OFFERING CIRCULAR

3,000,000 Shares

FannieMae

5.10% Non-Cumulative Preferred Stock, Series E

(stated value $50 per share)

This offering circular relates to the offer of 3,000,000 shares of the 5.10% Non-Cumulative Preferred Stock, Series E (the "Preferred Stock") of the Federal National Mortgage Association ("Fannie Mae"). The Preferred Stock has a stated value of $50 per share. Dividends at the rate of 5.10% per year will accrue from and including April 15, 1999. We will be required to pay dividends quarterly on March 31, June 30, September 30 and December 31 of each year, commencing June 30, 1999, at the annual rate of $2.55 per share. However, we will be required to pay dividends only when, as and if declared by our Board of Directors in its sole discretion out of funds legally available for such payment.

The amount of dividends we will be required to pay (if our Board declares them) may be increased if legislation is enacted that changes the Internal Revenue Code of 1986, as amended, to reduce the dividends-received deduction applicable to dividends on the Preferred Stock in certain specified ways. However, we will have the right to repurchase shares of the Preferred Stock before a holder transfers the shares if the transfer would require us to pay increased dividends on the transferred shares due to the enactment of a current federal budget proposal relating to the dividends-received deduction. If we are not given that right, the dividend will not be increased.

Dividends on the Preferred Stock will not be cumulative. Accordingly, if for any reason our Board of Directors does not declare a dividend on the Preferred Stock for a dividend period, we will have no obligation to pay a dividend for that period, whether or not our Board declares dividends on the Preferred Stock for any future dividend period. If, however, we have not paid or set aside for payment dividends on the Preferred Stock for a dividend period, we may not pay dividends on our common stock for that period.

On or after April 15, 2004, we may redeem the Preferred Stock, in whole or in part, at any time or from time to time, at our option at the redemption price of $50.00 per share plus an amount equal to the dividend for the then-current quarterly dividend period accrued to but excluding the date of redemption (whether or not declared, but without accumulation of any dividends for prior dividend periods).

The Preferred Stock will not have any voting rights, except as set forth under "Description of Preferred Stock—Voting Rights; Amendments."

The Preferred Stock has not been listed on any stock exchange.

Our obligations under the terms of the Preferred Stock are only our obligations and are not those of the United States or of any instrumentality thereof other than us.

	Price to Public (1)	Underwriting Discount (2)	Proceeds to Fannie Mae (1) (3)
Per Share	$50.00	$.50	$49.50
Total	$150,000,000	$1,500,000	$148,500,000

(1) Plus accrued dividends, if any, from April 15, 1999.
(2) We have agreed to indemnify the Underwriter against certain liabilities. See "Underwriting."
(3) Before deducting expenses payable by us estimated at $100,000.

The Preferred Stock is offered by the Underwriter, subject to prior sale, when, as and if issued to and accepted by it and subject to certain other conditions. The Underwriter reserves the right to withdraw, cancel or modify the offer and to reject orders in whole or in part. It is expected that delivery of the Preferred Stock will be made in New York, New York, on or about April 15, 1999 against payment in immediately available funds.

Bear, Stearns & Co. Inc.

April 8, 1999

The shares of Preferred Stock are exempt from the registration requirements of the Securities Act of 1933 and are ''exempted securities'' within the meaning of the Securities Exchange Act of 1934. Accordingly, we have not filed a registration statement with the U.S. Securities and Exchange Commission. Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved the Preferred Stock or determined if this Offering Circular is truthful or complete. Any representation to the contrary is a criminal offense.

The distribution of this Offering Circular and the offer, sale and delivery of the Preferred Stock in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by us and the Underwriter to inform themselves about and to observe any such restrictions.

DOCUMENTS INCORPORATED BY REFERENCE

This Offering Circular should be read only in conjunction with our Information Statement dated March 31, 1999 (the ''Information Statement''), which is attached as Appendix B and incorporated herein by this reference. This Offering Circular, together with the Information Statement and any documents incorporated herein by reference, are referred to as the ''Offering Circular.'' Any Information Statement, supplement to it, or proxy statement published by us subsequent to the date of this Offering Circular and prior to the termination of the offering of the Preferred Stock shall be deemed to be incorporated herein by this reference. You should rely only on the information provided or incorporated by reference in this Offering Circular, and you should rely only on the most current information.

AVAILABLE INFORMATION

You can obtain copies of any or all documents incorporated in this Offering Circular by reference without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue N.W., Washington, D.C. 20016 (telephone: (202) 752-7115). You can read the Information Statement, proxy statements and other information concerning us at the offices of the New York Stock Exchange, the Chicago Stock Exchange and the Pacific Exchange.

Because we are not subject to the periodic reporting requirements of the Securities Exchange Act of 1934, we do not file reports or other information with the U.S. Securities and Exchange Commission.

SUMMARY OF THE OFFERING

This summary highlights information contained elsewhere in this Offering Circular. It does not contain all of the information you should consider before investing in the Preferred Stock. You also should read the more detailed information and financial data appearing elsewhere in this Offering Circular, the Information Statement and the Certificate of Designation (as defined under "Description of Preferred Stock").

The Offering

Issuer . . . . Fannie Mae.

Securities Offered . . . . 3,000,000 shares of 5.10% Non-Cumulative Preferred Stock, Series E, no par value, stated value and liquidation preference of $50.00 per share.

Dividends . . . . Non-cumulative, quarterly cash dividends at the rate of 5.10% per year will accrue from and including April 15, 1999. We will be required to pay dividends quarterly on March 31, June 30, September 30 and December 31 of each year, commencing June 30, 1999, at the annual rate of $2.55 per share. However, we will be required to pay dividends only when, as and if declared by our Board of Directors in its sole discretion out of funds legally available for such payment.

The amount of dividends we will be required to pay (if our Board declares them) may be increased if legislation is enacted that changes the Internal Revenue Code of 1986, as amended, to reduce the dividends-received deduction applicable to dividends on the Preferred Stock in certain specified ways. However, we will have the right to repurchase shares of the Preferred Stock before a holder transfers the shares if the transfer would require us to pay increased dividends on the transferred shares due to the enactment of a current federal budget proposal relating to the dividends-received deduction. If we are not given that right, the dividend will not be increased. See "Description of the Preferred Stock—Dividends—Changes in the Dividends-Received Deduction."

Preferences . . . . The Preferred Stock will be entitled to a preference, both as to dividends and upon liquidation, over the common stock (and any other junior stock) of Fannie Mae.

Optional Redemption . . . . On or after April 15, 2004, we may redeem the Preferred Stock, in whole or in part, at any time or from time to time, at our option at the redemption price of $50.00 per share plus an amount equal to the dividend for the then-current quarterly dividend period accrued to but excluding the date of redemption (whether or not declared, but without accumulation of any dividends for prior dividend periods). Holders of Preferred Stock will have no right to require redemption of Preferred Stock. We also will have a first right to purchase shares of Preferred Stock upon the occurrence of certain events as described under "Description of Preferred Stock—Dividends—Changes in the Dividends-Received Deduction—Debt Financed Purchases."

Liquidation Rights . . . . Upon any dissolution, liquidation or winding up of Fannie Mae, record holders of the outstanding shares of Preferred Stock will be entitled to receive, out of our assets available for distribution to stockholders, before any payment or distribution is made on our common stock (or any other junior stock), $50.00 per share plus an amount equal to the dividend for the then-current quarterly dividend period accrued to but excluding the date of the liquidation payment (whether or not declared, but without accumulation of any dividends for prior dividend periods).

Voting Rights .... None, except as to certain amendments relating to the terms of the Preferred Stock.

Preemptive and Conversion Rights .... None.

Use of Proceeds .... To be added to our working capital and used for general corporate purposes, and may be used to repurchase our common stock.

Listing .... The Preferred Stock has not been listed on any stock exchange.

Summary Selected Financial Data
(Unaudited)
(Dollars in millions)

	December 31,				
	1998	1997	1996	1995	1994
Balance Sheet Data:					
Mortgage portfolio, net	$415,223	$316,316	$286,259	$252,588	$220,525
Total assets	485,014	391,673	351,041	316,550	272,508
Total liabilities	469,561	377,880	338,268	305,591	262,967
Stockholders' equity	15,453	13,793	12,773	10,959	9,541
Capital(1)	16,244	14,575	13,520	11,703	10,367

	Year Ended December 31,				
	1998	1997	1996	1995	1994
Income Statement Data:					
Net interest income	$ 4,110	$ 3,949	$ 3,592	$ 3,047	$ 2,823
Guaranty fees	1,229	1,274	1,196	1,086	1,083
Fee and other income, net	275	125	86	93	143
Special contribution	—	—	—	(350)	—
Net income	3,418	3,056	2,725	2,144	2,132

	Year Ended December 31,				
	1998	1997	1996	1995	1994
Other Data:					
Average net interest margin	1.03%	1.17%	1.18%	1.16%	1.24%
Ratio of earnings to combined fixed charges and preferred stock dividends(2)	1.18:1	1.19:1	1.19:1	1.17:1	1.22:1
Mortgage purchases	$188,448	$ 70,465	$ 68,618	$ 56,598	$ 62,389
MBS issued	326,148	149,429	149,869	110,456	130,622
MBS outstanding at year end(3)	834,518	709,582	650,780	582,959	530,343

(1) Stockholders' equity plus general allowance for losses.

(2) "Earnings" consists of (i) income before federal income taxes and extraordinary item and (ii) fixed charges. "Fixed charges" represents interest expense. There was no preferred stock outstanding in 1995 and 1994.

(3) Includes $197 billion, $130 billion, $103 billion, $70 billion, and $44 billion of MBS in portfolio at December 31, 1998, 1997, 1996, 1995, and 1994, respectively.

FANNIE MAE

Fannie Mae is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 *et seq.* (the ‘‘Charter Act’’). See ‘‘Government Regulation and Charter Act’’ in this Offering Circular and in the Information Statement. We are the largest investor in home mortgage loans in the United States. We were established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market, and were transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

We provide funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. We acquire funds to purchase these loans by issuing debt securities to capital market investors, many of whom ordinarily would not invest in mortgages. In this manner, we are able to expand the total amount of funds available for housing.

We also issue mortgage-backed securities (‘‘MBS’’), receiving guaranty fees for our guarantee of timely payment of principal and interest on MBS certificates. We issue MBS primarily in exchange for pools of mortgage loans from lenders. The issuance of MBS enables us to further our statutory purpose of increasing the liquidity of residential mortgage loans.

In addition, we offer various services to lenders and others for a fee. These services include issuing certain types of MBS and providing technology services for originating and underwriting loans. See ‘‘Business’’ in the Information Statement.

Our principal office is located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: (202) 752-7000).

USE OF PROCEEDS

The net proceeds from the sale of the Preferred Stock (as defined under ‘‘Description of Preferred Stock’’) will be added to our working capital and used for general corporate purposes and may be used to repurchase our common stock.

We anticipate that additional financing, including financing through various types of equity and debt securities, will be required from time to time. The amount and nature of our financing activities are dependent upon a number of factors, including the volume of our maturing debt obligations, the volume of mortgage loan prepayments, the volume and type of mortgage loans purchased by us, and general market conditions.

CAPITALIZATION

The following table sets forth the capitalization of Fannie Mae as of December 31, 1998, and as adjusted to give effect to the issuance of the Preferred Stock offered by this Offering Circular (before giving effect to the payment of estimated offering expenses and underwriting discount):

	Average Maturity	Average Cost(1)	Actual Outstanding at December 31, 1998	As Adjusted
			(Dollars in millions)	
Debentures, notes, and bonds, net:				
Due within one year:				
Short-term notes	3 mos.	5.18%	$136,400	$136,400
Global debt	8 mos.	5.30	2,986	2,986
Debentures	6 mos.	7.54	7,594	7,594
Medium-term notes(2)	6 mos.	5.41	57,977	57,977
Other(3)	—	5.23	456	456
Total due within one year			205,413	205,413
Due after one year:				
Global debt	6 yrs. 3 mos.	5.87	64,723	64,723
Debentures	5 yrs. 3 mos.	7.40	20,516	20,516
Medium-term notes(2)	5 yrs. 9 mos.	6.21	165,993	165,993
Other	17 yrs.	7.98	3,646	3,646
Total due after one year			254,878	254,878
Total debentures, notes, and bonds			$460,291	$460,291
Stockholders' equity:				
Preferred stock, $50.00 stated value, 100,000,000 shares authorized— 26,000,000 shares issued				
Series A, 7,500,000 shares issued			$ 375	$ 375
Series B, 7,500,000 shares issued			375	375
Series C, 5,000,000 shares issued			250	250
Series D, 3,000,000 shares issued			150	150
Series E, 3,000,000 shares issued			—	150
Common stock, $.525 stated value, no maximum authorization—1,129 million shares issued			593	593
Additional paid-in capital			1,533	1,533
Retained earnings			15,689	15,689
Accumulated other comprehensive income			(13)	(13)
			18,952	19,102
Less treasury stock, at cost—104 million shares(4)			3,499	3,499
Total stockholders' equity			$ 15,453	$ 15,603

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

(2) Medium-term notes may have maturities of one day or longer.

(3) Average maturity is indeterminate because the outstanding amount includes investment agreements that have varying maturities.

(4) Does not reflect any repurchases of our common stock that may be made using proceeds from the sale of the Preferred Stock, Series E. See "Use of Proceeds."

We frequently issue debentures, notes and other debt obligations. The amount of debentures, notes, and other debt obligations outstanding on any date subsequent to December 31, 1998 may differ from that shown in the table above.

SELECTED FINANCIAL INFORMATION

The following selected financial data for the years 1994 through 1998 (which data are not covered by the independent auditors' report) have been summarized or derived from the audited financial statements and other financial information. These data should be read in conjunction with the audited financial statements and notes to the financial statements.

(Dollars in millions, except per common share amounts)

Income Statement Data for the year ended December 31:	1998	1997	1996	1995	1994
Interest income	$ 29,995	$ 26,378	$ 23,772	$ 21,071	$ 17,347
Interest expense	(25,885)	(22,429)	(20,180)	(18,024)	(14,524)
Net interest income	4,110	3,949	3,592	3,047	2,823
Guaranty fees	1,229	1,274	1,196	1,086	1,083
Fee and other income, net	275	125	86	93	143
Credit-related expenses	(261)	(375)	(409)	(335)	(378)
Administrative expenses	(708)	(636)	(560)	(546)	(525)
Special contribution	—	—	—	(350)	—
Income before federal income taxes and extraordinary item	4,645	4,337	3,905	2,995	3,146
Provision for federal income taxes	(1,201)	(1,269)	(1,151)	(840)	(1,005)
Income before extraordinary item	3,444	3,068	2,754	2,155	2,141
Extraordinary item—loss on early extinguishment of debt, net of tax effect	(26)	(12)	(29)	(11)	(9)
Net income	$ 3,418	$ 3,056	$ 2,725	$ 2,144	$ 2,132
Preferred stock dividends	(66)	(65)	(42)	—	—
Net income available to common shareholders	$ 3,352	$ 2,991	$ 2,683	$ 2,144	$ 2,132
Basic earnings per common share(1):					
Earnings before extraordinary item	$ 3.28	$ 2.87	$ 2.53	$ 1.98	$ 1.96
Extraordinary item	(.02)	(.02)	(.03)	(.01)	(.01)
Net earnings	$ 3.26	$ 2.85	$ 2.50	$ 1.97	$ 1.95
Diluted earnings per common share(1):					
Earnings before extraordinary item	$ 3.26	$ 2.84	$ 2.51	$ 1.96	$ 1.95
Extraordinary item	(.03)	(.01)	(.03)	(.01)	(.01)
Net earnings	$ 3.23	$ 2.83	$ 2.48	$ 1.95	$ 1.94
Cash dividends per common share	$ .96	$ .84	$ .76	$ .68	$ .60
Balance Sheet Data at December 31:					
Mortgage portfolio, net	$415,223	$316,316	$286,259	$252,588	$220,525
Investments	58,515	64,596	56,606	57,273	46,335
Total assets	485,014	391,673	351,041	316,550	272,508
Borrowings:					
Due within one year	205,413	175,400	159,900	146,153	112,602
Due after one year	254,878	194,374	171,370	153,021	144,628
Total liabilities	469,561	377,880	338,268	305,591	262,967
Stockholders' equity	15,453	13,793	12,773	10,959	9,541
Capital(2)	16,244	14,575	13,520	11,703	10,367
Other Data for the year ended December 31:					
Average net interest margin	1.03%	1.17%	1.18%	1.16%	1.24%
Return on average common equity	25.2	24.6	24.1	20.9	24.3
Dividend payout ratio	29.5	29.4	30.4	34.6	30.8
Average effective guaranty fee rate	.202	.227	.224	.220	.225
Credit loss ratio	.027	.041	.053	.050	.057
Ratio of earnings to combined fixed charges and preferred stock dividends(3)	1.18:1	1.19:1	1.19:1	1.17:1	1.22:1
Mortgage purchases	$188,448	$ 70,465	$ 68,618	$ 56,598	$ 62,389
MBS issued	326,148	149,429	149,869	110,456	130,622
MBS outstanding at year-end(4)	834,518	709,582	650,780	582,959	530,343
Weighted-average diluted common shares outstanding, in millions	1,037	1,056	1,080	1,098	1,098

(1) Earnings per common share amounts in 1996, 1995, and 1994 have been restated to comply with Financial Accounting Standard No. 128, *Earnings per Share.*

(2) Stockholders' equity plus general allowance for losses.

(3) "Earnings" consists of (i) income before federal income taxes and extraordinary item and (ii) fixed charges. "Fixed charges" represents interest expense. There was no preferred stock outstanding in 1995 and 1994.

(4) Includes $197 billion, $130 billion, $103 billion, $70 billion, and $44 billion of MBS in portfolio at December 31, 1998, 1997, 1996, 1995, and 1994, respectively.

GOVERNMENT REGULATION AND CHARTER ACT

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

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

Although the 1968 Act eliminated all federal ownership interest in Fannie Mae, it did not terminate government regulation of Fannie Mae. Under the Charter Act, approval of the Secretary of the Treasury is required for our issuance of debt obligations and MBS. In addition, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the ''1992 Act'') established an independent Office of Federal Housing Enterprise Oversight (''OFHEO'') within HUD under the management of a Director (the ''Director'') who is responsible for ensuring that we are adequately capitalized and operating safely in accordance with the 1992 Act. The 1992 Act established minimum capital, risk-based capital and critical capital levels for Fannie Mae and required the Director to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital we must have to exceed the risk-based capital level from time to time. OFHEO issued a final rule (the ''Rule'') in 1996 related to the minimum capital levels for Fannie Mae and Federal Home Loan Mortgage Corporation (''Freddie Mac'') that sets forth how minimum capital requirements for both entities are to be calculated, reported and classified on a quarterly basis. The Rule, which finalized an original proposal dated June 1995, formalized the interim capital standards applied by OFHEO, with which we have been in compliance since their inception. See also ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements'' in the Information Statement.

In 1996, OFHEO released for comment part one (''Part I'') of the proposed regulations to establish the risk-based capital test. Part I specifies that ''benchmark loss experience'' will be combined with other yet to be determined assumptions and applied each quarter to our book of business to establish credit losses under the risk-based capital standard for Fannie Mae. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. We submitted comments to OFHEO in October 1996 stating that several aspects of the initial proposal require adjustments or amendment, because it does not accurately capture our credit history and derives credit loss rates that are significantly worse than any reasonable representation of Fannie Mae's and Freddie Mac's loss experience. On March 26, 1999, after inter-agency review and comment on a proposed second part of the risk-based capital regulation (''Part II''), OFHEO sent Part II to Congress for review. Shortly after the 15-day period for Congressional review, OFHEO is expected to publish Part II for public review and comment over at least a 120-day period. Part II will specify, among other matters, remaining aspects of the test and how the test will be used to determine Fannie Mae's and Freddie Mac's risk-based capital requirements. The summary accompanying Part II noted that if Part II had been in effect as of June 30, 1997, our required risk-based capital would have been $17.73 billion, as compared with $14.05 billion in actual capital at that time. OFHEO also noted that there were a variety of means, such as hedging, that we could have used to reduce required risk-based capital to the level of our actual capital. We have not yet thoroughly reviewed Part II but expect to comment extensively on the proposal, which could change before it is finally issued. The 1992 Act provides that the final regulations will be enforceable one year after issuance. Our management is confident that we will be able to meet any reasonable final test.

If we fail to meet one or more of the capital standards under the 1992 Act, the Director is required to take certain remedial measures and may take others, depending on the standards we fail to meet. The Director's enforcement powers include the power to impose temporary and final cease-and-desist orders and civil penalties on us and on our directors or executive officers. If the Director determines that we are engaging in conduct not approved by the Director that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by us has decreased significantly, the Director is authorized to treat us as not meeting one of the capital standards that we otherwise meet. In addition, we are required to submit a capital restoration plan if we fail to meet any of the capital standards. If the Director does not approve the plan or determines that we have failed to make reasonable efforts to comply with the plan, then the Director may treat us as not meeting one of the capital standards that we otherwise meet. Also, if we fail to meet or are treated by the Director as not meeting one of the capital standards and the Director has reasonable cause to believe that we or any of our executive officers or directors are engaging in or about to engage in any conduct that threatens to result in a significant depletion of our core capital, then the Director is authorized to commence proceedings pursuant to which, after a hearing, the Director could issue a cease-and-desist order prohibiting such conduct. The Director could issue such an order without a hearing, which would be effective until completion of the cease-and-desist proceedings, if the Director determined that the conduct in question was likely to cause a significant depletion of core capital. Prior approval of the Director is required for us to pay a dividend if the dividend would decrease our capital below risk-based capital or minimum capital levels established under the 1992 Act. The Director is authorized to levy, pursuant to annual Congressional appropriations, annual assessments on Fannie Mae and Freddie Mac to cover reasonable expenses of OFHEO.

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

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

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

In addition to placing us under federal regulation, the Charter Act also grants to us certain privileges. For instance, securities issued by us are deemed to be "exempt securities" under laws administered by the U.S. Securities and Exchange Commission ("SEC") to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. We are not required to file registration statements with respect to our securities or periodic reports with the SEC.

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

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

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

DESCRIPTION OF PREFERRED STOCK

We are authorized by the Charter Act to have preferred stock on such terms and conditions as our Board of Directors may prescribe. On December 27, 1995, our Board of Directors amended our bylaws to authorize us to issue up to 100,000,000 shares of preferred stock. On March 1, 1996, we issued 7,500,000 shares of 6.41% Non-Cumulative Preferred Stock, Series A (stated value $50 per share) (the "Preferred Stock, Series A"); on April 12, 1996, we issued 7,500,000 shares of 6.50% Non-Cumulative, Preferred Stock, Series B (stated value $50 per share) (the "Preferred Stock, Series B"); on September 20, 1996, we issued 5,000,000 shares of 6.45% Non-Cumulative Preferred Stock, Series C (stated value $50 per share) (the "Preferred Stock, Series C"); and on September 30, 1998, we issued 3,000,000 shares of 5.25% Non-Cumulative Preferred Stock, Series D (stated value $50 per share) (the "Preferred Stock, Series D").

The terms of the Preferred Stock, Series E (the "Preferred Stock") will be established by a Certificate of Designation of Terms of 5.10% Non-Cumulative Preferred Stock, Series E (the "Certificate of Designation"), adopted by a duly authorized committee of our Board of Directors, which will be substantially in the form attached as Appendix A to this Offering Circular. The following is a brief description of the terms of the Preferred Stock which does not purport to be complete and is subject to and qualified by reference to the Certificate of Designation.

General

We will have the right to create and issue additional shares of the Preferred Stock and to create and issue additional classes or series of stock ranking, as to dividends, liquidation or otherwise, prior to, on a parity with or junior to the Preferred Stock without the consent of holders of the Preferred Stock. As of the date of this Offering Circular, the shares of Preferred Stock, Series A; Preferred Stock, Series B; Preferred Stock, Series C; and Preferred Stock, Series D were the only shares of Fannie Mae preferred stock outstanding. The Preferred Stock will rank on a parity, as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, with the Preferred Stock, Series A; the Preferred Stock, Series B; the Preferred Stock, Series C; and the Preferred Stock, Series D.

The Preferred Stock has no par value, has a stated value and liquidation preference of $50 per share and, upon issuance against full payment of the purchase price, will be fully paid and nonassessable.

The Preferred Stock will not be convertible into any of our other stock or obligations and will have no preemptive rights.

First Chicago Trust Company of New York, a division of EquiServe, will be the transfer agent, dividend disbursing agent and registrar for shares of the Preferred Stock.

Our obligations under the terms of the Preferred Stock are only our obligations and are not those of the United States or of any instrumentality thereof other than us.

Dividends

Dividends on shares of the Preferred Stock will not be mandatory. Holders of record of Preferred Stock as they appear on our books and records (the "Holders") will be entitled to receive, when, as and if declared by our Board of Directors, or a duly authorized committee, in its sole discretion out of funds legally available therefor, non-cumulative, quarterly cash dividends. Dividends will accrue from and including April 15, 1999 and will be payable on March 31, June 30, September 30 and December 31 of each year (each, a "Dividend Payment Date"), commencing June 30, 1999, at the annual rate of $2.55 per share (without taking into account any adjustments as described below under "— Changes in the Dividends-Received Deduction"). Dividends on the Preferred Stock will be payable to the Holders on the relevant record date fixed by the Board of Directors, or a duly authorized committee, which may not be earlier than 45 days or later than 10 days prior to the applicable Dividend Payment Date. If declared, the initial dividend, which will be for the period from and including April 15, 1999 to but excluding June 30, 1999, will be $.53125 per share. Thereafter, the dividend period relating to a Dividend Payment Date will be the period from and including the preceding Dividend Payment Date to but excluding the Dividend Payment Date. If a Dividend Payment Date is not a Business Day, dividends (if declared) on the Preferred Stock will be paid on the succeeding business day, without interest. A "Business Day" shall mean any day other than a Saturday, Sunday or other day on which banking institutions in New York, New York are authorized or required by law to close. Dividends payable on the Preferred Stock for any period greater or less than a full dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months and the actual number of days elapsed in any period of less than one month. Dividends payable on the Preferred Stock for each full dividend period will be computed by dividing the per annum dividend rate by four.

The Preferred Stock will rank prior to our common stock with respect to the payment of dividends to the extent provided in the Certificate of Designation. No dividend (other than dividends or distributions paid in shares of, or options, warrants or rights to subscribe for or purchase shares of, our common stock or any other stock ranking junior to the Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae) may be declared or paid or set apart for payment on our common stock (or on any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock) unless dividends have been declared and paid or set apart (or ordered to be set apart) on the Preferred Stock for the then-current quarterly dividend period. When dividends are not paid in full upon the Preferred Stock and all other classes or series of our stock, if any, ranking on a parity as to the payment of dividends with the Preferred Stock, all dividends declared upon shares of Preferred Stock and all such other stock of Fannie Mae will be declared pro rata so that the amount of dividends declared per share on the Preferred Stock and all such other stock will in all cases bear to each other the same ratio that accrued dividends per share on the shares of Preferred Stock (including any adjustments in the amount of dividends payable as described below under "—Changes in the Dividends-Received Deduction," but without accumulation of unpaid dividends for prior dividend periods) and such other stock bear to each other.

Dividends on the Preferred Stock will not be cumulative. If a dividend is not declared and paid on the Preferred Stock, the Holders of Preferred Stock will have no claim in respect of such non-payment so long as no dividend (other than those referred to in the preceding paragraph) is declared or paid on our common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock) for the then-current quarterly dividend period.

Our Board of Directors, or a duly authorized committee, may, in its discretion, choose to pay dividends on the Preferred Stock without the payment of any dividends on our common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock).

No dividends may be declared or paid or set apart for payment on any shares of the Preferred Stock if at the same time any arrears exist or any default exists in the payment of dividends on any outstanding class or series of stock of Fannie Mae ranking prior to the Preferred Stock with respect to the payment of dividends. At the time of issuance of the Preferred Stock, no class or series of stock of Fannie Mae ranking prior to the Preferred Stock with respect to the payment of dividends will exist.

Holders of Preferred Stock will not be entitled to any dividends, whether payable in cash or property, other than as described above and will not be entitled to interest, or any sum in lieu of interest, in respect of any dividend payment.

See "Regulatory Matters" for a description of certain regulatory restrictions on our payment of dividends.

Changes in the Dividends-Received Deduction

The following paragraphs describe the circumstances in which the dividends payable in respect of the Preferred Stock will be adjusted as a result of changes in the Internal Revenue Code of 1986, as amended (the "Code"), relating to the dividends-received deduction. Unless the context otherwise requires, references to dividends in this Offering Circular will mean dividends as adjusted pursuant to the following paragraphs. Our calculation of the dividends payable as so adjusted shall be final and not subject to review.

See also "United States Taxation—Dividends—Recent Proposals" for a discussion of certain proposals that may affect the dividends-received deduction.

The Dividends-Received Percentage. If, prior to 18 months after the date of the original issuance of the Preferred Stock, one or more amendments to the Code are enacted that reduce the percentage of the dividends-received deduction applicable to the Preferred Stock (currently 70 percent) as specified in section 243(a)(1) of the Code or any successor provision (the "Dividends-Received Percentage"), certain adjustments may be made in respect of the dividends payable by us, and Post Declaration Date Dividends and Retroactive Dividends (as such terms are defined below) may become payable, as described below.

The amount of each dividend payable (if declared) per share of Preferred Stock for dividend payments made on or after the effective date of such change in the Code will be adjusted by multiplying the amount of the dividend payable described above under "Dividends" (before adjustment) by a factor, which will be the number determined in accordance with the following formula (the "DRD Formula"), and rounding the result to the nearest cent (with one-half cent rounded up):

$$\frac{1-.35(1-.70)}{1-.35(1-\text{DRP})}$$

For the purposes of the DRD Formula, "DRP" means the Dividends-Received Percentage (expressed as a decimal) applicable to the dividend in question; *provided*, *however*, that if the Dividends-Received Percentage applicable to the dividend in question shall be less than 50%, then the DRP shall equal .50. No amendment to the Code, other than a change in the percentage of the dividends-received deduction applicable to the Preferred Stock as set forth in section 243(a)(1) of the Code or any successor provision (or as described under "—Debt Financed Purchases" below), will give rise to an adjustment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, we receive either an unqualified opinion of nationally recognized independent tax counsel selected by us or a private letter ruling or similar form of authorization from the Internal Revenue Service (the "IRS") to the effect that such an amendment does not apply to a dividend payable on the Preferred Stock, then such amendment will not result in the adjustment provided for pursuant to the DRD Formula with respect to such dividend. That opinion shall be based upon the legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation.

Notwithstanding the foregoing, if any such amendment to the Code is enacted after the dividend payable on a Dividend Payment Date has been declared, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the "Post Declaration Date Dividends"), equal to the excess, if any, of (x) the product of the dividend paid by us on such Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage applicable to the dividend in question and .50) over (y) the dividend paid by us on such Dividend Payment Date, will be payable (if declared) to Holders of Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date or, if the Preferred Stock is called for redemption prior to such record date, to Holders of Preferred Stock on the applicable redemption date, as the case may be, in addition to any other amounts payable on such date.

If any such amendment to the Code is enacted and the reduction in the Dividends-Received Percentage retroactively applies to a Dividend Payment Date as to which we previously paid dividends on the Preferred Stock (each, an "Affected Dividend Payment Date"), we will pay (if declared) additional dividends (the "Retroactive Dividends") to Holders of Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date (or, if such amendment is enacted after the dividend payable on such Dividend Payment Date has been declared, to Holders of Preferred Stock on the record date applicable to the second succeeding Dividend Payment Date following the date of enactment) or, if the Preferred Stock is called for redemption prior to such record date, to Holders of Preferred Stock on the applicable redemption date, as the case may be. Retroactive Dividends will equal the excess of (x) the product of the dividend paid by us on each Affected Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage and .50 applied to each Affected Dividend Payment Date) over (y) the sum of the dividend paid by us on each Affected Dividend Payment Date. We will only make one payment of Retroactive Dividends for any such amendment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, we receive either an unqualified opinion of nationally recognized independent tax counsel selected by us or a private letter ruling or similar form of authorization from the IRS to the effect that such amendment does not apply to a dividend payable on an Affected Dividend Payment Date for the Preferred Stock, then such amendment will not result in the payment of Retroactive Dividends with respect to such Affected Dividend Payment Date. The opinion referenced in the previous sentence shall be based upon the legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation.

