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FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE

Form 10-Q

May 06, 2011

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

Form 10-Q

- þ** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2011
- OR**
- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File No.: 0-50231

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

Fannie Mae

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

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

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

20016
(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of March 31, 2011, there were 1,119,602,427 shares of common stock of the registrant outstanding.

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PART I FINANCIAL INFORMATION

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

We have been under conservatorship, with the Federal Housing Finance Agency (FHFA) acting as conservator, since September 6, 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of the company, and of any shareholder, officer or director of the company with respect to the company and its assets. The conservator has since delegated specified authorities to our Board of Directors and has delegated to management the authority to conduct our day-to-day operations. Our directors do not have any duties to any person or entity except to the conservator and, accordingly, are not obligated to consider the interests of the company, the holders of our equity or debt securities or the holders of Fannie Mae MBS unless specifically directed to do so by the conservator. We describe the rights and powers of the conservator, key provisions of our agreements with the U.S. Department of the Treasury (Treasury), and their impact on shareholders in our Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Form 10-K) in Business Conservatorship and Treasury Agreements.

You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in conjunction with our unaudited condensed consolidated financial statements and related notes and the more detailed information in our 2010 Form 10-K.

This report contains forward-looking statements that are based on management's current expectations and are subject to significant uncertainties and changes in circumstances. Please review Forward-Looking Statements for more information on the forward-looking statements in this report. Our actual results may differ materially from those reflected in these forward-looking statements due to a variety of factors including, but not limited to, those described in Risk Factors and elsewhere in this report and in Risk Factors in our 2010 Form 10-K.

You can find a Glossary of Terms Used in This Report in the MD&A of our 2010 Form 10-K.

INTRODUCTION

Fannie Mae is a government-sponsored enterprise (GSE) that was chartered by Congress in 1938 to support liquidity, stability and affordability in the secondary mortgage market, where existing mortgage-related assets are purchased and sold. Our charter does not permit us to originate loans or lend money directly to consumers in the primary mortgage market. Our most significant activities are securitizing mortgage loans originated by lenders into Fannie Mae mortgage-backed securities, which we refer to as Fannie Mae MBS, and purchasing mortgage loans and mortgage-related securities for our mortgage portfolio. We use the term acquire in this report to refer both to our securitization activity and our purchase activity.

We obtain funds to purchase mortgage-related assets for our mortgage portfolio by issuing a variety of debt securities in the domestic and international capital markets. We also make other investments that increase the supply of affordable housing.

We are a corporation chartered by the U.S. Congress. Our conservator is a U.S. government agency. Treasury owns our senior preferred stock and a warrant to purchase 79.9% of our common stock, and Treasury has made a commitment under a senior preferred stock purchase agreement to provide us with funds under specified conditions to maintain a positive net worth. The U.S. government does not guarantee our securities or other obligations.

Our common stock was delisted from the New York Stock Exchange and the Chicago Stock Exchange on July 8, 2010 and since then has been traded in the over-the-counter market and quoted on the OTC Bulletin Board under the symbol FNMA. Our debt securities are actively traded in the over-the-counter market.

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EXECUTIVE SUMMARY

Summary of Our Financial Performance for the First Quarter of 2011

Our financial results for the first quarter of 2011 reflect continued weakness in the housing and mortgage markets, which remain under pressure from high levels of unemployment, underemployment and the prolonged decline in home prices.

Comprehensive loss. Our total comprehensive loss for the first quarter of 2011 was \$6.3 billion, consisting of a net loss of \$6.5 billion and other comprehensive income of \$181 million. In comparison, we recognized a total comprehensive loss of \$435 million in the fourth quarter of 2010, consisting of net income of \$65 million and other comprehensive loss of \$500 million, and a total comprehensive loss of \$10.2 billion in the first quarter of 2010, consisting of a net loss of \$11.5 billion and other comprehensive income of \$1.4 billion.

The change from net income in the fourth quarter of 2010 to net loss in the first quarter of 2011 was primarily due to a \$6.7 billion increase in credit-related expenses. Credit-related expenses consist of the provision for loan losses, the provision for guaranty losses and foreclosed property expense. Our higher provision for loan losses during the period was primarily driven by an increase in our total loss reserves due to: (1) a decline in home prices and increase in initial charge-off severity during the period, (2) the number of loans that entered a trial modification period during the quarter, (3) a decline in future expected home prices and (4) loans continuing to remain delinquent for an extended period of time. In addition, the fourth quarter of 2010 reflects a \$1.2 billion reduction to credit-related expenses resulting from the resolution of outstanding repurchase requests with Bank of America, N.A. and its affiliates.

The \$5.1 billion decrease in our net loss in the first quarter of 2011 compared with the first quarter of 2010 was due primarily to a \$2.2 billion increase in net interest income, driven by lower interest expense on debt; \$289 million in net fair value gains in the first quarter of 2011 compared with \$1.7 billion in net fair value losses in the first quarter of 2010, primarily due to fair value gains on derivatives and trading securities; and an \$842 million decrease in credit-related expenses, due to a decrease in our provision for loan losses. Other comprehensive income in the first quarter of 2010 was primarily driven by a reduction in our unrealized loss due to significantly improved fair value of available-for-sale securities.

Net worth. Our net worth deficit of \$8.4 billion as of March 31, 2011 reflects the recognition of our total comprehensive loss of \$6.3 billion and our payment to Treasury of \$2.2 billion in senior preferred stock dividends during the first quarter of 2011. In May 2011, the Acting Director of FHFA submitted a request to Treasury on our behalf for \$8.5 billion to eliminate our net worth deficit.

In the first quarter of 2011, we received \$2.6 billion in funds from Treasury to eliminate our net worth deficit as of December 31, 2010. Upon receipt of the additional funds requested to eliminate our net worth deficit as of March 31, 2011, the aggregate liquidation preference on the senior preferred stock will be \$99.7 billion, which will require an annualized dividend payment of \$10.0 billion. This amount exceeds our reported annual net income for each year since our inception. Through March 31, 2011, we have paid an aggregate of \$12.4 billion to Treasury in dividends on the senior preferred stock.

Total loss reserves. Our total loss reserves, which reflect our estimate of the probable losses we have incurred in our guaranty book of business, increased to \$72.1 billion as of March 31, 2011 from \$66.3 billion as of December 31, 2010. Our total loss reserve coverage to total nonperforming loans was 34.66% as of March 31, 2011, compared with

30.85% as of December 31, 2010. The continued stress on a broad segment of borrowers from persistent high levels of unemployment and underemployment and the prolonged decline in home prices have caused our total loss reserves to remain high for the past several quarters. Further, the shift in our nonperforming loan balance from loans in our collective reserve to loans that are individually impaired has caused our coverage ratio to increase.

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Providing Liquidity, Our Strong New Book of Business and Expected Losses on Single-Family Loans We Acquired before 2009 (Our Legacy Book of Business)

In the first quarter of 2011, we continued our work to provide liquidity to the mortgage market, grow the strong new book of business we have acquired since January 1, 2009, shortly after we entered into conservatorship, and minimize our losses from delinquent loans.

