, to improve efficiency and generate cost savings; made progress on building out controls and instilling operational discipline; and met our housing goals in a difficult environment. While the Compensation Committee assesses each goal separately, it does not follow a pre-established formula for assigning a weight to the corporate performance goals.

The Board (and, in the case of Mr. Mudd, the independent members of the Board) then determined, based on the recommendation of the Compensation Committee, the individual bonus amounts for each named executive based on the officer's individual performance. These amounts are shown in the Summary Compensation Table below.

Long-Term Incentive Awards. Our compensation philosophy generally results in a greater portion of our named executives' compensation being stock-based than at companies in our comparator group. For 2006 performance, the Board and the Compensation Committee determined that, in light of Fannie Mae's not being a current filer, long-term incentive awards would be in the form of restricted shares of Fannie Mae common stock or restricted stock units. In January 2007, the Board and the Compensation Committee approved awards with the values shown above in the table titled Compensation Paid or Granted for 2006. These awards vest in four equal annual installments beginning in January 2008.

Is there any regulatory oversight of our compensation process?

Yes, our regulator, OFHEO, has a role in the compensation of our named executives and certain other officers identified by OFHEO. As long as the Fannie Mae Capital Restoration Plan is in effect, we must obtain OFHEO approval for non-salary compensation actions that relate to this group of executives. In addition, OFHEO must approve any termination benefits we wish to offer to this group of executives. We also notify OFHEO of all compensation programs intended primarily for executives.

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What are our practices for determining when we grant equity awards?

All restricted stock or restricted stock unit grants to senior executives, including the named executives, are granted on the date of approval by the Board or Compensation Committee or, if later, on the date the executive commences employment with us, with one exception. In February 2006, the Board granted senior executives restricted stock and restricted stock unit awards in dollar-denominated amounts, with the number of shares to be determined by dividing the dollar amounts by the trading price of Fannie Mae's common stock. The Board deferred the determination of how many shares of restricted stock each executive would receive until after the filing of our next Form 12b-25. That ensured that the results of the review of Fannie Mae by Paul, Weiss, Rifkind, Wharton & Garrison LLP would be publicly available prior to the determination date. The deferral of the grant date was structured to result in executives receiving whichever number of shares was lower—the number determined using the trading price at the time of the grant approval or the number determined using the trading price after the results of the Paul, Weiss report were made public. Stock awards to employees below the level of senior vice president are allocated by the chief executive officer pursuant to a delegation from the Compensation Committee. We are not currently granting stock options to employees and do not expect to grant options before we become a current filer.

What are our stock ownership requirements?

We encourage our directors, officers and employees to own our stock in order to align their interests with the interests of shareholders. Our chief executive officer is required to hold shares of Fannie Mae common stock with a value equal to five times his base salary. In addition, our chief executive officer's long-term incentive award for 2006 included a separate stock ownership requirement described above in footnote 2 to the Compensation Paid or Granted for 2006 table. Our other named executives are required to hold Fannie Mae common stock with a value equal to two times base salary. Senior executives have three years from the time of appointment to reach the expected ownership level. In addition to our stock ownership requirements, our officers are prohibited from purchasing and selling derivative securities related to Fannie Mae equity securities, including warrants, puts and calls, or from dealing in any derivative securities other than pursuant to our stock-based benefit plans.

How and why have we changed our policy on perquisites?

Perquisites represent a very small portion of the overall compensation package for our named executives. During 2006, Fannie Mae provided the named executives with perquisites that included a financial counseling benefit, personal use of certain of Fannie Mae's cars and drivers, excess personal liability insurance, annual physical exams, executive life insurance, airline club memberships, and dining services, as well as tax gross-ups related to the excess personal liability and life insurance benefit. In addition, all members of our Board of Directors, including Mr. Mudd, participated in the Director's Charitable Award program.

Our policy provides that perquisites should be based on business needs, and that existing perquisites should be evaluated from time to time and eliminated if no longer appropriate. Consistent with this policy, in February 2007 the following perquisites were eliminated:

reimbursement for financial counseling effective July 1, 2007;

use of company transportation for any non-business purpose without reimbursement effective January 1, 2007;

personal use of company-owned memberships at country clubs effective January 1, 2008;

excess liability insurance effective January 1, 2008 for all officers and March 1, 2007 for any person who became an officer on or after that date; and

the tax gross-up to cover taxes due on any excess liability insurance or life insurance provided by Fannie Mae to officers effective January 1, 2008.