Notwithstanding the foregoing, no adjustment in the dividends payable by us shall be made, and no Post Declaration Date Dividends or Retroactive Dividends shall be payable by us, in respect of the enactment of any amendment to the Code that reduces the Dividends-Received Percentage and occurs 18 months or more after the date of original issuance of the Preferred Stock.

In the event that the amount of dividends payable per share of the Preferred Stock is adjusted pursuant to the DRD Formula and/or Post Declaration Date Dividends or Retroactive Dividends are to be paid, we will give notice of each such adjustment and, if applicable, any Post Declaration Date Dividends and Retroactive Dividends to the Holders of Preferred Stock.

Debt Financed Purchases. Under existing law, a corporate shareholder's dividends-received deduction is reduced if the dividend is received with respect to "portfolio stock" that is "debt financed." Currently, "portfolio stock" is considered "debt financed" if a corporate shareholder incurs indebtedness "directly attributable" to a "portfolio stock" investment in another company, which would include an investment in the Preferred Stock. A proposal in the budget plan released by the Clinton Administration on February 1, 1999 (the "Budget Proposal") would modify the rules governing the reduction in the 70-percent dividends-received deduction in respect of a corporate shareholder's investment in "portfolio stock" that is "debt financed."

Under the Budget Proposal, the percentage of portfolio stock considered to be debt financed, and thus the percentage reduction in the dividends-received deduction, would equal the sum of (1) the percentage of stock directly financed by indebtedness and (2) the percentage of remaining stock "indirectly" financed by indebtedness. The percentage of portfolio stock that is indirectly financed by indebtedness would be determined by using a pro-rata allocation similar to the one used in section 264(f) of the Code, under which interest expense is allocated pro rata among the taxpayer's assets. This proposal would be effective for portfolio stock acquired on or after the date of enactment. It is possible that the effective date of this proposal could be amended to make the proposal, if enacted, applicable to preferred stock acquired before the date of enactment.

If, prior to 18 months after the date of the original issuance of the Preferred Stock, the Budget Proposal is enacted in substantially the form proposed (as determined by us in our sole discretion) and would (1) require a percentage reduction in a Holder's dividends-received deduction to the extent the Holder's investment in Preferred Stock was indirectly financed by indebtedness (determined using a pro rata allocation similar to that which is used in section 264(f) of the Code) and (2) be effective for Preferred Stock acquired on or after the effective date of the Budget Proposal's changes to the Code, certain adjustments may be made in respect of dividends payable by Fannie Mae as described below. However no adjustment shall be made unless prior to a Holder's acquisition of affected shares, Fannie Mae has been given the right to purchase those shares upon reasonable terms and at a fair market price, the determination of which shall be within Fannie Mae's sole discretion. The adjustment to dividends payable described in the following paragraph will be made only on shares of Preferred Stock that a Holder acquires on or after the effective date of such changes to the Code, and only if we were given the right to purchase those shares prior to such Holder's acquisition of the shares. There will be no adjustment to dividends payable on shares that a Holder acquires prior to the effective date of the changes to the Code.

If a Holder acquires shares of Preferred Stock under the circumstances described in the preceding paragraph, dividends will accrue on such shares at an adjusted rate from and including the date the Holder acquires such shares. The dividends payable on the transferred shares of Preferred Stock for the period beginning on the date of transfer shall be equal to (x) the amount of the dividend that would be payable for such period on such shares if the shares were not entitled to adjustment multiplied by (y) 1.08485 (the "Sale Factor"), rounded to the nearest cent (with one-half cent rounded upwards). Notwithstanding the foregoing provisions, if, with respect to any amendments to the Code described in the preceding paragraph, we receive either an unqualified opinion of a nationally recognized independent tax counsel selected by us or a private letter ruling or similar form of authorization from the IRS to the effect that such amendments do not apply to a dividend payable on the Preferred Stock, then such amendments will not result in the adjustment described above with respect to such dividend. The opinion shall be based upon the legislation amending the Code or upon a published pronouncement of the IRS addressing such legislation.

Notwithstanding the foregoing, if a Holder acquires shares of Preferred Stock under the circumstances described in the two preceding paragraphs but after the dividend payable on a Dividend Payment Date has been declared, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the "Second Post Declaration Date Dividends"), equal to the excess, if any, of (x) the dividend that would have been paid if the adjustment called for by the previous paragraph had been made over (y) the dividend paid by us on such Dividend Payment Date, will be payable (if declared) to Holders of Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date or, if the Preferred Stock is called for redemption prior to such record date, to Holders of Preferred Stock on the applicable redemption date, as the case may be, in addition to any other amounts payable on such date.

Notwithstanding the foregoing, no adjustment in the dividends payable by us shall be made, and no Second Post Declaration Date Dividends shall be payable by us, in respect of the enactment of the Budget Proposal 18 months or more after the date of original issuance of the Preferred Stock.

In the event that the amount of dividends payable per share of the Preferred Stock is adjusted and/or Second Post Declaration Date Dividends are to be paid with respect to certain shares of Preferred Stock, we will give notice of each such adjustment and, if applicable, any Second Post Declaration Date Dividends to the applicable Holders of such Preferred Stock.

Optional Redemption

The Preferred Stock is not subject to any mandatory redemption, sinking fund or other similar provisions. On or after April 15, 2004, we, at our option, may redeem the Preferred Stock, in whole or in part, at any time or from time to time, out of funds legally available therefor, at the redemption price of $50.00 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of redemption, including any adjustments in the amount of dividends as described under "Dividends—Changes in the Dividends-Received Deduction" above, but without accumulation of unpaid dividends on the Preferred Stock for prior dividend periods. If less than all of the outstanding shares of the Preferred Stock are to be redeemed, we will select shares to be redeemed from the outstanding shares not previously called for redemption by lot or pro rata (as nearly as possible) or by any other method that our Board of Directors, or a duly authorized committee, in its sole discretion deems equitable.

We will give notice of any redemption by mail to Holders of Preferred Stock not less than 30 days prior to the date fixed by the Board of Directors, or a duly authorized committee, for redemption. Each notice will state the number of shares of Preferred Stock to be redeemed and, if fewer than all of the shares of Preferred Stock held by the applicable Holder are to be redeemed, the number of shares to be redeemed from the Holder, the redemption price, the redemption date and the place at which the Holder's certificate(s) representing shares of the Preferred Stock must be presented upon redemption.

Under certain circumstances, we may need the approval of the Director prior to exercising our right to redeem shares of Preferred Stock. See "Regulatory Matters."

Holders of Preferred Stock will have no right to require redemption of Preferred Stock.

If we have given notice of redemption as described above, from and after the redemption date, dividends on the Preferred Stock called for redemption will cease to accrue and the Preferred Stock called for redemption will no longer be deemed outstanding, and all rights of the Holders as registered holders of the Preferred Stock will cease.

Liquidation Rights

Upon any voluntary or involuntary dissolution, liquidation or winding up of Fannie Mae, after payment or provision for our liabilities and the expenses of dissolution, liquidation or winding up, the Holders of the outstanding shares of the Preferred Stock will be entitled to receive out of our assets or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of our common stock (or any other stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Preferred Stock), the amount of $50.00 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such liquidation payment, including any adjustments in the amount of dividends as described under ''—Changes in the Dividends-Received Deduction'' above, but without accumulation of unpaid dividends on the Preferred Stock for prior dividend periods. If our assets available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of the Preferred Stock and holders of all other classes or series of our stock, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, on a parity with the Preferred Stock, the assets will be distributed to the Holders of Preferred Stock and holders of the other stock pro rata, based on the full respective preferential amounts to which they are entitled, including any adjustments in the amount of dividends as described under ''Dividends—Changes in the Dividends-Received Deduction'' above, but without accumulation of unpaid dividends on the Preferred Stock for prior dividend periods. After payment of the full amount of the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae to which they are entitled, the Holders of Preferred Stock will not be entitled to any further participation in any distribution of our assets.

Notwithstanding the foregoing, Holders of Preferred Stock will not be entitled to be paid any amount in respect of a dissolution, liquidation or winding up of Fannie Mae until holders of any classes or series of our stock ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, prior to the Preferred Stock have been paid all amounts to which these classes or series are entitled. At the time of issuance of the Preferred Stock, no class or series of stock ranking prior to the Preferred Stock with respect to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae will exist.

Neither the sale, lease or exchange (for cash, shares of stock, securities or other consideration) of all or substantially all of our property and assets, nor our merger, consolidation or combination into or with any other corporation or the merger, consolidation or combination of any other corporation into or with us, shall be deemed to be a dissolution, liquidation or winding up, voluntary or involuntary, for the purposes of these provisions on liquidation rights.

Regulatory Matters

Holders of Preferred Stock are entitled to receive dividends if, as and when declared by our Board of Directors, or a duly authorized committee. However, certain provisions of the 1992 Act may operate to restrict the ability of our Board of Directors to declare dividends in certain circumstances. The 1992 Act established minimum capital, risk-based capital, and critical capital levels for Fannie Mae, and required the Director of OFHEO to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital we must have to exceed the risk-based capital level from time to time. (See ''Government Regulation and Charter Act'' in this Offering Circular and the Information Statement for the current status of the required regulations.) Until one year after the final regulations establishing the risk-based capital test are in effect, a dividend may be paid without the prior approval of the Director if we meet the minimum capital level established under the 1992 Act and the dividend payment would not decrease our base capital below such level.

One year after final regulations establishing the risk-based capital test take effect, we may pay a dividend without the prior approval of the Director if we meet both the risk-based capital and minimum capital levels and the dividend payment would not decrease our total capital below the risk-based capital level or our core capital below the minimum capital level. If we meet either the risk-based capital standard or the minimum capital standard, we may make a dividend payment without obtaining the approval of the Director only if the dividend payment would not cause us to fail to meet another capital standard. At any time when we do not meet the risk-based capital standard but meet the minimum capital standard, we are prohibited from making a dividend payment that would cause us to fail to meet the minimum capital standard. If we meet neither the risk-based capital standard nor the minimum capital standard but do meet the critical capital standard established under the 1992 Act, we may make a dividend payment only if we would not fail to meet the critical capital standard as a result of such payment and the Director approves the payment after finding that it satisfies certain statutory conditions. The Director has the authority to require us to submit a report to the Director regarding any capital distribution (including any dividend) declared by us before we make the distribution. See also "Government Regulation and Charter Act" in this Offering Circular and in the Information Statement, and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements" in the Information Statement regarding the capital standards applicable to us.

Voting Rights; Amendments

Except as provided below, the Holders of Preferred Stock will not be entitled to any voting rights.

Without the consent of the Holders of Preferred Stock, we will have the right to amend, alter, supplement or repeal any terms of the Preferred Stock (1) to cure any ambiguity, or to cure, correct or supplement any defective provision contained in the Certificate of Designation or (2) to make any other provision with respect to matters or questions arising with respect to the Preferred Stock that is not inconsistent with the provisions of the Certificate of Designation so long as such action does not materially and adversely affect the interests of the Holders of Preferred Stock; *provided, however,* that any increase in the amount of authorized or issued Preferred Stock or the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of our stock, whether ranking prior to, on a parity with or junior to the Preferred Stock as to dividends or liquidation or otherwise, will not be deemed to materially and adversely affect the interests of the Holders of Preferred Stock. Otherwise, the terms of the Preferred Stock may be amended, altered, supplemented or repealed only with the consent of the Holders of at least two-thirds of the outstanding shares of Preferred Stock. On matters requiring their consent, Holders of Preferred Stock will be entitled to one vote per share.

Absence of Trading Market

We have not applied for listing of the Preferred Stock on any stock exchange and we do not expect an active trading market to develop with respect to the Preferred Stock. Accordingly, the ability of a Holder to dispose of the Preferred Stock may be limited.

LEGALITY OF INVESTMENT

National banks may purchase, hold and invest in the shares of Preferred Stock for their own accounts without regard to limitations generally applicable to investment securities. The Preferred Stock would be subject to a 100% risk weighting for federal capital adequacy purposes.

Federal savings associations and federal savings banks may invest in the shares of Preferred Stock without regard to limitations generally applicable to investments. Preferred Stock held by a federal savings association or federal savings bank would be subject to a 100% risk weighting for federal capital adequacy purposes.

Federally insured state-chartered banks, state-chartered savings banks and state-chartered savings and loan associations may invest in the shares of Preferred Stock to the extent permitted by the Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA") and by applicable state law, after complying with any procedures imposed by the state. Preferred Stock held by such an institution would be subject to a 100% risk weighting for federal capital adequacy purposes.

Federal credit unions may purchase the shares of Preferred Stock without regard to limitations generally applicable to investments.

The shares of Preferred Stock are "stock . . . of a corporation which is an instrumentality of the United States" within the meaning of § 7701(a)(19)(C)(ii) of the Code for purposes of the 60 percent of assets limitation applicable to domestic building and loan associations.

In addition to the specific authorizations discussed above, § 106(a)(1) of SMMEA provides that any person, trust, corporation, partnership, association, business trust or business entity created pursuant to or existing under the laws of the United States or any state (including the District of Columbia and Puerto Rico) (an "investor") is authorized to purchase, hold and invest in securities issued or guaranteed by us (including the shares of Preferred Stock) to the same extent that such investor is authorized to purchase, hold or invest in obligations issued or guaranteed as to principal and interest by the United States or any agency or instrumentality thereof. Prior to October 4, 1991, states were authorized by SMMEA to enact legislation that either prohibited or limited an investor's authority to purchase, hold or invest in securities issued or guaranteed by Fannie Mae. To the best of our knowledge, 18 states currently have legislation limiting to varying extents the ability of certain entities (in most cases, insurance companies) to invest in securities issued or guaranteed by us, including the shares of Preferred Stock.

Notwithstanding the above, investors should consult their legal advisors to determine whether and to what extent the shares of Preferred Stock constitute legal investments for such investors or are eligible to be used as security for borrowings. The foregoing does not take into consideration the application of statutes, regulations, orders, guidelines or agreements generally governing investments made by a particular investor, including but not limited to "prudent investor" provisions, safety and soundness conditions and percentage-of-assets limits. The regulatory authorities that administer the legal provisions referred to above generally reserve discretion as to whether securities, such as the Preferred Stock, that are otherwise acceptable for investment may be purchased or pledged by the institutions subject to their jurisdiction. An institution under the jurisdiction of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, or any other federal or state agency with similar authority should review any applicable regulations, policy statements and guidelines before purchasing the Preferred Stock.

UNITED STATES TAXATION

The Preferred Stock and payments thereon are not generally exempt from taxation by the United States or other U.S. or non-U.S. taxing jurisdictions.

In the opinion of Arnold & Porter, our special tax counsel, the following discussion correctly describes the principal U.S. federal income tax treatment of U.S. Persons (as defined below) that are beneficial owners ("Owners") of the Preferred Stock. This discussion does not address the U.S. federal income tax treatment of Owners that are not U.S. Persons. This discussion is based on the Code, existing and proposed Treasury regulations, revenue rulings and judicial decisions, changes to any of which subsequent to the date of this Offering Circular may affect the tax consequences described herein.

This summary discusses only preferred stock held as a capital asset (within the meaning of section 1221 of the Code). This discussion does not purport to address all of the U.S. federal income tax consequences that may be applicable to particular investors in light of their individual circumstances or to Owners subject to special rules, such as dealers in securities, certain financial institutions and certain securities traders. In all cases, investors are advised to consult their own tax advisors regarding the U.S. federal tax consequences to them of holding, owning and disposing of Preferred Stock, as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

For purposes of this discussion, "U.S. Person" generally means (1) a citizen or individual resident of the United States, (2) a corporation or partnership created or organized in or under the laws of the United States or any political subdivision thereof, (3) an estate the income of which is includible in its gross income for U.S. federal income tax purposes without regard to its source, or (4) a trust if a court within the United States is able to exercise primary supervision over its administration and at least one United States person has the authority to control all substantial decisions of the trust.

Dividends

Current Law

Dividends declared and paid on the Preferred Stock will be dividends for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits, as determined for federal income tax purposes, and will be taxable as ordinary income. Although we expect that our current and accumulated earnings and profits will be such that all dividends paid with respect to the Preferred Stock will qualify as dividends for federal income tax purposes, we cannot guarantee that result. Our accumulated earnings and profits or our current earnings and profits in future years will depend in significant part on our future profits or losses, which we cannot accurately predict. To the extent that the amount of any dividend paid on a share of Preferred Stock exceeds our current or accumulated earnings and profits for federal income tax purposes attributable to that share, such dividend will be treated first as a return of capital (rather than as ordinary income) and will be applied against and reduce the Owner's adjusted tax basis in that share of Preferred Stock. The amount of any such dividend in excess of the Owner's adjusted tax basis will then be taxed as capital gain. For purposes of the remainder of this discussion, it is assumed that dividends paid with respect to the Preferred Stock will constitute dividends for U.S. federal income tax purposes.

Dividends received by Owners that are corporations generally will be eligible for the 70-percent dividends-received deduction under section 243 of the Code. The 70-percent dividends-received deduction will not be available with respect to a dividend received on Preferred Stock that an Owner has held for 45 days or less (including the day of disposition, but excluding the day of acquisition) during the 90-day period beginning on the day which is 45 days before the date on which the Preferred Stock becomes ex-dividend with respect to that dividend. If the dividend is attributable to a period or periods aggregating more than 366 days, the dividend received deduction will be available only if the Owner has held the Preferred Stock for more than 90 days (including the day of disposition, but excluding the day of acquisition) during the 180-day period beginning 90 days before the date on which the Preferred Stock becomes ex-dividend. The length of time that a corporate shareholder is deemed to have held stock for these purposes is reduced for periods during which the shareholder's risk of loss with respect to the stock is diminished by reason of the existence of certain options, contracts to sell, short sales or other similar transactions. The aggregate dividends-received deduction allowed a corporate shareholder cannot exceed 70 percent of its taxable income (with certain adjustments). Moreover, the dividends-received deduction may be reduced if the stock is "debt financed." Stock is "debt financed" if a corporate shareholder incurs indebtedness "directly attributable" to a "portfolio stock" investment in another company, which would include an investment in the Preferred Stock.

Recent Proposals

On February 1, 1999, the Clinton Administration released a budget plan that includes certain tax proposals that may affect Owners of Preferred Stock. Under one of the proposals, the 70-percent dividends-received deduction generally available to corporate shareholders, as discussed above under "Current Law," would be eliminated for dividends on "nonqualified preferred stock" issued on or after the date of enactment. The Preferred Stock would not be affected by this proposal as it is currently drafted.

Another proposal in the Clinton Administration's budget plan would modify the rules governing the reduction in the 70-percent dividends-received deduction in respect of a corporate shareholder's investment in "portfolio stock" that is "debt financed." Under the proposal, the percentage of portfolio stock considered to be debt financed, and thus the percentage reduction in the dividends-received deduction, would equal the sum of (1) the percentage of stock directly financed by indebtedness and (2) the percentage of remaining stock ''indirectly'' financed by indebtedness. The percentage of portfolio stock that is indirectly financed by indebtedness would be determined by using a pro rata allocation similar to the one used in section 264(f) of the Code, under which interest expense is allocated pro rata among the taxpayer's assets. This proposal would be effective for portfolio stock acquired on or after the date of enactment. It is possible that the effective date of this proposal could be amended to make the proposal, if enacted, applicable to preferred stock acquired before the date of enactment. If this proposal is enacted and reduces the dividends-received deduction applicable to the Preferred Stock, the amount of dividends payable per share of Preferred Stock may be adjusted to the extent discussed above under ''Description of Preferred Stock — Dividends — Changes in the Dividends-Received Deduction — Debt Financed Purchases.''

Dispositions, Including Redemptions

Any sale, exchange, redemption (except as discussed below) or other disposition of the Preferred Stock generally will result in taxable gain or loss equal to the difference between the amount of cash received and the shareholder's adjusted tax basis in the Preferred Stock. Such gain or loss will be capital gain or loss and will be long-term capital gain or loss if the holding period for the Preferred Stock exceeds one year. Tax rates on capital gain for individual Owners vary depending on each Owner's income and holding period for the Preferred Stock. Owners that are individuals should contact their own tax advisors for more information or for the capital gains tax rate applicable to specific shares of Preferred Stock. The deduction of capital losses is subject to certain limitations.

A redemption of Preferred Stock may be treated as a dividend, rather than as payment in exchange for the Preferred Stock, unless the redemption is ''not essentially equivalent to a dividend'' with respect to the Owner within the meaning of section 302(b)(1) of the Code, ''is in complete redemption of all of the stock'' of Fannie Mae held by the Owner as described in section 302(b)(3) of the Code or otherwise meets the requirements of one of the other exceptions from dividend treatment provided in section 302(b) of the Code. In applying these rules, the Owner must take into account not only the Preferred Stock and other stock of Fannie Mae that it owns directly, but also the Preferred Stock and other stock in Fannie Mae that it constructively owns within the meaning of section 318 of the Code. Because of the complex nature of these rules, each Owner should consult its tax advisor to determine whether a redemption of Preferred Stock will be treated as a dividend or as payment in exchange for the Preferred Stock. If the redemption payment is treated as a dividend, the rules discussed above under ''Dividends'' apply.

Information Reporting and Backup Withholding

Payments of dividends on shares of Preferred Stock held of record by U.S. persons other than corporations and other exempt holders are required to be reported to the IRS.

Backup withholding of U.S. federal income tax at a rate of 31 percent may apply to payments made with respect to shares of Preferred Stock, as well as payments of proceeds from the sale of shares of Preferred Stock, to holders or Owners that are not ''exempt recipients'' and that fail to provide certain identifying information (such as the taxpayer identification number of the holder or Owner) in the manner required. Individuals generally are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients.

The U.S. federal tax discussion set forth above is included for general information only and may not be applicable depending upon an Owner's particular situation. Each Owner should consult its own tax advisor with respect to the tax consequences to it of the ownership and disposition of the Preferred Stock, including the tax consequences under the tax laws of the United States, states, localities, countries other than the United States and any other taxing jurisdiction and the possible effects of changes in such tax laws.

UNDERWRITING

Subject to the terms and conditions set forth in the underwriting agreement (the "Underwriting Agreement"), we have agreed to sell to Bear, Stearns & Co. Inc. (the "Underwriter"), and the Underwriter has agreed to purchase, 3,000,000 shares of Preferred Stock.

In the Underwriting Agreement, the Underwriter has agreed, subject to the terms and conditions set forth therein, to purchase all the Preferred Stock offered by this Offering Circular if any is purchased.

The Underwriter has advised us that the Underwriter proposes initially to offer the Preferred Stock to the public at the price set forth on the cover page of this Offering Circular.

Prior to this offering, there has been no public market for the Preferred Stock. The Preferred Stock has not been listed on any stock exchange.

In the Underwriting Agreement, we and the Underwriter have agreed to indemnify each other against and contribute toward certain liabilities.

The Underwriter and certain of its affiliates engage in transactions with and perform services for us in the ordinary course of business.

The Underwriter may engage in certain transactions that stabilize the price of the Preferred Stock. These transactions may include entering stabilizing bids, which means the placing of a bid or the effecting of a purchase for the purpose of pegging, fixing or maintaining the price of the Preferred Stock. Neither we nor the Underwriter makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the Preferred Stock. The Underwriter is not required to engage in any of these transactions. When so doing, the Underwriter acts on its own behalf and not as our representative. Any such transactions, if commenced, may be discontinued at any time.

VALIDITY OF THE PREFERRED STOCK

The validity of the Preferred Stock will be passed upon for us by Wilmer, Cutler & Pickering, Washington, D.C., and for the Underwriter by Sullivan & Cromwell, Washington, D.C. Certain U.S. federal income tax matters will be passed upon for us by Arnold & Porter, Washington, D.C.

APPENDIX A

CERTIFICATE OF DESIGNATION OF TERMS OF 5.10% NON-CUMULATIVE PREFERRED STOCK, SERIES E

1. Designation, Par Value and Number of Shares.

The designation of the series of preferred stock of the Federal National Mortgage Association (the "Corporation") created by this resolution shall be "5.10% Non-Cumulative Preferred Stock, Series E" (the "Series E Preferred Stock"), and the number of shares constituting the Series E Preferred Stock is Three Million (3,000,000). Shares of Series E Preferred Stock will have no par value and a stated value and liquidation preference of $50 per share. The Board of Directors of the Corporation, or a duly authorized committee thereof, in its sole discretion, may increase the number of shares of Series E Preferred Stock and may reduce the number of shares of Series E Preferred Stock, provided such reduction is not below the number of shares of Series E Preferred Stock then outstanding.

2. Dividends.

(a) Holders of record of Series E Preferred Stock (each individually a "Holder", or collectively the "Holders") will be entitled to receive, when, as and if declared by the Board of Directors of the Corporation, or a duly authorized committee thereof, in its sole discretion out of funds legally available therefor, non-cumulative, quarterly cash dividends which will accrue from and including April 15, 1999, and will be payable on March 31, June 30, September 30 and December 31 of each year (each, a "Dividend Payment Date"), commencing June 30, 1999, at the annual rate of $2.55 per share or 5.10% of the stated value and liquidation preference of $50 per share (without taking into account any adjustments referred to in paragraphs (b)and (c) of this Section 2). Dividends on the Series E Preferred Stock will be payable to the Holders as they appear on the books and records of the Corporation on the relevant record date fixed by the Board of Directors, or a duly authorized committee thereof, which may not be earlier than 45 days or later than 10 days prior to the applicable Dividend Payment Date. If declared, the initial dividend, which will be for the period from and including April 15, 1999 to but excluding June 30, 1999, will be $.53125 per share. Thereafter, the dividend period relating to a Dividend Payment Date will be the period from and including the preceding Dividend Payment Date to but excluding such Dividend Payment Date. If a Dividend Payment Date is not a Business Day, dividends (if declared) on the Series E Preferred Stock will be paid on the succeeding Business Day, without interest. A "Business Day" shall mean any day other than a Saturday, Sunday or other day on which banking institutions in New York, New York are authorized or required by law to close. Dividends payable on the Series E Preferred Stock for any period greater or less than a full dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months and the actual number of days elapsed in any period of less than one month. Dividends payable on the Series E Preferred Stock for each full dividend period will be computed by dividing the per annum dividend rate by four.

(b) (i) If, prior to 18 months after the date of original issuance of the Series E Preferred Stock, one or more amendments to the Internal Revenue Code of 1986, as amended (the "Code"), are enacted that reduce the percentage of the dividends-received deduction applicable to the Series E Preferred Stock (a "Dividends-Received Reduction Amendment") as specified in section 243(a)(1) of the Code or any successor provision thereto (the "Dividends-Received Percentage"), the adjustments set forth in this paragraph (b) shall be made in respect of the dividends payable by the Corporation.

(ii) Subject to subclauses (v) and (vi) of this paragraph (b), the amount of each dividend payable (if declared) per share of Series E Preferred Stock for dividend payments made on or after the effective date of a Dividends-Received Reduction Amendment will be adjusted by multiplying the amount of the dividend payable pursuant to paragraph (a) of this Section 2 (before adjustment) by a factor, which will be the number determined in accordance with the following formula (the "DRD Formula"), and rounding the result to the nearest cent (with one-half cent rounded up):

$$\frac{1-.35(1-.70)}{1-.35(1-\text{DRP})}$$

For the purposes of the DRD Formula, "DRP" means the Dividends-Received Percentage (expressed as a decimal) applicable to the dividend in question; *provided, however,* that if the Dividends-Received Percentage applicable to the dividend in question shall be less than 50%, then the DRP shall equal .50. No amendment to the Code, other than a change in the percentage of the dividends-received deduction applicable to the Series E Preferred Stock as set forth in section 243(a)(1) of the Code or any successor provision thereto, will give rise to an adjustment.

(iii) Notwithstanding the foregoing and subject to subclauses (v) and (vi) of this paragraph (b), if any Dividends-Received Reduction Amendment is enacted after the dividend payable on a Dividend Payment Date has been declared, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the "Post Declaration Date Dividends"), equal to the excess, if any, of (x) the product of the dividend paid by the Corporation on such Divided Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage applicable to the dividend in question and .50) over (y) the dividend paid by the Corporation on such Dividend Payment Date, will be payable (if declared) to Holders on the record date applicable to the next succeeding Dividend Payment Date or, if the Series E Preferred Stock is called for redemption prior to such record date, to Holders on the applicable redemption date, as the case may be, in addition to any other amounts payable on such date.

(iv) Subject to subclauses (v) and (vi) of this paragraph (b), if any Dividends-Received Reduction Amendment is enacted and the reduction in the Dividends-Received Percentage retroactively applies to a Dividend Payment Date as to which the Corporation previously paid dividends on the Series E Preferred Stock (each, an "Affected Dividend Payment Date"), the Corporation will pay (if declared) additional dividends (the "Retroactive Dividends") to Holders on the record date applicable to the next succeeding Dividend Payment Date (or, if such amendment is enacted after the dividend payable on such Dividend Payment Date has been declared, to Holders on the record date applicable to the second succeeding Dividend Payment Date following the date of enactment) or, if the Series E Preferred Stock is called for redemption prior to such record date, to Holders on the applicable redemption date, as the case may be, in an amount equal to the excess of (x) the product of the dividend paid by the Corporation on each Affected Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage and .50 applied to each Affected Dividend Payment Date) over (y) the sum of the dividend paid by the Corporation on each Affected Dividend Payment Date. The Corporation will only make one payment of Retroactive Dividends for any such amendment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, the Corporation receives either an unqualified opinion of nationally recognized independent tax counsel selected by the Corporation or a private letter ruling or similar form of authorization from the IRS to the effect that such amendment does not apply to a dividend payable on an Affected Dividend Payment Date for the Series E Preferred Stock, then such amendment will not result in the payment of Retroactive Dividends with respect to such Affected Dividend Payment Date. The opinion referenced in the previous sentence shall be based upon legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation.

(v) Notwithstanding the foregoing provisions, if, with respect to any Dividends-Received Reduction Amendment, the Corporation receives either an unqualified opinion (which opinion shall be based on the Dividends-Received Reduction Amendment or upon a published pronouncement of the IRS addressing such legislation) of nationally recognized independent tax counsel selected by the Corporation or a private letter ruling or similar form of authorization from the Internal Revenue Service (the "IRS") to the effect that such an amendment does not apply to a dividend payable on the Series E Preferred Stock, then such amendment will not result in the adjustment provided for pursuant to the DRD Formula with respect to such dividend. Unless the context otherwise requires, references to dividends herein will mean dividends as adjusted by the DRD Formula. The Corporation's calculation of the dividends payable as so adjusted shall be final and not subject to review.

(vi) Notwithstanding the foregoing, no adjustment in the dividends payable by the Corporation shall be made, and no Post Declaration Date Dividends or Retroactive Dividends shall be payable by the Corporation, in respect of the enactment of any Dividends-Received Reduction Amendment occurring 18 months or more after the date of original issuance of the Series E Preferred Stock.

(vii) In the event that the amount of dividends payable per share of Series E Preferred Stock is adjusted pursuant to the DRD Formula and/or Post Declaration Date Dividends or Retroactive Dividends are to be paid, the Corporation will cause notice of each such adjustment and, if applicable, Post Declaration Date Dividends and Retroactive Dividends to be given as soon as practicable to the Holders of Series E Preferred Stock.

(c)(i) If one or more amendments to the Code (the "Debt Financed Purchase Amendments") are enacted in substantially the form that was proposed by the President of the United States in a budget plan released on February 1, 1999 (the determination of which shall be in the Corporation's sole discretion) and that (1) would deny a percentage of a corporation's dividends-received deduction attributable to the percentage of Series E Preferred Stock that is indirectly financed by indebtedness (including using a pro-rata allocation of interest expense similar to the one used in section 264(f) of the Code) and (2) would be effective for Series E Preferred Stock acquired on or after the effective date of such changes to the Code, the adjustments set forth in this paragraph (c) (the "Debt Financed Purchase Adjustments") shall be made in respect of dividends payable by the Corporation; *provided, however,* that no Debt Financed Purchase Adjustments shall be made unless the Corporation has been offered the right to purchase the affected shares of Series E Preferred Stock pursuant to subclause (vi) of this paragraph (c).

(ii) Subject to subclauses (iv) through (vi) of this paragraph (c), upon any transfer of shares of Series E Preferred Stock that closes on or after the effective date of the Debt Financed Purchase Amendments, the dividends payable on the transferred shares of Series E Preferred Stock for the period beginning on the date of transfer shall be equal to (1) the amount of the dividend that would be payable for such period on such shares if the shares were not entitled to adjustment multiplied by (2) 1.08485 (the "Sale Factor"), rounded to the nearest cent (with one-half cent rounded upwards).