From January 1, 2009 to March 31, 2011, we acquired approximately 6,595,000 single-family conventional loans, excluding delinquent loans we purchased from our MBS trusts, and we acquired multifamily loans secured by multifamily properties with approximately 761,000 units.

The single-family loans we have acquired since the beginning of 2009, which we refer to in this discussion as our new single-family book of business, have a strong overall credit profile and are performing well. We expect these loans will be profitable over their lifetime, by which we mean they will generate more fee income than credit losses and administrative costs, as we discuss below in *Building a Strong New Single-Family Book of Business Expected Profitability of Our Single-Family Acquisitions*. For further information, see *Table 2: Single-Family Serious Delinquency Rates by Year of Acquisition* and *Table 3: Credit Profile of Single-Family Conventional Loans Acquired*.

The vast majority of our realized credit losses in 2009, 2010 and the first quarter of 2011 were attributable to single-family loans that we purchased or guaranteed from 2005 through 2008. While these loans will give rise to additional credit losses that we will realize when the loans are charged-off (upon foreclosure or our acceptance of a short sale or deed-in-lieu of foreclosure), we estimate that we have reserved for the substantial majority of the remaining losses on these loans. Even though we believe a substantial majority of the credit losses we have yet to realize on these loans has already been reflected in our results of operations as credit-related expenses, we expect that our credit-related expenses will be higher in 2011 than in 2010 as weakness in the housing and mortgage markets continues. We are taking a number of actions to reduce our credit losses, which we discuss in our 2010 Form 10-K in *Business Executive Summary Our Strategies and Actions to Reduce Credit Losses on Loans in our Single-Family Guaranty Book of Business* and in *Risk Management Credit Risk Management Single-Family Mortgage Credit Risk Management*.

Factors that Could Cause Actual Results to be Materially Different from Our Estimates and Expectations

We present a number of estimates and expectations in this executive summary regarding the profitability of single-family loans we have acquired, our single-family credit losses and credit-related expenses, and our draws from and dividends to be paid to Treasury. These estimates and expectations are forward-looking statements based on our current assumptions regarding numerous factors, including future home prices and the future performance of our loans. Our future estimates of these amounts, as well as the actual amounts, may differ materially from our current estimates and expectations as a result of home price changes, changes in interest rates, unemployment, direct and indirect consequences resulting from failures by servicers to follow proper procedures in the administration of foreclosure cases, government policy, changes in generally accepted accounting principles (GAAP), credit availability, social behaviors, other macro-economic variables, the volume of loans we modify, the effectiveness of our loss mitigation strategies, management of our real-estate owned (REO) inventory and pursuit of contractual remedies, changes in the fair value of our assets and liabilities, impairments of our assets, or many other factors, including those discussed in *Risk Factors, Forward-Looking Statements* and elsewhere in this report and in *Risk Factors* in our 2010 Form 10-K. For example, if the economy were to enter a deep recession, we would expect actual outcomes to differ substantially from our current expectations.

Providing Mortgage Market Liquidity

We support liquidity and stability in the secondary mortgage market, serving as a stable source of funds for purchases of homes and multifamily rental housing and for refinancing existing mortgages. We provide this financing through the activities of our three complementary businesses: our Single-Family business (Single-Family), our Multifamily Mortgage business (Multifamily) and our Capital Markets group. Our Single-

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Family and Multifamily businesses work with our lender customers, who deliver mortgage loans that we purchase and securitize into Fannie Mae MBS. Our Capital Markets group manages our investment activity in mortgage-related assets, funding investments primarily through proceeds we receive from the issuance of debt securities in the domestic and international capital markets. The Capital Markets group also works with lender customers to provide funds to the mortgage market through short-term financing and other activities, making short-term use of our balance sheet. These financing activities include whole loan conduit transactions, early funding transactions, Real Estate Mortgage Investment Conduit (REMIC) and other structured securitization activities, and dollar rolls, which we describe in more detail in our 2010 Form 10-K in Business Business Segments Capital Markets Group.

In the first quarter of 2011, we purchased or guaranteed approximately \$189 billion in loans, measured by unpaid principal balance, which includes approximately \$20 billion in delinquent loans we purchased from our single-family MBS trusts. Excluding delinquent loans purchased from our MBS trusts, our purchases and guarantees enabled our lender customers to finance approximately 759,000 single-family conventional loans and multifamily loans secured by multifamily properties with approximately 83,000 units.

We remained the largest single issuer of mortgage-related securities in the secondary market, with an estimated market share of new single-family mortgage-related securities issuances of 48.6% during the first quarter of 2011. In comparison, our estimated market share of new single-family mortgage-related securities issuances was 49.0% in the fourth quarter of 2010 and 40.8% in the first quarter of 2010. If the Federal Housing Administration (FHA) continues to be the lower-cost option for some consumers, and in some cases the only option, for loans with higher loan-to-value (LTV) ratios, our market share could be adversely impacted if the market shifts away from refinance activity, which is likely to occur when interest rates rise. We remain a constant source of liquidity in the multifamily market. Currently, we own or guarantee approximately one-fifth of the outstanding debt on multifamily properties.

Building a Strong New Single-Family Book of Business

Our new single-family book of business has a strong overall credit profile and is performing well. In this section, we discuss our expectations for these loans and their performance to date.

Expected Profitability of Our Single-Family Acquisitions

While it is too early to know how loans in our new single-family book of business will ultimately perform, given their strong credit risk profile, low levels of payment delinquencies shortly after acquisition, and low serious delinquency rates, we expect that, over their lifetime, these loans will be profitable. Table 1 provides information about whether we expect loans we acquired in 1991 through the first quarter of 2011 to be profitable, and the percentage of our single-family guaranty book of business represented by these loans as of March 31, 2011. The expectations reflected in Table 1 are based on the credit risk profile of the loans we have acquired, which we discuss in more detail in Table 3: Credit Profile of Single-Family Conventional Loans Acquired and in Table 34: Risk Characteristics of Single-Family Conventional Business Volume and Guaranty Book of Business. These expectations are also based on numerous other assumptions, including our expectations regarding home price declines set forth below in Outlook. As shown in Table 1, we expect loans we have acquired in 2009, 2010 and the first quarter of 2011 to be profitable. If future macroeconomic conditions turn out to be significantly more adverse than our expectations, these loans could become unprofitable. For example, we believe that these loans would become unprofitable if home prices declined more than 15% from their March 2011 levels over the next five years based on our home price index, which would be an approximately 34% decline from their peak in the third quarter of 2006.

