

FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE  
Form 10-Q  
August 08, 2008

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

**Form 10-Q**

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

**For the quarterly period ended June 30, 2008**

**OR**

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

**For the transition period from            to**

**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**

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE - Form 10-Q

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting  
(Do not check if a smaller reporting company)  company

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

As of June 30, 2008, there were 1,076,594,797 shares of common stock outstanding.

---

## TABLE OF CONTENTS

<b><u>Part I Financial Information</u></b>	1
<b><u>Item 1.</u></b>	91
<u>Financial Statements</u>	91
<u>Condensed Consolidated Balance Sheets</u>	91
<u>Condensed Consolidated Statements of Operations</u>	92
<u>Condensed Consolidated Statements of Cash Flows</u>	93
<u>Condensed Consolidated Statements of Changes in Stockholders' Equity</u>	94
<u>Note 1 Summary of Significant Accounting Policies</u>	95
<u>Note 2 Consolidations</u>	100
<u>Note 3 Mortgage Loans</u>	100
<u>Note 4 Allowance for Loan Losses and Reserve for Guaranty Losses</u>	103
<u>Note 5 Investments in Securities</u>	105
<u>Note 6 Financial Guarantees</u>	107
<u>Note 7 Acquired Property, Net</u>	109
<u>Note 8 Short-term Borrowings and Long-term Debt</u>	110
<u>Note 9 Derivative Instruments and Hedging Activities</u>	111
<u>Note 10 Income Taxes</u>	113
<u>Note 11 Earnings (Loss) Per Share</u>	115
<u>Note 12 Employee Retirement Benefits</u>	116
<u>Note 13 Segment Reporting</u>	117
<u>Note 14 Stockholders' Equity</u>	119
<u>Note 15 Regulatory Capital Requirements</u>	120
<u>Note 16 Concentrations of Credit Risk</u>	122
<u>Note 17 Fair Value of Financial Instruments</u>	124
<u>Note 18 Commitments and Contingencies</u>	135
<u>Note 19 Subsequent Events</u>	139
<b><u>Item 2.</u></b>	1
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	1
<u>Introduction</u>	1
<u>Selected Financial Data</u>	2
<u>Executive Summary</u>	5
<u>Legislation Relating to Our Regulatory Framework</u>	9
<u>Critical Accounting Policies and Estimates</u>	11
<u>Consolidated Results of Operations</u>	16
<u>Business Segment Results</u>	37
<u>Consolidated Balance Sheet Analysis</u>	41
<u>Supplemental Non-GAAP Information - Fair Value Balance Sheets</u>	58
<u>Liquidity and Capital Management</u>	63
<u>Off-Balance Sheet Arrangements and Variable Interest Entities</u>	69
<u>Risk Management</u>	71
<u>Impact of Future Adoption of Accounting Pronouncements</u>	88
<u>Forward-Looking Statements</u>	88
<b><u>Item 3.</u></b>	140
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	140
<b><u>Item 4.</u></b>	140
<u>Controls and Procedures</u>	140

<b><u>Part II Other Information</u></b>	140
<u>Item 1. Legal Proceedings</u>	140
<u>Item 1A. Risk Factors</u>	142
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	151
<u>Item 3. Defaults Upon Senior Securities</u>	154
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	154
<u>Item 5. Other Information</u>	155
<u>Item 6. Exhibits</u>	155
<b><u>Signatures</u></b>	
<b><u>Index to Exhibits</u></b>	

## MD&amp;A TABLE REFERENCE

Table	Description	Page
	<u>Selected Financial Data</u>	2
1	<u>Level 3 Recurring Assets at Fair Value</u>	13
2	<u>Summary of Condensed Consolidated Results of Operations</u>	16
3	<u>Analysis of Net Interest Income and Yield</u>	17
4	<u>Rate/Volume Analysis of Net Interest Income</u>	19
5	<u>Guaranty Fee Income and Average Effective Guaranty Fee Rate</u>	21
6	<u>Investment Gains (Losses), Net</u>	23
7	<u>Fair Value Gains (Losses), Net</u>	24
8	<u>Derivatives Fair Value Gains (Losses), Net</u>	25
9	<u>Credit-Related Expenses</u>	28
10	<u>Allowance for Loan Losses and Reserve for Guaranty Losses</u>	28
11	<u>Statistics on Seriously Delinquent Loans Purchased from MBS Trusts Subject to SOP 03-3</u>	30
12	<u>Activity of Seriously Delinquent Loans Purchased from MBS Trusts Subject to SOP 03-3</u>	31
13	<u>Re-performance Rates of Seriously Delinquent Single-Family Loans Purchased from MBS Trusts</u>	31
14	<u>Re-performance Rates of Seriously Delinquent Single-Family Loans Purchased from MBS Trusts and Modified</u>	32
15	<u>Required and Optional Purchases of Loans from MBS Trusts</u>	33
16	<u>Credit Loss Performance Metrics</u>	34
17	<u>Single-Family Credit Loss Sensitivity</u>	36
18	<u>Single-Family Business Results</u>	38
19	<u>HCD Business Results</u>	39
20	<u>Capital Markets Group Results</u>	40
21	<u>Mortgage Portfolio Activity</u>	41
22	<u>Mortgage Portfolio Composition</u>	42
23	<u>Trading and AFS Investment Securities</u>	44
24	<u>Investments in Private-Label Mortgage-Related Securities and Mortgage Revenue Bonds</u>	45
25	<u>Investments in Alt-A Private-Label Mortgage-Related Securities, Excluding Wraps</u>	49
26	<u>Investments in Subprime Private-Label Mortgage-Related Securities, Excluding Wraps</u>	51
27	<u>Alt-A and Subprime Private-Label Wraps</u>	53
28	<u>Debt Activity</u>	55
29	<u>Outstanding Debt</u>	56
30	<u>Changes in Risk Management Derivative Assets (Liabilities) at Fair Value, Net</u>	57
31	<u>Purchased Options Premiums</u>	58
32	<u>Supplemental Non-GAAP Consolidated Fair Value Balance Sheets</u>	59
33	<u>Non-GAAP Estimated Fair Value of Net Assets (Net of Tax Effect)</u>	61
34	<u>Selected Market Information</u>	62
35	<u>Fannie Mae Credit Ratings</u>	67
36	<u>Composition of Mortgage Credit Book of Business</u>	71
37	<u>Risk Characteristics of Conventional Single-Family Business Volume and Mortgage Credit Book of Business</u>	73