(iii) Notwithstanding the foregoing, if a Debt Financed Purchase Adjustment is required after the dividend payable on a Dividend Payment Date has been declared, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the "Second Post Declaration Date Dividends"), equal to the excess, if any, of (x) the amount of the dividend that would have been payable if the adjustment described in subclause (ii) of this paragraph (c) had been made over (y) the dividend paid by the Corporation on such Dividend Payment Date, will be payable (if declared) to the Holders of the affected shares of Series E Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date or, if the Series E Preferred Stock is called for redemption prior to such record date, to Holders of the affected shares of Series E Preferred Stock on the applicable redemption date, as the case may be, in addition to any other amounts payable on such date.

(iv) Notwithstanding the foregoing provisions, if, with respect to the Debt Financed Purchase Amendments, the Corporation receives either an unqualified opinion (which shall be based upon the Debt Financed Purchase Amendments or upon a published pronouncement of the IRS addressing such amendments) of a nationally recognized independent tax counsel selected by the Corporation or a private letter ruling or similar form of authorization from the IRS to the effect that such amendments do not apply to a dividend payable on the Series E Preferred Stock, then such amendments will not result in a Debt Financed Purchase Adjustment.

(v) Notwithstanding the foregoing, no adjustment in the dividends payable by the Corporation shall be made, and no Second Post Declaration Date Dividends shall be payable by the Corporation, in respect of the enactment of any Debt Financed Purchase Amendment occurring 18 months or more after the date of original issuance of the Series E Preferred Stock.

(vi) No Debt Financed Purchase Adjustment shall be made, or Second Post Declaration Date Dividends paid, to any Holder of shares of Series E Preferred Stock unless, after the date of enactment of the Debt Financed Purchase Amendment and prior to any transfer to the Holder that gives rise to the rights to such adjustment, the Corporation is offered the right to purchase such shares upon reasonable terms and at a fair market price (which determination shall be in the sole discretion of the Corporation). If the Corporation has not notified the Holder of its intent to exercise such right in writing within three trading days of receipt of written notice from the Holder, the Corporation will be deemed to have declined to exercise such right.

(vii) If a Debt Financed Purchase Adjustment is made, or Second Post Declaration Date Dividends are to be paid, with respect to certain shares of Series E Preferred Stock, the Corporation will give notice of each such occurrence to the applicable Holders of such shares of Series E Preferred Stock.

(d) No dividend (other than dividends or distributions paid in shares of, or options, warrants or rights to subscribe for or purchase shares of, the common stock of the Corporation or any other stock of the Corporation ranking, as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the Corporation, junior to the Series E Preferred Stock) may be declared or paid or set apart for payment on the Corporation's common stock (or on any other stock of the Corporation ranking, as to the payment of dividends, junior to the Series E Preferred Stock) unless dividends have been declared and paid or set apart (or ordered to be set apart) on the Series E Preferred Stock for the then-current quarterly dividend period; provided, however, that the foregoing dividend preference shall not be cumulative and shall not in any way create any claim or right in favor of the Holders of Series E Preferred Stock in the event that dividends have not been declared or paid or set apart (or ordered to be set apart) on the Series E Preferred Stock in respect of any prior dividend period. If the full dividend on the Series E Preferred Stock is not paid for any quarterly dividend period, the Holders of Series E Preferred Stock will have no claim in respect of the unpaid amount so long as no dividend (other than those referred to above) is paid on the Corporation's common stock (or any other stock of the Corporation ranking, as to the payment of dividends, junior to the Series E Preferred Stock) for such dividend period.

(e) The Board of Directors of the Corporation, or a duly authorized committee thereof, may, in its discretion, choose to pay dividends on the Series E Preferred Stock without the payment of any dividends on the Corporation's common stock (or any other stock of the Corporation ranking, as to the payment of dividends, junior to the Series E Preferred Stock).

(f) No full dividends shall be declared or paid or set apart for payment on any stock of the Corporation ranking, as to the payment of dividends, on a parity with the Series E Preferred Stock for any period unless full dividends have been declared and paid or set apart for payment on the Series E Preferred Stock for the then-current quarterly dividend period. When dividends are not paid in full upon the Series E Preferred Stock and all other classes or series of stock of the Corporation, if any, ranking, as to the payment of dividends, on a parity with the Series E Preferred Stock, all dividends declared upon shares of Series E Preferred Stock and all such other stock of the Corporation will be declared pro rata so that the amount of dividends declared per share of Series E Preferred Stock and all such other stock will in all cases bear to each other the same ratio that accrued dividends per share of Series E Preferred Stock (including any adjustments in dividends payable pursuant to Sections 2(b) and 2(c) but without accumulation of unpaid dividends on the Series E Preferred Stock for prior dividend periods) and such other stock bear to each other.

(g) No dividends may be declared or paid or set apart for payment on any shares of Series E Preferred Stock if at the same time any arrears exist or default exists in the payment of dividends on any outstanding class or series of stock of the Corporation ranking, as to the payment of dividends, prior to the Series E Preferred Stock.

(h) Holders of Series E Preferred Stock will not be entitled to any dividends, whether payable in cash or property, other than as herein provided and will not be entitled to interest, or any sum in lieu of interest, in respect of any dividend payment.

3. Optional Redemption.

(a) On or after April 15, 2004, the Corporation, at its option, may redeem the Series E Preferred Stock, in whole or in part, at any time or from time to time, out of funds legally available therefor, at the redemption price of $50.00 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such redemption, including any adjustments in dividends payable pursuant to Sections 2(b) and 2(c) but without accumulation of unpaid dividends on the Series E Preferred Stock for prior dividend periods. If less than all of the outstanding shares of Series E Preferred Stock are to be redeemed, the Corporation will select the shares to be redeemed from the outstanding shares not previously called for redemption by lot or pro rata (as nearly as possible) or by any other method that the Board of Directors of the Corporation, or a duly authorized committee thereof, in its sole discretion deems equitable.

(b) In the event the Corporation shall redeem any or all of the Series E Preferred Stock as aforesaid, the Corporation will give notice of any such redemption to Holders of Series E Preferred Stock not less than 30 days prior to the date fixed by the Board of Directors of the Corporation, or duly authorized committee thereof, for such redemption. Each such notice will state: (1) the number of shares of Series E Preferred Stock to be redeemed and, if fewer than all of the shares of Series E Preferred Stock held by a Holder are to be redeemed, the number of shares to be redeemed from such Holder; (2) the redemption price; (3) the redemption date; and (4) the place at which a Holder's certificate(s) representing shares of Series E Preferred Stock must be presented upon such redemption. Failure to give notice, or any defect in the notice, to any Holder of Series E Preferred Stock shall not affect the validity of the proceedings for the redemption of shares of any other Holder of Series E Preferred Stock being redeemed.

(c) Notice having been given as herein provided, from and after the redemption date, dividends on the Series E Preferred Stock called for redemption shall cease to accrue and such Series E Preferred Stock called for redemption will no longer be deemed outstanding, and all rights of the Holders thereof as registered holders of such shares of Series E Preferred Stock will cease. Upon surrender in accordance with said notice of the certificate(s) representing shares of Series E Preferred Stock so redeemed (properly endorsed or assigned for transfer, if the Board of Directors of the Corporation, or a duly authorized committee thereof, shall so require and the notice shall so state), such shares shall be redeemed by the Corporation at the redemption price aforesaid. Any shares of Series E Preferred Stock that shall at any time have been redeemed shall, after such redemption, be cancelled and not reissued. In case fewer than all the shares represented by any such certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without cost to the Holder thereof.

(d) The Series E Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. In addition, Holders of Series E Preferred Stock will have no right to require redemption of any shares of Series E Preferred Stock.

4. Liquidation Rights.

(a) Upon any voluntary or involuntary dissolution, liquidation or winding up of the Corporation, after payment or provision for the liabilities of the Corporation and the expenses of such dissolution, liquidation or winding up, the Holders of outstanding shares of the Series E Preferred Stock will be entitled to receive out of the assets of the Corporation or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of the Corporation's common stock (or any other stock of the Corporation ranking, as to the distribution of assets upon dissolution, liquidation or winding up of the Corporation, junior to the Series E Preferred Stock), the amount of $50.00 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such liquidation payment, including any adjustments in dividends payable pursuant to Sections 2(b) and 2(c) but without accumulation of unpaid dividends on the Series E Preferred Stock for prior dividend periods.

(b) If the assets of the Corporation available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of Series E Preferred Stock and holders of all other classes or series of stock of the Corporation, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of the Corporation, on a parity with the Series E Preferred Stock, the assets will be distributed to the Holders of Series E Preferred Stock and holders of all such other stock pro rata, based on the full respective preferential amounts to which they are entitled, including any adjustments in dividends payable pursuant to Sections 2(b) and 2(c) but without accumulation of unpaid dividends on the Series E Preferred Stock for prior dividend periods.

(c) Notwithstanding the foregoing, Holders of Series E Preferred Stock will not be entitled to be paid any amount in respect of a dissolution, liquidation or winding up of the Corporation until holders of any classes or series of stock of the Corporation ranking, as to the distribution of assets upon dissolution, liquidation or winding up of the Corporation, prior to the Series E Preferred Stock have been paid all amounts to which such classes or series are entitled.

(d) Neither the sale, lease or exchange (for cash, shares of stock, securities or other consideration) of all or substantially all of the property and assets of the Corporation, nor the merger, consolidation or combination of the Corporation into or with any other corporation or the merger, consolidation or combination of any other corporation into or with the Corporation, shall be deemed to be a dissolution, liquidation or winding up, voluntary or involuntary, for the purposes of this Section 4.

(e) After payment of the full amount of the distribution of assets upon dissolution, liquidation or winding up of the Corporation to which they are entitled pursuant to paragraphs (a), (b) and (c) of this Section 4, the Holders of Series E Preferred Stock will not be entitled to any further participation in any distribution of assets by the Corporation.

5. No Conversion or Exchange Rights.

The Holders of shares of Series E Preferred Stock will not have any rights to convert such shares into or exchange such shares for shares of any other class or classes, or of any other series of any class or classes, of stock or obligations of the Corporation.

6. No Pre-emptive Rights.

No Holder of Series E Preferred Stock shall be entitled as a matter of right to subscribe for or purchase, or have any pre-emptive right with respect to, any part of any new or additional issue of stock of any class whatsoever, or of securities convertible into any stock of any class whatsoever, whether now or hereafter authorized and whether issued for cash or other consideration or by way of dividend.

7. Voting Rights; Amendments.

(a) Except as provided below, the Holders of Series E Preferred Stock will not be entitled to any voting rights, either general or special.

(b) Without the consent of the Holders of Series E Preferred Stock, the Corporation will have the right to amend, alter, supplement or repeal any terms of the Series E Preferred Stock (i) to cure any ambiguity, or to cure, correct or supplement any defective provision contained in this Certificate of Designation or (ii) to make any other provision with respect to matters or questions arising with respect to the Series E Preferred Stock that is not inconsistent with the provisions of this Certificate of Designation so long as such action does not materially and adversely affect the interests of the Holders of Series E Preferred Stock; *provided, however,* that any increase in the amount of authorized or issued Series E Preferred Stock or the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of stock of the Corporation, whether ranking prior to, on a parity with or junior to the Series E Preferred Stock, as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Corporation, or otherwise, will not be deemed to materially and adversely affect the interests of the Holders of Series E Preferred Stock.

(c) Except as set forth in paragraph (b) of this Section 7, the terms of the Series E Preferred Stock may be amended, altered, supplemented or repealed only with the consent of the Holders of at least two-thirds of the shares of Series E Preferred Stock then outstanding, given in person or by proxy, either in writing or at a meeting of stockholders at which the Holders of Series E Preferred Stock shall vote separately as a class. On matters requiring their consent, Holders of Series E Preferred Stock will be entitled to one vote per share.

(d) The rules and procedures for calling and conducting any meeting of Holders (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents, and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules that the Board of Directors of the Corporation, or a duly authorized committee thereof, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of any national securities exchange on which the shares of the Series E Preferred Stock are listed at the time.

8. Additional Classes or Series of Stock.

The Board of Directors of the Corporation, or a duly authorized committee thereof, shall have the right at any time in the future to authorize, create and issue, by resolution or resolutions, one or more additional classes or series of stock of the Corporation, and to determine and fix the distinguishing characteristics and the relative rights, preferences, privileges and other terms of the shares thereof. Any such class or series of stock may rank prior to, on a parity with or junior to the Series E Preferred Stock as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Corporation, or otherwise.

9. Priority.

For purposes of this Certificate of Designation, any stock of any class or series of the Corporation shall be deemed to rank:

(a) Prior to the shares of Series E Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Corporation, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of the Corporation, as the case may be, in preference or priority to the Holders of shares of Series E Preferred Stock.

(b) On a parity with shares of Series E Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Corporation, whether or not the dividend rates or amounts, dividend payment dates or redemption or liquidation prices per share, if any, be different from those of the Series E Preferred Stock, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of the Corporation, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other, as between the holders of such class or series and the Holders of shares of Series E Preferred Stock.

(c) Junior to shares of Series E Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Corporation, if such class shall be common stock of the Corporation or if the Holders of shares of Series E Preferred Stock shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of the Corporation, as the case may be, in preference or priority over the holders of such class or series.

(d) The shares of Preferred Stock of the Corporation designated "6.41% Non-Cumulative Preferred Stock, Series A" (the "Series A Preferred Stock"), "6.50% Non-Cumulative Preferred Stock, Series B" (the "Series B Preferred Stock"), "6.45% Non-Cumulative Preferred Stock, Series C" ("the Series C Preferred Stock") and "5.25% Non-Cumulative Preferred Stock, Series D" (the "Series D Preferred Stock") shall be deemed to rank on a parity with shares of Series E Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the Corporation. Accordingly, the holders of record of Series A Preferred Stock, the holders of record of Series B Preferred Stock, the holders of record of Series C Preferred

Stock, the holders of record of Series D Preferred Stock and the Holders of Series E Preferred Stock shall be entitled to the receipt of dividends and of amounts distributable upon dissolution, liquidation or winding up of the Corporation, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other.

10. Transfer Agent, Dividend Disbursing Agent and Registrar.

The Corporation hereby appoints First Chicago Trust Company of New York, a division of EquiServe, as its initial transfer agent, dividend disbursing agent and registrar for the Series E Preferred Stock. The Corporation may at any time designate an additional or substitute transfer agent, dividend disbursing agent and registrar for the Series E Preferred Stock.

11. Notices.

Any notice provided or permitted by this Certificate of Designation to be made upon, or given or furnished to, the Holders of Series E Preferred Stock by the Corporation shall be made by first-class mail, postage prepaid, to the addresses of such Holders as they appear on the books and records of the Corporation. Such notice shall be deemed to have been sufficiently made upon deposit thereof in the United States mail. Notwithstanding anything to the contrary contained herein, in the case of the suspension of regular mail service or by reason of any other cause it shall be impracticable, in the Corporation's judgment, to give notice by mail, then such notification may be made, in the Corporation's discretion, by publication in a newspaper of general circulation in The City of New York or by hand delivery to the addresses of Holders as they appear on the books and records of the Corporation.

With respect to any right to purchase shares of the Series E Preferred Stock afforded the Corporation under Section 2(c)(vi) hereof, a Holder must submit notice via facsimile transmission of the terms and price of the offer to each of the following persons at the Corporation:

Facsimile number: (202) 752-5980
Attention: Executive Vice President and Chief Financial Officer

Facsimile number: (202) 752-4948
Attention: General Counsel

Facsimile number: (202) 752-0410
Attention: Vice President - Corporate Finance

The notice also must contain the name, title, address, telephone number and facsimile transmission number of an authorized representative of the Holder to whom the Corporation should respond.

RECEIPT AND ACCEPTANCE OF A SHARE OR SHARES OF THE SERIES E PREFERRED STOCK BY OR ON BEHALF OF A HOLDER SHALL CONSTITUTE THE UNCONDITIONAL ACCEPTANCE BY SUCH HOLDER (AND ALL OTHERS HAVING BENEFICIAL OWNERSHIP OF SUCH SHARE OR SHARES) OF ALL OF THE TERMS AND PROVISIONS OF THIS CERTIFICATE OF DESIGNATION. NO SIGNATURE OR OTHER FURTHER MANIFESTATION OF ASSENT TO THE TERMS AND PROVISIONS OF THIS CERTIFICATE OF DESIGNATION SHALL BE NECESSARY FOR ITS OPERATION OR EFFECT AS BETWEEN THE CORPORATION AND THE HOLDER (AND ALL SUCH OTHERS).

Information Statement

FannieMae

This Information Statement describes the business and operations of the Federal National Mortgage Association ("Fannie Mae" or the "Corporation") as of March 31, 1999 and its financial condition as of December 31, 1998.

In connection with offerings of securities, Fannie Mae distributes Offering Circulars, Prospectuses, or other offering documents that describe securities offered, their selling arrangements and other information. Although typically incorporated by reference into such selling documents, the Information Statement does not offer any securities for sale. Any incorporation of this Information Statement by reference includes all supplements hereto. You may obtain copies of Fannie Mae's current Information Statement, any supplements thereto and other available information from the office listed on page 2.

This Information Statement contains Fannie Mae's audited financial statements for the year ended December 31, 1998. Fannie Mae updates its Information Statement quarterly.

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

Fannie Mae's securities are not required to be registered under the Securities Act of 1933. At the close of business on February 28, 1999, approximately 1,027 million shares of Fannie Mae's common stock (without par value) were outstanding.

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

March 31, 1999

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DOCUMENTS INCORPORATED BY REFERENCE

Fannie Mae's Proxy Statement for the 1998 Annual Meeting of Shareholders is incorporated by reference herein under "Management—Additional Information." Any later proxy statement published by Fannie Mae prior to the publication of a new Information Statement is incorporated herein by this reference. Fannie Mae will supplement this Information Statement to reflect its quarterly financial results and other events and information as Fannie Mae determines. References to the "Information Statement" include any documents incorporated herein by reference and any applicable amendments or supplements hereto. If Fannie Mae modifies or updates information in the Information Statement in a later supplement or in a document incorporated by reference in this Information Statement, the information as modified or updated replaces the information initially reported by Fannie Mae in this Information Statement.

AVAILABLE INFORMATION

Fannie Mae periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about Fannie Mae. You may obtain copies of this Information Statement, any supplements relating hereto, as well as Fannie Mae's annual and quarterly reports to stockholders, the Federal National Mortgage Association Charter Act, Fannie Mae's bylaws and other information regarding Fannie Mae without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone: (202/752-7115)). This Information Statement also is available from Fannie Mae by accessing the Corporation's World Wide Web site at http://www.fanniemae.com. You may inspect reports and other information concerning Fannie Mae at the offices of the New York Stock Exchange, the Chicago Stock Exchange and the Pacific Stock Exchange. Fannie Mae does not file reports or other information with the Securities and Exchange Commission.

BUSINESS

General

Fannie Mae is a federally chartered and stockholder-owned corporation, and is the largest investor in home mortgage loans in the United States. Fannie Mae was established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market, and was transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

Fannie Mae provides funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. Fannie Mae acquires funds to purchase these loans by issuing debt securities to capital market investors, many of whom ordinarily would not invest in mortgages. In this manner, Fannie Mae is able to expand the total amount of funds available for housing.

Fannie Mae also issues Mortgage-Backed Securities ("MBS"), receiving guaranty fees for its guarantee of timely payment of principal and interest on MBS certificates. Fannie Mae issues MBS primarily in exchange for pools of mortgage loans from lenders. The issuance of MBS enables Fannie Mae to further its statutory purpose of increasing the liquidity of residential mortgage loans.

In addition, Fannie Mae offers various services to lenders and others for a fee. These services include issuing certain types of MBS and providing technology services for originating and underwriting loans.

For information regarding Fannie Mae's mortgage loan, MBS and other activities in 1998, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

Mortgage Loan Portfolio

Mortgage Loans Purchased

Fannie Mae purchases primarily single-family, conventional (i.e., not federally insured or guaranteed), fixed- or adjustable-rate ("ARMs"), first mortgage loans, but it also purchases other types of residential mortgage loans for its loan portfolio, including mortgage loans insured by the Federal Housing Administration ("FHA"), mortgage loans guaranteed by the Department of Veterans Affairs ("VA"), mortgage loans guaranteed by the Rural Housing Service, multifamily mortgage loans and second mortgage loans (i.e., loans secured by second liens). The Corporation's purchases have a variety of maturities. Fannie Mae's purchases of ARMs, fixed-rate loans with intermediate terms of 20 years or less, and second mortgage loans are designed to provide a secondary market for a variety of loans that may be attractive to homeowners.

The composition of Fannie Mae's loan portfolio at the end of each of the last five years is shown in the table in "Portfolio Composition." The composition of its purchases during the last three years is shown in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Mortgage Portfolio." Of the single-family and multifamily mortgage loans that the Corporation purchased in 1998, including mortgage-backed securities, approximately 77 percent (measured by unpaid principal balance ("UPB")) were from investment banking companies, 8 percent were from mortgage banking companies, 6 percent were from commercial and mutual savings banks, 4 percent were from savings and loan associations and 5 percent were from other institutions. All of Fannie Mae's mortgage loan purchases from investment banking companies were through purchases of mortgage-backed securities.

Principal Balance Limits. Maximum principal balance limits apply to Fannie Mae's mortgage loan purchases. For 1998, Fannie Mae could not purchase conventional mortgage loans on single-family dwellings if the loan's original principal balance exceeded $227,150, except for loans secured by properties in Alaska, Hawaii and the Virgin Islands. Higher principal balance limits apply to loans secured by properties in those areas or secured by two- to four-family dwelling units. The maximum principal balance limits applicable to conventional mortgage loans secured by one- to four-family dwellings can be adjusted by Fannie Mae annually based on the national average price of a single-family dwelling as surveyed by the Federal Housing Finance Board. In January 1999, Fannie Mae increased its maximum principal balance limit to $240,000.

Prior to last year, maximum principal balance limits also applied to Fannie Mae's purchases of conventional multifamily mortgage loans. These limits were removed by the VA-HUD fiscal year 1999 appropriations bill.

Mortgage loans insured by the FHA or guaranteed by the Rural Housing Service are subject to statutory maximum amount limitations. Fannie Mae will not purchase VA-guaranteed mortgage loans that have principal amounts in excess of amounts that Fannie Mae specifies from time to time.

Fixed-Rate/Adjustable-Rate. Substantially all fixed-rate mortgage loans purchased by Fannie Mae provide for level monthly installments of principal and interest. Some of these loans (1 percent of the single-family portfolio at December 31, 1998) have balloon payments due 5, 7 or 10 years after origination, but with monthly payments based on longer (in many cases 30-year) amortization schedules. Many of the 7-year balloon single-family mortgage loans permit the borrower to refinance the balloon payment at maturity with a 23-year fixed-rate mortgage loan if certain requirements are satisfied. Many of the multifamily mortgage loans have balloon payments due 5, 7, 10 or 15 years after origination, but with payments based on 25- or 30-year amortization schedules.

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

Fannie Mae also purchases certain ARMs, called reverse mortgages, that provide for monthly installments of principal to be paid to the borrower. Over the life of the loan, interest and certain other fees accrue on the balance of the payments made to the borrower. Fannie Mae currently purchases reverse mortgages only if the reverse mortgages are subject to a cap on the amount the interest rate may change over the life of the loan. Generally, the loan is due when the borrower no longer occupies the property.

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

Repayments

Substantially all of the single-family mortgage loans in Fannie Mae's portfolio are prepayable by the borrower without penalty. Therefore, Fannie Mae bears the risk that prepayments may increase when interest rates decline significantly or as a result of other factors. Fannie Mae manages this risk as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Interest Rate Risk Management." Most multifamily loans in Fannie Mae's portfolio provide for a prepayment premium that is calculated under a formula that is intended to protect Fannie Mae from loss of yield on its investment in the mortgage loan being prepaid.

Portfolio Composition

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

Mortgage Loan Portfolio Composition
(Dollars in millions)

	December 31,				
	1998	**1997**	**1996**	**1995**	**1994**
Single-family:					
Government insured or guaranteed	$ 21,805	$ 19,478	$ 15,912	$ 13,102	$ 11,659
Conventional:					
Long-term, fixed-rate	297,106	211,541	177,070	140,466	109,079
Intermediate-term, fixed-rate	71,560	61,571	66,284	68,752	68,166
Adjustable-rate	11,873	11,373	12,783	15,108	16,718
Second	206	268	323	423	536
Multifamily	11,965	12,447	14,680	15,660	15,899
Total UPB	$ 414,515	$316,678	$287,052	$253,511	$222,057
Yield	7.12%	7.60%	7.69%	7.80%	7.80%

Commitments

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

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

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

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

Underwriting Guidelines

Fannie Mae has established certain underwriting guidelines for purchases of conventional mortgage loans to help reduce the risk of loss from mortgagor defaults. These guidelines are designed to assess the creditworthiness of the mortgagor, as well as the value of the mortgaged property relative to the amount of the mortgage loan. Fannie Mae, in its discretion, accepts deviations from the guidelines. Fannie Mae also reviews and changes its guidelines from time to time. As part of its affordable housing initiatives, Fannie Mae continues to introduce new underwriting criteria that could make the mortgage finance system more accessible to minorities, low-and moderate-income families, underserved and rural residents and people with special housing needs. In addition, Fannie Mae is continuing its underwriting experiments involving alternative methods of assessing the creditworthiness of potential borrowers, among other factors. See "Affordable Housing Initiatives and Goals."

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

In each of the last three years, Fannie Mae enhanced Desktop Underwriter®, its automated underwriting system, to assist lenders in meeting its underwriting standards. Desktop Underwriter is designed to help lenders process mortgage applications in a more efficient and accurate manner and to apply Fannie Mae's underwriting criteria consistently and objectively, and in a more customized manner, to all prospective borrowers. If Desktop Underwriter provides an "approve" recommendation to a loan application, the Corporation waives certain representations as long as the loan is originated in accordance with the information that was submitted to Desktop Underwriter.

Fannie Mae generally requires that the UPB of each conventional single-family first mortgage loan it purchases not be greater than 80 percent of the value of the mortgaged property unless at least the excess over the 80 percent level is insured by a mortgage insurance company acceptable to Fannie Mae. If mortgage insurance is required initially, Fannie Mae requires it to be maintained as long as the UPB is greater than 80 percent of the original value (or of the appraised value as determined by a subsequent appraisal). Fannie Mae does not require mortgage insurance on conventional single-family loans with LTV ratios greater than 80 percent if the mortgage loan seller provides other acceptable credit enhancement. Fannie Mae bears the risk that in some cases parties assuming credit enhancement obligations may be unable to meet their contractual obligations to the Corporation. Fannie Mae regularly monitors this risk and follows specific criteria in evaluating and accepting credit enhancement arrangements in order to minimize its exposure to credit loss.

Fannie Mae has required credit enhancement for a majority of the mortgage loans in its multifamily loan portfolio. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management—Multifamily."

Servicing

Fannie Mae does not service mortgage loans, except for government-insured multifamily loans, for which the primary servicing functions are performed by a major servicing entity under a subservicing arrangement. However, Fannie Mae generally manages and markets properties acquired through foreclosure. Fannie Mae mortgage loans held in portfolio or backing MBS can be serviced only by a servicer approved by the Corporation, and must be serviced subject to the Corporation's guidelines. Lenders who sell single-family mortgage loans and conventional multifamily loans to Fannie Mae often are such servicers. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, evaluation of transfers of ownership interests, responding to requests for partial releases of security, granting of easements, handling proceeds from casualty losses, negotiating problem loan workouts and, if necessary, processing of foreclosures. In the case of multifamily loans, servicing also includes performing property inspections, evaluating the financial condition of owners, and administering various types of agreements (including agreements regarding replacement reserves, completion/repair, and operations and maintenance). Fannie Mae compensates servicers by permitting them to retain a specified portion of each interest payment on a serviced mortgage loan. Fannie Mae reserves the right to remove servicing responsibility from a lender.

Mortgage-Backed Securities

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

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

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

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

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

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

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

In many instances, the lender or lenders that originated the loans in an MBS pool created from Fannie Mae's portfolio or the lender or lenders that exchanged the loans for the MBS (in the case of a "swap" transaction) initially service the loans. Fannie Mae, however, reserves the right to remove the servicing responsibility from a lender at any time if it considers such removal to be in the best interest of MBS certificate holders. In such event, Fannie Mae finds a replacement lender that will service the loans. Generally, Fannie Mae ultimately is responsible to MBS holders for the administration and servicing of mortgage loans underlying MBS, including the collection and receipt of payments from lenders, and the remittance of distributions and certain reports to holders of MBS certificates.

Affordable Housing Initiatives and Goals

In 1994, Fannie Mae announced that, for the seven years from 1994 through the year 2000, the Corporation would commit $1 trillion to help finance over 10 million homes for families and communities most in need (the "Trillion Dollar Commitment"). As part of the Trillion Dollar Commitment announcement, Fannie Mae laid out 11 initiatives targeting specific areas of the mortgage finance system for improvement. (In early 1996, the Fannie Mae Foundation undertook three of the initiatives.) By the end of 1998, Fannie Mae was able to report the following progress with respect to each of the eleven initiatives (including progress on the three Foundation initiatives that have been supported by the Corporation): (i) established 33 Partnership Offices around the country (initiative: Fannie Mae Partnership Offices); (ii) integrated research on credit scoring and loan performance with Fannie Mae's automated underwriting, offering lenders a tool that allows them to use the most flexible loan criteria to extend full consideration for each borrower's unique credit profile (initiative: Underwriting Flexibilities); (iii) issued $9.4 billion of total commitments to specific underwriting experiments intended to lower barriers to homeownership (initiative: Underwriting Experiments); (iv) addressed emerging markets with products designed to meet home improvement renovation financing needs and targeted those most in need with products designed for seniors, disabled people and their families, and Native Americans (initiative: Innovations for Change); (v) originated $40.3 billion in multifamily financing (initiative: Multifamily Housing Finance);

(vi) identified potential savings of approximately $800 per mortgage related to the origination costs of mortgages through the use of Fannie Mae technology (initiative: Technology to Reduce Costs); (vii) approved more than $50 million of investments in community development financial institutions and provided financing to more than 1.4 million minority borrowers (initiative: Fighting Discrimination); (viii) together with 29 for-profit, nonprofit and governmental organizations, created the American Homeowner Education and Counseling Institute, an independent nonprofit organization committed to increased professionalism in homeowner counseling and to identifying more effective ways to finance home buyer education (initiative: HomePath Initiative); (ix) exceeded its original commitment to increase giving to the Fannie Mae Foundation (initiative: Increased Foundation Giving); (x) handled over 6.6 million consumers' requests for homeownership information (initiative: Opening Doors for Every American campaign—Fannie Mae Foundation initiative); and (xi) provided nearly 1.7 million immigrants with home-buying information, using multilingual media and community organizations supportive of immigrants (initiative: New Americans Campaign—Fannie Mae Foundation initiative).

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act"), Fannie Mae has certain goals to promote affordable housing for moderate-, low- and very low-income families and to serve the housing needs of those in underserved areas. In 1998, Fannie Mae exceeded the applicable goals. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Housing Goals."

Delinquencies and REO

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

Fee-Based Services

Fannie Mae offers certain services to lenders and other customers in return for a fee. These include issuing REMICs, SMBS, Fannie Megas, and grantor trust securities, technology services for originating and underwriting loans, and the facilitation of securities transactions.

Fannie Mae receives fee income from dealers in exchange for creating and issuing REMICs, SMBS, grantor trust securities, and Megas. In addition to issuing these securities, Fannie Mae is responsible for all tax reporting and administration costs associated with these securities.

Fannie Mae also receives fee income in return for providing technology related services such as Desktop Underwriter, Desktop Originator®, Desktop Trader®, and other on-line services. These services provide lenders the ability to underwrite mortgage loans electronically, communicate with third-party originators, access Fannie Mae loan pricing schedules, and enter into sale commitments with the Corporation on a real-time basis.

Fannie Mae also simultaneously purchases and sells MBS and certain other mortgage-related securities, such as Ginnie Mae certificates, with the intention of earning a spread on such trades or as a service to customers. In addition, Fannie Mae receives fee income through other activities, such as repurchase transactions, and by providing other investment alternatives for customers.