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Table 1: Expected Lifetime Profitability of Single-Family Loans Acquired in 1991 through the First Quarter of 2011

As Table 1 shows, the key years in which we acquired loans that we expect will be unprofitable are 2005 through 2008. The vast majority of our realized credit losses since the beginning of 2009 were attributable to these loans. Although loans we acquired in 2004 were originated under more conservative acquisition policies than loans we acquired from 2005 through 2008, our 2004 acquisitions were made during a time when home prices were rapidly increasing, and their performance has suffered from the subsequent decline in home prices, which continued in the first quarter of 2011. We currently expect these loans to perform close to break-even, but changes in home prices, other economic conditions or borrower behavior could change our expectation regarding whether these loans will be profitable.

Loans we have acquired since the beginning of 2009 comprised 45% of our single-family guaranty book of business as of March 31, 2011. Our 2005 to 2008 acquisitions are becoming a smaller percentage of our guaranty book of business, having decreased from 39% of our guaranty book of business as of December 31, 2010 to 36% as of March 31, 2011.

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Serious Delinquency Rates by Year of Acquisition

In our experience, an early predictor of the ultimate performance of loans is the rate at which the loans become seriously delinquent within a short period of time after acquisition. Loans we acquired in 2009 and 2010 have experienced historically low levels of delinquencies shortly after their acquisition. Table 2 shows, for single-family loans we acquired in each year from 2001 to 2010, the percentage that were seriously delinquent (three or more months past due or in the foreclosure process) as of the end of the first quarter following the acquisition year. Loans we acquired in 2011 are not included in this table because they were originated so recently that they could not yet have become seriously delinquent. As Table 2 shows, the percentage of our 2009 acquisitions that were seriously delinquent as of the end of the first quarter following their acquisition year was more than seven times lower than the average comparable serious delinquency rate for loans acquired in 2005 through 2008. For loans originated in 2010, this percentage was more than nine times lower than the average comparable rate for loans acquired in 2005 through 2008. Table 2 also shows serious delinquency rates for each year's acquisitions as of March 31, 2011. Except for the most recent acquisition years, whose serious delinquency rates are likely lower than they will be after the loans have aged, Table 2 shows that the current serious delinquency rate generally tracks the trend of the serious delinquency rate as of the end of the first quarter following the year of acquisition. Below the table we provide information about the economic environment in which the loans were acquired, specifically home price appreciation and unemployment levels.

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Table 2: Single-Family Serious Delinquency Rates by Year of Acquisition

* For 2010, the serious delinquency rate as of March 31, 2011 is the same as the serious delinquency rate as of the end of the first quarter following the acquisition year.

- (1) Based on Fannie Mae's Home Price Index (HPI), which measures average price changes based on repeat sales on the same properties. For 2011, the data show an initial estimate based on purchase transactions in Fannie-Freddie acquisition and public deed data available through the end of March 2011, supplemented by preliminary data that became available in April 2011. Previously reported data has been revised to reflect additional available historical data. Including subsequently available data may lead to materially different results.
- (2) Based on the average national unemployment rates for each month reported in the labor force statistics current population survey (CPS), Bureau of Labor Statistics.

Credit Profile of Our Single-Family Acquisitions

Single-family loans we purchased or guaranteed from 2005 through 2008 were acquired during a period when home prices were rising rapidly, peaked, and then started to decline sharply, and underwriting and eligibility standards were more relaxed than they are now. These loans were characterized, on average and as discussed below, by higher LTV ratios and lower FICO credit scores than loans we have acquired since January 1, 2009. In addition, many of these loans were Alt-A loans or had other higher-risk loan attributes such as interest-only

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payment features. As a result of the sharp declines in home prices, 34% of the loans that we acquired from 2005 through 2008 had mark-to-market LTV ratios that were greater than 100% as of March 31, 2011, which means the principal balance of the borrower's primary mortgage exceeded the current market value of the borrower's home. This percentage is higher when second lien loans secured by the same properties that secure our loans are included. The sharp decline in home prices, the severe economic recession that began in December 2007 and continued through June 2009, and continuing high unemployment and underemployment have significantly and adversely impacted the performance of loans we acquired from 2005 through 2008. We are taking a number of actions to reduce our credit losses. We discuss these actions and our strategy in our 2010 Form 10-K in Business Executive Summary Our Strategies and Actions to Reduce Credit Losses on Loans in our Single-Family Guaranty Book of Business and in MD&A Risk Management Credit Risk Management Single-Family Mortgage Credit Risk Management.

In 2009, we began to see the effect of actions we took, beginning in 2008, to significantly strengthen our underwriting and eligibility standards and change our pricing to promote sustainable homeownership and stability in the housing market. As a result of these changes and other market dynamics, we reduced our acquisitions of loans with higher-risk attributes. Compared with the loans we acquired in 2005 through 2008, the loans we have acquired since January 1, 2009 have had better overall credit risk profiles at the time we acquired them and their early performance has been strong. Our experience has been that loans with characteristics such as lower original LTV ratios (that is, more equity held by the borrowers in the underlying properties), higher FICO credit scores and more stable payments will perform better than loans with risk characteristics such as higher original LTV ratios, lower FICO credit scores, Alt-A underwriting and payments that may adjust over the term of the loan. Table 3 shows improvements in the credit risk profile of single-family loans we have acquired since January 1, 2009 compared to loans we acquired from 2005 through 2008.

Table 3: Credit Profile of Single-Family Conventional Loans Acquired⁽¹⁾

	Acquisitions from 2009 through the first quarter of 2011	Acquisitions from 2005 through 2008
Weighted average loan-to-value ratio at origination	68%	73%
Weighted average FICO credit score at origination	762	722
Fully amortizing, fixed-rate loans	95%	86%
Alt-A loans ⁽²⁾	1%	14%
Interest-only	1%	12%
Original loan-to-value ratio > 90%	5%	11%
FICO credit score < 620	*	5%

* Represent less than 0.5% of the total acquisitions.

(1) Loans that meet more than one category are included in each applicable category.

(2) Newly originated Alt-A loans acquired in 2009 through 2011 consist of the refinance of existing loans.

Improvements in the credit risk profile of our acquisitions since the beginning of 2009 over acquisitions in prior years reflect changes that we made to our pricing and eligibility standards, as well as changes that mortgage insurers made to their eligibility standards. We discuss these changes in our 2010 Form 10-K in Business Executive Summary Our

Expectations Regarding Profitability, the Single-Family Loans We Acquired Beginning in 2009, and Credit Losses Credit Profile of Our Single-Family Acquisitions. In addition, FHA's role as the lower-cost option for some consumers for loans with higher LTV ratios has also reduced our acquisitions of these types of loans. The credit risk profile of our acquisitions since the beginning of 2009 has been influenced further by its significant percentage of refinanced loans. Refinanced loans generally perform better than purchase money loans, as the borrower has demonstrated a desire to maintain homeownership. As we discuss in Outlook below, we expect fewer refinancings in 2011 than in 2010.