<b>Table</b>	<b>Description</b>	<b>Page</b>
<u>38</u>	<u>Serious Delinquency Rates</u>	77
<u>39</u>	<u>Nonperforming Single-Family and Multifamily Loans</u>	78
<u>40</u>	<u>Single-Family and Multifamily Foreclosed Properties</u>	79
<u>41</u>	<u>Mortgage Insurance Coverage</u>	81
<u>42</u>	<u>Credit Loss Exposure of Risk Management Derivatives Instruments</u>	83
<u>43</u>	<u>Activity and Maturity Data for Risk Management Derivatives</u>	84
<u>44</u>	<u>Fair Value Sensitivity of Net Portfolio to Changes in Level and Slope of Yield Curve</u>	86
<u>45</u>	<u>Interest Rate Sensitivity of Financial Instruments</u>	87

## PART I FINANCIAL INFORMATION

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) in conjunction with our unaudited condensed consolidated financial statements and related notes, and the more detailed information contained in our Annual Report on Form 10-K for the year ended December 31, 2007 ( 2007 Form 10-K ). The results of operations presented in our interim financial statements and discussed in MD&A are not necessarily indicative of the results that may be expected for the full year. Please refer to Glossary of Terms Used in This Report in our 2007 Form 10-K for an explanation of key terms used throughout this discussion.*

#### INTRODUCTION

Fannie Mae is a government-sponsored enterprise ( GSE ), 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 Credit Guaranty ( Single-Family ), Housing and Community Development ( 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 United States 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. 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. Our business is self-sustaining and funded exclusively with private capital.

Our Single-Family business works with our lender customers to securitize single-family mortgage loans into Fannie Mae mortgage-backed securities ( Fannie Mae MBS ) and to facilitate the purchase of single-family mortgage loans for our mortgage portfolio. Our 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 makes debt and equity investments to increase the supply of affordable housing. Our Capital Markets group manages our investment activity in mortgage loans, mortgage-related securities and other investments, our debt financing activity, and our liquidity and capital positions. We fund our investments primarily through proceeds from our issuance of debt securities in the domestic and international capital markets.

**SELECTED FINANCIAL DATA**

The selected financial data presented below is summarized from our condensed consolidated results of operations for the three and six months ended June 30, 2008 and 2007, as well as from selected condensed consolidated balance sheet data as of June 30, 2008 and December 31, 2007. This data should be read in conjunction with this MD&A, as well as with the unaudited condensed consolidated financial statements and related notes included in this report and with our audited consolidated financial statements and related notes included in our 2007 Form 10-K.

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007<sup>(1)</sup></b>	<b>2008</b>	<b>2007<sup>(1)</sup></b>
	<b>(In millions, except per share amounts)</b>			
<b><u>Statement of operations data:</u></b>				
Net interest income	\$ 2,057	\$ 1,193	\$ 3,747	\$ 2,387
Guaranty fee income	1,608	1,120	3,360	2,218
Losses on certain guaranty contracts		(461)		(744)
Trust management income	75	150	182	314
Fair value gains (losses), net <sup>(2)</sup>	517	1,424	(3,860)	858
Other income (expenses), net <sup>(3)</sup>	(889)	(3)	(1,059)	397
Credit-related expenses <sup>(4)</sup>	(5,349)	(518)	(8,592)	(839)
Net income (loss)	(2,300)	1,947	(4,486)	2,908
Preferred stock dividends and issuance costs at redemption	(303)	(118)	(625)	(253)
Net income (loss) available to common stockholders	(2,603)	1,829	(5,111)	2,655
<b><u>Per common share data:</u></b>				
Earnings (loss) per share:				
Basic	\$ (2.54)	\$ 1.88	\$ (5.11)	\$ 2.73
Diluted	(2.54)	1.86	(5.11)	2.72
Weighted-average common shares outstanding:				
Basic	1,025	973	1,000	973
Diluted	1,025	1,001	1,000	1,001
Cash dividends declared per common share	\$ 0.35	\$ 0.50	\$ 0.70	\$ 0.90
<b><u>New business acquisition data:</u></b>				
Fannie Mae MBS issues acquired by third parties <sup>(5)</sup>	\$ 137,731	\$ 134,440	\$ 293,433	\$ 259,642
Mortgage portfolio purchases <sup>(6)</sup>	61,347	48,676	97,670	84,833
New business acquisitions	\$ 199,078	\$ 183,116	\$ 391,103	\$ 344,475