Table of Contents***What decisions have we made with regard to our Performance Share Program?***

Prior to 2005, we had a practice of granting awards under our performance share program, or PSP. These awards entitled executives to receive shares of common stock based upon our meeting corporate financial and qualitative performance objectives over three-year periods, or performance cycles. In early 2005, in light of our need to restate our financial results and our lack of current financial statements, our Board determined that it was not appropriate at that time to begin a new performance cycle under the PSP. For similar reasons, the Board did not begin a new performance cycle in 2006 and has not begun a new performance cycle in 2007.

Under our PSP, in January of each year the Compensation Committee generally determined our achievement of corporate performance objectives measured against the goals for the three-year performance cycle that ended in the prior year. The level of achievement determined the payout of the performance shares and the shares were paid out to executives in two annual installments. As of early 2005, we had paid the first installment, but not the second installment, of PSP awards for the 2001-2003 performance cycle. For the reasons stated above, the Board determined in early 2005 to defer the payout of the second installment of the 2001-2003 performance cycle and to defer the determination of the 2002-2004 performance cycle.

After we restated our prior period financial statements and completed our 2004 financial statements, on February 15, 2007, our Board reviewed qualitative and quantitative analyses of our performance from 2001 to 2004. Based on these assessments, our Board determined (1) that the first installment of shares that was paid in January 2004 exceeded the amount due for the 2001-2003 performance cycle, (2) that the unpaid second installment of the award for the 2001-2003 performance cycle should not be paid, and (3) not to make any payouts under the 2002-2004 performance cycle.

On June 15, 2007, our Board reviewed available quantitative and qualitative analyses of our performance from 2003 to 2006. Based on its review, the Board decided to pay awards for the 2003-2005 performance cycle at 40% of the original target award and decided to pay awards for the 2004-2006 performance cycle at 47.5% of the original target award. The highest level at which awards for these two cycles could have been paid if performance met or exceeded the maximum objectives was 150% of the original target award. These payouts reflected the Board's determination that our performance during these cycles with respect to the financial goals did not meet threshold performance levels and our performance during these cycles with respect to the qualitative goals was between the threshold and target performance levels. Payment of these awards to our named executives and certain other officers designated by OFHEO is subject to approval of OFHEO. The table below shows the number of shares of common stock to which each named executive who was employed by Fannie Mae as of December 31, 2006 is entitled based on the Board's determination.

Performance Share Program Payouts for 2003-2005 and 2004-2006 Cycles

Named Executive ⁽¹⁾	2003 to 2005 Performance		2004 to 2006	
	Shares (#)	Value (\$) ⁽²⁾	Performance Cycle	
			Shares (#)	Value (\$) ⁽²⁾
Daniel Mudd	11,438	\$ 786,363	15,960	\$ 1,097,250
Robert Blakely ⁽³⁾				
Robert Levin	9,994	687,088	15,184	1,043,900
Peter Niculescu	6,238	428,863	8,968	616,550
Beth Wilkinson ⁽³⁾				

Michael Williams	8,806	605,413	11,150	766,563
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- (1) Information regarding performance share program awards held by Ms. St. John is set forth below in the Outstanding Equity Awards at Fiscal Year-End table.
- (2) The value of the shares is based on the closing price of our common stock of \$68.75 on June 15, 2007, the date of the Board's determination.
- (3) Mr. Blakely and Ms. Wilkinson did not receive awards under the performance share program because they joined Fannie Mae in 2006.

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What is our compensation recoupment policy?

Under our May 23, 2006 consent order with OFHEO, we have agreed that any new employment contracts with named executives will include an escrow of certain payments if OFHEO or any other agency has communicated allegations of misconduct concerning the named executive's official duties at Fannie Mae and OFHEO has directed Fannie Mae to escrow such funds. In addition, we have agreed to include appropriate provisions in new employment agreements to address terminations for cause and recovery of compensation paid to executives where there are proven allegations of misconduct. All future employment agreements with named executives will contain these provisions.

What written agreements do we have with our named executives that provide for continued employment?