In 2010 and 2011 our acquisitions of refinanced loans included a significant number of loans under our Refi Plustm initiative. Under Refi Plus we acquire refinancings of performing Fannie Mae loans that have current LTV ratios up to 125% and, in some cases, lower FICO credit scores than we generally require. Refi Plus

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loans reduce the borrowers' monthly payments or are otherwise more sustainable than the borrowers' old loans. Our acquisitions under Refi Plus include our acquisitions under the Home Affordable Refinance Program (HARP), which was established by the Administration to help borrowers who may be unable to refinance the mortgage loan on their primary residence due to a decline in home values. The LTV ratios at origination for our 2010 and 2011 acquisitions are higher than for our 2009 acquisitions, primarily due to our acquisition of Refi Plus loans. The percentage of loans with LTV ratios at origination greater than 90% has increased from 4% for 2009 acquisitions to 7% for 2010 acquisitions and 8% for acquisitions in the first quarter of 2011.

Despite the increases in LTV ratios at origination associated with Refi Plus, the overall credit profile of our 2010 and 2011 acquisitions remains significantly stronger than the credit profile of our 2005 through 2008 acquisitions. Whether the loans we acquire in the future exhibit an overall credit profile similar to our acquisitions since the beginning of 2009 will depend on a number of factors, including our future eligibility standards and those of mortgage insurers, the percentage of loan originations representing refinancings, our future objectives, government policy, and market and competitive conditions.

Expected Losses on Our Legacy Book of Business

The single-family credit losses we realized from January 1, 2009 through March 31, 2011, combined with the amounts we have reserved for single-family credit losses as of March 31, 2011, as described below, total approximately \$120 billion. The vast majority of these losses are attributable to single-family loans we purchased or guaranteed from 2005 through 2008.

While loans we acquired in 2005 through 2008 will give rise to additional credit losses that we have not yet realized, we estimate that we have reserved for the substantial majority of the remaining losses on these loans. Even though we believe a substantial majority of the credit losses we have yet to realize on these loans has already been reflected in our results of operations as credit-related expenses, we expect that our credit-related expenses will be higher in 2011 than in 2010 as weakness in the housing and mortgage markets continues. We also expect that future defaults on our legacy book of business and the resulting charge-offs will occur over a period of years. In addition, given the large current and anticipated supply of single-family homes in the market, we anticipate that it will take years before our REO inventory is reduced to pre-2008 levels.

We show how we calculate our realized credit losses in Table 13: Credit Loss Performance Metrics. Our reserves for credit losses described in this discussion consist of (1) our allowance for loan losses, (2) our allowance for accrued interest receivable, (3) our allowance for preforeclosure property taxes and insurance receivables, and (4) our reserve for guaranty losses (collectively, our total loss reserves), plus the portion of fair value losses on loans purchased out of MBS trusts reflected in our condensed consolidated balance sheets that we estimate represents accelerated credit losses we expect to realize. For more information on our reserves for credit losses, please see Table 10: Total Loss Reserves.

The fair value losses that we consider part of our reserves are not included in our total loss reserves. The majority of the fair value losses were recorded prior to our adoption in 2010 of new accounting standards on the transfers of financial assets and the consolidation of variable interest entities. Prior to our adoption of the new standards, upon our acquisition of credit-impaired loans out of unconsolidated MBS trusts, we recorded fair value loss charge-offs against our reserve for guaranty losses to the extent that the acquisition cost of these loans exceeded their estimated fair value. We expect to realize a portion of these fair value losses as credit losses in the future (for loans that eventually involve charge-offs or foreclosure), yet these fair value losses have already reduced the mortgage loan balances reflected in our condensed consolidated balance sheets and have effectively been recognized in our condensed consolidated statements of operations and comprehensive loss through our provision for guaranty losses. We consider these fair value losses as an effective reserve, apart from our total loss reserves, to the extent that we expect to realize credit

losses on the acquired loans in the future.

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Table 4 presents information for each of the last five quarters about the credit performance of mortgage loans in our single-family guaranty book of business and actions taken by our servicers with borrowers to resolve existing or potential delinquent loan payments. We refer to these actions as workouts. The workout information in Table 4 does not reflect repayment plans and forbearances that have been initiated but not completed, nor does it reflect trial modifications that have not become permanent.

Table 4: Credit Statistics, Single-Family Guaranty Book of Business⁽¹⁾

	2011		2010			
	Q1	Full Year	Q4 (Dollars in millions)	Q3	Q2	Q1
As of the end of each period:						
Serious delinquency rate ⁽²⁾	4.27%	4.48%	4.48%	4.56%	4.99%	5.47%
Nonperforming loans ⁽³⁾	\$ 206,098	\$ 212,858	\$ 212,858	\$ 212,305	\$ 217,216	\$ 222,892
Foreclosed property inventory:						
Number of properties	153,224	162,489	162,489	166,787	129,310	109,989
Carrying value	\$ 14,086	\$ 14,955	\$ 14,955	\$ 16,394	\$ 13,043	\$ 11,423
Combined loss reserves ⁽⁴⁾	\$ 66,240	\$ 60,163	\$ 60,163	\$ 58,451	\$ 59,087	\$ 58,900
Total loss reserves ⁽⁵⁾	\$ 70,466	\$ 64,469	\$ 64,469	\$ 63,105	\$ 64,877	\$ 66,479
During the period:						
Foreclosed property (number of properties):						
Acquisitions ⁽⁶⁾	53,549	262,078	45,962	85,349	68,838	61,929
Dispositions	(62,814)	(185,744)	(50,260)	(47,872)	(49,517)	(38,095)
Credit-related expenses ⁽⁷⁾	\$ 11,106	\$ 26,420	\$ 4,064	\$ 5,559	\$ 4,871	\$ 11,926
Credit losses ⁽⁸⁾	\$ 5,604	\$ 23,133	\$ 3,111	\$ 8,037	\$ 6,923	\$ 5,062
Loan workout activity (number of loans):						
Home retention loan workouts ⁽⁹⁾	60,959	440,276	89,691	113,367	132,192	105,026
Preforeclosure sales and deeds-in-lieu of foreclosure	17,120	75,391	15,632	20,918	21,515	17,326
Total loan workouts	78,079	515,667	105,323	134,285	153,707	122,352
Loan workouts as a percentage of delinquent loans in our guaranty book of business ⁽¹⁰⁾	25.01%	37.30%	30.47%	37.86%	41.18%	31.59%

- (1) Our single-family guaranty book of business consists of (a) single-family mortgage loans held in our mortgage portfolio, (b) single-family mortgage loans underlying Fannie Mae MBS, and (c) other credit enhancements that we provide on single-family mortgage assets, such as long-term standby commitments. It excludes non-Fannie Mae mortgage-related securities held in our mortgage portfolio for which we do not provide a guaranty.
- (2) Calculated based on the number of single-family conventional loans that are three or more months past due and loans that have been referred to foreclosure but not yet foreclosed upon, divided by the number of loans in our single-family conventional guaranty book of business. We include all of the single-family conventional loans that we own and those that back Fannie Mae MBS in the calculation of the single-family serious delinquency rate.
- (3) Represents the total amount of nonperforming loans that are on accrual status, including troubled debt restructurings and HomeSaver Advance (HSA) first-lien loans. A troubled debt restructuring is a restructuring of a mortgage loan in which a concession is granted to a borrower experiencing financial difficulty. HSA first-lien loans are unsecured personal loans in the amount of past due payments used to bring mortgage loans current. We generally classify loans as nonperforming when the payment of principal or interest on the loan is two months or more past due.
- (4) Consists of the allowance for loan losses for loans recognized in our condensed consolidated balance sheets and the reserve for guaranty losses related to both single-family loans backing Fannie Mae MBS that we do not consolidate in our condensed consolidated balance sheets and single-family loans that we have guaranteed under long-term standby commitments.