Competition

Fannie Mae competes, within the limits prescribed by its Charter Act, for the purchase of mortgage loans for portfolio and the issuance of mortgage-backed securities in the secondary mortgage market. For single-family products, Fannie Mae competes primarily with the Federal Home Loan Mortgage Corporation ("Freddie Mac"), another government-sponsored enterprise also regulated by the Department of Housing and Urban Development ("HUD") and the Office of Federal Housing

Enterprise Oversight ("OFHEO") with a mission and authority that is virtually identical to that of Fannie Mae. Fannie Mae competes to a lesser extent with savings and loan associations, savings banks, commercial banks, other government-sponsored entities, and other companies that purchase for their own portfolio or pool single-family mortgage loans for sale to investors as whole loans or mortgage-backed securities. A number of Federal Home Loan Banks ("FHLBs") are participating in a pilot program, which was expanded in 1998, for the financing and servicing of single-family mortgage loans. Given the pace of the pilot's development, the FHLBs are not currently significant competitors. Fannie Mae competes with the FHA insurance program, a HUD program, for the business of guaranteeing the credit performance of mortgage loans and, due to the eligibility of such FHA-insured loans for securitization by Ginnie Mae, with Ginnie Mae as well.

In 1999, Fannie Mae is limited to purchasing and guaranteeing the credit performance of mortgage loans with a maximum principal balance of $240,000 (or more depending upon geographical area and number of dwelling units). The fiscal year 1999 federal budget increased the maximum principal balance for loans eligible for the FHA insurance program to 48 percent from 38 percent of Fannie Mae's loan limits. The loan limit for FHA-insured loans in high cost areas was increased from 75 percent, and now can be as high as 87 percent of Fannie Mae's limits. The higher FHA limits may result in increased competition for Fannie Mae's guaranty business. (For additional information on the maximum principal balances for loans purchased by the Corporation, see "Mortgage Loan Portfolio—Mortgage Loans Purchased—Principal Balance Limits.")

In the case of multifamily products, Fannie Mae generally competes with government housing programs, with insurance companies, and with the same kinds of entities as in the case of single-family products. Competition for multifamily mortgage loans is intense from certain entities typically sponsored by investment banks which purchase such loans and pool them for sale to investors in the commercial mortgage-backed securities market. Such entities are referred to as "conduits," and their role in the multifamily mortgage market increased significantly in 1997. In 1998, conduits continued to be a strong source of competition, but with the disruption in the fixed-income capital market in the latter part of the year, they became less of a factor due to decreased loan originations. However, Fannie Mae expects that they will provide increased competition as market conditions stabilize. Prior to 1999, under the Charter Act, maximum principal balance limits also applied to Fannie Mae's purchase of conventional multifamily mortgage loans. The fiscal year 1999 federal budget removed the limitations on the size of multifamily mortgage loans that Fannie Mae has authority to purchase. Notwithstanding the change, Fannie Mae currently intends to continue to comply with prior limitations in most cases.

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

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

Competition is particularly intense for multifamily mortgage loans eligible for government subsidies, which have low-income rent and occupancy restrictions. As a prerequisite to expansion or merger plans, commercial banks must fund such loans to meet certain obligations under the Community Reinvestment Act, and they often are willing to do so at or below their own cost of funds. Fannie Mae competes for these same investment opportunities to meet its housing goals.

Competition also is a consideration in connection with the issuance of Fannie Mae's debt securities. Fannie Mae competes with Freddie Mac, the FHLB system, the Student Loan Marketing Association, and other government-sponsored entities for funds raised through the issuance of unsecured debt in the "agency" debt market. Increases in the issuance of unsecured debt by other government-sponsored entities generally, and in the issuance of callable debt in particular, may have an adverse effect on the issuance of Fannie Mae's unsecured debt, or result in the issuance of such debt at higher interest rates than would otherwise be the case. In addition, the availability and cost of funds raised through the issuance of certain types of unsecured debt may be adversely affected by regulatory initiatives that tend to reduce investments by certain depository institutions in unsecured debt with greater than normal volatility or interest-rate sensitivity.

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

Facilities

Fannie Mae owns its principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, an office at 3939 Wisconsin Avenue, NW, Washington, DC, and two facilities in Herndon, Virginia. These owned facilities total 620,000 square feet. In addition, Fannie Mae leases approximately 379,000 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to the Corporation's principal office, and approximately 64,000 square feet of office space at 2115 Wisconsin Avenue, NW. The present lease for 4000 Wisconsin Avenue expires in 2003, but the Corporation has options to extend the lease for up to 15 additional years, in 5-year increments. The lease for 2115 Wisconsin expires in 2002. Fannie Mae also maintains regional offices in leased premises in Pasadena, California; Atlanta, Georgia; Chicago, Illinois; Philadelphia, Pennsylvania; and Dallas, Texas. The regional offices negotiate mortgage loan and MBS business with lenders, assist in supervising the servicing of the Corporation's mortgage loan portfolio by lenders, assist in supervising or managing the handling and disposition of REO, and provide training to the staffs of lenders. In addition to the regional offices, Fannie Mae has opened 33 "Fannie Mae Partnership Offices" to date in leased premises around the country which will work with cities, rural areas and other underserved communities. Fannie Mae also plans to establish 11 additional Partnership Offices in 1999. There currently are Fannie Mae Partnership Offices in Birmingham, Alabama; Phoenix, Arizona; Los Angeles, California; Denver, Colorado; Hartford, Connecticut; Washington, D.C.; Miami, Florida; Orlando, Florida; Atlanta, Georgia; Chicago, Illinois; Des Moines, Iowa; Kansas City, Kansas; New Orleans, Louisiana; Baltimore, Maryland; Boston, Massachusetts; Detroit, Michigan; St. Paul, Minnesota; Jackson, Mississippi; St. Louis, Missouri; Lincoln, Nebraska; Las Vegas, Nevada; Albuquerque, New Mexico; Buffalo, New York; New York, New York; Charlotte, North Carolina; Oklahoma City, Oklahoma; Cleveland, Ohio; Columbus, Ohio; Portland, Oregon; Houston, Texas; San Antonio, Texas (two offices, one of which is responsible for border region issues); and Seattle, Washington.

Employees

At December 31, 1998, Fannie Mae employed approximately 3,800 full-time personnel.

GOVERNMENT REGULATION AND CHARTER ACT

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

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

Although the 1968 Act eliminated all federal ownership interest in Fannie Mae, it did not terminate government regulation of the Corporation. Under the Charter Act, approval of the Secretary of the Treasury is required for Fannie Mae's issuance of its debt obligations and MBS. In addition, the 1992 Act established OFHEO, an independent office within HUD under the management of a Director (the "Director") who is responsible for ensuring that the Corporation is adequately capitalized and operating safely in accordance with the 1992 Act. The 1992 Act established minimum capital, risk-based capital, and critical capital requirements for Fannie Mae and required the Director to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital the Corporation must have to exceed the risk-based capital level from time to time. OFHEO issued a final rule (the "Rule") in 1996 related to the minimum capital levels for Fannie Mae and Freddie Mac that sets forth how minimum capital requirements for both entities are to be calculated, reported, and classified on a quarterly basis. The Rule, which finalized an original proposal dated June 1995, formalized the interim capital standards applied by OFHEO, with which Fannie Mae has been in compliance since their inception. See also "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements."

In 1996, OFHEO also released for comment part one ("Part I") of the proposed regulations to establish the risk-based capital test. Part I specifies that "benchmark loss experience" will be combined with other yet to be determined assumptions and applied each quarter to Fannie Mae's book of business to establish credit losses under the risk-based capital standard for the Corporation. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. Fannie Mae submitted comments to OFHEO in October 1996 stating that several aspects of the initial proposal require adjustments or amendment, because it does not accurately capture Fannie Mae's credit history and derives credit loss rates that are significantly worse than any reasonable representation of Fannie Mae's and Freddie Mac's loss experience. On March 26, 1999, after inter-agency review and comment on a proposed second part of the risk-based capital regulation ("Part II"), OFHEO sent Part II to Congress for review. Shortly after the 15-day period for Congressional review, OFHEO is expected to publish Part II for public review and comment over at least a 120-day period. Part II will specify, among other matters, remaining aspects of the test and how the test will be used to determine Fannie Mae's and Freddie Mac's risk-based capital requirements. The summary accompanying Part II noted that if Part II had been in effect as of June 30, 1997, Fannie Mae's required risk-based capital would have been $17.73 billion, as compared with $14.05 billion in actual capital at that time. OFHEO also noted that there were a variety of means, such as hedging, that Fannie Mae could have used to reduce required risk-based capital to the level of its actual capital. Fannie Mae has not yet thoroughly reviewed Part II but expects to comment extensively on the proposal, which could change before it is finally issued. The 1992 Act provides that the final regulations will be enforceable one year after issuance. Management is confident that Fannie Mae will be able to meet any reasonable final test.

If Fannie Mae fails to meet one or more of the capital standards under the 1992 Act, the Director is required to take certain remedial measures and may take others, depending on the standards the Corporation fails to meet. The Director's enforcement powers include the power to impose temporary and final cease-and-desist orders and civil penalties on the Corporation and on directors or executive officers of the Corporation. If the Director determines that Fannie Mae is engaging in conduct not approved by the Director that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by the Corporation has decreased significantly, the Director is authorized to treat the Corporation as not meeting one of the capital standards that it otherwise meets. In addition, Fannie Mae is required to submit a capital restoration plan if it fails to meet any of the capital standards. If the Director does not approve the plan or determines that Fannie Mae has failed to make reasonable efforts to comply with the plan, then the Director may treat the Corporation as not meeting one of the capital standards that it otherwise meets. Also, if Fannie Mae fails to meet or is treated by the Director as not meeting one of the capital standards and the Director has reasonable cause to believe that the Corporation or any executive officer or director of the Corporation is engaging in or about to engage in any conduct that threatens to result in a significant depletion of the Corporation's core capital, then the Director is authorized to commence proceedings pursuant to which, after a hearing, the Director could issue a cease and desist order prohibiting such conduct. The Director could issue such an order without a hearing, which would be effective until completion of the cease-and-desist proceedings, if the Director determined that the conduct in question was likely to cause a significant depletion of core capital. Prior approval of the Director is required for Fannie Mae to pay a dividend if the dividend would decrease the Corporation's capital below risk-based capital or minimum capital levels established under the 1992 Act. See "Common Stock." The Director is authorized to levy, pursuant to annual Congressional appropriations, annual assessments on Fannie Mae and Freddie Mac to cover reasonable expenses of OFHEO.

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

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

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

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

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

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

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

LEGAL PROCEEDINGS

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

Fannie Mae is a party to legal proceedings from time to time arising from its relationships with its seller/servicers. Disputes with lenders concerning their loan origination or servicing obligations to Fannie Mae, or disputes concerning termination by Fannie Mae (for any of a variety of reasons) of a lender's authority to do business with the Corporation as a seller and/or servicer, can result in litigation. Also, loan servicing issues have resulted from time to time in claims against Fannie Mae brought as putative class actions for borrowers.

Fannie Mae also is a party to legal proceedings from time to time arising from other aspects of its business and administrative policies.

Claims and proceedings of all types are subject to many uncertain factors that generally cannot be predicted with assurance. However, in the case of the legal proceedings and claims that are currently pending against Fannie Mae, management believes that their outcome will not have a material adverse effect on the Corporation's financial condition or results of operations.

COMMON STOCK

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

Fannie Mae also is authorized by the Charter Act to have preferred stock on such terms and conditions as the Board of Directors of the Corporation may prescribe. No common stockholder approval is required to issue preferred stock. Fannie Mae issued $1 billion of non-cumulative preferred stock in 1996 and $150 million in 1998 that is redeemable at the Corporation's option beginning in 2001 and 1999, respectively. Holders of these preferred stock issues are entitled to receive noncumulative, quarterly dividends when, and if, declared by Fannie Mae's Board of Directors. Payment of dividends on preferred stock is not mandatory, but has priority over payment of dividends on common stock. After the specified period, preferred stock is redeemable at its stated value at the option of Fannie Mae. See "Notes to Financial Statements—Note 12" for additional information on preferred stock.

The Charter Act contains no limitation on the amount of stock that may be issued, except that if Fannie Mae fails to meet certain minimum capital standards, the Director could require that the Director approve the Corporation's issuance of stock or securities convertible into stock. At February 28, 1999, there were outstanding approximately 1,027 million shares of common stock, which were held by approximately 25,000 stockholders of record. Based on the number of requests for proxies and quarterly reports, Fannie Mae estimates that on February 28, 1999 there were approximately 340,000 additional stockholders who held shares through banks, brokers and nominees.

Holders of the common stock are entitled to receive cash dividends if, as, and when declared by the Board of Directors. However, certain provisions of the 1992 Act may operate to restrict the ability of the Board of Directors to declare dividends in certain circumstances. The 1992 Act established risk-based capital, minimum capital and critical capital requirements for Fannie Mae, and required the Director of OFHEO to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital Fannie Mae must have to exceed the risk-based capital level from time to time. As discussed in "Government Regulation and Charter Act," the Director of OFHEO publicly released Part I of the proposed risk-based capital regulations in 1996, and it is expected that Part II of the proposed risk-based capital regulations will be published for public review and comment shortly. Until one year after the final regulations establishing the risk-based capital test are in effect, a dividend may be paid without the prior approval of the Director of OHFEO if Fannie Mae meets the minimum capital level established under the 1992 Act and the dividend payment would not decrease the Corporation's base capital below such level. See "Government Regulation and Charter Act."

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

The payment of dividends on common stock also is subject to the payment of dividends on any preferred stock outstanding. Accordingly, no cash dividend may be declared or paid or set apart for payment on common stock unless cash dividends have been declared and paid or set apart (or ordered to be set apart) on preferred stock outstanding for the then-current dividend period.

Dividends on common stock have been declared and paid for each quarter during Fannie Mae's two most recent fiscal years. See "Quarterly Results of Operations" on pages 73-74 for quarterly dividends paid on common stock during 1998 and 1997.

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

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

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

Fannie Mae's common stock is publicly traded on the New York, Pacific and Chicago stock exchanges and is identified by the ticker symbol "FNM." The transfer agent and registrar for the common stock is First Chicago Trust Company of New York, 525 Washington Boulevard, Jersey City, New Jersey 07310.

The following table shows, for the periods indicated, the high and low prices per share of Fannie Mae's common stock on the New York Stock Exchange Composite Transactions as reported in the Bloomberg Financial Markets service.

Quarterly Common Stock Data

	1998		1997	
Quarter	**High**	**Low**	**High**	**Low**
1st	$66.38	$56.06	$43.75	$36.13
2nd	67.19	55.75	47.63	36.13
3rd	68.31	55.56	49.44	41.13
4th	76.19	49.56	57.31	44.69

The closing price of Fannie Mae's common stock on March 30, 1999, as so reported, was $70.19.

FORWARD-LOOKING INFORMATION

From time to time, Fannie Mae may make forward-looking statements relating to matters such as the Corporation's anticipated financial performance, business prospects, future business plans, financial condition or other matters. For example, "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements, which are statements therein that are not historical facts or explanations of historical data. The words "believes," "anticipates," "expects," and similar expressions generally identify forward-looking statements.

Forward-looking statements reflect management's expectations based on various assumptions and management's estimates of trends and economic factors in the markets in which Fannie Mae is active, as well as Fannie Mae's business plans. As such, forward-looking statements are subject to risks and uncertainties, and Fannie Mae's actual results may differ (possibly significantly) from those indicated in such statements. Among the factors that may affect the performance, development or results of Fannie Mae's business, and thereby cause actual results to differ from management's expressed expectations, are the following:

- significant changes in borrower preferences for fixed- or adjustable-rate mortgages, originator preferences for selling mortgages in the secondary market, investor preferences for Fannie Mae's securities versus other investments, the availability of funding at attractive spreads in the financial markets (in particular from callable debt), and other factors affecting the overall mix of mortgage loans available for purchase, Fannie Mae's funding opportunities, or Fannie Mae's net interest margins;
- significant changes in employment rates, housing price appreciation, or other factors affecting delinquency or foreclosure levels and credit losses;
- significant changes in Fannie Mae's policies or strategies, such as its underwriting requirements or its interest rate risk management, credit loss mitigation, or investment strategies;
- regulatory or legislative changes affecting Fannie Mae, its competitors, or the markets in which the Corporation is active, including changes in taxes or capital requirements applicable to Fannie Mae or its activities (see "Government Regulation and Charter Act," and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements" regarding certain matters currently being considered by regulators, legislators or the Administration);
- competitive developments in the markets for mortgage loan purchases and for the sale of mortgage-backed and debt securities, or significant changes in the rate of growth in conforming residential mortgage debt;
- significant changes in the amount and rate of growth of Fannie Mae's expenses, and the costs (and effects) of legal or administrative proceedings (see "Legal Proceedings") or changes in accounting policies or practices;
- operational, legal, or other issues related to the Year 2000 (see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management — Operational Risk Management");
- significant changes in general economic conditions, or the monetary or fiscal policy of the United States; and
- unanticipated, substantial changes in interest rates. While Fannie Mae has achieved 44 consecutive quarters of record operating earnings despite major fluctuations in interest rates during this period and employs a variety of interest rate risk management techniques, it is possible that sudden, severe swings in interest rates could have at least a short-term significant effect on Fannie Mae's results.

Fannie Mae does not undertake to update any forward-looking statement herein or that may be made from time to time on behalf of the Corporation.

SELECTED FINANCIAL INFORMATION: 1994-1998

The following selected financial data for the years 1994 through 1998 (which data are not covered by the independent auditors' report) have been summarized or derived from the audited financial statements and other financial information. These data should be read in conjunction with the audited financial statements and notes to the financial statements.

(Dollars in millions, except per common share amounts)

Income Statement Data for the year ended December 31:	1998	1997	1996	1995	1994
Interest income	$ 29,995	$ 26,378	$ 23,772	$ 21,071	$ 17,347
Interest expense	(25,885)	(22,429)	(20,180)	(18,024)	(14,524)
Net interest income	4,110	3,949	3,592	3,047	2,823
Guaranty fees	1,229	1,274	1,196	1,086	1,083
Fee and other income, net	275	125	86	93	143
Credit-related expenses	(261)	(375)	(409)	(335)	(378)
Administrative expenses	(708)	(636)	(560)	(546)	(525)
Special Contribution	—	—	—	(350)	—
Income before federal income taxes and extraordinary item	4,645	4,337	3,905	2,995	3,146
Provision for federal income taxes	(1,201)	(1,269)	(1,151)	(840)	(1,005)
Income before extraordinary item	3,444	3,068	2,754	2,155	2,141
Extraordinary item—loss on early extinguishment of debt, net of tax effect	(26)	(12)	(29)	(11)	(9)
Net income	$ 3,418	$ 3,056	$ 2,725	$ 2,144	$ 2,132
Preferred stock dividends	(66)	(65)	(42)	—	—
Net income available to common shareholders	$ 3,352	$ 2,991	$ 2,683	$ 2,144	$ 2,132
Basic earnings per common share(1):					
Earnings before extraordinary item	$ 3.28	$ 2.87	$ 2.53	$ 1.98	$ 1.96
Extraordinary item	(.02)	(.02)	(.03)	(.01)	(.01)
Net earnings	$ 3.26	$ 2.85	$ 2.50	$ 1.97	$ 1.95
Diluted earnings per common share(1):					
Earnings before extraordinary item	$ 3.26	$ 2.84	$ 2.51	$ 1.96	$ 1.95
Extraordinary item	(.03)	(.01)	(.03)	(.01)	(.01)
Net earnings	$ 3.23	$ 2.83	$ 2.48	$ 1.95	$ 1.94
Cash dividends per common share	$ .96	$ .84	$ .76	$ .68	$ .60
Balance Sheet Data at December 31:					
Mortgage portfolio, net	$415,223	$316,316	$286,259	$252,588	$220,525
Investments	58,515	64,596	56,606	57,273	46,335
Total assets	485,014	391,673	351,041	316,550	272,508
Borrowings:					
Due within one year	205,413	175,400	159,900	146,153	112,602
Due after one year	254,878	194,374	171,370	153,021	144,628
Total liabilities	469,561	377,880	338,268	305,591	262,967
Stockholders' equity	15,453	13,793	12,773	10,959	9,541
Capital(2)	16,244	14,575	13,520	11,703	10,367
Other Data for the year ended December 31:					
Average net interest margin	1.03%	1.17%	1.18%	1.16%	1.24%
Return on average common equity	25.2	24.6	24.1	20.9	24.3
Dividend payout ratio	29.5	29.4	30.4	34.6	30.8
Average effective guaranty fee rate	.202	.227	.224	.220	.225
Credit loss ratio	.027	.041	.053	.050	.057
Ratio of earnings to combined fixed charges and preferred stock dividends(3)	1.18:1	1.19:1	1.19:1	1.17:1	1.22:1
Mortgage purchases	$188,448	$ 70,465	$ 68,618	$ 56,598	$ 62,389
MBS issued	326,148	149,429	149,869	110,456	130,622
MBS outstanding at year-end(4)	834,518	709,582	650,780	582,959	530,343
Weighted-average diluted common shares outstanding, in millions	1,037	1,056	1,080	1,098	1,098

(1) Earnings per common share amounts in 1996, 1995, and 1994 have been restated to comply with Financial Accounting Standard No. 128, *Earnings per Share.*

(2) Stockholders' equity plus general allowance for losses.

(3) "Earnings" consists of (i) income before federal income taxes and extraordinary item and (ii) fixed charges. "Fixed charges" represents interest expense. There was no preferred stock outstanding in 1995 and 1994.

(4) Includes $197 billion, $130 billion, $103 billion, $70 billion, and $44 billion of MBS in portfolio at December 31, 1998, 1997, 1996, 1995, and 1994, respectively.

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

This discussion highlights significant factors influencing Fannie Mae's financial condition and results of operations. It should be read in conjunction with the financial statements and related notes. This discussion (and other sections of this Information Statement) includes certain forward-looking statements based on management's estimates of trends and economic factors in markets in which Fannie Mae is active, as well as the corporation's business plans. In light of securities law developments, including the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, Fannie Mae notes that such forward-looking statements are subject to risks and uncertainties. Accordingly, the corporation's actual results may differ from those set forth in such statements. Significant changes in economic conditions; regulatory or legislative changes affecting Fannie Mae, its competitors, or the markets in which it is active; or changes in other factors may cause future results to vary from those expected by Fannie Mae. The "Forward-Looking Information" section in Fannie Mae's Information Statement discusses certain factors that may cause such differences to occur.

Overview

Fannie Mae extended its string of record earnings in 1998 to 12 years, with diluted earnings per common share increasing to $3.23 per share, or 14 percent, compared with $2.83 in 1997. Net income increased $362 million to $3.418 billion in 1998, compared with $3.056 billion for 1997. Fannie Mae's 1998 double-digit earnings growth was principally due to a record volume of mortgage purchases and Fannie Mae mortgage-backed securities issues, increased fee and other income, strengthened credit performance, and continued effective management of interest rate risk. The 31 percent increase in the portfolio was the product of a number of factors, including a sustained period of lower interest rates that resulted in record mortgage originations, as well as wide mortgage-to-debt spreads that, in part, stemmed from a period of exceptional market turbulence in the second half of the year.

In 1998, Fannie Mae initiated a new funding product called Benchmark Notes℠. Benchmark Notes are large issues of noncallable debt securities designed to provide liquidity and performance to investors while reducing Fannie Mae's cost of debt. Benchmark Notes have served to consolidate much of Fannie Mae's noncallable long-term debt issuances from a large number of small, unscheduled issues to a smaller number of larger, regular, more liquid issues. Fannie Mae anticipates that the liquidity of the Benchmark Notes, combined with Fannie Mae's outstanding credit quality, will cause Benchmark Notes to be viewed by many investors as a liquid investment alternative to U.S. Treasuries. During 1998, Fannie Mae issued $42 billion of Benchmark Notes.

Fannie Mae's credit risk management continued to excel during 1998. The decline in credit-related expenses was a result of the combined beneficial effects of an improved housing market, particularly in California; a significant degree of risk sharing on higher-risk loans; and continued success in loss mitigation activities. The credit loss ratio—credit losses as a percentage of the average unpaid principal balance of total mortgages in portfolio and Fannie Mae MBS outstanding—declined to .027 percent in 1998 from .041 percent in 1997.

Fannie Mae's core capital grew 12 percent, to $15.5 billion at December 31, 1998. Fannie Mae also repurchased $1.1 billion of common stock during the year. Core capital exceeded applicable regulatory capital standards by $131 million at December 31, 1998.

The remainder of Management's Discussion and Analysis includes detailed information on Fannie Mae's results of operations, risk management, balance sheet analysis, mortgage-backed securities, and housing goals, as well as a new accounting standard.

Results of Operations

Net Interest Income

Net interest income increased $161 million to $4.110 billion in 1998, compared with $3.949 billion in 1997. The 4 percent increase was a result of a $53 billion, or 18 percent, increase in the average mortgage portfolio balance, which was partially offset by a 14 basis point decrease in the average net interest margin. The decline in the average net interest margin stemmed from an increase in the refinancing of high-coupon mortgages; the recording, during the fourth quarter of 1998, of additional amortization of premiums on mortgages held in portfolio ; an increase in tax-advantaged investments, which generally have lower investment yields; and the repurchase of common shares. The additional amortization recorded in the fourth quarter reflects management's estimate of the effects of the decline in interest rates and the high level of 1998 refinancing activity on the unamortized premium and discount balances associated with the net mortgage portfolio. The repurchase of common shares reduces the net interest margin, as such share repurchases are funded through the issuance of debt, but has a positive effect on earnings per common share. For 1999, management expects that net interest income will increase due to continued growth in the average net mortgage portfolio and a more stable net interest margin.

Net interest income excludes interest receivable on nonperforming loans. Conventional single-family and multifamily loans are classified as nonperforming and previously accrued interest is removed from income when the collection of interest payments is deemed less than probable.

Guaranty Fee Income

Guaranty fees compensate Fannie Mae for its guarantee of the timely payment of principal and interest to MBS investors and for the assumption of credit risk on loans underlying MBS. Guaranty fees on Fannie Mae MBS held in portfolio are included in interest income. Guaranty fee income decreased 4 percent, or $45 million, from $1.274 billion in 1997 to $1.229 billion in 1998. The decrease in guaranty fee income primarily resulted from a decrease of .025 percentage points in the average effective guaranty fee rate, which was partially offset by a $48 billion, or 9 percent, increase in average net MBS outstanding. The decline in the average effective guaranty fee rate was due to several factors, including recording additional amortization of prepaid or deferred guaranty fees in the fourth quarter of 1998, reflecting management's estimate of the effects of the decline in interest rates and refinance activity on such fees; growth in the number of loans swapped for MBS for which the default risk is shared by a third party; and competitive pricing in the market. For 1999, management expects that guaranty fee income will increase as a result of continued growth in average net MBS outstanding.

The table below presents guaranty fee income as a percentage of the average balance of MBS outstanding, net of MBS held in portfolio, in 1998, 1997, and 1996.

Guaranty Fee Data

	1998	1997	1996
		(Dollars in millions)	
Guaranty fee income	$ 1,229	$ 1,274	$ 1,196
Average balance of net MBS outstanding	609,513	561,079	534,553
Effective guaranty fee rate	.202%	.227%	.224%

Additional information on Fannie Mae's MBS and guaranty fees is presented under "Mortgage-Backed Securities" below.

Fee and Other Income

Fee and other income is composed of multifamily fees, structured transaction fees, and technology fees, as well as other miscellaneous items, and is net of operating losses from certain tax-advantaged investments. Fee and other income increased 120 percent, or $150 million, to $275 million in 1998, compared with $125 million in 1997. The increase was primarily due to increases in technology fees, multifamily fees, and other fees. The increase in technology fees was driven by record usage of Fannie Mae's Desktop Underwriter® and Desktop Originator® systems. Additional information on structured transactions is presented under "Mortgage-Backed Securities." For 1999, management expects that fee and other income will be somewhat lower than in 1998.

Credit-Related Expenses

Credit-related expenses, which include the provision for losses and foreclosed property expenses, decreased $114 million to $261 million in 1998, compared with $375 million in 1997. The credit loss ratio fell to 2.7 basis points in 1998 from 4.1 basis points in 1997. The decrease in credit-related expenses was driven by a significant reduction in the provision for losses as compared with 1997. In 1998, Fannie Mae recorded a negative loss provision of $50 million, compared with a $100 million loss provision recorded in 1997. Contributing to the decrease in credit-related expenses was a reduction in the number of foreclosed properties. A stronger national housing market (especially in California), a significant degree of risk sharing on higher-risk loans, and continued loss mitigation efforts contributed to the reduction in the provision for losses and the number of foreclosed properties.

Management anticipates that credit-related expenses will continue to decline in 1999 in spite of continued growth in the mortgage portfolio and MBS outstanding. In 1999, Fannie Mae expects to continue to benefit from a healthy national housing market and the Corporation's loss mitigation efforts.

Administrative Expenses

Administrative expenses grew 11 percent to $708 million in 1998, compared with $636 million in 1997. The ratio of Fannie Mae's administrative expenses to the average net mortgage portfolio plus average net MBS outstanding was .074 percent in both 1998 and 1997. The ratio of administrative expenses to revenues (net interest income, guaranty fees, and fee and other income) was 12.6 percent in 1998 and 11.9 percent in 1997. The increase in administrative expenses resulted primarily from higher technology equipment costs and compensation costs, which included efforts to make Fannie Mae's computer systems Year 2000 compliant and the effect of a higher common share price on certain Fannie Mae stock-based compensation plans. Compensation expense was $453 million in 1998, compared with $394 million in 1997. Additional information concerning the Year 2000 issue is presented under "Risk Management."

Income Taxes

The provision for federal income taxes, net of the tax benefit from extraordinary losses, was $1.187 billion in 1998, compared with $1.262 billion in 1997. The effective federal income tax rate was 26 percent in 1998, compared with 29 percent in 1997. The reduction in federal income tax expense and the effective federal income tax rate for 1998 reflect the recording of additional low-income housing tax credits in the fourth quarter of 1998. The additional tax credits were a result of the Corporation using improved systems and information to refine the timing of the recognition of the tax benefits associated with investments qualifying for low-income housing tax credits. Management expects the effective federal income tax rate to increase slightly in 1999.

Extraordinary Loss

Extraordinary loss is recognized when debt or certain interest rate swaps are repurchased or called. The repurchase and call of debt and the call of certain interest rate swaps are part of Fannie

Mae's interest rate risk management strategy, and are designed to favorably affect Fannie Mae's future cost of funds. For 1998, as a result of these transactions, Fannie Mae recognized net extraordinary losses of $40 million ($26 million after tax), compared with $19 million ($12 million after tax) in 1997.

During 1998, the amount of long-term debt called or repurchased plus the notional amount of interest rate swaps called totaled $77 billion, with a weighted-average cost of 6.71 percent. The comparable amount in 1997 was $31 billion, with a weighted-average cost of 7.22 percent.

Risk Management

Fannie Mae is subject to three major areas of risk: interest rate risk, credit risk, and operational risk. Active management of these risks is an essential part of Fannie Mae's operations and a key determinant of its ability to maintain steady earnings growth. The following discussion highlights Fannie Mae's various strategies to diversify and mitigate these three risks.

Interest Rate Risk Management

Fannie Mae is exposed to interest rate risk because changes in interest rates may affect mortgage portfolio cash flows in a way that will adversely impact earnings or long-term value. Fannie Mae's management of interest rate risk involves analyses and actions that position the corporation to meet its objective of consistent earnings growth in a wide range of interest rate environments. Fannie Mae's interest rate risk is concentrated primarily in the mortgage portfolio, where exposure to changes in interest rates is managed to achieve stable earnings growth and an acceptable return on equity over time. Central elements of Fannie Mae's approach to managing interest rate risk include: (1) investing in assets and issuing liabilities that perform similarly in different interest rate environments, (2) assessing the sensitivity of portfolio profitability and risk to changes in interest rates, and (3) taking rebalancing actions in the context of a well-defined risk management process.

The first element of interest rate risk management is the funding of mortgage assets with liabilities that have similar durations or average cash flow patterns through time. To achieve the desired liability durations, Fannie Mae issues debt across a broad spectrum of maturities. Because the durations of mortgage assets change as interest rates change, callable debt with similar duration characteristics is frequently issued. The duration of callable debt, like that of a mortgage asset, shortens when interest rates decrease and lengthens when interest rates increase. Fannie Mae also utilizes off-balance-sheet derivative financial instruments, including interest rate swaps and other derivative instruments with embedded interest rate options, to achieve its desired liability structure and to better match the prepayment risk of the mortgage portfolio. A high degree of diversification of the interest rate option characteristics embedded in the assets and liabilities of the portfolio also serves to reduce interest rate risk.