On November 15, 2005, we entered into an employment agreement with Mr. Mudd, effective June 1, 2005 when he was appointed our president and chief executive officer. We entered into a letter agreement with Mr. Levin, dated June 19, 1990, that provides for severance in connection with a termination without cause. The severance benefits provided under these agreements are described below under Potential Payments Upon Termination or Change-in-Control.

Report of the Compensation Committee of the Board of Directors:

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis included in this Form 10-K with management and, based on the review and discussions, the Compensation Committee has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Form 10-K.

Compensation Committee:

Bridget A. Macaskill, Chair

Stephen B. Ashley

Dennis R. Beresford (committee member from May 2006 to July 2007)

Louis J. Freeh (committee member since May 2007)

Brenda J. Gaines

Greg C. Smith

Table of Contents**Summary Compensation Table for 2006**

The following table shows summary compensation information for the named executives for 2006.

Named Principal	Year	Salary (\$) ⁽¹⁾	Bonus (\$) ⁽²⁾	Stock Awards (\$) ⁽³⁾	Option Awards (\$) ⁽⁴⁾	Non-Equity Incentive Plan Compensation (\$) ⁽²⁾	Change in Pension Value and Nonqualified Compensation	All Other Compensation (\$) ⁽⁶⁾	Total Compensation (\$) ⁽⁷⁾
							Deferred Compensation Earnings (\$) ⁽⁵⁾		
Richard L. Addington President and Chief Executive Officer	2006	\$ 950,000		\$ 4,799,057	\$ 962,112	\$ 3,500,000	\$ 932,958	\$ 136,072	\$ 11,180,198
Robert J. Bakely Vice President and Chief Executive Officer	2006	587,500	\$ 926,250	3,898,589		364,325	209,087	140,480	6,726,151
John W. Bin Vice President and Chief Executive Officer	2006	750,000		2,477,097	883,442	2,087,250	307,078	70,710	6,475,577
John P. Blescu Vice President and Chief Executive Officer	2006	538,188		1,388,328	533,816	1,029,060	232,562	39,906	3,728,890
William H. Brinson Vice President and General Secretary	2006	490,961	1,748,750	396,712		199,238	198,413	35,578	3,873,642
William J. Williams Vice President and Chief Executive Officer	2006	650,000		1,808,182	701,446	1,630,200	371,753	69,482	5,170,663
John A. Johnson ⁽⁷⁾ Executive Vice President and Chief Executive Officer	2006	536,618		1,514,019	744,008		936,773	1,841,777	5,032,195

- (1) Mr. Mudd is entitled to a minimum base salary of \$950,000 under his employment agreement. Salary for Mr. Blakely includes \$275,000 he elected to defer to later years.
- (2) Except as otherwise noted, amounts reported in the Bonus column do not include amounts earned under our annual incentive plan, which are shown in the Non-Equity Incentive Plan Compensation column. In 2007, Mr. Blakely was awarded a total bonus of \$1,290,575 under our annual incentive plan, which he deferred to later years. Of this amount, we guaranteed him in connection with his joining Fannie Mae a minimum bonus of \$926,250 for 2006, which we have reported in the Bonus column. Ms. Wilkinson was awarded a total bonus of \$1,147,988 under our annual incentive plan for 2007. Of this amount, Ms. Wilkinson was guaranteed to receive \$948,750 in connection with her joining Fannie Mae. We have reported the guaranteed amount, along with an \$800,000 sign-on bonus Ms. Wilkinson received, in the Bonus column.
- (3) These amounts represent the dollar amounts we recognized for financial statement reporting purposes with respect to 2006 for the fair value of restricted stock, restricted stock units and performance shares granted during 2006 and in prior years in accordance with SFAS 123R. As required by SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions and do not reflect the impact of Ms. St. John's actual forfeiture of 27,931 shares of restricted stock and performance shares upon her departure from Fannie Mae in December 2006. As a result of the Board's decision to pay out awards at 40% for the 2003-2005 performance cycle and at 47.5% for the 2004-2006 performance cycle, we reversed expenses we previously recorded based on our estimate that awards would be paid out at 50%. To the extent these expenses were recorded prior to 2006, the amounts above do not reflect the reversal of these expenses.

The SFAS 123R grant date fair value of restricted stock and restricted stock units is calculated as the average of the high and low trading price of our common stock on the date of grant. Because performance shares do not participate in dividends during the three-year performance cycle and include a cap on the market value to be paid equal to three times the grant date market value, the SFAS 123R grant date fair value of performance shares is calculated as the market value on date of grant, less the present value of expected dividends over the three-year performance period discounted at the risk-free rate, less the value of the three-times cap based on a Black-Scholes option pricing model.