	As of	
	June 30, 2008	December 31, 2007 <sup>(1)</sup>
	(Dollars in millions)	
<b><u>Balance sheet data:</u></b>		
Investments in securities:		
Trading	\$ 99,562	\$ 63,956
Available-for-sale	245,226	293,557
Mortgage loans:		
Loans held for sale	6,931	7,008
Loans held for investment, net of allowance	411,300	396,516
Total assets	885,918	879,389
Short-term debt	240,223	234,160
Long-term debt	559,279	562,139
Total liabilities	844,528	835,271
Preferred stock	21,725	16,913
Total stockholders' equity	41,226	44,011
<b><u>Regulatory capital data:</u></b>		
Core capital <sup>(7)</sup>	\$ 46,964	\$ 45,373
Total capital <sup>(8)</sup>	55,568	48,658
<b><u>Book of business data:</u></b>		
Mortgage portfolio <sup>(9)</sup>	\$ 754,116	\$ 727,903
Fannie Mae MBS held by third parties <sup>(10)</sup>	2,252,282	2,118,909
Other guarantees <sup>(11)</sup>	31,812	41,588
Mortgage credit book of business	\$ 3,038,210	\$ 2,888,400
Guaranty book of business <sup>(12)</sup>	\$ 2,898,207	\$ 2,744,237

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007 <sup>(1)</sup>	2008	2007 <sup>(1)</sup>
<b><u>Ratios:</u></b>				
Return on assets ratio <sup>(13)*</sup>	(1.20)%	0.86%	(1.16)%	0.62%
Return on equity ratio <sup>(14)*</sup>	(50.3)	22.6	(43.9)	16.6
Equity to assets ratio <sup>(15)*</sup>	4.6	4.8	4.8	4.8
Dividend payout ratio <sup>(16)</sup>	N/A	26.8	N/A	33.1
Average effective guaranty fee rate (in basis points) <sup>(17)</sup>	26.3bp	21.5bp	27.9bp	21.6bp
Credit loss ratio (in basis points) <sup>(18)</sup>	17.5bp	4.0bp	15.1bp	3.7bp

- (1) Certain prior period amounts have been reclassified to conform to the current period presentation.
- (2) Consists of the following: (a) derivatives fair value gains (losses), net; (b) trading securities gains (losses), net; (c) hedged mortgage assets gains (losses), net; (d) debt foreign exchange gains (losses), net; and (e) debt fair value gains (losses), net.
- (3) Consists of the following: (a) investment gains (losses), net; (b) debt extinguishment gains (losses), net; (c) losses from partnership investments; and (d) fee and other income.
- (4) Consists of provision for credit losses and foreclosed property expense.
- (5) Unpaid principal balance of Fannie Mae MBS issued and guaranteed by us during the reporting period less:  
(a) securitizations of mortgage loans held in our portfolio during the reporting period and (b) Fannie Mae MBS purchased for our investment portfolio during the reporting period.

- (6) Unpaid principal balance of mortgage loans and mortgage-related securities we purchased for our investment portfolio during the reporting period. Includes mortgage-related securities acquired through the extinguishment of debt and capitalized interest.
- (7) 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) our retained earnings. Core capital excludes accumulated other comprehensive income (loss).
- (8) 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).
- (9) Unpaid principal balance of mortgage loans and mortgage-related securities held in our portfolio.
- (10) Unpaid principal balance of Fannie Mae MBS held by third-party investors. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.
- (11) Includes single-family and multifamily credit enhancements that we have provided and that are not otherwise reflected in the table.
- (12) Unpaid principal balance of: mortgage loans held in our mortgage portfolio; Fannie Mae MBS (whether held in our mortgage portfolio or held by third parties); and other credit enhancements that we provide on mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.
- (13) Annualized net income (loss) available to common stockholders divided by average total assets during the period.
- (14) Annualized net income (loss) available to common stockholders divided by average outstanding common equity during the period.
- (15) Average stockholders' equity divided by average total assets during the period.
- (16) Common dividends declared during the period divided by net income (loss) available to common stockholders for the period.
- (17) Annualized guaranty fee income as a percentage of average outstanding Fannie Mae MBS and other guarantees during the period.
- (18) Annualized (a) charge-offs, net of