Because the assets and the liabilities in Fannie Mae's mortgage portfolio are not perfectly matched, the portfolio's projected performance changes with movements in interest rates. Accordingly, the second element of interest rate risk management involves regularly assessing the portfolio's risk using a diverse set of analyses and measures, including net interest income simulations, duration gap analysis, portfolio value analysis, and stress testing. Portfolio net interest income is projected for a wide range of interest rate environments, including specific rising and falling interest rate paths, and interest rate simulations based on historical interest rate volatility. These analyses generally include assumptions about new business activity to provide a more realistic assessment of possible portfolio performance. Duration gap and portfolio value analyses are used to provide information on the interest rate sensitivity of the existing portfolio only (assuming no new business.) The portfolio duration gap—the difference between the durations of portfolio assets and liabilities—summarizes for management the extent to which asset and liability estimated cash flows are matched, on average, through time. Management regularly monitors the portfolio's duration gap under current market conditions and for a series of hypothetical interest rate scenarios. In addition, management tracks the portfolio's long-term value and potential changes in value for a broad range of potential interest rate scenarios. Information about interest rate risk is also obtained by means of financial performance simulations in which highly stressful interest rate scenarios are assumed.

Management monitors interest rate risk not only by using a diverse set of risk measures, but also by evaluating the sensitivity of those measures to changes in assumptions about future business conditions and financial market relationships. Fannie Mae's practice of employing a variety of risk measures and assumptions proved especially useful during the high level of financial market volatility experienced in 1998. Risk measures and assumptions are regularly reevaluated, and modeling tools are enhanced as management believes appropriate.

The third element of Fannie Mae's interest rate risk management is a framework that facilitates the communication and attainment of corporate objectives. The Board of Directors oversees interest rate risk management through the adoption of corporate goals and objectives and the review of regular reports on performance relative to these. Senior management is responsible for ensuring that the appropriate long-term strategies are in place to achieve the goals and objectives. Short-term strategies are formulated in weekly meetings of senior mortgage portfolio management, based on recent financial market information and the portfolio's standing relative to long-term objectives. Management establishes reference points for the key performance measures that are used to signal material changes in risk and to assist in determining whether adjustments in portfolio strategy are required to achieve long-term objectives. These measures and reference points are reported regularly to the Board of Directors. Comparing the performance measures with the reference points helps management make decisions about the necessity or desirability of portfolio rebalancing.

Fannie Mae's performance in 1998 is evidence of management's ability to meet its interest rate risk objectives. During the year, long-term interest rates dropped to their lowest levels in over 30 years. In the quarter ending September 30, 1998, interest rates dropped by the largest amount in any three-month period in nine years. Consequently, the mortgage portfolio's duration gap moved somewhat outside Fannie Mae's established reference points and reached its lowest point in early October. Portfolio rebalancing and the subsequent rise in long-term interest rates resulted in the duration gap returning to a level within management's target reference range by year-end.

At December 31, 1998, the duration gap of Fannie Mae's mortgage portfolio was a negative three months. A negative duration gap results when the duration of mortgage assets is shorter than the duration of the related liabilities, and generally indicates that the existing portfolio's long-term earnings stream is more vulnerable to a declining interest rate environment. At the end of 1998, the projected net interest income of the mortgage portfolio over the next one to two years was also somewhat more exposed to declining interest rates than to rising interest rates. Actual portfolio net interest income performance may differ from projections because of specific interest rate movements, changing business conditions, and management actions.

Interest Rate Sensitivity of Net Asset Value

Another indicator of the interest rate exposure of Fannie Mae's existing business is the sensitivity of the fair value of net assets (net asset value) to changes in interest rates. The following table presents Fannie Mae's estimated net asset value as of December 31, 1998, and two projections of the value 12 months later assuming hypothetical changes in interest rates over the 12-month period. These interest rate movements represent the most extreme changes in rates that would be expected over this period within a 95 percent confidence interval, based on historical interest rate volatility. The interest rate changes include an increase in long-term U.S. Treasury yields of approximately 175 basis points and a decrease of approximately 125 basis points from December 31, 1998 levels.

Interest Rate Sensitivity of Net Asset Value

	Net Asset Value	Percentage of December 31, 1998 Net Asset Value
	(Dollars in billions)	
December 31, 1998	$14.9	—
Assuming a 175 basis point increase	15.5	104%
Assuming a 125 basis point decrease	13.0	87

The net asset value of Fannie Mae as of December 31, 1998, as presented in the above table, is the same as that disclosed in Note 15 to the Financial Statements, "Disclosures of Fair Value of Financial Instruments," and includes the values of all portfolio business, as well as the guaranty fee business. The projected net asset values were derived in a manner consistent with the estimation procedures used in determining the December 31, 1998 net asset value.

As the table indicates, the net asset value of Fannie Mae's existing book of business is projected to increase if interest rates were to rise 175 basis points over the next year, and decline if interest rates were to fall 125 basis points over the next year. These sensitivities reflect the generally greater exposure of the company's existing book of business to declining interest rates at the end of 1998.

These fair value estimates represent valuations for the company's existing business only, and do not take into account the value of the company as a going concern, which would include the value of future business opportunities. For example, in a declining interest rate environment, the projected faster runoff of the company's guaranty fee business would lower the net asset value of the company's existing business. In the same environment, however, it is likely that new business opportunities would result in faster growth of the total guaranty fee book outstanding. Similarly, in a declining rate environment there are likely to be increased opportunities for portfolio growth and wider portfolio purchase spreads.

Additional information on interest rate risk management is presented under "Balance Sheet Analysis—Financing Activities."

Credit Risk Management

Fannie Mae's primary exposure to credit risk results from the possibility that it will not recover amounts due from borrowers. Management's overall objective in managing credit risk is to minimize losses by applying prudent underwriting guidelines and loan servicing requirements. Furthermore, Fannie Mae and its servicers use analytical models to apply credit risk analysis throughout the life of a loan.

Fannie Mae is also subject to the credit risk that counterparties to its transactions may be unable to meet their contractual obligations. Additional information on this credit risk exposure is presented under "Balance Sheet Analysis—Financing Activities" and in the Notes to Financial Statements, "Off-Balance-Sheet Credit Risk" and "Concentrations of Credit Risk." The discussion that follows addresses the major elements of credit risk management as they pertain to conventional single-family and multifamily mortgage loans.

Single-Family

Fannie Mae manages its single-family mortgage credit risk by focusing on two phases: loan underwriting and loan servicing. If these are not managed effectively, the likelihood of credit loss increases.

In the first phase, loan underwriting, the corporation manages credit risk through its efforts to develop sound underwriting policies and to ensure that loans sold to Fannie Mae meet the corporation's credit quality criteria.

Desktop Underwriter, Fannie Mae's automated underwriting model, was designed to help lenders process mortgage applications more efficiently, accurately, and consistently. It provides benefits to lenders, borrowers, and Fannie Mae by consistently and objectively applying the corporation's underwriting standards to all prospective borrowers, as well as customizing Fannie Mae's underwriting standards to a loan's unique combination of credit risk factors. Use of Desktop Underwriter significantly increased in 1998. Desktop Underwriter was used by nearly 800 lenders and was processing, on average, 22 percent of the loans that were delivered to Fannie Mae in 1998 versus 9 percent in 1997. By December 1998, 26 percent of loans delivered to Fannie Mae were processed through Desktop Underwriter. Management expects Desktop Underwriter usage to continue to increase in 1999.

In the second phase of credit risk management, loan servicing, Fannie Mae manages the risk of credit loss by requiring its servicers to follow guidelines for servicing a loan owned or securitized by Fannie Mae. The guidelines help ensure that loans are serviced consistently and efficiently.

An important element in loan servicing is the servicer's responsibility to carry out loss mitigation activities. A major component of loss mitigation is early intervention in a delinquency. To help keep borrowers in their homes or reduce the costs incurred when a loan goes through the foreclosure process, borrowers are contacted early in the delinquency to determine whether their delinquency might be resolved through a repayment plan, temporary forbearance, or modification of terms. If repayment plans, forbearance, or modification are not appropriate, the loan servicer may attempt to arrange a preforeclosure sale. The benefits of a preforeclosure sale include avoidance of the costs of foreclosure and a tendency for the property to sell at a better price because the home is usually occupied. If a preforeclosure sale is not possible, Fannie Mae's goal is to handle the foreclosure process expeditiously in order to minimize the amount of time the Corporation retains a nonearning asset.

In 1998, Fannie Mae expanded on two initiatives introduced in 1997 that it believes will contribute to reducing future credit losses. The first initiative, Risk Profiler™, is a default prediction model that assists servicers in loss mitigation activities. Risk Profiler predicts the likelihood that a loan will go into default by using updated borrower credit data, current property values, and loan characteristics, all of which are strong predictors of credit risk. Currently, servicers are using Risk Profiler to evaluate more than seven million loans on a quarterly basis, which represents approximately 75 percent of the loans in Fannie Mae's book of business. Servicers have been able to integrate the results from Risk Profiler into their loss mitigation activities to prioritize their efforts on the high-risk loans if they become delinquent. As a result of servicers using Risk Profiler, in 1998 Fannie Mae experienced an increase in the number of loan workouts as compared with 1997, and management expects this trend to continue as the use of Risk Profiler expands.

The second initiative involves placing Fannie Mae employees, or servicing consultants, on-site with certain servicers to facilitate loss mitigation efforts. The servicing consultants work with servicers to improve the default management process and increase the number of loss mitigation workouts. At the end of 1998, Fannie Mae had servicing consultants working on-site periodically with nearly all of its major servicers. Servicing consultants also provide value-added benefits to the servicer, including working with the servicer to improve operational processes and implement best practices. As a result of this initiative, Fannie Mae has experienced an increased flow of information between itself and its servicers, which has led to greater efficiencies in the servicers' loss mitigation activities, a strengthened relationship between Fannie Mae and its servicers, and a reduction in credit losses.

Desktop Underwriter and Risk Profiler are part of Fannie Mae's strategy to increase homeownership opportunities by providing a broad array of desktop products that enable lenders to process and manage all of their business more efficiently. Management expects to continue investing in research and technology to provide lenders and Fannie Mae with additional quantitative information for evaluating and managing credit risk while expanding homeownership opportunities.

In addition to Fannie Mae's continuing loss mitigation efforts, a much stronger California economy, a healthy national housing market, and the increased payments from mortgage insurance were key factors in the continued improvement of credit performance in 1998. To illustrate the company's improvement in California, at December 31, 1998, 20 percent of Fannie Mae's total book of business was located in California, while 35 percent of Fannie Mae's properties acquired due to foreclosure during the year were from California. The comparable amounts in 1997 were 20 percent and 45 percent, respectively. Moreover, 40 percent of total credit-related losses came from California loans in 1998, compared with 61 percent in 1997. The improved California economy has contributed to reductions in the number of foreclosures and serious delinquencies, while strong home price appreciation has resulted in a lower loss per case experienced on foreclosures.

As shown in the table below, single-family credit-related losses declined by 28 percent, or $96 million, in 1998, compared with 1997. The decrease in credit-related losses was attributable to net recoveries experienced in 1998 compared with net charge-offs experienced in 1997, slightly offset by an increase in foreclosed property expenses. The average loss per foreclosed property decreased to $9,400 in 1998 from $12,800 in 1997, and single-family foreclosed property acquisitions decreased to 20,703 in 1998, compared with 22,222 in 1997.

Single-Family Credit-Related Losses

	Year Ended December 31,		
	1998	1997	1996
	(Dollars in millions)		
(Recoveries) Charge-offs, net	$(57)	$ 66	$191
Foreclosed property expenses	306	279	216
Credit-related losses	$249	$345	$407
Credit loss ratio	.027%	.042%	.053%

With the improvement in the California economy and a healthy national housing market, Fannie Mae expects to continue to experience a reduction in its total credit-related losses in 1999.

Fannie Mae's single-family credit loss ratio declined to .027 percent in 1998, compared with .042 percent in 1997. Management expects the 1999 credit loss ratio to be somewhat lower than the 1998 level.

The total number of single-family properties owned by Fannie Mae at December 31, 1998, was 8,576, compared with 9,481 at December 31, 1997. These properties had net carrying amounts of $730 million and $735 million at December 31, 1998 and 1997, respectively.

In evaluating expected future credit performance, management analyzes the risk profile of the conventional single-family loans in Fannie Mae's mortgage portfolio and underlying MBS. The loan-to-value ("LTV") ratio is an important factor in credit performance because the amount of equity a borrower has in a home has proven to be highly predictive of both the incidence and the severity of default. Fannie Mae utilizes an increasing array of credit-risk-sharing partnerships to manage credit risk. For instance, Fannie Mae offsets its potential risk of loss by, among other strategies, requiring or purchasing mortgage insurance, or structuring other credit protection on loans with LTV ratios over 80 percent and certain loans with lower LTV ratios.

Fannie Mae experienced record volumes in 1998 as a result of the attractive market conditions throughout much of the year. The lower interest rate environment subjected a greater proportion of Fannie Mae's book of business to refinancing, which in turn resulted in a large percentage of new business consisting of refinanced fixed-rate mortgages. Refinanced loans typically have higher credit quality because they usually involve loans with lower LTV ratios and often convert higher-risk, adjustable-rate loans into lower-risk, fixed-rate loans. Accordingly, management believes that the higher credit quality loans added to Fannie Mae's portfolio in 1998 will contribute to improved credit performance in the future.

Experience has shown that loan age is also a major factor affecting delinquency rates and that the incidence of default for a group of mortgage loans peaks in the third through fifth years after origination. Unless real estate values decline significantly, loans outstanding after five years tend to have lower default rates because borrowers have a history of being able to make their payments and most likely have built up additional equity in their properties. Between 1992 and 1994, Fannie Mae acquired a significant portion of the loans in its portfolio and underlying MBS outstanding (30 percent of total outstanding UPB at December 31, 1998). These loans are now largely past their peak default years.

Product mix also influences potential future credit losses because the credit risks associated with each product type vary. Adjustable-rate mortgages generally have a higher incidence of default than long-term, fixed-rate mortgages, while intermediate-term, fixed-rate mortgages tend to have a lower incidence of default than long-term, fixed-rate mortgages.

The following table presents data, by percentage of UPB, on conventional mortgage loans outstanding in the Corporation's own portfolio or underlying MBS issued at December 31, 1998 and 1997 by product distribution, original LTV ratio, and current LTV ratio. In addition, the table presents data by product distribution and original LTV ratio for conventional loans purchased for the corporation's portfolio or underlying MBS in the years 1998, 1997, and 1996. Current LTV ratios are derived by adjusting the value of a property by the estimated change in the price of the home since the mortgage was originated and by comparing this adjusted value with the current UPB of the mortgage at December 31, 1998 and 1997.

Distribution of Single-Family Loans
by Product Type and Loan-to-Value Ratio

	Outstanding at December 31,		Percentage of Business Volumes		
	1998	**1997**	**1998**	**1997**	**1996**
Product:					
Long-term, fixed-rate	69%	64%	77%	72%	70%
Intermediate-term, fixed-rate(1)	24	26	19	17	22
Adjustable-rate	7	10	4	11	8
Total	100%	100%	100%	100%	100%
Original loan-to-value ratio:					
Greater than 90%	12%	13%	10%	16%	16%
81% to 90%	15	17	12	17	18
71% to 80%	40	38	43	40	38
61% to 70%	15	14	16	13	13
Less than 61%	18	18	19	14	15
Total	100%	100%	100%	100%	100%
Average original loan-to-value ratio	74%	74%	74%	76%	76%
Current loan-to-value ratio:					
Greater than 90%	2%	2%			
81% to 90%	9	13			
71% to 80%	24	22			
61% to 70%	23	22			
Less than 61%	42	41			
Total	100%	100%			
Average current loan-to-value ratio	61%	62%			
Average loan amount (Maximum $227,150 in 1998)	$85,800	$80,800	$112,800	$99,900	$99,900

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

The following table summarizes conventional single-family serious delinquency rates by region as of December 31, 1998, 1997, and 1996. Single-family serious delinquency rates are based on the number of conventional loans in portfolio or underlying MBS for which Fannie Mae has primary risk of loss and that are delinquent 90 days or more or are in the process of foreclosure.

Single-Family Serious Delinquency Rates

	December 31,		
	1998	**1997**	**1996**
Northeast	.83%	.89%	.87%
Southeast	.57	.59	.51
Midwest	.41	.40	.33
Southwest	.46	.45	.40
West	.61	.71	.74
Total	.58%	.62%	.58%

Multifamily

There are two primary risks involved in the underwriting and management of income-producing multifamily properties: (1) that underlying property cash flows will be insufficient to service the debt over the life of the loan and (2) that proceeds from the sale or refinancing of a property will be insufficient to repay the loan at maturity.

Fannie Mae manages the credit risk on its multifamily loan portfolio in several ways. First, the Corporation maintains rigorous loan-underwriting guidelines coupled with extensive real estate due diligence examinations for loan acquisitions. Because multifamily loans are primarily cash flow dependent and much larger than single-family loans, management monitors the ongoing performance of individual loans by requiring servicers to submit periodic operating information and property condition reviews. This information, combined with other loan risk characteristics, is used to evaluate the credit quality of the portfolio, identify potential problem loans, and initiate appropriate loss mitigation activities.

During the last two years, Fannie Mae has strengthened its credit risk management of multifamily assets by creating a dedicated portfolio monitoring team and expanding the quality control function. The activities of these groups include detailed quarterly portfolio loss reviews, identification and monitoring of borrower and geographic concentration risks, lender assessments, counterparty risk analyses, and enhanced reviews of large transactions.

Fannie Mae also manages its credit risk exposure through various forms of credit enhancement. For the majority of multifamily loans, Fannie Mae has shared risk arrangements with lenders, full or partial recourse to lenders or third parties for loan losses (which may be secured by letters of credit, investment agreements, or pledged collateral), or government mortgage insurance. The following table presents the risk profile, by UPB, of multifamily loans in the Corporation's portfolio or underlying MBS at December 31, 1998, 1997, and 1996.

Multifamily Risk Profile

	December 31,		
	1998	1997	1996
Fannie Mae risk	11%	14%	15%
Shared risk(1)	52	48	44
Recourse(2)	37	38	41
Total	100%	100%	100%

(1) Includes loans where the lender initially bears losses of up to 5 percent of UPB and shares any remaining losses with Fannie Mae.

(2) Includes loans not included in "shared risk" that have government mortgage insurance, or full or partial recourse to lenders or third parties.

As a result of strong underwriting standards and quality control processes, continued improvements in the multifamily rental market, declining interest rates, and continued emphasis on early loss mitigation efforts, the level of serious delinquencies for multifamily loans has declined significantly over the past several years.

Multifamily serious delinquencies at December 31, 1998, 1997, and 1996 were .29 percent, .37 percent, and .68 percent, respectively. Multifamily serious delinquencies are those loans for which Fannie Mae has primary risk of loss (including those with shared risk) and that are delinquent two months or more. Multifamily delinquency percentages are based on the UPB of such loans in portfolio and underlying MBS.

Multifamily foreclosed property acquisitions where Fannie Mae has the primary risk of loss totaled 12 properties and 28 properties during 1998 and 1997, respectively. At December 31, 1998 and 1997, the corporation held 9 primary risk foreclosed properties with an aggregate carrying value of $12 million and 14 such properties with an aggregate carrying value of $17 million, respectively.

Credit-related losses and the ratio of credit-related losses to average UPB outstanding for multifamily loans in portfolio or underlying MBS are summarized in the following table.

Multifamily Credit-Related Losses

	Year Ended December 31,		
	1998	**1997**	**1996**
	(Dollars in millions)		
Charge-offs, net	$ 8	$ 11	$ 19
Foreclosed property expense (income), net	5	(4)	(3)
Credit-related losses	$ 13	$ 7	$ 16
Credit loss ratio	.036%	.020%	.054%

In 1998, multifamily credit-related losses increased as a result of higher foreclosed property expenses, primarily property preservation costs. Despite increased business, credit-related losses have remained relatively low over the past three years primarily because of aggressive management of delinquent multifamily assets and a healthy multifamily rental market. Management anticipates that these losses will increase somewhat in 1999.

Allowance for Losses

In evaluating the risk of loss on portfolio loans and MBS outstanding, management considers current delinquency levels, historical loss experience, current economic conditions, geographic concentrations, and other pertinent factors. The allowance for losses is established by recording an expense for the provision for losses. It is subsequently reduced through charge-offs on foreclosed properties and is increased through recoveries on foreclosed properties. Changes in the allowance for losses for the years 1994 through 1998 are presented in the following table.

Allowance for Losses

	Total (Dollars in millions)
Balance, January 1, 1994	$ 841
Provision	155
Net foreclosure losses charged off	(169)
Balance, December 31, 1994	827
Provision	140
Net foreclosure losses charged off	(172)
Balance, December 31, 1995	795
Provision	195
Net foreclosure losses charged off	(210)
Balance, December 31, 1996	780
Provision	100
Net foreclosure losses charged off	(77)
Balance, December 31, 1997	803
Provision	(50)
Net recoveries	49
Balance, December 31, 1998	$ 802

Operational Risk Management

Operational risk is the risk of potential loss due to a breakdown in established controls and procedures, examples of which include circumvention of internal controls, fraud, human error, and systems malfunction or failure. Fannie Mae has established extensive policies and procedures to decrease the potential likelihood of such occurrences. Fannie Mae's Internal Audit Department tests the adequacy of and adherence to internal controls and established policies and procedures. Financial system data are regularly reconciled to source documents to ensure the accuracy of financial system outputs. Additionally, Fannie Mae has a comprehensive disaster recovery plan that is designed to allow critical operations to be restored with minimal interruption in the event of a natural disaster.

The use of financial forecast models is another potential operational risk. To mitigate the risk associated with the use of financial models, Fannie Mae regularly reconciles forecasted results to actual results and makes adjustments to the models for differences affecting future periods.

The major operational risk faced by Fannie Mae is its Year 2000 system compliance issue. Fannie Mae has been actively addressing the Year 2000 issues that may result from computer programs that currently use two digits instead of four digits to identify the year in a date field. If these issues are not resolved, Fannie Mae's information technology ("IT") and non-IT systems (such as facilities management systems) or those of its business partners may make incorrect calculations or fail. Because this issue creates significant operational risks, Fannie Mae has undertaken a major effort to identify and modify its internal systems so that they are Year 2000 compliant. In addition, Fannie Mae is coordinating with its business partners to assess whether their systems will be operational in the Year 2000. However, due to the pervasive and complex nature of the risks associated with Year 2000, there can be no assurance that Fannie Mae will identify all the risks or undertake all actions necessary to prevent a material adverse impact on the Corporation's business or results of operations.

Risks Associated with the Year 2000

The business of Fannie Mae is highly dependent on the smooth interaction of numerous internal and external (non-Fannie Mae) computer systems, and, as such, the Year 2000 issue poses significant operational risks to Fannie Mae. Fannie Mae is focusing on four types of Year 2000 risks: disruptions and/or inaccuracies in decision support systems and business processing; disruptions from third-party Year 2000 noncompliance; disruptions from Year 2000 noncompliance of funds and securities wiring and clearing systems, including the Federal Reserve Bank; and disruptions in the telecommunications and utilities industries and economic environment outside of Fannie Mae's control. These risks may result in interruptions or delays in Fannie Mae's daily processing relating to MBS issuance, mortgage purchases, financial reporting, calculation of securities payments, and other matters. Such results could lead to loss of revenue, loss of investor confidence, and possible litigation against the Corporation. Fannie Mae cannot determine the likelihood or severity of such events.

In addition, the level of economic and market activities may be temporarily reduced as market participants assess the effectiveness of the global and domestic markets' Year 2000 readiness in the period before and subsequent to the Year 2000 date change. Such an event also could result in a reduction of Fannie Mae's business activities. Fannie Mae cannot predict the likelihood of such a reduction or estimate the impact such a reduction would have on its business.

Project Organization

Oversight of Fannie Mae's Year 2000 effort is structured in three tiers. First, a core Year 2000 project team representing the technology and business areas of Fannie Mae shares primary accountability for the overall Year 2000 effort. Second, a steering committee chaired by the President of Fannie Mae meets monthly to review progress and resolve corporate-wide issues. Third, Fannie Mae's Board of Directors interacts with the Year 2000 project team on a regular basis to monitor project status.

Fannie Mae has developed a comprehensive approach to the Year 2000 issue that includes preventative efforts and contingency planning to address the risks discussed above. Fannie Mae has divided its Year 2000 project into three areas of concentration: internal compliance, external compliance, and business continuity planning. Internal compliance is designed to address the systems and applications (internally developed and third-party vendor packages) used by Fannie Mae employees. It also extends to Fannie Mae-developed applications that are used by third parties. External compliance is designed to address Fannie Mae applications with external interfaces and other electronic linkages between Fannie Mae and its business partners. Business continuity planning includes developing contingency plans for Fannie Mae's business operations.

Internal Compliance

Internal compliance involves four phases: (1) an inventory, assessment, and planning phase; (2) a repair phase; (3) a validation phase; and (4) an enterprise testing phase. Also included in internal compliance is MORNET®/MORNETPlus® software compliance and facilities management readiness.

The inventory, assessment, and planning phase first identified existing business applications and systems used internally (developed internally or purchased from third-party vendors) and technology infrastructure components that are sensitive to the date change. The second step in this phase assessed the Year 2000 readiness of each identified application, system, or infrastructure component. Finally, a timeline for necessary repair was planned. Fannie Mae has completed the inventory, assessment, and planning phase.

The repair phase modified the code in an existing system or application that is not Year 2000 compliant or, where necessary, replaced the existing system, application, or infrastructure component with one that is designed to be Year 2000 compliant. The repair phase first addressed mission-critical systems necessary for Fannie Mae to conduct its day-to-day operations and then proceeded to non-mission-critical systems. Fannie Mae has completed the necessary repairs on all identified mission-critical and non-mission-critical systems.

The validation phase tests systems and applications individually to ensure that they are Year 2000 compliant. Fannie Mae's validation test environment is designed to mirror its production environment and to test each system by simulating key business events in the Year 2000. At December 31, 1998, Fannie Mae completed 100 percent of the testing of all systems identified as mission critical. Testing on identified non-mission-critical systems is expected to be completed by the second quarter of 1999. At December 31, 1998, Fannie Mae completed 90 percent of non-mission critical testing.

After the validation phase is completed for all systems, Fannie Mae will use enterprise testing to further assess whether Fannie Mae will be able to operate under normal business circumstances in the Year 2000. Fannie Mae expects to use enterprise testing to simultaneously test both internal interfaces among Fannie Mae's systems and external interfaces with certain of Fannie Mae's major business partners using simulated Year 2000 business events. Fannie Mae expects to begin enterprise testing in the second quarter of 1999 and to complete enterprise testing early in the fourth quarter of 1999, followed by a suspension of discretionary changes to Fannie Mae's production environment through January 2000.

Fannie Mae's internal compliance effort also involves efforts to make the software provided to its customers Year 2000 ready. Most of Fannie Mae's lenders use MORNET and MORNETPlus software applications to communicate with Fannie Mae. Fannie Mae released 100 percent of its Year 2000-ready versions of these applications to subscribers in 1998.

Fannie Mae's facilities, building security, and building control systems are also likely to be affected by the Year 2000 date change. Providers of Fannie Mae's facilities management services have been asked to submit Year 2000 certifications. Fannie Mae has received certifications from its facilities management service providers and, on that basis, believes that Fannie Mae's facilities, building security, and building control systems will be Year 2000 compliant by the second quarter of 1999.

External Compliance

External compliance focuses on business partners and, in particular, on those with which Fannie Mae exchanges electronic information. These business partners include lenders that sell loans to or service loans for Fannie Mae, securities dealers, clearing agencies, securities depositories, data vendors, and the Federal Reserve Bank. Fannie Mae's approach to the Year 2000 issue includes measures intended to protect against the risk that its operations could be materially affected by its business partners' failure to ensure Year 2000 readiness. These preventative measures include on-site assessments of major lenders, evaluation of service providers, testing with the Federal Reserve Bank, and participation in the Mortgage Bankers Association's (''MBA's'') industry test.

Fannie Mae's Year 2000 project team has developed a methodology to evaluate the Year 2000 readiness of its servicers. This includes on-site meetings with each of Fannie Mae's top-tier servicers to determine their respective Year 2000 readiness. Fannie Mae has completed this assessment. Fannie Mae expects to complete the assessment of the readiness of its smaller lenders by the second quarter of 1999. Fannie Mae is one of the premier sponsors of the Year 2000 Inter-System Readiness Test sponsored by the MBA, which was developed to assist servicers and other mortgage industry participants in evaluating their Year 2000 readiness. Fannie Mae has mandated that its servicers validate certain critical business functions using the MBA test by March 31, 1999.

Fannie Mae's day-to-day operations are highly dependent on the smooth interaction between Fannie Mae and its service providers. Fannie Mae's service providers are involved in certain mission-critical activities, including the securities clearing and depository functions. They also provide services related to Fannie Mae's capital markets transactions. Accordingly, Fannie Mae's Year 2000 efforts include assessing the readiness of these service providers. Fannie Mae is currently testing with its major external service providers, with the degree of testing commensurate with the perceived level of business risk.

Fannie Mae's operations are also highly dependent on the Federal Reserve Bank for handling book-entry securities and the wiring of funds and securities. During 1998, Fannie Mae completed extensive testing with the Federal Reserve Bank. Additionally, Fannie Mae established the Washington, DC, Year 2000 Usergroup, a forum for industry participants to share best practices regarding Year 2000 awareness and readiness.

The steps outlined above are intended to evaluate Fannie Mae's external business partners' Year 2000 readiness. However, Fannie Mae cannot predict the Year 2000 compliance of these external entities. In the event that these entities are not Year 2000 compliant, Fannie Mae's ability to purchase mortgage loans and to issue, transfer, and make periodic payments on its debt, mortgage, and other securities may be adversely affected.

Business Continuity Planning

The third area of concentration is business continuity planning. Fannie Mae has completed its business continuity plan and will continue to refine it throughout 1999. The business continuity plan identifies the most likely and worst-case scenarios, prioritizes the risks associated with each scenario, and addresses how Fannie Mae intends to handle such a scenario.

Fannie Mae's business continuity plan includes the addition of alternate suppliers, including multiple telephone service providers, vendors, servicers, and trading partners, as necessary, to permit business operations to continue and to minimize possible disruptions if key business partners have significant Year 2000 problems. Fannie Mae's plan also includes several measures designed to ensure adequate liquidity in the event of Year 2000 problems affecting the financial markets. Additional measures include backup systems, manual processes, or changes in business practices. Fannie Mae expects to be prepared to move functions from noncompliant partners to companies that are Year 2000 compliant, if necessary. Fannie Mae intends to test key aspects of its business continuity plan during 1999.

Costs

Fannie Mae's Year 2000 project is proceeding as scheduled and budgeted. The estimated total cost to Fannie Mae is expected to be between $60 million and $65 million for the project, which began in early 1997 and runs through the year 2000. Approximately $38 million has been spent on the project from its inception through December 31, 1998.

Balance Sheet Analysis

This section discusses Fannie Mae's mortgage portfolio and other investments as well as related financing activities. A discussion of liquidity and capital resources and regulatory capital requirements is also included.

Mortgage Portfolio

At December 31, 1998, the net mortgage portfolio totaled $415 billion, compared with $316 billion at December 31, 1997. The increase in the net mortgage portfolio was due primarily to the increased availability of mortgage products in the secondary market resulting from the prolonged period of lower interest rates; record fixed-rate mortgage originations; and wide mortgage-to-debt spreads stemming from the period of exceptional market turbulence in the fall of 1998. The volume of mortgage purchases in 1999 will depend on financial and mortgage market conditions over the course of the year.

The yield on the net mortgage portfolio was 7.12 percent at December 31, 1998, compared with 7.60 percent at December 31, 1997. The yield on the net mortgage portfolio averaged 7.38 percent in 1998, compared with 7.67 percent in 1997. The decline in both the ending yield and average yield for the year was due largely to the lower interest rate environment that existed in 1998, which resulted in the refinancing of many mortgages with high interest rates.

The following table summarizes mortgage purchases, sales, and repayments for the years 1996 through 1998.