- (4) These amounts represent the dollar amounts we recognized for financial statement reporting purposes with respect to 2006 for the fair value of stock option awards granted during 2004 and in prior years in accordance with SFAS 123R. No named executive has received a stock option award since January 2004. As required by SEC rules, the amounts

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shown exclude the impact of estimated forfeitures related to service-based vesting conditions. For the assumptions used in calculating the value of these awards, see Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies Stock-Based Compensation.

- (5) The reported amounts represent change in pension value.
- (6) The table below shows more information about the components of the All Other Compensation column. The Charitable Award Program amounts reflect a matching contribution program under which an employee who contributes to the Fannie Mae Political Action Committee may direct that an equal amount, up to \$5,000, be donated by Fannie Mae to charities chosen by the employee in the employee's name. Mr. Mudd's Charitable Award Program amount consists of \$5,000 under this matching program plus \$15,447 for our incremental cost of his participation in our charitable award program for directors, which is described below under Director Compensation Information. We calculated our incremental cost of each director's participation in our charitable award program for directors based on (1) the present value of our expected future payment of the benefit that became vested during 2006 and (2) the time value during 2006 of amounts vested for that director in prior years. We estimated the present values of our expected future payment based on the age and gender of our directors, the RP 2000 white collar mortality table projected to 2010, and a discount rate of approximately 5.5%. Ms. St. John's Payments in Connection with Termination of Employment shown in the table below consist of: \$794,463 in severance payments, \$943,035 in a 2006 annual incentive plan cash bonus award, and \$18,000 for outplacement services. Under the terms of her separation agreement, Ms. St. John received a bonus equal to a prorated share of her target bonus adjusted for corporate performance. In addition to the amounts shown in the Certain Components of All Other Compensation table below, Mr. Williams' All Other Compensation includes our incremental cost of providing tax counseling and financial planning services and dining services. Amounts shown under All Other Compensation do not include gifts made by the Fannie Mae Foundation under its matching gifts program, under which gifts made by our employees and directors to 501(c)(3) charities are matched, up to an aggregate total of \$10,500 in any calendar year. No amounts are included for this program because the matching gifts are made by the Fannie Mae Foundation, not Fannie Mae.

Certain Components of All Other Compensation for 2006

Executive	401(k) Plan Matching Contributions	Universal Life Insurance Coverage Premiums	Universal Life Insurance Tax Gross-up	Excess Liability Insurance Coverage Premiums	Excess Liability Insurance Tax Gross-up	Charitable Award Programs	Payments in Connection with Termination of Employment
Daniel Mudd	\$ 6,600	\$ 58,650	\$ 48,278	\$ 1,150	\$ 947	\$ 20,447	
Robert Blakely		86,709	46,998	1,150	623	5,000	
Robert Levin	6,600	31,715	25,326	1,150	918	5,000	
Peter Niculescu	6,600	18,101	13,216	1,150	840		
Beth Wilkinson	6,600	14,400	7,805	1,150	623	5,000	
Michael Williams	6,600	23,304	18,610	1,150	918	5,000	
Julie St. John	6,600	39,921	32,861	1,150	947	4,800	1,755,498

- (7) Ms. St. John entered into a separation agreement with us in July 2006, and she retired from Fannie Mae in December 2006. Her separation benefits were provided pursuant to the Board-approved management severance program and were approved by OFHEO.

Table of Contents**Grants of Plan-Based Awards in 2006**

The following table shows grants of awards made under our Annual Incentive Plan and our Stock Compensation Plan of 2003 to the named executives during 2006.

Name	Grant Date ⁽¹⁾	Award Approval Date ⁽¹⁾	Estimated Possible Payouts	All Other Stock	Grant Date Fair Value of Stock and Option Awards (\$) ⁽⁴⁾
			Under Non-Equity Incentive Plan Awards ⁽²⁾ Target (\$)	Awards: Number of Shares of Stock or Units (#) ⁽³⁾	
Daniel Mudd	3/22/2006	2/8/2006	\$ 2,612,500	146,574	\$ 7,905,469
Robert Blakely	1/30/2006	11/8/2005			