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For additional information on the change in our loss reserves see Consolidated Results of Operations Credit-Related Expenses Provision for Credit Losses.

- (5) Consists of (a) the combined loss reserves, (b) allowance for accrued interest receivable, and (c) allowance for preforeclosure property taxes and insurance receivables.
- (6) Includes acquisitions through deeds-in-lieu of foreclosure.
- (7) Consists of the provision for loan losses, the provision (benefit) for guaranty losses and foreclosed property expense (income).
- (8) Consists of (a) charge-offs, net of recoveries and (b) foreclosed property expense; adjusted to exclude the impact of fair value losses resulting from credit-impaired loans acquired from MBS trusts.
- (9) Consists of (a) modifications, which do not include trial modifications or repayment plans or forbearances that have been initiated but not completed; (b) repayment plans and forbearances completed and (c) HomeSaver Advance first-lien loans. See Table 38: Statistics on Single-Family Loan Workouts in Risk Management Credit Risk Management for additional information on our various types of loan workouts.
- (10) Calculated based on annualized problem loan workouts during the period as a percentage of delinquent loans in our single-family guaranty book of business as of the end of the period.

We provide additional information on our credit-related expenses in Consolidated Results of Operations Credit-Related Expenses and on the credit performance of mortgage loans in our single-family book of business and our loan workouts in Risk Management Credit Risk Management Single-Family Mortgage Credit Risk Management.

Housing and Mortgage Market and Economic Conditions

During the first quarter of 2011, the United States economic recovery continued at a very slow pace. The U.S. gross domestic product, or GDP, rose by 1.8% on an annualized basis during the quarter, according to the Bureau of Economic Analysis advance estimate. The overall economy gained an estimated 478,000 jobs in the first quarter as a result of employment growth in the private sector. According to the U.S. Bureau of Labor Statistics, as of March 2011, over the past 12 months there has been an increase of 1.3 million non-farm jobs. The unemployment rate was 8.8% in March 2011, compared with 9.0% in January 2011, based on data from the U.S. Bureau of Labor Statistics. Employment will likely need to post sustained improvement for an extended period to have a positive impact on housing.

Housing activity remained weak during the first quarter of 2011. Although home sales during the quarter increased modestly from the fourth quarter's levels, sales of foreclosed homes and short sales (distressed sales) represented an outsized portion of the market. Distressed sales accounted for 40% of existing home sales in March 2011, up from 35% in March 2010, according to the National Association of REALTORS®. In the face of competition from distressed sales, sales of new homes remained very low.

The overall mortgage market serious delinquency rate has trended down since peaking in the fourth quarter of 2009 but has remained historically high, with an estimated four million loans seriously delinquent (90 days or more past due or in the foreclosure process) as of December 31, 2010, based on the Mortgage Bankers Association National Delinquency Survey. In March, the supply of single-family homes as measured by the inventory/sales ratio remained above long-term average levels. Properties that are vacant and held off the market, combined with the portion of

properties backing seriously delinquent mortgages not currently listed for sale, represent a significant shadow inventory putting downward pressure on home prices.

We estimate that home prices on a national basis declined by 1.8% in the first quarter of 2011 and have declined by 22.5% from their peak in the third quarter of 2006. Our home price estimates are based on preliminary data and are subject to change as additional data become available. The decline in home prices has left many homeowners with negative equity in their mortgages, which means their principal mortgage balance exceeds the current market value of their home. According to CoreLogic, approximately 11 million, or 23%, of all residential properties with mortgages were in a negative equity position in the fourth quarter of 2010. This increases the risk that borrowers might walk away from their mortgage obligations, causing the loans to become delinquent and proceed to foreclosure.

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During the first quarter of 2011, the multifamily sector continued to improve due to increased rental demand and improving job growth. Based on preliminary third-party data, we estimate that the national multifamily vacancy rate on average fell by 25 basis points during the first quarter of 2011 to 7.0%, after having held steady in the fourth quarter of 2010. In addition, it appears that asking rents increased in the first quarter of 2011 by an estimated 50 basis points on a national basis. As indicated by data from Axiometrics, Inc., multifamily concession rates, the rental discount rate as a percentage of asking rents, declined during the first quarter of the year to 4.64% as of February 2011, after having increased during the fourth quarter of 2010 to end the year at 5.07%. The increase in rental demand is also reflected in an estimated increase of 44,000 units in the number of occupied rental units during the first three months of 2011, according to preliminary data from REIS, Inc. National multifamily fundamentals, which generally include factors such as effective rents, vacancy rates, supply and demand, job growth, and demographic trends, continued to improve in the first quarter. However, certain local markets and properties continue to exhibit weak fundamentals.

Outlook

Overall Market Conditions. We expect weakness in the housing and mortgage markets to continue in 2011. The high level of delinquent mortgage loans will result in the foreclosure of troubled loans, which is likely to add to the excess housing inventory. Home sales are unlikely to rise before the unemployment rate improves further. In addition, servicer foreclosure process deficiencies and their consequences have created uncertainty for potential home buyers, because foreclosed homes account for a substantial part of the existing home market. Thus, widespread concerns about foreclosure process deficiencies could suppress home sales in the near term and interfere with the housing recovery.

We expect that single-family default and severity rates, as well as the level of single-family foreclosures, will remain high in 2011. Despite signs of multifamily sector improvement at the national level, we expect multifamily charge-offs in 2011 to remain commensurate with 2010 levels as certain local markets and properties continue to exhibit weak fundamentals. Conditions may worsen if the unemployment rate increases on either a national or regional basis.

We expect the pace of our loan acquisitions for the remainder of 2011 will be significantly lower than in 2010 and the first quarter of 2011, primarily because we expect fewer refinancings as a result of increasing mortgage rates and, to a lesser extent, the high number of mortgages that have already refinanced to low rates in recent years. To the extent our acquisitions decline, we will receive fewer risk-based fees, which are charged at loan acquisition and recognized over time; as a result, our future revenues will be negatively impacted. We estimate that total originations in the U.S. single-family mortgage market in 2011 will decrease from 2010 levels by approximately one-third, from an estimated \$1.5 trillion to an estimated \$1.0 trillion, and that the amount of originations in the U.S. single-family mortgage market that are refinancings will decline from approximately \$1.1 trillion to approximately \$413 billion. Refinancings comprised approximately 82% of our single-family business volume in the first quarter of 2011, compared with 78% for all of 2010.