Mortgage Portfolio Activity

	Purchases			Sales			Repayments (1)		
	1998	1997	1996	1998	1997	1996	1998	1997	1996
	(Dollars in millions)								
Single-family:									
Government insured or guaranteed	$ 6,016	$ 5,539	$ 4,461	$ —	$ —	$ —	$ 3,729	$ 1,973	$ 1,650
Conventional:									
Long-term, fixed-rate	147,615	55,925	54,021	1,383	563	105	60,718	20,995	17,554
Intermediate-term, fixed-rate	28,703	6,001	8,139	1	26	44	18,713	10,688	10,564
Adjustable-rate	3,507	1,977	706	—	476	—	2,965	2,807	2,789
Second	22	29	17	—	—	—	84	84	117
Total single-family	185,863	69,471	67,344	1,384	1,065	149	86,209	36,547	32,674
Multifamily	2,585	994	1,274	409	23	—	2,658	3,204	2,254
Total	$188,448	$70,465	$68,618	$1,793	$1,088	$149	$88,867	$39,751	$34,928
Average net yield	6.61%	7.40%	7.57%				7.66%	7.70%	7.81%
Repayments as a percentage of average mortgage portfolio							25.0%	13.2%	12.9%

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

Investments

Fannie Mae maintains an investment portfolio consisting of high-quality, short-term nonmortgage investments, such as federal funds, commercial paper, repurchase agreements, asset-backed securities, and other investments. The objectives of the investment portfolio are to serve as a source of liquidity and to provide a return on the excess capital of Fannie Mae. As of December 31, 1998, the balance in Fannie Mae's investment portfolio was $59 billion, compared with $65 billion at December 31, 1997. The decline in the investment portfolio was a result of Fannie Mae utilizing its excess capital, during the period of exceptional market turbulence in the fall of 1998, to significantly increase its purchases of mortgage loans in support of the market. The weighted-average interest rate earned on investment securities was 5.76 percent for 1998 and 5.82 percent for 1997.

Additional information on these investments is presented in Note 4 to the Financial Statements, "Investments."

Financing Activities

The following table sets forth the amount and average cost of debt issued and repaid in 1998, 1997, and 1996, and of debt outstanding at the end of each year. The average cost of debt outstanding at December 31, 1998 was 6.10 percent, compared with 6.46 percent at December 31, 1997. The average cost of debt outstanding at December 31, 1998 declined because of lower interest rates during 1998 and the call and refunding of higher-cost debt. The weighted-average maturity of effective long-term, fixed-rate debt outstanding at December 31, 1998 and 1997 was 68 months and 66 months, respectively.

Short-Term and Long-Term Debt Activity

	1998	1997	1996
	(Dollars in millions)		
Issued during the year:			
Short-term(1):			
Amount	$695,495	$755,281	$635,595
Average cost	5.42%	5.53%	5.36%
Long-term(1):			
Amount	$147,430	$ 86,325	$ 80,302
Average cost	5.81%	6.37%	6.17%
Repaid during the year:			
Short-term(1):			
Amount	$657,308	$738,552	$636,768
Average cost	5.51%	5.49%	5.41%
Long-term(1):			
Amount	$ 94,728	$ 63,690	$ 46,937
Average cost	6.40%	6.65%	6.93%
Outstanding at year-end:			
Due within one year:			
Net amount	$205,413	$175,400	$159,900
Average cost(2)	5.33%	5.76%	5.66%
Due after one year:			
Net amount	$254,878	$194,374	$171,370
Average cost(2)	6.25%	6.67%	6.66%
Total debt:			
Net amount	$460,291	$369,774	$331,270
Average cost(2)	6.10%	6.46%	6.49%

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

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

In 1998, Fannie Mae initiated a new funding product called Benchmark Notes. Benchmark Notes are large issues of noncallable debt securities designed to provide liquidity and performance to investors while reducing Fannie Mae's cost of debt. Benchmark Notes have served to consolidate much of Fannie Mae's long-term debt issuances from a large number of small, unscheduled issues to a smaller number of larger, regular, more liquid issues. During 1998, Fannie Mae issued $42 billion of Benchmark Notes with maturities ranging from 3 years to 10 years.

As described under "Risk Management—Interest Rate Risk Management," matching the duration of mortgage assets with the duration of liabilities funding those assets is accomplished through the use of varied debt maturities and embedded option characteristics, as well as the use of off-balance-sheet financial instruments, primarily interest rate swaps, caps, and swaptions.

The following table presents option-embedded debt instruments as a percentage of mortgage purchases and the net mortgage portfolio. Option-embedded debt instruments include derivative financial instruments.

Option-Embedded Debt Instruments

	1998	1997	1996
	(Dollars in billions)		
Issued during the year	$113	$ 36	$ 44
Percentage of total mortgage purchases	60%	51%	64%
Outstanding at year-end	$174	$139	$130
Percentage of total net mortgage portfolio	42%	44%	45%

The decline in the percentage of option-embedded debt instruments to 42 percent at December 31, 1998 from 44 percent at December 31, 1997 was primarily attributable to the large amount of debt called in 1998.

Derivative financial instruments increase the flexibility of Fannie Mae's funding alternatives by providing the specific cash flows or characteristics that the portfolio requires but that might not be as readily available or cost-effective if obtained in the standard debt market. Fannie Mae does not speculate using derivatives and does not engage in derivatives trading. Fannie Mae primarily uses four types of derivative instruments: (1) generic swaps, which involve the exchange of fixed and variable interest payments based on contractual notional principal amounts, and which may include callable swaps (which give the counterparties or, in some cases, Fannie Mae the right to terminate the interest rate swap agreement before its stated maturity); (2) basis swaps, whereby the Corporation exchanges variable payments that have maturities similar to the underlying debt but rates based on different indices; (3) swaptions, which provide Fannie Mae with the option to enter into a swap at a future date, thereby mirroring the economic effect of callable debt; and (4) interest rate caps, which effectively cap the interest rate on a variable-rate debt instrument in exchange for a premium.

The following table summarizes Fannie Mae's derivative activity for the years ended December 31, 1998 and 1997, together with the expected maturities and weighted-average interest rates to be received and paid on these derivative instruments.

Derivative Activity and Maturity Data

	Generic-Pay Fixed/Receive Variable Swaps (1)			Pay Variable/ Receive Fixed Swaps	Basis Swaps	Caps and Swaptions	Total
	Notional (2)	Pay Rate (3)	Receive Rate (3)				
	(Dollars in millions)						
Balance on January 1, 1997	$100,111	6.73%	5.59%	$15,624	$40,078	$ —	$155,813
Additions	12,557	6.56	5.71	24,685	15,234	—	52,476
Maturities	15,955	6.36	5.69	10,656	32,929	—	59,540
Balance on December 31, 1997	96,713	6.77	5.82	29,653	22,383	—	148,749
Additions	23,725	5.31	5.28	20,448	10,931	27,165	82,269
Maturities	24,424	6.25	5.72	20,631	16,395	—	61,450
Balance on December 31, 1998	$ 96,014	6.53%	5.30%	$29,470	$16,919	$27,165	$169,568
Future Maturities (4)							
1999	$ 5,450	6.64%	4.89%	$16,325	$15,120	$ 250	$ 37,145
2000	14,648	5.18	5.19	3,275	1,200	5,500	24,623
2001	9,800	6.22	5.28	2,892	—	4,750	17,442
2002	4,950	6.28	5.36	400	79	7,000	12,429
2003	4,376	5.96	5.35	1,000	200	7,365	12,941
Thereafter	56,790	6.98	5.36	5,578	320	2,300	64,988
	$ 96,014	6.53%	5.30%	$29,470	$16,919	$27,165	$169,568

(1) Included in the notional amounts are callable swaps of $26 billion, and $23 billion with weighted-average pay rates of 4.93 percent, and 6.58 percent, and weighted-average receive

rates of 5.44 percent, and 5.89 percent at December 31, 1998, and December 31, 1997, respectively.

(2) The notional value only indicates the amount on which swap payments are being calculated and does not represent the amount at risk of loss.

(3) The weighted-average interest rate payable and receivable is as of the date indicated. The interest rates of the swaps may be floating-rate, so these rates may change as prevailing interest rates change.

(4) Based on stated maturities. Assumes that variable interest rates remain constant at December 31, 1998 levels.

Fannie Mae's interest rate swaps had a weighted-average term of 68 months and 72 months at December 31, 1998 and 1997, respectively. Long-term debt outstanding, including the effect of swaps but excluding effective variable-rate debt (i.e., long-term debt that reprices within one year), totaled $352 billion at December 31, 1998, and $294 billion at December 31, 1997. Interest rate swaps effectively lengthened the final maturity of Fannie Mae's liabilities by 13 months at December 31, 1998, and 18 months at December 31, 1997.

The primary risk posed by Fannie Mae's derivative instruments is credit risk, or the risk that a counterparty will fail to meet its contractual obligations on a transaction, thereby causing Fannie Mae to have to replace the derivative instrument at market prices. Fannie Mae manages this risk by dealing only with experienced counterparties with high credit quality, diversifying its derivative instruments across many counterparties, and entering into interest rate swaps under master agreements that require counterparties to post collateral if Fannie Mae is exposed to credit loss exceeding an agreed-upon threshold. In addition, master agreements provide for netting of certain amounts payable by each party. Fannie Mae regularly monitors the exposures on its derivative instruments by determining the market value of positions via dealer quotes and internal pricing models. Fannie Mae held $72 million of collateral for derivative instruments at December 31, 1998.

Fannie Mae's off-balance-sheet exposure on derivative instruments (taking into account master agreements that allow for netting of payments) was $46 million at December 31, 1998, compared with $26 million at December 31, 1997.

Fannie Mae also hedges against fluctuations in interest rates on planned debt issuances using derivative instruments that simulate the short sale of U.S. Treasury securities, through interest rate swaps, and through deferred rate-setting agreements. Gains and losses on these instruments are deferred and reflected as basis adjustments to the cost of the debt when issued. The hedging of anticipated debt issuances enables Fannie Mae to maintain an orderly and cost-effective debt issuance schedule and to make daily loan purchase commitments without significantly increasing its interest rate risk exposure.

Additional information on interest rate swaps and other off-balance-sheet financial instruments are presented in Notes 13 and 15 to the Financial Statements, "Off-Balance-Sheet Credit Risk" and "Disclosures of Fair Value of Financial Instruments."

Liquidity and Capital Resources

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

Fannie Mae's primary sources of cash are issuances of debt obligations, mortgage loan repayments, interest income, and MBS guaranty fees. In addition, at December 31, 1998, Fannie Mae had cash and cash equivalents and short-term investments totaling $59 billion, compared with $67 billion at December 31, 1997. Primary uses of cash include the purchase of mortgages and other securities, repayment of debt, interest payments, administrative expenses, and taxes.

At December 31, 1998, Fannie Mae had mandatory delivery commitments and lender-option commitments outstanding to purchase $11 billion and $2 billion of mortgage loans, respectively, compared with $4 billion and $2 billion, respectively, outstanding at December 31, 1997.

Fannie Mae's capital base (stockholders' equity plus general allowance for losses) grew to $16.2 billion at December 31, 1998, compared with $14.6 billion at the end of 1997. At year-end 1998, there were 1.025 billion shares of common stock outstanding. In January 1999, the Board of Directors approved a quarterly dividend rate for 1999 of $.27 per common share, and dividends of $.80125 per Series A preferred share, $.81250 per Series B preferred share, $.80625 per Series C preferred share, and $.65625 per Series D preferred share for the period December 31, 1998, up to but excluding March 31, 1999. In 1998, the quarterly dividend rate was $.24 per common share.

During the third quarter of 1998, Fannie Mae issued 3 million shares of 5.25 percent noncumulative preferred stock, Series D, with a stated value of $50 per share. In addition, in October 1998, the Board of Directors authorized the issuance of up to $850 million in preferred stock by January 1, 2001. During 1998, Fannie Mae continued implementing its capital restructuring program, approved by the Board of Directors in December 1995, by repurchasing 17 million shares of common stock. The shares were repurchased pursuant to the Board's approval for the repurchase of up to an additional six percent of outstanding common shares as of December 27, 1995 (adjusted for a stock split), to offset the dilutive effect of common shares issued or expected to be issued in conjunction with various stock compensation plans, and to use the $150 million proceeds from the Series D preferred stock offering. In 1997, Fannie Mae repurchased 31 million shares of common stock to offset the effect of shares issued in conjunction with various stock compensation plans and toward the aforementioned capital restructuring program.

Fannie Mae assesses the adequacy of its capital using an internally developed stress test methodology. The stress test model calculates the amount of capital required under different economic scenarios. By using this model, Fannie Mae can estimate the amount of capital needed to carry out the company's mission during times of economic distress. At December 31, 1998, Fannie Mae's capital was sufficient under all tested scenarios. As discussed below, a regulatory capital standard based on a stress test is being developed.

Regulatory Capital Requirements

Fannie Mae is subject to capital adequacy and risk-based standards established by the 1992 Act. The capital adequacy standards require that Fannie Mae's core capital equal or exceed a minimum capital standard and a critical capital standard. The following table shows Fannie Mae's core capital compared with the requirements.

Capital Requirements

	December 31, 1998	December 31, 1997
	(Dollars in millions)	
Core capital(1)	$15,465	$13,793
Required minimum capital(2)	15,334	12,703
Required critical capital(3)	7,863	6,528
Excess of core capital over minimum capital	$ 131	$ 1,090

(1) The sum of (a) the par value of outstanding common stock; (b) the par value of outstanding noncumulative perpetual preferred stock; (c) paid-in capital; and (d) retained earnings.

(2) The sum of (a) 2.50 percent of on-balance-sheet assets; (b) .45 percent of outstanding MBS; and (c) .45 percent of other off- balance-sheet obligations, except as adjusted by the Director of OFHEO.

(3) The sum of (a) 1.25 percent of on-balance-sheet assets; (b) .25 percent of outstanding MBS; and (c) .25 percent of other off-balance-sheet obligations, except as adjusted by the Director of OFHEO.

The Director of OFHEO also is developing a risk-based standard consistent with the parameters specified in the 1992 Act. The risk-based standard includes credit and interest rate risk components along with an additional amount of required capital for management and operations risk. To meet that standard, Fannie Mae must hold total capital equal to the amount necessary to meet the combined occurrence of highly stressful credit and interest rate conditions over a ten-year period, plus an additional 30 percent of this amount for management and operations risk.

The Director of OFHEO publicly released Part I of the proposed risk-based capital regulations in 1996. Part I creates benchmarks for credit testing and specifies the housing price index that will be used in connection with this standard. After interagency review and comment, OFHEO recently sent Part II of the proposed risk-based capital regulations to Congress for review and comment. After the Congressional review period, OFHEO is expected to publish Part II for public review and comment. Part II will specify the remaining credit risk criteria and the interest rate risk criteria. The 1992 Act provides that the final regulations will be enforceable one year after issuance. Management is confident that Fannie Mae will be able to meet any reasonable stress test. See "Government Regulation and Charter Act."

Mortgage-Backed Securities

MBS outstanding grew to $835 billion at December 31, 1998, compared with $710 billion at December 31, 1997. MBS are backed by loans from a single lender, from multiple lenders, or from Fannie Mae's mortgage loan portfolio. Single-lender MBS are issued through lender swap transactions whereby a lender exchanges pools of mortgage loans for MBS. Multiple-lender MBS allow several lenders to pool mortgage loans and receive, in return, MBS (called Fannie Majors®) representing a proportionate share of a larger pool. In some instances, Fannie Mae buys loans and at the same time enters into a forward sale commitment. These loans are designated as held for sale and sold from the portfolio as MBS.

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

The table below summarizes MBS issued and outstanding for the years ended December 31, 1998, 1997, and 1996. The increase in the total amount of MBS issued compared with prior periods was due to several factors including a sustained period of lower interest rates that resulted in record mortgage originations and increased refinance activity. The increase in the percentage of total MBS issued in the lender or shared risk category in 1998, compared with 1997, was primarily a result of increases in deals in which the default risk is shared with a third party.

MBS Risk Distribution

	Issued (1)			Outstanding (1)		
	Lender or Shared Risk	Fannie Mae Risk	Total	Lender or Shared Risk (2)	Fannie Mae Risk	Total (3)
	(Dollars in millions)					
1998	$90,694	$235,454	$326,148	$160,223	$674,295	$834,518
1997	35,740	113,689	149,429	94,262	615,320	709,582
1996	13,389	136,480	149,869	70,642	580,138	650,780

(1) Based on primary default risk category. MBS outstanding includes MBS that have been pooled to back Fannie Megas, SMBS, or REMICs.

(2) Included in lender risk are $123 billion, $57 billion, and $31 billion at December 31, 1998, 1997, and 1996, respectively, on which the lender or a third party had agreed to bear default risk limited to a certain portion or percentage of the loans delivered and, in some cases, on which the lender had pledged collateral to secure that obligation.

(3) Included are $197 billion, $130 billion, and $103 billion at December 31, 1998, 1997, and 1996, respectively, of MBS in Fannie Mae's portfolio.

Fannie Mae issues REMICs backed by MBS, SMBS, Ginnie Mae mortgage-backed securities, other REMIC securities, or whole loans. REMICs provide an additional source of fee income that does not subject the Corporation to added credit risk, except for REMICs backed by whole loans. In 1998, REMIC issuances were $76 billion, compared with $75 billion in 1997. The outstanding balance of REMICs at December 31, 1998 was $311 billion, compared with $329 billion at December 31, 1997.

Housing Goals

The 1992 Act gives the Secretary of HUD authority to establish low- and moderate-income, underserved areas, and special affordable housing goals for Fannie Mae. In December 1995, the Secretary of HUD issued final regulations setting the housing goals for 1996 through 1999. Under the final regulation, the Corporation's goal for 1997 through 1999 in low- and moderate-income housing is 42 percent of Fannie Mae's conventional mortgage business. The geographic goal for 1997 through 1999, based on underserved census tracts in metropolitan statistical areas and counties in rural areas, is 24 percent of Fannie Mae's conventional mortgage business. The special affordable housing goal, which serves very low-income families and low-income families in low-income areas, is 14 percent of Fannie Mae's single-family conventional mortgage business and multifamily business for the years 1996 through 1999. Under this goal, Fannie Mae also must include mortgage purchases of multifamily units totaling no less than $1.3 billion (.8 percent of Fannie Mae's 1994 total dollar volume of such mortgage purchases). All of these goals are measured as a percentage of dwelling units financed.

Fannie Mae exceeded its low- and moderate-income housing goal in 1998 and 1997, with 44 percent and 45 percent, respectively, of its conventional mortgage business counting toward this goal. In 1998, Fannie Mae exceeded its geographic goal, with over 26 percent of its conventional mortgage business counting toward this goal. Fannie Mae exceeded the 1997 geographic goal, with 29 percent of the conventional mortgage business serving families in underserved areas. In addition, in 1998 Fannie Mae exceeded its special affordable housing goal, with over 15 percent of the conventional single-family and multifamily business counting toward this goal and with $3.6 billion of multifamily business meeting the $1.3 billion multifamily requirement. In 1997, Fannie Mae exceeded the special affordable housing goal, with 19 percent of single-family and multifamily business counting toward this goal and with special affordable multifamily purchases of $3.2 billion.

Fannie Mae has built a solid foundation in affordable housing through significant community outreach efforts, products directed at certain disadvantaged groups, and the introduction of products with targeted underwriting flexibilities, including an initiative to purchase loans with lower down payments to help low-income households afford homes. In 1994, Fannie Mae announced a commitment to increase outreach and access to mortgage credit under our Trillion Dollar Commitment to serve 10 million households by the end of the year 2000. Through the end of 1998, Fannie Mae has financed $700 billion under this commitment, serving 8.3 million households. This targeted housing finance serves families with incomes below the median for their areas, minorities and new immigrants, families who live in central cities and distressed communities, and people with special housing needs. With this announcement, Fannie Mae pledged to provide the innovation and leadership necessary to transform the housing finance industry into one without arbitrary barriers to individuals and families who have been shut out of the dream of homeownership or have not had ready access to decent, safe rental housing.

New Accounting Standard

In the second quarter of 1998, the Financial Accounting Standards Board issued Financial Accounting Standard No. 133 (''FAS 133''), *Accounting for Derivative Instruments and Hedging Activities,* which is effective for Fannie Mae on January 1, 2000. FAS 133 requires that all derivatives be recognized either as assets or liabilities on the balance sheet at fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the fair value of a fixed-rate instrument (fair value hedge) or as a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge). For a derivative qualifying as a fair value hedge, fair value gains or losses would be reported in earnings along with offsetting fair value gains or losses attributable to the risk being hedged. For derivatives qualifying as a cash flow hedge, fair value gains or losses associated with the risk being hedged would be reported in a separate component of stockholders' equity (other comprehensive income) and then recognized in earnings in the period(s) in which the hedged item affects income. For a derivative instrument not qualifying as a hedge, fair value gains and losses would be reported in earnings. Management currently is evaluating the impact that this standard will have on its internal operations. If Fannie Mae continues with its current business strategies, this standard will not have a significant effect on net income, although it is likely to have a material effect on the ''other comprehensive income'' component of stockholders' equity.

Comparison of 1997 with 1996

The following discussion and analysis provides a comparison of Fannie Mae's results of operations for the years ended December 31, 1997 and 1996.

Results of Operations

Net income increased to $3.056 billion in 1997 from $2.725 billion in 1996, and earnings per common share were $2.83, up from $2.48 in 1996.

Net interest income increased $357 million to $3.949 billion in 1997, as a result of a $30 billion, or 11 percent, increase in the average mortgage portfolio balance, which was partially offset by a 1 basis point decrease in the average net interest margin.

Guaranty fee income increased $78 million to $1.274 billion in 1997, compared with $1.196 billion in 1996. The increase in guaranty fee income resulted from a $27 billion increase in average net Fannie Mae MBS outstanding coupled with an increase of .3 basis points in the average effective guaranty fee rate.

Fee and other income increased $39 million to $125 million in 1997, compared with $86 million in 1996. The 45 percent increase was due largely to increases in income from structured transaction fees, multifamily fees, and special transaction fees.

Credit-related expenses decreased $34 million to $375 million in 1997 from $409 million in 1996. The decrease in credit-related expenses was driven by a reduction in the provision for losses, reflecting a lower average loss per foreclosed property in 1997. The lower average loss per foreclosed property resulted from a stronger national housing market, increased payments from mortgage insurance, and continued loss mitigation efforts.

Administrative expenses grew $76 million, or 14 percent, to $636 million in 1997, compared with $560 million in 1996. The increase in administrative expenses resulted primarily from additional investments in systems development, which included efforts to make Fannie Mae's computer systems Year 2000 compliant, expenses associated with restructuring the corporation's regional offices, and the effect of a higher common share price on Fannie Mae's stock-based compensation plans. Compensation expense was $394 million in 1997, compared with $344 million in 1996.

The provision for federal income taxes, net of the tax benefit from extraordinary losses, was $1.262 billion in 1997, compared with $1.135 billion in 1996. The effective federal income tax rate was 29 percent for both periods.

During 1997, the amount of long-term debt called or repurchased and the notional principal amount of interest rate swaps called was $31 billion, with a weighted-average cost of 7.22 percent. The comparable amount in 1996 was $26 billion, with a weighted-average cost of 7.09 percent. As a result of repurchase and call activity, Fannie Mae recognized net extraordinary losses of $19 million ($12 million after tax) in 1997, compared with $45 million ($29 million after tax) in 1996. The repurchase or call of high-coupon debt favorably affects Fannie Mae's future cost of funds.

FANNIE MAE

INDEX TO FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Fannie Mae:

We have audited the accompanying balance sheets of Fannie Mae as of December 31, 1998 and 1997, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998. These financial statements are the responsibility of Fannie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fannie Mae as of December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

We also have audited in accordance with generally accepted auditing standards the supplemental fair value balance sheets of Fannie Mae as of December 31, 1998 and 1997, included in Note 15 to the financial statements. As described in Note 15, the supplemental fair value balance sheets have been prepared by management to present relevant financial information that is not provided by the financial statements and is not intended to be a presentation in conformity with generally accepted accounting principles. In addition, the supplemental fair value balance sheets do not purport to present the net realizable, liquidation, or market value of Fannie Mae as a whole. Furthermore, amounts ultimately realized by Fannie Mae from the disposal of assets may vary significantly from the fair values presented. In our opinion, the supplemental fair value balance sheets included in Note 15 present fairly, in all material respects, the information set forth therein.

KPMG LLP

Washington, DC
January 13, 1999

FANNIE MAE

STATEMENTS OF INCOME

	Year Ended December 31,		
	1998	1997	1996
	(Dollars in millions, except per common share amounts)		
Interest income:			
Mortgage portfolio	$25,676	$22,716	$20,560
Investments and cash equivalents	4,319	3,662	3,212
Total interest income	29,995	26,378	23,772
Interest expense:			
Short-term debt	4,809	3,659	3,395
Long-term debt	21,076	18,770	16,785
Total interest expense	25,885	22,429	20,180
Net interest income	4,110	3,949	3,592
Other income:			
Guaranty fees	1,229	1,274	1,196
Fee and other income, net	275	125	86
Total other income	1,504	1,399	1,282
Other expenses:			
Provision for losses	(50)	100	195
Foreclosed property	311	275	214
Administrative	708	636	560
Total other expenses	969	1,011	969
Income before federal income taxes and extraordinary item	4,645	4,337	3,905
Provision for federal income taxes	1,201	1,269	1,151
Income before extraordinary item	3,444	3,068	2,754
Extraordinary item—loss on early extinguishment of debt (net of tax effect of $14 million in 1998, $7 million in 1997, and $16 million in 1996)	26	12	29
Net income	$ 3,418	$ 3,056	$ 2,725
Preferred stock dividends	66	65	42
Net income available to common stockholders	$ 3,352	$ 2,991	$ 2,683
Basic earnings per common share (1):			
Earnings before extraordinary item	$ 3.28	$ 2.87	$ 2.53
Extraordinary item	(.02)	(.02)	(.03)
Net earnings	$ 3.26	$ 2.85	$ 2.50
Diluted earnings per common share (1):			
Earnings before extraordinary item	$ 3.26	$ 2.84	$ 2.51
Extraordinary item	(.03)	(.01)	(.03)
Net earnings	$ 3.23	$ 2.83	$ 2.48
Cash dividends	$ .96	$ .84	$ .76
Weighted-average shares outstanding:			
Basic	1,029	1,049	1,071
Diluted	1,037	1,056	1,080

(1) Earnings per share amounts in 1996 have been restated to comply with Financial Accounting Standard No. 128, *Earnings per Share.*

See Notes to Financial Statements

FANNIE MAE

BALANCE SHEETS

Assets

	December 31, 1998	December 31, 1997
	(Dollars in millions)	
Mortgage portfolio, net	$415,223	$316,316
Investments:		
Held-to-maturity	42,299	58,690
Available-for-sale	16,216	5,906
Cash and cash equivalents	743	2,205
Accrued interest receivable	3,453	2,864
Acquired property and foreclosure claims, net	827	919
Other	6,253	4,773
Total assets	$485,014	$391,673

Liabilities and Stockholders' Equity

	December 31, 1998	December 31, 1997
Liabilities:		
Debentures, notes and bonds, net:		
Due within one year	$205,413	$175,400
Due after one year	254,878	194,374
Total	460,291	369,774
Accrued interest payable	5,262	4,611
Other	4,008	3,495
Total liabilities	469,561	377,880
Stockholders' Equity:		
Preferred stock, $50 stated value, 100 million shares authorized— 23 million shares outstanding in 1998 and 20 million shares outstanding in 1997	1,150	1,000
Common stock, $.525 stated value, no maximum authorization— 1,129 million shares outstanding	593	593
Additional paid-in capital	1,533	1,495
Retained earnings	15,689	13,326
Accumulated other comprehensive income	(13)	(1)
	18,952	16,413
Less: Treasury stock, at cost, 104 million shares in 1998 and 92 million shares in 1997	3,499	2,620
Total stockholders' equity	15,453	13,793
Total liabilities and stockholders' equity	$485,014	$391,673

See Notes to Financial Statements.

FANNIE MAE

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Number of Common Shares Outstanding	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
				(Dollars and shares in millions)				
Balance, January 1, 1996	1,092	$ —	$593	$1,389	$ 9,348	$ —	$ (371)	$10,959
Comprehensive Income:								
Net income	—	—	—	—	2,725	—	—	2,725
Other comprehensive income:								
Unrealized losses on available-for-sale securities, net of tax effect	—	—	—	—	—	(1)	—	(1)
Total comprehensive income								2,724
Dividends	—	—	—	—	(858)	—	—	(858)
Shares repurchased	(48)	—	—	—	—	—	(1,536)	(1,536)
Preferred stock issued	—	1,000	—	(20)	—	—	—	980
Contribution to Foundation	11	—	—	12	—	—	338	350
Treasury stock issued for stock options and benefit plans	6	—	—	70	—	—	84	154
Balance, December 31, 1996	1,061	1,000	593	1,451	11,215	(1)	(1,485)	12,773
Comprehensive Income:								
Net income	—	—	—	—	3,056	—	—	3,056
Other comprehensive income:								
Unrealized losses on available-for-sale securities, net of tax effect	—	—	—	—	—	—	—	—
Total comprehensive income								3,056
Dividends	—	—	—	—	(945)	—	—	(945)
Shares repurchased	(31)	—	—	—	—	—	(1,291)	(1,291)
Treasury stock issued for stock options and benefit plans	7	—	—	44	—	—	156	200
Balance, December 31, 1997	1,037	1,000	593	1,495	13,326	(1)	(2,620)	13,793
Comprehensive Income:								
Net income	—	—	—	—	3,418	—	—	3,418
Other comprehensive income:								
Unrealized losses on available-for-sale securities, net of tax effect	—	—	—	—	—	(12)	—	(12)
Total comprehensive income								3,406
Dividends	—	—	—	—	(1,055)	—	—	(1,055)
Shares repurchased	(17)	—	—	—	—	—	(1,051)	(1,051)
Preferred stock issued	—	150	—	—	—	—	—	150
Treasury stock issued for stock options and benefit plans	5	—	—	38	—	—	172	210
Balance, December 31, 1998	1,025	$1,150	$593	$1,533	$15,689	$(13)	$(3,499)	$15,453

See Notes to Financial Statements

FANNIE MAE

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1998	1997	1996
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	$ 3,418	$ 3,056	$ 2,725
Adjustments to reconcile net income to net cash provided by operating activities:			
Discount amortization on short-term debt	5,828	5,012	4,338
Provision for losses	(50)	100	195
Loss on early extinguishment of debt	40	19	45
Other decreases, net	(1,540)	(1,691)	(830)
Net cash provided by operating activities	7,696	6,496	6,473
Cash flows from investing activities:			
Purchases of mortgages	(189,721)	(70,768)	(68,471)
Proceeds from sales of mortgages	1,824	1,082	102
Mortgage principal repayments	86,918	37,714	32,853
Net proceeds from disposition of foreclosed properties	2,890	3,085	2,448
Net decrease (increase) in investments	6,081	(7,990)	667
Net cash used in investing activities	(92,008)	(36,877)	(32,401)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	149,034	86,079	79,189
Payments to redeem long-term debt	(95,920)	(63,716)	(46,966)
Proceeds from issuance of short-term debt	682,524	737,054	606,427
Payments to redeem short-term debt	(650,961)	(725,584)	(610,876)
Net payments from stock activities	(1,827)	(2,097)	(1,314)
Net cash provided by financing activities	82,850	31,736	26,460
Net (decrease) increase in cash and cash equivalents	(1,462)	1,355	532
Cash and cash equivalents at beginning of year	2,205	850	318
Cash and cash equivalents at end of year	$ 743	$ 2,205	$ 850
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 24,415	$ 21,622	$ 19,526
Income taxes	555	1,240	1,053

See Notes to Financial Statements

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Fannie Mae is a federally chartered and stockholder-owned corporation operating in the residential mortgage finance industry.

The accounting and reporting policies of Fannie Mae conform with generally accepted accounting principles. Certain amounts in prior years' financial statements have been reclassified to conform with the current presentation.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Mortgage Portfolio

Mortgages and mortgage-backed securities that Fannie Mae has the ability and positive intent to hold to maturity are classified as held-to-maturity and are carried at their unpaid principal balances ("UPB") adjusted for unamortized purchase discount or premium and deferred price adjustments. Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in current period earnings. Mortgage-backed securities that Fannie Mae intends to hold for an undetermined period, but not necessarily to maturity, are classified as available-for-sale and are carried at fair value, with any valuation adjustments reported as a component of other comprehensive income, net of deferred taxes, in stockholders' equity.