Home Price Declines. We expect that home prices on a national basis will decline further, with greater declines in some geographic areas than others, before stabilizing in late 2011. We now expect that the peak-to-trough home price decline on a national basis will range between 22% and 29%, as compared with our expectation at the time we filed our 2010 Form 10-K that the peak-to-trough home price decline on a national basis would range between 21% and 26%. These estimates are based on our home price index, which is calculated differently from the S&P/Case-Shiller U.S. National Home Price Index and therefore results in different percentages for comparable declines. These estimates also contain significant inherent uncertainty in the current market environment regarding a variety of critical assumptions we make when formulating these estimates, including the effect of actions the federal government has taken and may take with respect to housing finance reform; the management of the Federal Reserve's MBS holdings; and the impact of those actions on home prices, unemployment and the general economic and interest rate

environment. Because of these uncertainties, the actual home price decline we experience may differ significantly from these estimates. We also expect significant regional variation in home price declines and stabilization.

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Our 22% to 29% peak-to-trough home price decline estimate corresponds to an approximate 32% to 40% peak-to-trough decline using the S&P/Case-Shiller index method. Our estimates differ from the S&P/Case-Shiller index in two principal ways: (1) our estimates weight expectations by number of properties, whereas the S&P/Case-Shiller index weights expectations based on property value, causing home price declines on higher priced homes to have a greater effect on the overall result; and (2) our estimates attempt to exclude sales of foreclosed homes because we believe that differing maintenance practices and the forced nature of the sales make foreclosed home prices less representative of market values, whereas the S&P/Case-Shiller index includes foreclosed homes sales. The S&P/Case-Shiller comparison numbers are calculated using our models and assumptions, but modified to account for weighting based on property value and the impact of foreclosed property sales. In addition to these differences, our estimates are based on our own internally available data combined with publicly available data, and are therefore based on data collected nationwide, whereas the S&P/Case-Shiller index is based on publicly available data, which may be limited in certain geographic areas of the country. Our comparative calculations to the S&P/Case-Shiller index provided above are not modified to account for this data pool difference. We are working on enhancing our home price estimates to identify and exclude a greater portion of foreclosed home sales. When we begin reporting these enhanced home price estimates, we expect that some period to period comparisons of home prices may differ from those determined using our current estimates.

Credit-Related Expenses and Credit Losses. We expect that our credit-related expenses and our credit losses will be higher in 2011 than in 2010. We describe our credit loss outlook above under *Providing Liquidity, Our Strong New Book of Business and Expected Losses on Single-Family Loans We Acquired before 2009* *Expected Losses on Our Legacy Book of Business.*

Uncertainty Regarding our Long-Term Financial Sustainability and Future Status. There is significant uncertainty in the current market environment, and any changes in the trends in macroeconomic factors that we currently anticipate, such as home prices and unemployment, may cause our future credit-related expenses and credit losses to vary significantly from our current expectations. Although Treasury's funds under the senior preferred stock purchase agreement permit us to remain solvent and avoid receivership, the resulting dividend payments are substantial. We do not expect to earn profits in excess of our annual dividend obligation to Treasury for the indefinite future. As a result of these factors, there is significant uncertainty about our long-term financial sustainability.

In addition, there is significant uncertainty regarding the future of our company, including how long we will continue to be in existence, the extent of our role in the market, what form we will have, and what ownership interest, if any, our current common and preferred stockholders will hold in us after the conservatorship is terminated. We expect this uncertainty to continue. On February 11, 2011 Treasury and the Department of Housing and Urban Development (HUD) released a report to Congress on reforming America's housing finance market. The report states that the Administration will work with FHFA to determine the best way to responsibly wind down both Fannie Mae and Freddie Mac. The report emphasizes the importance of providing the necessary financial support to Fannie Mae and Freddie Mac during the transition period. We cannot predict the prospects for the enactment, timing or content of legislative proposals regarding long-term reform of the GSEs. Please see *Legislation and GSE Reform* in this report and in our 2010 Form 10-K for a discussion of recent legislative reform of the financial services industry, and proposals for GSE reform, that could affect our business and *Risk Factors* for a discussion of the risks to our business relating to the uncertain future of our company.

LEGISLATIVE AND REGULATORY DEVELOPMENTS

GSE Reform

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), on February 11, 2011, Treasury and HUD released their report to Congress on ending the conservatorships of Fannie Mae and Freddie Mac and reforming the housing finance market. The report provides that the Administration will work with FHFA to determine the best way to responsibly reduce Fannie Mae's and Freddie Mac's role in the market and ultimately wind down both institutions.

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The report identifies a number of policy steps that could be used to wind down Fannie Mae and Freddie Mac, reduce the government's role in housing finance and help bring private capital back to the mortgage market. These steps include (1) increasing guaranty fees, (2) gradually increasing the level of required down payments so that any mortgages insured by Fannie Mae or Freddie Mac eventually have at least a 10% down payment, (3) reducing conforming loan limits to those established in the Federal Housing Finance Regulatory Reform Act of 2008 (the 2008 Reform Act), (4) encouraging Fannie Mae and Freddie Mac to pursue additional credit loss protection and (5) reducing Fannie Mae's and Freddie Mac's portfolios, consistent with Treasury's senior preferred stock purchase agreements with the companies.

In addition, the report outlines three potential options for a new long-term structure for the housing finance system following the wind-down of Fannie Mae and Freddie Mac. The first option would privatize housing finance almost entirely. The second option would add a government guaranty mechanism that could scale up during times of crisis. The third option would involve the government offering catastrophic reinsurance behind private mortgage guarantors. Each of these options assumes the continued presence of programs operated by FHA, the Department of Agriculture and the Veterans Administration to assist targeted groups of borrowers. The report does not state whether or how the existing infrastructure or human capital of Fannie Mae may be used in the establishment of such a reformed system. The report emphasizes the importance of proceeding with a careful transition plan and providing the necessary financial support to Fannie Mae and Freddie Mac during the transition period. A copy of the report can be found on the Housing Finance Reform section of Treasury's Web site, www.Treasury.gov. We are providing Treasury's Web site address solely for your information, and information appearing on Treasury's Web site is not incorporated into this quarterly report on Form 10-Q.

We expect that Congress will continue to hold hearings and consider legislation in 2011 on the future status of Fannie Mae and Freddie Mac. In both the House of Representatives and the Senate, legislation has been introduced that would require FHFA to make a determination within two years of enactment whether the GSEs were financially viable and, if the GSEs were determined to be not financially viable, to place them into receivership. As drafted, these bills may upon enactment impair our ability to issue securities in the capital markets and therefore our ability to conduct our business, absent the federal government providing an explicit guarantee of their existing and ongoing liabilities.

In the House of Representatives, the Subcommittee on Capital Markets and Government Sponsored Enterprises of the Financial Services Committee has also approved several specific bills relating to GSE operations, including the following: (1) suspending current compensation packages and applying a government pay scale for GSE employees; (2) requiring the GSEs to increase guarantee fees; (3) subjecting GSE loans to the risk retention standards in the Dodd-Frank Act; (4) requiring a quicker reduction of GSE portfolios than required under the senior preferred stock purchase agreement; (5) requiring Treasury to pre-approve all GSE debt issuances; (6) repealing the GSEs' affordable housing goals; and (7) prohibiting FHFA from approving any new GSE products during conservatorship or receivership, with certain exceptions.

We expect additional legislation relating to the GSEs to be introduced and considered by Congress in 2011. We cannot predict the prospects for the enactment, timing or content of legislative proposals regarding the future status of the GSEs.

In sum, there continues to be uncertainty regarding the future of our company, including how long we will continue to be in existence, the extent of our role in the market, what form we will have, and what ownership interest, if any, our current common and preferred stockholders will hold in us after the conservatorship is terminated. Please see "Risk Factors" for a discussion of the risks to our business relating to the uncertain future of our company.

Proposed Rules Implementing the Dodd-Frank Act

Below we describe some rules that have been proposed by various government agencies to implement provisions of the Dodd-Frank Act. We are currently evaluating these proposed rules and how they may impact our business and the housing finance industry.

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Risk Retention. On March 29, 2011, the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, FHFA and HUD issued a joint proposed rule implementing the risk retention requirements established by the Dodd-Frank Act. Under the proposed rule, securitizers would be required to retain at least 5% of the credit risk with respect to the assets they securitize. The proposed rule offers several options for compliance by parties with assets to securitize, one of which is to have either Fannie Mae or Freddie Mac securitize the assets. As long as Fannie Mae or Freddie Mac (1) fully guarantees the assets, thereby taking on 100% of their credit risk, and (2) is in conservatorship or receivership at the time the assets are securitized, no further retention of credit risk is required. Certain mortgage loans meeting the definition of a Qualified Residential Mortgage are exempt from the requirements of the rule. Only mortgage loans that are first lien mortgages on primary residences with loan-to-value ratios not exceeding 80% (75% for refinancings and 70% for cash-out refinancings) and that meet certain other underwriting requirements, would meet the definition of Qualified Residential Mortgage under the proposal.

Ability to Repay. On April 19, 2011, the Federal Reserve Board issued a proposed rule pursuant to the Dodd-Frank Act that, among other things, requires creditors to determine a borrower's ability to repay a mortgage loan under Regulation Z, which implements the Truth in Lending Act. If a creditor fails to comply, a borrower may be able to offset amounts owed as part of a foreclosure or recoup monetary damages. The proposed rule offers several options for complying with the ability to repay requirement, including making loans that meet certain terms and characteristics (so-called qualified mortgages), which may provide creditors with special protection from liability. As proposed, a loan is generally a qualified mortgage if, among other things, the borrower's income and assets are verified, the loan term does not exceed 30 years, the loan is fully amortizing with no negative amortization, interest-only or balloon features, and the loan is underwritten at the maximum interest rate applicable in the first five years of the loan, taking into account all mortgage-related obligations.

Derivatives. On April 12, 2011, the Federal Reserve Board, the Federal Deposit Insurance Corporation, FHFA, the Farm Credit Administration and the Office of the Comptroller of the Currency proposed rules under the Dodd-Frank Act governing margin and capital requirements applicable to entities that are subject to their oversight. On April 28, 2011, the Commodity Futures Trading Commission proposed rules under the Dodd-Frank Act governing margin requirements for swap dealers and major swap participants engaging in derivative trades that are not submitted for clearing to a derivatives clearing organization (uncleared trades). These proposed rules would require that, for all uncleared trades, we collect from our counterparties and provide to our counterparties collateral in excess of the amounts we have historically collected or provided, regardless of whether we are deemed to be a major swap participant.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the condensed consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We describe our most significant accounting policies in Note 1, Summary of Significant Accounting Policies of this report and in our 2010 Form 10-K.

We evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. Management has discussed any significant changes in judgments and assumptions in applying our critical accounting policies with the Audit Committee of our Board of Directors. We have identified three of our accounting policies as critical because they involve significant judgments and assumptions about highly complex and inherently uncertain matters, and the use of

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reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition. These critical accounting policies and estimates are as follows:

Fair Value Measurement

Total Loss Reserves

Other-Than-Temporary Impairment of Investment Securities

See MD&A Critical Accounting Policies and Estimates in our 2010 Form 10-K for a detailed discussion of these critical accounting policies and estimates. We provide below information about our Level 3 assets and liabilities as of March 31, 2011 as compared with December 31, 2010.

Fair Value Measurement

The use of fair value to measure our assets and liabilities is fundamental to our financial statements and is a critical accounting estimate because we account for and record a portion of our assets and liabilities at fair value. In determining fair value, we use various valuation techniques. We describe the valuation techniques and inputs used to determine the fair value of our assets and liabilities and disclose their carrying value and fair value in Note 13, Fair Value.

Fair Value Hierarchy Level 3 Assets and Liabilities

The assets and liabilities that we have classified as Level 3 consist primarily of financial instruments for which there is limited market activity and therefore little or no price transparency. As a result, the valuation techniques that we use to estimate the fair value of Level 3 instruments involve significant unobservable inputs, which generally are more subjective and involve a high degree of management judgment and assumptions. Our Level 3 assets and liabilities consist of certain mortgage- and asset-backed securities and residual interests, certain mortgage loans, certain acquired property, certain long-term debt arrangements and certain highly structured, complex derivative instruments.

Table 5 presents a comparison, by balance sheet category, of the amount of financial assets carried in our condensed consolidated balance sheets at fair value on a recurring basis (recurring asset) that were classified as Level 3 as of March 31, 2011 and December 31, 2010. The availability of observable market inputs to measure fair value varies based on changes in market conditions, such as liquidity. As a result, we expect the amount of financial instruments carried at fair value on a recurring basis and classified as Level 3 to vary each period.

Table 5: Level 3 Recurring Financial Assets at Fair Value

Balance Sheet Category	As of	
	March 31, 2011	December 31, 2010
	(Dollars in millions)	
Trading securities	\$ 3,981	\$ 4,576
Available-for-sale securities	31,762	31,934
Mortgage loans	2,221	2,207
Other assets	239	247

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Level 3 recurring assets	\$ 38,203	\$ 38,964
Total assets	\$ 3,227,042	\$ 3,221,972
Total recurring assets measured at fair value	\$ 155,996	\$ 161,696
Level 3 recurring assets as a percentage of total assets	1%	1%
Level 3 recurring assets as a percentage of total recurring assets measured at fair value	24%	24%
Total recurring assets measured at fair value as a percentage of total assets	5%	5%

Assets measured at fair value on a nonrecurring basis and classified as Level 3, which are not presented in the table above, primarily include mortgage loans and acquired property. The fair value of Level 3 nonrecurring

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assets totaled \$42.7 billion during the quarter ended March 31, 2011 and \$63.0 billion during the year ended December 31, 2010.