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

Interest income is not accrued on nonperforming loans. Conventional single-family and multifamily loans are classified as nonperforming and previously accrued interest is removed from income when the collection of interest payments is deemed less than probable.

Investments

Nonmortgage investments are classified as either available-for-sale or held-to-maturity. Investments that are classified as available-for-sale are carried at fair value as of the balance sheet date, with any valuation adjustments reported as a component of other comprehensive income, net of deferred taxes, in stockholders' equity. Investments that are classified as held-to-maturity are carried at historical cost, adjusted for unamortized discount or premium. Interest income is recognized on an accrual basis unless the collection of interest income is considered doubtful, in which case interest income is recognized on a cash basis.

Guaranteed Mortgage-Backed Securities

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

Allowance for Losses

The allowance for losses is based on an analysis of portfolio loans and MBS outstanding and provides for known probable losses and losses inherent in the mortgage portfolio and MBS. Management's analysis considers current delinquency levels, historical loss experience, current economic conditions, geographic conditions and concentrations, and other pertinent factors. The allowance for losses is established by recording an expense for the provision for losses. It is subsequently reduced through charge-offs on foreclosed properties and is increased through recoveries on foreclosed properties. In management's judgement, the allowance for losses is adequate to provide for expected losses.

Acquired Property

Foreclosed assets are carried at the lower of cost or fair value less estimated costs to sell. Cost is defined as fair value at foreclosure and represents the amount that a willing seller could reasonably expect from a willing buyer in an arm's-length transaction. The difference between estimated fair value of the collateral at foreclosure and the carrying amount of the underlying loan is recorded as a charge-off against the allowance for losses. Foreclosure, holding, and disposition costs are charged directly to earnings.

Hedging Instruments

Fannie Mae utilizes certain financial instruments, such as interest rate swaps, swaptions, derivative instruments that simulate the short sale of Treasury securities, interest rate caps, deferred rate-setting agreements, and foreign currency swaps to achieve a specific financing or investment objective at a desired cost or yield. Fannie Mae does not engage in trading or other speculative use of these financial instruments. Specific criteria must be met for financial instruments to qualify as a hedge on either an accrual or a deferred basis. Financial instruments not qualifying as hedges are marked to market through earnings. Financial instruments used to hedge the anticipated issuance of debt must maintain a high correlation between the hedging instrument and the item being hedged, both at inception and throughout the hedge period.

Interest rate swaps are contractual agreements between two parties for the exchange of periodic payments, generally based on a notional principal amount and agreed-upon fixed and variable rates. Fannie Mae has long-term interest rate swap agreements with various parties to extend the effective maturity of certain short-term debt obligations and to adjust the effective maturity of certain long-term debt obligations. Fannie Mae also has interest rate swap agreements that are linked to specific debt issues ("debt swaps") or specific investments ("asset swaps"). These swaps achieve a specific financing or investment objective at a desired cost or yield. The costs and terms of the specific debt issues and yield of these specific investments, as presented in the financial statements, include the effects of these swaps. Interest rate swaps are accounted for on an accrual basis with the net payable or receivable recognized as an adjustment to interest income or expense on the related assets or liabilities. Gains or losses on terminated interest rate swaps are deferred and amortized over the shorter of the remaining life of the hedged items or the term of the original swap. The fair value of the interest rate swap agreements and changes in these fair values as a result of changes in market interest rates are not recognized in the financial statements.

Swaptions are derivative instruments that provide Fannie Mae with the option to enter into an interest rate swap at a future date, thereby mirroring the economic effect of callable debt. Swaptions are used to hedge planned debt issuances or existing debt instruments. The fair value of the swaptions and changes in these fair values as a result of changes in market interest rates are not recognized in the financial statements.

Derivative instruments that simulate short sales of Treasury securities are used to hedge interest rate risk on planned debt issuances. Gains and losses that result from the hedge positions are deferred and recognized as adjustments to debt cost over the life of the hedged debt issuance.

An interest rate cap agreement is entered into with a counterparty to effectively cap Fannie Mae's exposure on a variable-rate debt instrument in a rising interest rate environment. In exchange for the premium paid for the cap, the counterparty agrees to pay Fannie Mae an amount equal to any interest on the debt in excess of the agreed-upon rate. Interest rate caps are used to hedge planned debt issuances. The fair value of the interest rate caps and changes in these fair values as a result of changes in market interest rates are not recognized in the financial statements.

Fannie Mae enters into deferred rate-setting agreements when fixed-rate debt is issued prior to the commitment for mortgages that the debt will support. Under these agreements, Fannie Mae is able to set the effective interest rate on the debt based on prevailing market conditions at one or more future dates. At settlement of all or a portion of a deferred rate-setting agreement, Fannie Mae pays or receives cash in an amount representing the present value of the interest rate differential between the fixed-rate debt and the prevailing rate. Gains and losses that result from the hedge position are deferred and recognized as adjustments to debt cost over the life of the debt issuance.

Fannie Mae issues debt securities in which principal, interest, or both are payable in a foreign currency or are determined by reference to an index that includes one or more foreign currencies. Concurrently, Fannie Mae enters into currency swaps that convert the proceeds of certain borrowings into dollars or provide for scheduled exchanges of the currencies to insulate Fannie Mae against foreign currency exchange risk. Foreign currency swaps are accounted for on an accrual basis with the net differential received or paid under such swaps recognized as an adjustment to interest income or expense on the related asset or liability. Foreign currency borrowings and the related net receivables and payables from currency swaps are translated at the market rates of exchange as of the balance sheet date.

Cash and Cash Equivalents

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

Income Taxes

Deferred federal income tax assets and liabilities are established for temporary differences between financial and taxable income and are measured using the current marginal statutory tax rate. Investment and other tax credits are generally recognized when recorded on the tax return.

Comprehensive Income

In 1998, Financial Accounting Standard No. 130 ("FAS 130"), *Reporting Comprehensive Income,* became effective. FAS 130 requires reporting of comprehensive income by its components and in total in the financial statements.

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Fannie Mae adopted the requirements of FAS 130 on January 1, 1998. Presentation of prior year amounts have been restated to conform with the requirements of FAS 130.

2. Mortgage Portfolio, Net

The mortgage portfolio consisted of the following at December 31, 1998 and 1997.

	1998	1997
	(Dollars in millions)	
Single-family mortgages:		
Government insured or guaranteed	$ 21,805	$ 19,478
Conventional:		
Long-term, fixed-rate	297,106	211,541
Intermediate-term, fixed-rate(1)	71,560	61,571
Adjustable-rate	11,873	11,373
Second	206	268
	402,550	304,231
Multifamily mortgages:		
Government insured	3,607	3,360
Conventional	8,358	9,087
	11,965	12,447
Total unpaid principal balance	414,515	316,678
Less:		
Unamortized (premium) discount and deferred price adjustments, net	(919)	86
Allowance for losses	211	276
Net mortgage portfolio	$415,223	$316,316

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

Included in the mortgage portfolio are $260 billion and $157 billion of MBS and other mortgage-related securities at December 31, 1998 and 1997, respectively, with fair values of $264 billion and $163 billion, respectively. MBS held in portfolio at December 31, 1998 and 1997 included $77 billion and $35 billion, respectively, of Real Estate Mortgage Investment Conduits (“REMICs”) and Stripped MBS (“SMBS”). REMICs and SMBS backed by MBS do not subject Fannie Mae to added credit risk but generally have different interest rate risks than MBS. At December 31, 1998, these securities had aggregate gross unrealized losses of $444 million and gross unrealized gains of $1,122 million. At December 31, 1997, the aggregate gross unrealized losses and gains were $175 million and $796 million, respectively.

Mortgage assets available for sale were $8.9 billion with unrealized gains of $17 million at December 31, 1998 and $.6 billion with unrealized gains of $1 million at December 31, 1997.

The UPB of multifamily impaired loans at December 31, 1998 was $250 million, of which $120 million had a specific loss allowance, compared with $351 million and $161 million, respectively, at December 31, 1997. The average balance of impaired loans during 1998 and 1997 was $310 million and $438 million, respectively.

Nonperforming loans outstanding totaled $3.2 billion at the end of 1998, compared with $2.6 billion at the end of 1997. If these nonperforming loans had been fully performing, they would have contributed an additional $68 million to net interest income in 1998 and $138 million in 1997.

3. Allowance for Losses

Changes in the allowance for the years 1996 through 1998 are summarized below.

	Total (Dollars in millions)
Balance, January 1, 1996	$ 795
Provision	195
Net foreclosure losses charged off	(210)
Balance, December 31, 1996	780
Provision	100
Net foreclosure losses charged off	(77)
Balance, December 31, 1997	803
Provision	(50)
Net recoveries	49
Balance, December 31, 1998	$ 802

At December 31, 1998, $211 million of the allowance for losses is included in the balance sheet under “Mortgage portfolio, net,” which represents the allocation for portfolio loan losses; $588 million is included in liabilities under “Other” for estimated losses on MBS; and the remainder, or $3 million, which relates to unrecoverable losses on Federal Housing Administration loans, is included in “Acquired property and foreclosure claims, net.” The corresponding amounts at December 31, 1997 were $276 million, $523 million, and $4 million, respectively. Included in the allowance for losses at December 31, 1998, are $10 million of specific allowances for impaired loans, compared with $21 million at the end of 1997. During 1998, Fannie Mae established $3 million of specific allowances for these loans, compared with $29 million in 1997.

4. Investments

Presented below are the amortized cost and fair value of nonmortgage investments classified as held-to-maturity at December 31, 1998 and 1997.

	1998				1997			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Held-to-maturity investments:								
Asset-backed securities . . .	$12,188	$15	$ —	$12,203	$13,034	$ 1	$ —	$13,035
Eurodollar time deposits	5,179	—	—	5,179	12,828	1	—	12,829
Commercial paper	5,155	5	—	5,160	11,745	4	—	11,749
Repurchase agreements . .	7,556	—	—	7,556	6,715	—	—	6,715
Federal funds	2,747	—	—	2,747	6,384	—	—	6,384
Auction rate preferred stock	933	—	—	933	1,641	—	—	1,641
Other	8,541	22	—	8,563	6,343	6	—	6,349
Total	$42,299	$42	$ —	$42,341	$58,690	$12	$ —	$58,702

Presented below are the amortized cost and fair value of nonmortgage investments classified as available-for-sale at December 31, 1998 and 1997.

	1998				1997			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Available-for-sale securities:								
Asset-backed securities . .	$ 8,831	$—	$26	$ 8,805	$3,607	$—	$ 2	$3,605
Other	7,415	—	4	7,411	2,301	—	—	2,301
Total	$16,246	$—	$30	$16,216	$5,908	$—	$ 2	$5,906

The following table shows the amortized cost, fair value, and yield of nonmortgage investments at December 31, 1998 and 1997, by remaining maturity.

	1998			1997		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in millions)					
Due within one year	$28,268	$28,280	5.81%	$44,562	$44,567	5.93%
Due after one year through five years	9,258	9,269	5.66	3,395	3,401	6.13
	37,526	37,549	5.77	47,957	47,968	5.95
Asset-backed securities(1)	21,019	21,008	5.76	16,641	16,640	6.16
Total	$58,545	$58,557	5.77%	$64,598	$64,608	6.00%

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

5. Debentures, Notes, and Bonds, Net

Borrowings Due Within One Year

Borrowings due within one year at December 31, 1998 and 1997 are summarized below. Amounts are net of unamortized discount and premium.

	1998					1997				
	Outstanding at December 31,		Average Outstanding During Year		Maximum Outstanding at Any Month-End	Outstanding at December 31,		Average Outstanding During Year		Maximum Outstanding at Any Month-End
	Amount	Cost(1)	Amount	Cost(1)		Amount	Cost(1)	Amount	Cost(1)	
	(Dollars in millions)									
Short-term notes	$136,400	5.18%	$107,344	5.47%	$136,400	$104,964	5.69%	$91,535	5.57%	$104,964
Other short-term debt	38,192	5.25	39,625	5.49	43,601	32,226	5.74	36,874	5.59	41,044
Current portion of borrowings due after one year(2):										
Debentures	5,394	8.42				14,300	6.40			
Global debt	2,986	5.30				—	—			
Medium-term notes	22,171	5.67				23,629	5.68			
Other	270	6.09				281	6.50			
Total due within one year	$205,413	5.33%				$175,400	5.76%			

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

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

Borrowings Due After One Year

Borrowings due after one year consisted of the following at December 31, 1998 and 1997.

		1998		1997	
	Maturity Date	Amount Outstanding	Average Cost (1)	Amount Outstanding	Average Cost (1)
		(Dollars in millions)			
Medium-term notes, net of $380 of discount for 1998 ($299 for 1997)	1999-2028	$165,993	6.21%	$135,453	6.48%
Benchmark notes, net of $113 of discount for 1998	2001-2008	42,137	5.63	—	—
Other global debt, net of $495 of discount for 1998 ($28 for 1997)	1999-2038	22,586	6.32	21,752	6.47
Debentures, net of $54 of discount for 1998 ($99 for 1997)	1999-2022	20,516	7.40	35,170	7.36
Zero coupon securities and subordinated capital debentures, net of $13,687 of discount for 1998 ($12,612 for 1997)	1999-2019	4,037	7.89	2,671	8.96
Long-term other, net of $43 of discount for 1998 ($47 for 1997)	1999-2018	188	9.99	193	9.99
		255,457	6.25%	195,239	6.67%
Adjustment for foreign currency translation		(579)		(865)	
Total due after one year		$254,878		$194,374	

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

Debentures, notes, and bonds at December 31, 1998, included $135 billion of callable debt, which generally is redeemable in whole or in part (and, in certain cases, at a specified premium) at the option of Fannie Mae any time on or after a specified date. At December 31, 1998, debentures, notes, and bonds did not include any debt instruments that are subject to mandatory redemptions tied to certain indices or rates after an initial nonredemption period.

The following table summarizes the amounts and call periods of callable debt, the notional amount of callable swaps, and other option-embedded financial instruments, excluding $9 billion of callable debt that was swapped to variable-rate debt. Medium-term notes and subordinated capital debentures that are redeemable at the Corporation's option are also included in the table.

Call Date	Year of Maturity	Amount Outstanding	Average Cost
	(Dollars in millions)		
Callable Debt and Callable Swaps:			
Currently callable	1999-2008	$ 563	5.46%
1999	2000-2024	66,618	6.47
2000	2001-2026	37,056	6.25
2001	2003-2026	30,740	5.64
2002	2005-2027	5,900	6.88
2003	2006-2028	9,100	5.59
2004 and later	2007-2012	826	6.88
		150,803	6.21%
Other option-embedded financial instruments		23,220	
Total option-embedded financial instruments		$174,023	

Principal amounts at December 31, 1998 of total debt payable in the years 2000-2004, assuming callable debt is paid at maturity and assuming callable debt is redeemed at the initial call date, were as follows:

	Total Debt by Year of Maturity (1)	Assuming Callable Debt Redeemed at Initial Call Date (1)
	(Dollars in millions)	
2000	$38,540	$64,634
2001	31,770	34,333
2002	24,754	20,177
2003	53,206	26,362
2004	9,487	3,504

(1) Excludes $9 billion of callable debt that was swapped to variable-rate debt.

In 1998 and 1997, Fannie Mae repurchased or called $77 billion of debt and swaps with an average cost of 6.71 percent and $31 billion with an average cost of 7.22 percent, respectively. Fannie Mae recorded extraordinary losses of $40 million ($26 million after tax) in 1998 and $19 million ($12 million after tax) in 1997 on the early extinguishment of debt.

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

6. Income Taxes

Components of the provision for federal income taxes for the years ended December 31, 1998, 1997, and 1996, were as follows:

	1998	1997	1996
	(Dollars in millions)		
Current	$ 692	$1,247	$1,109
Deferred	509	22	42
	1,201	1,269	1,151
Tax benefit of extraordinary loss	(14)	(7)	(16)
Net federal income tax provision	$1,187	$1,262	$1,135

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1998 and 1997, consisted of the following:

	1998	1997
	(Dollars in millions)	
Deferred tax assets:		
MBS guaranty and REMIC fees	$501	$404
Provision for losses	331	339
Other items, net	76	55
Deferred tax assets	908	798
Deferred tax liabilities:		
Purchase discount and deferred fees	420	—
Debt-related expenses	266	14
Benefits from tax-advantaged investments	93	171
Other items, net	16	9
Deferred tax liabilities	795	194
Net deferred tax assets	$113	$604

Management anticipates that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the entire balance of deferred tax assets.

Fannie Mae's effective tax rates differed from statutory federal rates for the years ended December 31, 1998, 1997, and 1996, as follows:

	1998	1997	1996
Statutory corporate rate	35%	35%	35%
Tax-exempt interest and dividends received deductions	(4)	(4)	(4)
Equity investments in affordable housing projects	(5)	(2)	(2)
Effective rate	26%	29%	29%

Fannie Mae is exempt from state and local taxes, except for real estate taxes.

7. Earnings per Common Share

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

	1998		1997		1996	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
	(Dollars and shares in millions, except per common share amounts)					
Net income before extraordinary loss	$3,444	$3,444	$3,068	$3,068	$2,754	$2,754
Less: Extraordinary loss	(26)	(26)	(12)	(12)	(29)	(29)
Preferred stock dividend	(66)	(66)	(65)	(65)	(42)	(42)
Net income available to common stockholders	$3,352	$3,352	$2,991	$2,991	$2,683	$2,683
Weighted average common shares	1,029	1,029	1,049	1,049	1,071	1,071
Dilutive potential common shares(1)	—	8	—	7	—	9
Average number of common shares outstanding used to calculate earnings per common share	1,029	1,037	1,049	1,056	1,071	1,080
Earnings before extraordinary item	$ 3.28	$ 3.26	$ 2.87	$ 2.84	$ 2.53	$ 2.51
Net earnings	3.26	3.23	2.85	2.83	2.50	2.48

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

For additional disclosures regarding Fannie Mae's stock compensation plans and the outstanding preferred stock, see Notes 8 and 12, respectively.

8. Stock Compensation Plans

At December 31, 1998, Fannie Mae had five stock-based compensation plans, which are described below. Financial Accounting Standard No. 123 ("FAS 123"), *Accounting for Stock-Based Compensation,* gives companies the option of either recording an expense for all stock compensation awards based on fair value at grant date or continuing to follow Accounting Principles Board Opinion No. 25 ("APB Opinion 25") with the additional requirement that they disclose, in a footnote, pro forma net income and earnings per common share as if they had adopted the expense recognition provisions of FAS 123. Fannie Mae elected to apply APB Opinion 25 and related interpretations in accounting for its plans. As a result, no compensation expense has been recognized for the nonqualified stock options and Employee Stock Purchase Plan. Had compensation expense been recognized for benefits under all five plans, based on their fair value at grant date and consistent with FAS 123, Fannie Mae's net income and earnings per common share would have been $3.312 billion and $3.19, $3.025 billion and $2.80, and $2.701 billion and $2.46 for the years ended December 31, 1998, 1997, and 1996, respectively.

The fair value of benefits under Fannie Mae's stock-based plans was determined using a Black-Scholes pricing model. The following table summarizes the major assumptions used in the model.

	1998	1997	1996
Risk free rate (1)	4.04 - 5.79%	5.53 - 6.80%	6.45 - 7.74%
Volatility	25-30	23 - 25	21 - 22
Forfeiture	15	15	15
Dividend(2)	$.96	$.84	$.76
Expiration	1 - 10 yrs.	1 - 10 yrs.	1 - 10 yrs.

(1) The closing yield on the comparable average life U.S. Treasury on the day prior to grant.

(2) Dividend rate on common stock at date of grant. Dividend rate assumed to remain constant over the option life.

Employee Stock Purchase Plan

Fannie Mae has an Employee Stock Purchase Plan that allows issuance of up to 36 million shares of common stock to qualified employees at a price equal to 85 percent of the fair market value on the grant date. In 1998, Fannie Mae granted each qualified employee, excluding certain officers and other highly compensated employees, the right to purchase in January 1999 up to 393 shares of common stock. Under the 1998 offering, 1,336,278 common shares were purchased at $54.03 per share, compared with 1,883,197 common shares purchased at $33.73 per share under the 1997 offering. The Board of Directors has approved a 1999 offering under the plan, granting each qualified employee the right to purchase 348 common shares at $60.99 per share.

Employee Stock Ownership Plan

Fannie Mae has an Employee Stock Ownership Plan ("ESOP") for qualified employees. Fannie Mae may contribute to the ESOP an amount based on defined earnings goals, not to exceed 4 percent of the aggregate base salary for all participants. The contribution is made in the subsequent year either in shares of Fannie Mae common stock or in cash that is used to purchase such stock.

Performance Shares

Fannie Mae's Stock Compensation Plans authorize eligible employees to receive performance awards, generally issued with an award period that can range from three to five years. The performance awards become actual awards only if Fannie Mae attains the goals set for the award period. At the end of such time, the awards generally are payable in common stock, in three installments over a two-year period. The outstanding contingent grants made for the 1999-2001, 1998-2000, and 1997-1999 periods were 323,640 common shares, 366,712 common shares, and 273,215 common shares, respectively.

Nonqualified Stock Options

Stock options may be granted to eligible employees and nonmanagement members of the Board of Directors. The options generally do not become exercisable until at least one year after the grant date and generally expire ten years from the grant date. The purchase price of the common stock covered by each option is equal to the fair value of the stock on the date the option is granted.

The following table summarizes stock option activity for the years 1996 through 1998:

	1998		1997		1996	
	Options	Weighted-average Exercise Price	Options	Weighted-average Exercise Price	Options	Weighted-average Exercise Price
			(options in thousands)			
Balance, January 1	22,777	$27.15	23,910	$22.24	24,249	$18.90
Granted	3,381	67.63	3,373	50.16	3,418	38.67
Exercised	(3,712)	19.15	(4,065)	17.46	(3,014)	14.31
Forfeited	(452)	35.60	(441)	26.16	(743)	21.01
Balance, December 31	21,994	$34.55	22,777	$27.15	23,910	$22.24
Options vested, December 31	13,729	$23.89	13,275	$20.30	11,767	$17.65

The following table summarizes information about stock options outstanding at December 31, 1998:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options	Weighted-average Remaining Contractual Life	Weighted-average Exercise Price	Number of Options Exercisable	Weighted-average Exercise Price
			(options in thousands)		
$ 8.00 - $23.97	8,853	5.0 yrs.	$17.94	8,829	$17.94
26.69 - 42.69	6,958	7.4	32.79	4,153	31.47
43.00 - 58.69	2,829	8.9	51.59	703	51.49
60.31 - 75.16	3,354	9.8	67.67	44	61.18
Total	21,994	7.0 yrs.	$34.55	13,729	$23.89

Restricted Stock

In 1998, 98,280 shares of restricted stock were awarded, issued, and placed in escrow under the Stock Compensation Plans and Restricted Stock Plan for Directors (66,240 shares in 1997); 100,600 shares were released as vesting of participants occurred (138,968 shares in 1997).

9. Employee Retirement Benefits

Retirement Savings Plan

All regular employees of Fannie Mae scheduled to work 1,000 hours or more in a calendar year are eligible to participate in the Corporation's Retirement Savings Plan, which includes a 401(k) option. In 1998, employees could contribute up to the lesser of 15 percent of their base salary or the current annual dollar cap established and revised annually by the Internal Revenue Service ("IRS"), with the Corporation matching such contributions up to 3 percent of base salary.

Postretirement Benefit Plans

All regular employees of Fannie Mae scheduled to work 1,000 hours or more in a calendar year are covered by a noncontributory corporate retirement plan or by the contributory Civil Service Retirement Law. Benefits payable under the corporate plan are based on years of service and compensation using the average pay during the 36 consecutive highest-paid months of the last 120 months of employment. Fannie Mae's policy is to contribute an amount no less than the minimum required employer contribution under the Employee Retirement Income Security Act of 1974. Contributions to the corporate plan reflect benefits attributed to employees' service to date and compensation expected to be paid in the future. A $7 million contribution was made to the corporate plan in 1998. Corporate plan assets consist primarily of listed stocks, fixed-income securities, and other liquid assets.

At December 31, 1998 and 1997, the projected benefit obligations for services rendered were $229 million and $185 million, respectively, while the plan assets were $238 million and $190 million, respectively. The pension liability at December 31, 1998 and 1997 was $38 million and $36 million, respectively, while net periodic pension costs were $9 million and $8 million, respectively.

At December 31, 1998 and 1997, the weighted-average discount rates used in determining the actuarial present value of the projected benefit obligation were 6.75 percent and 7.25 percent, respectively; the average rates of increase in future compensation levels used in the calculation were 5.75 percent for both 1998 and 1997; and the expected long-term rates of return on assets were 9.00 percent and 9.25 percent, respectively. Fannie Mae uses the straight-line method of amortization for prior service costs.

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

Fannie Mae sponsors a Postretirement Health Care Plan that covers substantially all full-time employees. The plan pays stated percentages of most necessary medical expenses incurred by retirees, after subtracting payments by Medicare or other providers and after a stated deductible has been met. Participants become eligible for the subsidized benefits as follows: (1) for employees hired prior to January 1, 1998, if they retire from Fannie Mae after reaching age 55 with five or more years of service; or (2) for employees hired January 1, 1998, or later, if they retire from Fannie Mae after reaching age 55 with ten or more years of service. Employees hired January 1, 1998 or later who retire with less than 10 years of service may purchase coverage by paying the full premium. The plan is contributory, with retiree contributions adjusted annually. The expected cost of these postretirement benefits is charged to expense during the years that employees render service. Cost-sharing percentages are based on length of service with Fannie Mae, eligibility for and date of retirement, and a defined dollar benefit cap. Fannie Mae does not fund this plan.

Fannie Mae's accrued postretirement health care plan obligation for the years ending December 31, 1998 , and 1997 was $32 million and $27 million, respectively. The net postretirement health care costs were $8 million in 1998, $6 million in 1997 and $7 million in 1996. In determining the net postretirement health care cost for 1998, a 5.5 percent annual rate of increase in the per capita cost of covered health care claims was assumed for 1998; the rate was assumed to decrease gradually to 4.5 percent over four years and remain at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. In determining the net postretirement health care cost for 1997, a 6.25 percent annual rate of increase in the per capita cost of covered health care claims was assumed for 1997; the rate was assumed to decrease gradually to 4.75 percent over five years and remain at that level thereafter. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1998 by $6 million and the aggregate of the service and interest cost components of net postretirement health care cost for the year by $1 million.

The weighted-average discount rates used in determining the health care cost and the year-end accumulated postretirement benefit obligation were 6.75 percent at December 31, 1998, and 7.25 percent at December 31, 1997.

10. Line of Business Reporting

Management analyzes corporate performance on the basis of two lines of business: Portfolio Investment and Credit Guaranty.

The Portfolio Investment business includes the management of asset purchases and funding activities for Fannie Mae's mortgage and nonmortgage investment portfolios. Income is derived primarily from the difference, or spread, between the yield on mortgage loans and nonmortgage investments, and the borrowing costs related to those loans and investments.

The Credit Guaranty business involves guaranteeing the credit performance of both single-family and multifamily mortgage loans for a fee. Guaranty fees for MBS are based on a market rate of return for the credit risk assumed. For mortgages held in portfolio, the Credit Guaranty business charges the Portfolio Investment business a guaranty fee similar to what it would charge on an MBS. These ''notional'' guaranty fees are classified as net interest income for the Credit Guaranty business. Net interest income for the Credit Guaranty business also includes interest on capital invested in guaranty activities and income from temporary investment of principal and interest payments on guaranteed mortgages prior to remittance to investors, and is net of interest charges paid to the Portfolio Investment business for delinquent loans.

Fannie Mae assigns actual direct revenues and expenses among its lines of business and uses estimates to apportion overhead and other corporate items. For instance, administrative expenses are allocated on the basis of direct expenses for the line of business or, where not assignable to a particular associated business, are based on revenues, profits, or volumes, as applicable. Capital is allocated to the separate businesses through an assessment of the interest rate and credit risk associated with each business.

The following table sets forth Fannie Mae's financial performance by line of business for the years ended December 31, 1998, 1997, and 1996.

	1998(1)			1997			1996		
	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Total
				(Dollars in millions)					
Net interest income	$3,460	$ 650	$ 4,110	$3,483	$ 466	$ 3,949	$3,191	$ 401	$3,592
Guaranty fees	(823)	2,052	1,229	(746)	2,020	1,274	(712)	1,908	1,196
Fee and other income, net	158	117	275	88	37	125	83	3	86
Credit-related expenses	—	(261)	(261)	—	(375)	(375)	—	(409)	(409)
Administrative expenses	(184)	(524)	(708)	(174)	(462)	(636)	(160)	(400)	(560)
Federal income taxes	(707)	(494)	(1,201)	(745)	(524)	(1,269)	(679)	(472)	(1,151)
Extraordinary item— early extinguishment of debt	(26)	—	(26)	(12)	—	(12)	(29)	—	(29)
Net income	$1,878	$1,540	$ 3,418	$1,894	$1,162	$ 3,056	$1,694	$1,031	$2,725

(1) Results include the recognition of additional non-recurring tax benefits associated with investments qualifying for low-income housing tax credits, and additional amortization of premiums or discounts and deferred or prepaid guaranty fees that were recorded in the fourth quarter of 1998.

11. Dividend Restrictions

Fannie Mae's payment of dividends is subject to certain statutory restrictions, including approval by the Director of the Office of Federal Housing Enterprise Oversight of any dividend payment that would cause Fannie Mae's capital to fall below specified capital levels.

Fannie Mae has exceeded the applicable capital standard since the adoption of these restrictions in 1992 and, consequently, has been making dividend payments without the need for Director approval.

Payment of dividends on common stock is also subject to payment of dividends on preferred stock outstanding.

12. Preferred Stock

The following table presents the nonvoting preferred stock outstanding as of December 31, 1998 and 1997.

	Issue Date	Shares Issued and Outstanding	Stated Value Per Share	Annual Dividend Rate	Redeemable On or After
Series A	March 1, 1996	7,500,000	$50	6.41%	March 1, 2001
Series B	April 12, 1996	7,500,000	50	6.50	April 12, 2001
Series C	September 20, 1996	5,000,000	50	6.45	September 20, 2001
Series D	September 30, 1998	3,000,000	50	5.25	September 30, 1999
Total		23,000,000			

Holders of preferred stock are entitled to receive noncumulative, quarterly dividends when, and if, declared by Fannie Mae's Board of Directors. Payment of dividends on preferred stock is not mandatory, but has priority over payment of dividends on common stock. After the specified period, preferred stock is redeemable at its stated value at the option of Fannie Mae.

13. Off-Balance-Sheet Credit Risk

Fannie Mae is a party to transactions involving financial instruments with off-balance-sheet risk. Fannie Mae uses these instruments to fulfill its statutory purpose of meeting the financing needs of the secondary mortgage market and to reduce its own exposure to fluctuations in interest rates. These financial instruments include MBS, commitments to purchase mortgages or to issue and guarantee MBS, credit enhancements, and certain hedge instruments. These instruments involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the balance sheet.

Guaranteed Mortgage-Backed Securities

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

Fannie Mae's credit risk is mitigated to the extent that sellers of pools of mortgages elect to remain at risk for the loans sold to the corporation or other credit enhancement was provided to protect against the risk of loss from borrower default. Lenders have the option to retain the primary default risk, in whole or in part, in exchange for a lower guaranty fee. Fannie Mae, however, bears the ultimate risk of default.

Commitments

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

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

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

Hedge Instruments

Fannie Mae typically uses derivative instruments that simulate short sales of Treasury securities, interest rate swaps, swaptions, interest rate caps, and deferred rate-setting agreements to hedge against interest rate movements. Changes in the value of these hedge instruments caused by fluctuations in interest rates are expected to offset changes in the value of the items hedged. Consequently, the primary risks associated with these hedging instruments are that (1) changes in the value of the item hedged will not substantially offset changes in the value of the hedge instrument, and (2) the counterparty to the agreement will be unable or unwilling to meet the terms of the agreement.

Credit risk on derivative instruments that simulate short sales of Treasury securities arises from the possible inability or unwillingness of the counterparty to pay any difference between the agreed-upon price and the current price for the referenced securities at settlement. This risk is reduced through evaluation of the creditworthiness of counterparties and continuous monitoring of hedge positions. The amount of deferrable net unrealized gains on open hedge positions was $34 million at December 31, 1998, compared with $3 million of unrealized losses at December 31, 1997. Total deferred gains and losses on closed positions were $172 million and $473 million, respectively, at December 31, 1998, compared with $188 million and $231 million, respectively, at December 31, 1997.

Fannie Mae reduces counterparty risk on interest rate swaps, swaptions, and interest rate caps by dealing only with experienced counterparties with high credit quality, diversifying these derivative instruments across many counterparties, and ensuring that these derivative instruments generally are executed under master agreements that provide for netting of certain amounts payable by each party. In addition, counterparties are obligated to post collateral if Fannie Mae is exposed to credit loss on the related derivative instruments exceeding an agreed-upon threshold. The amount of required collateral is based on credit ratings and the level of credit exposure. Fannie Mae generally requires overcollateralization from counterparties whose credit ratings have dropped below predetermined levels. Fannie Mae regularly monitors the exposures on its derivative instruments by valuing the positions via dealer quotes and internal pricing models. At December 31, 1998, 93 percent of the notional amount of Fannie Mae's outstanding interest rate swaps, swaptions, and interest rate caps were with counterparties rated A or better (68 percent with counterparties rated AA or better), and 100 percent of the notional amount of outstanding swaps, swaptions, and interest rate caps were subject to collateral arrangements. At December 31, 1998, six counterparties represented approximately 69 percent of the total notional amount of the outstanding interest rate swaps, swaptions, and interest rate caps.

Counterparty risk on deferred rate-setting arrangements is limited to the cash receivable, if any, due under the deferred rate-setting agreement. This risk is reduced through evaluating the creditworthiness of counterparties.

Credit Enhancements

Fannie Mae provides credit enhancement and, in some cases, liquidity support for certain financings involving taxable or tax-exempt housing bonds issued by state and local governmental entities to finance multifamily housing for low- and moderate-income families. In these transactions, Fannie Mae issues an MBS, pledges an interest in certain mortgages it owns, or otherwise provides contractual assurance of payment to a trustee for the bonds or another credit party in the transaction. Fannie Mae's direct credit enhancement in a multifamily housing bond transaction improves the rating on the bond, thus resulting in lower-cost financing for multifamily housing.

Credit Exposure for Off-Balance-Sheet Financial Instruments

The following table presents the contract or notional amount of derivative instruments at December 31, 1998 and 1997.

	1998	1997
	(Dollars in billions)	
Contractual Amounts:		
MBS outstanding(1)	$ 834.0	$ 709.1
MBS in portfolio	(197.4)	(130.4)
Net MBS outstanding(1)	$ 636.6	$ 578.7
Master commitments:		
Mandatory	$ 31.7	$ 38.2
Optional	56.1	45.9
Portfolio commitments:		
Mandatory	11.1	3.6
Optional	1.6	1.6
MBS commitments:		
Optional	—	0.1
Notional Amounts(2):		
Simulated short sales of Treasury securities	3.6	1.6
Interest rate swaps(3)	95.8	96.1
Debt swaps(4)	46.6	52.7
Asset swaps (5)	0.4	1.0
Interest rate caps	14.5	—
Swaptions	12.7	—
Credit enhancements	6.6	7.3
Other guarantees	2.8	2.6

(1) Net of $588 million in allowance for losses in 1998 and $523 million in 1997. Includes $160.2 billion and $94.3 billion of MBS with lender or third-party recourse at December 31, 1998 and 1997, respectively.

(2) Notional amounts do not necessarily represent the market or credit risk of the derivative instrument positions.

(3) The weighted-average interest rate being received under these swaps was 5.32 percent and the weighted-average interest rate being paid was 6.53 percent at December 31, 1998, compared with 5.85 percent and 6.79 percent, respectively, at December 31, 1997.

(4) The weighted-average interest rate being received under these swaps was 5.48 percent and the weighted-average interest rate being paid was 5.18 percent at December 31, 1998, compared with 5.94 percent and 5.65 percent, respectively, at December 31, 1997.

(5) The weighted-average interest rate being received under these swaps was 5.86 percent and the weighted-average interest rate being paid was 5.32 percent at December 31, 1998, compared with 6.03 percent and 6.27 percent, respectively, at December 31, 1997.

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

Fannie Mae's exposure to credit loss for derivative instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all those derivative instruments outstanding for which the Corporation was in a gain position. Fannie Mae's net exposure (taking into account master netting agreements) was $46 million at December 31, 1998, and $26 million at December 31, 1997. Fannie Mae expects the net credit exposure to fluctuate as interest rates change.

14. Concentrations of Credit Risk

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

The following table presents UPB by primary default risk and the general geographic distribution of properties underlying mortgages in the portfolio or backing MBS outstanding at December 31, 1998 and 1997.

		Geographic Distribution					
1998	Gross UPB (Dollars in millions)	Northeast	Southeast	Midwest	Southwest	West	Total
Fannie Mae risk	$ 867,272	20%	20%	18%	15%	27%	100%
Lender or shared risk	184,386	15	19	21	16	29	100
Total	$1,051,658	19%	20%	19%	15%	27%	100%

		Geographic Distribution					
1997	Gross UPB (Dollars in millions)	Northeast	Southeast	Midwest	Southwest	West	Total
Fannie Mae risk	$ 780,771	20%	21%	17%	15%	27%	100%
Lender or shared risk	115,045	16	18	18	14	34	100
Total	$ 895,816	20%	20%	17%	15%	28%	100%

No significant concentration exists at the state level except for California, where, at both December 31, 1998 and 1997, 20 percent of the gross UPB of mortgages in portfolio and backing MBS were located.

To minimize credit risk, Fannie Mae requires primary mortgage insurance or other credit protection if the loan-to-value ("LTV") ratio of a single-family conventional mortgage loan (the UPB of the loan divided by the value of the mortgaged property) is greater than 80 percent when the loan is delivered to Fannie Mae.

Fannie Mae accepts conventional loans delivered with mortgage insurance from 15 insurance organizations. At December 31, 1998, $257 billion in current UPB of single-family conventional mortgage loans in portfolio and underlying MBS outstanding was covered by primary mortgage insurance at acquisition. Six companies, all rated AA or higher, represented approximately 93 percent of that insurance coverage. Fannie Mae monitors on a regular basis the performance and financial strength of its mortgage insurers.

The following table presents the original LTV ratio distribution of single-family loans in portfolio or backing MBS outstanding at December 31, 1998 and 1997.

1998	Gross UPB	Loan-to-Value Ratio 60% or less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$832,048	20%	16%	16%	23%	14%	11%	100%
Lender or shared risk	149,165	6	8	12	33	22	19	100
Total	$981,213	18%	15%	15%	25%	15%	12%	100%

1997	Gross UPB	Loan-to-Value Ratio 60% or less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$752,654	19%	15%	15%	23%	16%	12%	100%
Lender or shared risk	86,195	9	10	12	26	24	19	100
Total	$838,849	18%	14%	15%	23%	17%	13%	100%

The rate at which mortgage loans prepay tends to be sensitive to the level and direction of prevailing market interest rates. In a declining interest rate environment, higher-rate mortgage loans will pay off at a faster rate; conversely, in an increasing interest rate environment, lower-rate mortgage loans will prepay at a slower rate. The following table presents the distribution by note rate of fixed-rate, single-family loans in the mortgage portfolio or underlying MBS at December 31, 1998 and 1997.

Gross UPB at December 31,	Fixed-Rate Loans by Note Rate (1) Under 7.00%	7.00% to 7.99%	8.00% to 8.99%	9.00% to 9.99%	10.00% and over	Total
			(Dollars in billions)			
1998	$201	$484	$155	$30	$14	$884
Percent of total	23%	55%	17%	3%	2%	100%
1997	$ 83	$380	$227	$45	$20	$755
Percent of total	11%	50%	30%	6%	3%	100%

(1) Excludes housing revenue bonds and non-Fannie Mae securities.

15. Disclosures of Fair Value of Financial Instruments

The basic assumptions used and the estimates disclosed in the Fair Value Balance Sheets represent management's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to management as of December 31, 1998 and 1997. In certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors, and management's evaluation of those factors, change.

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

Fair Value Balance Sheets

Assets

	December 31, 1998		December 31, 1997	
	Cost	Fair Value	Cost	Fair Value
	(Dollars in millions)			
Assets:				
Mortgage portfolio, net	$415,223	$424,171	$316,316	$325,500
Investments	58,515	58,557	64,596	64,608
Cash and cash equivalents	743	743	2,205	2,205
Other assets	10,533	8,933	8,556	6,489
	485,014	492,404	391,673	398,802
Off-balance-sheet items:				
Guaranty fee income, net	—	3,698	—	3,357
Swaps in gain position, net	—	32	—	4
Other	—	34	—	—
Total assets	$485,014	$496,168	$391,673	$402,163

Liabilities and Net Assets

	December 31, 1998 Cost	December 31, 1998 Fair Value	December 31, 1997 Cost	December 31, 1997 Fair Value
Liabilities:				
Noncallable debt:				
Due within one year	$202,260	$202,957	$156,725	$158,526
Due after one year	123,396	131,268	85,699	91,177
Callable debt:				
Due within one year	3,153	3,144	18,675	17,464
Due after one year	131,482	131,774	108,675	108,706
	460,291	469,143	369,774	375,873
Other liabilities	9,270	7,844	8,106	7,137
Off-balance-sheet items:				
Swaps in loss position, net	—	4,296	—	3,168
Other	—	—	—	3
Total liabilities	469,561	481,283	377,880	386,181
Net asset value, net of tax effect	$ 15,453	$ 14,885	$ 13,793	$ 15,982

See accompanying Notes to Fair Value Balance Sheets.

Notes to Fair Value Balance Sheets

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

Mortgage Portfolio, Net

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

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

Investments

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

Cash and Cash Equivalents

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

Other Assets

Other assets include accrued interest receivable, net currency swap receivables, and several other smaller asset categories. The fair value of other assets, excluding currency swap receivables and certain deferred items that have no fair value, approximates their carrying amount. Net currency swap receivables are included in other assets at their fair value.

Guaranty Fee Income, Net

MBS are not assets owned by Fannie Mae, except when acquired for investment purposes, nor are MBS recorded as liabilities of Fannie Mae. On MBS outstanding, the Corporation receives a guaranty fee calculated on the outstanding principal balance of the related mortgages. The guaranty fee represents a future income stream for the Corporation. Under generally accepted accounting principles, this guaranty fee is recognized as income over the life of the securities. The Fair Value Balance Sheets reflect the present value of guaranty fees, net of estimated future administrative costs and credit losses, and taking into account estimated prepayments.

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

Swap Obligations, Net

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

In addition, Fannie Mae enters into swaptions and interest rate caps. Under a swaption, Fannie Mae has the option to enter into a swap, as described above, at a future date. Fannie Mae uses interest rate caps to effectively manage its interest expense in a period of rising interest rates by entering into an agreement whereby a counterparty makes payments to the Corporation for interest rates above a specified rate. The fair values of these derivative instruments are estimated based on either the expected cash flows or the quoted market values of these instruments.

Noncallable and Callable Debt

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

Other Liabilities

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

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

FANNIE MAE

QUARTERLY RESULTS OF OPERATIONS (Unaudited)

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

	1998 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per common share amounts)			
Interest income	$7,895	$7,724	$7,351	$7,025
Interest expense	6,919	6,657	6,320	5,989
Net interest income	976	1,067	1,031	1,036
Guaranty fees	261	324	323	321
Fee and other income, net	71	69	79	56
Provision for losses	20	15	10	5
Foreclosed property expenses	(70)	(80)	(79)	(82)
Administrative expenses	(185)	(179)	(174)	(170)
Income before federal income taxes and extraordinary item	1,073	1,216	1,190	1,166
Provision for federal income taxes	(174)	(354)	(339)	(334)
Income before extraordinary item	899	862	851	832
Extraordinary item—early extinguishment of debt (net of tax effect)	(10)	(5)	(3)	(8)
Net income	$ 889	$ 857	$ 848	$ 824
Preferred stock dividends	(18)	(16)	(16)	(16)
Net income available to common stockholders	$ 871	$ 841	$ 832	$ 808
Basic earnings per common share(1):				
Earnings before extraordinary item	$ .86	$ .83	$ .81	$ .79
Extraordinary item	(.01)	(.01)	—	(.01)
Net earnings	$ .85	$ .82	$ .81	$ .78
Diluted earnings per common share(1):				
Earnings before extraordinary item	$ .85	$ .82	$ .80	$ .78
Extraordinary item	(.01)	(.01)	—	(.01)
Net earnings	$ .84	$ .81	$ .80	$ .77
Cash dividends per common share	$ .24	$ .24	$ .24	$ .24

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

FANNIE MAE

QUARTERLY RESULTS OF OPERATIONS (Unaudited) — (Continued)

	1997 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per common share amounts)			
Interest income	$6,884	$6,651	$6,514	$6,329
Interest expense	5,848	5,658	5,544	5,379
Net interest income	1,036	993	970	950
Guaranty fees	324	320	317	313
Fee and other income, net	29	33	33	30
Provision for losses	—	(20)	(40)	(40)
Foreclosed property expenses	(77)	(71)	(61)	(66)
Administrative expenses	(167)	(159)	(159)	(151)
Income before federal income taxes and extraordinary item	1,145	1,096	1,060	1,036
Provision for federal income taxes	(339)	(319)	(309)	(302)
Income before extraordinary item	806	777	751	734
Extraordinary item—early extinguishment of debt (net of tax effect)	(12)	(2)	2	—
Net income	$ 794	$ 775	$ 753	$ 734
Preferred stock dividends	(16)	(16)	(17)	(16)
Net income available to common stockholders	$ 778	$ 759	$ 736	$ 718
Basic earnings per common share(1):				
Earnings before extraordinary item	$ .76	$ .73	$ .70	$ .68
Extraordinary item	(.01)	—	—	—
Net earnings	$ .75	$ .73	$ .70	$ .68
Diluted earnings per common share(1):				
Earnings before extraordinary item	$ .75	$ .72	$ .69	$ .67
Extraordinary item	(.01)	—	—	—
Net earnings	$ .74	$ .72	$ .69	$ .67
Cash dividends per common share	$ .21	$ .21	$ .21	$ .21

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

FANNIE MAE

NET INTEREST INCOME AND AVERAGE BALANCES (Unaudited)

	1998	1997	1996
	(Dollars in millions)		
Interest income:			
Mortgage portfolio	$ 25,676	$ 22,716	$ 20,560
Investments and cash equivalents	4,319	3,662	3,212
Total interest income	29,995	26,378	23,772
Interest expense(1):			
Short-term debt	4,809	3,659	3,395
Long-term debt	21,076	18,770	16,785
Total interest expense	25,885	22,429	20,180
Net interest income	4,110	3,949	3,592
Tax equivalent adjustment(2)	304	283	247
Net interest income tax equivalent basis	$ 4,414	$ 4,232	$ 3,839
Average balances:			
Interest-earning assets(3):			
Mortgage portfolio, net	$352,169	$298,698	$268,629
Investments and cash equivalents	75,369	63,441	57,161
Total interest-earning assets	$427,538	$362,139	$325,790
Interest-bearing liabilities(1):			
Short-term debt	$ 89,890	$ 68,691	$ 63,974
Long-term debt	319,638	277,129	246,733
Total interest-bearing liabilities	409,528	345,820	310,707
Interest-free funds	18,010	16,319	15,083
Total interest-bearing liabilities and interest-free funds	$427,538	$362,139	$325,790
Average interest rates(2):			
Interest-earning assets:			
Mortgage portfolio, net	7.38%	7.67%	7.71%
Investments and cash equivalents	5.76	5.82	5.68
Total interest-earning assets	7.09	7.34	7.36
Interest-bearing liabilities(1):			
Short-term debt	5.29	5.29	5.22
Long-term debt	6.60	6.77	6.82
Total interest-bearing liabilities	6.31	6.48	6.49
Investment spread(4)	.78	.86	.87
Interest-free return(5)	.25	.31	.31
Net interest margin(6)	1.03%	1.17%	1.18%

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

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

(3) Includes average balance of nonperforming loans of $2.6 billion in 1998 and $2.2 billion in 1997 and 1996.

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

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

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

FANNIE MAE

RATE / VOLUME ANALYSIS (Unaudited)

	Increase (Decrease)	Attributable to changes in (1) Volume	Attributable to changes in (1) Rate
	(Dollars in millions)		
1998 vs. 1997			
Interest income:			
Mortgage portfolio	$2,960	$3,930	$(970)
Investments and cash equivalents	657	684	(27)
Total interest income	3,617	4,614	(997)
Interest expense(2):			
Short-term debt	1,150	1,134	16
Long-term debt	2,306	2,814	(508)
Total interest expense	3,456	3,948	(492)
Net interest income	$ 161	$ 666	$(505)
1997 vs. 1996			
Interest income:			
Mortgage portfolio	$2,156	$2,287	$(131)
Investments and cash equivalents	450	361	89
Total interest income	2,606	2,648	(42)
Interest expense(2):			
Short-term debt	264	251	13
Long-term debt	1,985	2,059	(74)
Total interest expense	2,249	2,310	(61)
Net interest income	$ 357	$ 338	$ 19

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

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

MANAGEMENT

Directors

The age and background, as of March 29, 1999, of each of the members of the Board of Directors of Fannie Mae are as follows:

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships (1)
Stephen B. Ashley, 59	Chairman and Chief Executive Officer, The Ashley Group, a group of commercial and multi-family real estate, brokerage and investment companies, January 1997 to present; Chairman and Chief Executive Officer, Sibley Mortgage Corporation, a mortgage banking company, 1985 to 1996; Chairman and Chief Executive Officer, Sibley Real Estate Services, Inc., a property management company, 1985 to 1996; Livonia, New York	1995	Exeter Fund, Inc.; The Genesee Corporation; Hahn Automotive Warehouse, Inc.; Manning & Napiers Insurance Fund, Inc.
Roger E. Birk, 68	Former President and Chief Operating Officer of the Corporation, November 1987 until his retirement in January 1992; Tequesta, Florida	1985	Golden Bear Golf Inc.; Mutual of America Capital Corp.; Penske Corp.; WellPoint Health Networks Inc.
Kenneth M. Duberstein, 54	Chairman and Chief Executive Officer, The Duberstein Group, an independent strategic planning and consulting company, July 1989 to present; Chief of Staff to the President of the United States, 1988 to 1989	1998	The Boeing Company; Cinergy Corporation; Global Vacation Group; St. Paul Companies, Inc.
Stephen Friedman, 61	Senior Principal, Marsh McLennan Risk Capital Corp., an insurance brokerage, money management, and consulting firm, since March 1998; Limited Partner, December 1994 to present, Senior Chairman from December 1994 to March 1998, and Co-Chairman or sole Chairman, December 1990 to November 1994, Goldman, Sachs & Co., an investment banking firm; New York, NY	1996	Risk Capital Holdings Inc.; Wal-Mart Stores, Inc.
Thomas P. Gerrity, 57	Dean of The Wharton School of the University of Pennsylvania, an educational institution, July 1990 to present; President of CSC Consulting, a subsidiary of Computer Sciences Corporation, and Vice President of Computer Sciences Corporation, May 1989 to June 1990; Chairman and Chief Executive Officer, Index Group, a technology-oriented consulting company, 1969 to April 1989; Haverford, Pennsylvania	1991	CVS Corporation; Fiserv, Inc.; IKON Office Solutions, Inc.; Reliance Group Holdings, Inc.; Sunoco, Inc.
Jamie S. Gorelick, 48	Vice Chair of the Corporation, May 1997 to present; Deputy Attorney General of the United States, March 1994 to April 1997; General Counsel to the U.S. Department of Defense, May 1993 to March 1994; Partner, Miller, Cassidy, Larroca & Lewin, a law firm, January 1981 to April 1993; Chevy Chase, Maryland	1997	
James A. Johnson, 55	Chairman of the Executive Committee of the Board, January 1999 to present; Chairman of the Board of Directors and Chief Executive Officer of the Corporation, February 1991 to December 1998; Vice Chairman of the Board of the Corporation, January 1990 to January 1991; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, April 1985 to December 1989; Washington, D.C.	1990	Cummins Engine Company, Inc.; Dayton Hudson Corporation; Kaufman and Broad Home Corporation; United HealthCare Corporation

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships(1)
Vincent A. Mai, 58	President and Chief Executive Officer, AEA Investors Inc., a private investment company, April 1989 to present; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, 1974 to April 1989; Port Washington, New York	1991	Dal-Tile International, Inc.
Ann McLaughlin, 57	Chairman, October 1996 to present, Vice Chairman, August 1993 to September 1996, The Aspen Institute, a nonprofit organization; President, Federal City Council, May 1990 to September 1995; President and Chief Executive Officer, New American Schools Development Corporation, June 1992 to April 1993; Visiting Fellow, Urban Institute, January 1989 to June 1992; Chairman, President's Commission on Aviation Security and Terrorism, September 1989 to May 1990; U.S. Secretary of Labor, December 1987 to December 1989; Washington, D.C.	1994	AMR Corporation (and its subsidiary, American Airlines); Donna Karan International Inc.; General Motors Corporation; Harman International Industries, Inc.; Host Marriott Corporation; Kellogg Company; Nordstrom Inc.
Joe K. Pickett, 53	Chairman and Chief Executive Officer, HomeSide Lending, Inc. (successor entity to BancBoston Mortgage Corporation), a mortgage banking company, April 1990 to present; Jacksonville, Florida	1996	
Jack Quinn, 49	Partner, Arnold & Porter, a law firm, 1982 to 1992 and February 1997 to present; Counsel to the President of the United States, November 1995 to February 1997; Chief of Staff and Counselor to the Vice President of the United States, May 1993 to November 1995; Counsel and Deputy Chief of Staff to the Vice President of the United States, January 1993 to May 1993	1998	
Franklin D. Raines, 50	Chairman of the Board of Directors and Chief Executive Officer of the Corporation, January 1999 to present; Chairman of the Board and Chief Executive Officer-Designate, May 1998 to December 31, 1998; Director, U.S. Office of Management and Budget, September 1996 to May 1998; Vice Chairman of the Corporation, September 1991 to August 1996	1991	America Online, Inc.; Pfizer Inc.
Eli J. Segal(2), 56	President and Chief Executive Officer of The Welfare to Work Partnership, a non-profit organization, February 1997 to present; Assistant to the President of the United States, January 1993 to February 1996; Washington, D.C.	1997	Tower Air Inc.
Lawrence M. Small, 57	President and Chief Operating Officer of the Corporation, February 1992 to present; President and Chief Operating Officer-Designate of the Corporation, September 1991 to January 1992; Vice Chairman and Chairman of the Executive Committee, January 1990 to July 1991, Sector Executive, January 1985 to December 1989, Citicorp/Citibank, a financial institution; Washington, D.C.	1991	The Chubb Corporation; Marriott International, Inc.
José H. Villarreal(2), 45	Partner, Akin, Gump, Strauss, Hauer & Feld, L.L.P., a law firm, August 1994 to present; Partner, McGinnis, Lochridge & Kilgore, L.L.P., a law firm, July 1993 to August 1994; Associate Director, White House Office of Presidential Personnel, April 1993 to June 1993; Presidential Transition Team, November 1992 to March 1993; Deputy Campaign Manager, Clinton Campaign, June 1992 to November 1992; Associate, McGinnis, Lochridge & Kilgore, February 1991 to May 1992; San Antonio, Texas	1993	Wal-Mart Stores, Inc.

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships (1)
Karen Hastie Williams, 54	Partner, Crowell & Moring, a law firm practicing in the District of Columbia, 1982 to present; Washington, D.C.	1988	Continental Airlines, Inc.; Crestar Financial Corporation; Gannett Co., Inc.; Washington Gas Company

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

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

The term of each director will end on the date of the May 1999 annual meeting of stockholders, except that the President of the United States may remove any director that the President appointed for good cause.

Executive Officers

The age and business experience, as of March 29, 1999, of each of the executive officers of Fannie Mae, are as follows:

Franklin D. Raines, 50, has been the Chairman of the Board of Directors and Chief Executive Officer since January 1999. Mr. Raines was Chairman of the Board and Chief Executive Officer-Designate from May 1998 to December 1998. Mr. Raines was Director, Office of Management and Budget from September 1996 to May 1998, and Vice Chairman of the Corporation from September 1991 to August 1996.

James A. Johnson, 55, has been Chairman of the Executive Committee from January 1999 to present. Mr. Johnson was Chairman of the Board of Directors and Chief Executive Officer of the Corporation from February 1991 to December 1998. Mr. Johnson was Vice Chairman of the Board of Directors from January 1990 to January 1991. Mr. Johnson was a Managing Director in Corporate Finance at Shearson Lehman Brothers, Inc. from April 1985 to December 1989.

Lawrence M. Small, 57, has been President and Chief Operating Officer since February 1992. Mr. Small was President and Chief Operating Officer-Designate of the Corporation from September 1991 to January 1992. Prior to his employment with the Corporation, Mr. Small was with Citicorp/Citibank, where he was Vice Chairman and Chairman of the Executive Committee from January 1990 to July 1991.

Jamie S. Gorelick, 48, has been Vice Chair since May 1997. Ms. Gorelick was Deputy Attorney General of the United States from March 1994 to April 1997. Ms. Gorelick served as General Counsel to the United States Department of Defense from May 1993 to March 1994 and was a Partner with Miller, Cassidy, Larroca & Lewin, a law firm, from January 1981 to April 1993.

J. Timothy Howard, 50, has been Executive Vice President and Chief Financial Officer since February 1990.

William E. Kelvie, 51, has been Executive Vice President and Chief Information Officer since November 1992.

Robert J. Levin, 43, has been Executive Vice President—Housing and Community Development since June 1998. Mr. Levin was Executive Vice President—Marketing from June 1990 to June 1998.

Ann D. Logan, 44, has been Executive Vice President—Single-Family Mortgage Business since June 1998. Ms. Logan was Executive Vice President and Chief Credit Officer from May 1993 to June 1998.

Adolfo Marzol, 38, has been Executive Vice President and Chief Credit Officer since July 1998. Mr. Marzol was Senior Vice President—Single-Family Business Management from July 1996 to July 1998. Mr. Marzol was Senior Vice President—Capital Markets from February 1996 to July 1996. Mr. Marzol was Executive Vice President and Chief Financial Officer of Chase Manhattan Mortgage Corporation, a mortgage company, from July 1993 to January 1996.

Glenn T. Austin, Jr., 50, has been Senior Vice President—Southeastern Regional Office since May 1985.

Kenneth J. Bacon, 44, has been Senior Vice President of the Community Development Capital Corporation since September 1998. Mr. Bacon was Senior Vice President—Northeastern Regional Office from April 1993 to September 1998.

John Buckley, 42, has been Senior Vice President—Communications since November 1991.

Donna Callejon, 36, has been Senior Vice President—Corporate Development since July 1996. Ms. Callejon was Senior Vice President—Single-Family Marketing from November 1991 to July 1996.

William G. Ehrhorn, 50, has been Senior Vice President—Operations and Corporate Services since February 1998. Mr. Ehrhorn was Senior Vice President—Mortgage Operations from May 1993 to February 1998.

Elizabeth S. Harshfield, 45, has been Senior Vice President—Midwestern Regional Office since February 1999. Ms. Harshfield was Senior Vice President—Western Regional Office from February 1996 to February 1999. Ms. Harshfield was Senior Vice President—Investor Relations from April 1994 to February 1996.

Lynda C. Horvath, 46, has been Senior Vice President—Capital Markets since July 1996. Ms. Horvath was Senior Vice President—Corporate Development from May 1993 to July 1996.

Louis W. Hoyes, 50, has been Senior Vice President—Multifamily Lending and Investment since July 1995. Prior to his employment with Fannie Mae, Mr. Hoyes was Managing Director of the residential segment of Citicorp's Real Estate business in North America, where he held a number of other positions after joining Citicorp/Citibank in 1973.

Linda K. Knight, 49, has been Senior Vice President and Treasurer since February 1993.

Thomas A. Lawler, 46, has been Senior Vice President—Portfolio Management since November 1989.

Thomas A. Lund, 40, has been Senior Vice President—Southwestern Regional Office since July 1996. Mr. Lund was Vice President—Marketing in the Southwestern Regional Office from January 1995 to July 1996. Prior to his employment with the Corporation, Mr. Lund was Senior Vice President and General Manager for Negotiated Transactions for the GE Capital Mortgage Corporation from 1990 to 1994.

William R. Maloni, 54, has been Senior Vice President—Government and Industry Relations since November 1995. Mr. Maloni was Senior Vice President—Policy and Public Affairs from March 1989 to November 1995.

Peter Niculescu, 39, has been Senior Vice President—Portfolio Strategy since March 1999. Prior to his employment with Fannie Mae, Mr. Niculescu was a Managing Director and Co-Head of Fixed Income Research for Goldman Sachs. He joined Goldman Sachs in 1990 and held a variety of positions including Managing Director—Mortgage Research, Vice President—Mortgage Research and Corporate Bond Strategist.

Thomas R. Nides, 38, has been Senior Vice President—Human Resources since November 1997 and was Vice President—Human Resources from May 1997 to November 1997. Mr. Nides was a Principal with Morgan Stanley from April 1996 to April 1997. Mr. Nides was the Corporation's Vice President—Housing Impact from January 1995 to April 1996. He was Chief of Staff to the United

States Trade Representative from May 1993 to December 1994 and Executive Assistant to the Speaker of the House from May 1989 to May 1993.

Zach Oppenheimer, 39, has been Senior Vice President—Northeastern Regional Office since November 1998. Mr. Oppenheimer was Vice President—Marketing in the Northeastern Regional Office from April 1991 through November 1998.

Michael A. Quinn, 44, has been Senior Vice President—Single Family Mortgage Business since June 1998. He was Senior Vice President—Credit Loss Management from April 1994 to June 1998. Mr. Quinn was Senior Vice President and Controller from March 1991 to April 1994.

Sampath Rajappa, 53, has been Senior Vice President—Operations Risk since November 1998. Mr. Rajappa was Senior Vice President and Controller from April 1994 to November 1998. Mr. Rajappa joined the Corporation in March 1994 as Corporate Controller. Prior thereto, Mr. Rajappa was Senior Vice President and Controller for ITT Residential Capital Corporation, a mortgage banking company, from August 1993 to February 1994.

Jayne J. Shontell, 44, has been Senior Vice President—Investor Relations since February 1996. Ms. Shontell was Senior Vice President—Financial and Information Services from November 1992 to February 1996.

Leanne Spencer, 43, has been Senior Vice President and Controller since November 1998. Ms. Spencer was Vice President—Financial Reporting from June 1993 to November 1998.

Michael Williams, 41, has been Senior Vice President—Customer Technology Services since February 1996. Mr. Williams was Senior Vice President—Customer Applications and Technology Integration from November 1993 to January 1996.

Barry Zigas, 47, has been Senior Vice President and Executive Director—National Housing Impact Division since February 1996. Mr. Zigas was Senior Vice President—Housing Impact Policy from November 1995 to January 1996, and Vice President—Housing Impact from June 1993 to October 1995.

Additional Information

For information concerning executive compensation, stock ownership of management and directors, certain transactions of executive officers, and any person or group owning more than five percent of the voting stock of Fannie Mae, reference is made to Fannie Mae's proxy statement, dated March 30, 1998 for the Corporation's 1998 annual meeting of stockholders and any later proxy statement published prior to the Corporation's publication of a new Information Statement, which are incorporated herein by this reference. The proxy statement for Fannie Mae's 1999 annual meeting of stockholders will be available in April 1999.

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

ACCOUNTANTS

The financial statements of Fannie Mae as of December 31, 1998 and 1997 and for each of the years in the three-year period ended December 31, 1998, included herein, have been included in reliance upon the report of KPMG LLP, independent certified public accountants, and upon the authority of that firm as experts in accounting and auditing.

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Neither we nor the Underwriter have authorized anyone to give any information or to make any representation not contained in this Offering Circular. If given or made, such information or representation must not be relied upon as having been authorized by us or the Underwriter. Neither delivery of this Offering Circular nor any sale of Preferred Stock shall under any circumstances imply that there has been no change in our affairs since the date of this Offering Circular or that the information contained herein is correct as of any time subsequent to the date of such information. This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the Preferred Stock or an offer to sell or a solicitation of an offer to buy the Preferred Stock by or to any person in any jurisdiction or in any circumstance in which such offer or solicitation would be unlawful or not authorized.

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3,000,000 Shares

FannieMae

5.10% Non-Cumulative Preferred Stock, Series E
(stated value $50 per share)

OFFERING CIRCULAR

Bear, Stearns & Co. Inc.

April 8, 1999