Financial liabilities measured at fair value on a recurring basis and classified as Level 3 consisted of long-term debt with a fair value of \$1.1 billion as of March 31, 2011 and \$1.0 billion as of December 31, 2010, and other liabilities with a fair value of \$121 million as of March 31, 2011 and \$143 million as of December 31, 2010.

CONSOLIDATED RESULTS OF OPERATIONS

In this section we discuss our condensed consolidated results of operations for the periods indicated. You should read this section together with our condensed consolidated financial statements, including the accompanying notes.

Table 6 summarizes our condensed consolidated results of operations for the periods indicated.

Table 6: Summary of Condensed Consolidated Results of Operations

	For the Three Months Ended March 31,		
	2011	2010	Variance
	(Dollars in millions)		
Net interest income	\$ 4,960	\$ 2,789	\$ 2,171
Fee and other income	237	233	4
Net revenues	\$ 5,197	\$ 3,022	\$ 2,175
Investment gains, net	75	166	(91)
Net other-than-temporary impairments	(44)	(236)	192
Fair value gains (losses), net	289	(1,705)	1,994
Administrative expenses	(605)	(605)	
Credit-related expenses ⁽¹⁾	(11,042)	(11,884)	842
Other non-interest expenses ⁽²⁾	(339)	(354)	15
Loss before federal income taxes	(6,469)	(11,596)	5,127
Benefit (provision) for federal income taxes	(2)	67	(69)
Net loss	(6,471)	(11,529)	5,058
Less: Net income attributable to the noncontrolling interest		(1)	1
Net loss attributable to Fannie Mae	\$ (6,471)	\$ (11,530)	\$ 5,059

(1) Consists of provision for loan losses, reserve for guaranty losses, and foreclosed property income (expense).

(2) Consists of debt extinguishment losses, net and other expenses.

Net Interest Income

Table 7 presents an analysis of our net interest income, average balances, and related yields earned on assets and incurred on liabilities for the periods indicated. For most components of the average balances, we used a daily weighted average of amortized cost. When daily average balance information was not available, such as for mortgage loans, we used monthly averages. Table 8 presents the change in our net interest income between periods and the extent to which that variance is attributable to: (1) changes in the volume of our interest-earning assets and interest-bearing liabilities or (2) changes in the interest rates of these assets and liabilities. In the fourth quarter of 2010, we changed the presentation to distinguish the change in net interest income of Fannie Mae from the change in net interest income of consolidated trusts. We have revised the presentation of results for prior periods to conform to the current period presentation.

Table of Contents**Table 7: Analysis of Net Interest Income and Yield**

	For the Three Months Ended March 31,					
	Average Balance	2011 Interest Income/ Expense	Average Rates Earned/Paid	Average Balance	2010 Interest Income/ Expense	Average Rates Earned/Paid
	(Dollars in millions)					
Interest-earning assets:						
Mortgage loans of Fannie Mae ⁽¹⁾	\$ 405,820	\$ 3,725	3.67%	\$ 276,346	\$ 3,298	4.77%
Mortgage loans of consolidated trusts ⁽¹⁾	2,598,508	31,865	4.91	2,713,611	34,321	5.06
Total mortgage loans	3,004,328	35,590	4.74	2,989,957	37,619	5.03
Mortgage-related securities	334,057	4,245	5.08	435,754	5,550	5.09
Elimination of Fannie Mae MBS held in portfolio	(214,370)	(2,793)	5.21	(286,701)	(3,799)	5.30
Total mortgage-related securities, net	119,687	1,452	4.85	149,053	1,751	4.70
Non-mortgage securities ⁽²⁾	79,719	45	0.23	66,860	37	0.22
Federal funds sold and securities purchased under agreements to resell or similar arrangements	13,743	7	0.20	40,061	21	0.21
Advances to lenders	4,089	21	2.05	2,512	18	2.87
Total interest-earning assets	\$ 3,221,566	\$ 37,115	4.61%	\$ 3,248,443	\$ 39,446	4.86%
Interest-bearing liabilities:						
Short-term debt ⁽³⁾	\$ 138,848	\$ 104	0.30%	\$ 185,042	\$ 116	0.25%
Long-term debt	631,917	4,196	2.66	564,875	5,081	3.60
Total short-term and long-term funding debt	770,765	4,300	2.23	749,917	5,197	2.77
Debt securities of consolidated trusts	2,652,024	30,648	4.62	2,758,387	35,259	5.11
Elimination of Fannie Mae MBS held in portfolio	(214,370)	(2,793)	5.21	(286,701)	(3,799)	5.30
Total debt securities of consolidated trusts held by third parties	2,437,654	27,855	4.57	2,471,686	31,460	5.09

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Total interest-bearing liabilities	\$ 3,208,419	\$ 32,155	4.01%	\$ 3,221,603	\$ 36,657	4.55%
Impact of net non-interest bearing funding	\$ 13,147		0.02%	\$ 26,840		0.03%
Net interest income/net interest yield		\$ 4,960	0.62%		\$ 2,789	0.34%
Net interest income/net interest yield of consolidated trusts ⁽⁴⁾		\$ 1,217	0.19%		\$ (938)	(0.14)%
Selected benchmark interest rates at end of period:⁽⁵⁾						
3-month LIBOR			0.30%			0.29%
2-year swap interest rate			1.00			1.19
5-year swap interest rate			2.47			2.73
30-year Fannie Mae MBS par coupon rate			4.30			4.51

(1) Interest income includes interest income on acquired credit-impaired loans of \$486 million and \$587 million for the three months ended March 31, 2011 and 2010, respectively. These amounts include accretion income of \$231 million and \$266 million for the three months ended March 31, 2011 and 2010, respectively, relating to a portion of the fair value losses recorded upon the acquisition of the loans. Average balance includes loans on nonaccrual status, for which interest income is recognized when collected.

(2) Includes cash equivalents.

(3) Includes federal funds purchased and securities sold under agreements to repurchase.

(4) Net interest income of consolidated trusts represents interest income from mortgage loans of consolidated trusts less interest expense from debt securities of consolidated trusts. Net interest yield is calculated based on net interest income from consolidated trusts divided by average balance of mortgage loans of consolidated trusts.

(5) Data from British Bankers Association, Thomson Reuters Indices and Bloomberg.

Table of Contents**Table 8: Rate/Volume Analysis of Changes in Net Interest Income**

	For the Three Months Ended March 31, 2011 vs. 2010		
	Total Variance	Variance Due to:⁽¹⁾ Volume Rate	
	(Dollars in millions)		
Interest income:			
Mortgage loans of Fannie Mae	\$ 427	\$ 1,306	\$ (879)
Mortgage loans of consolidated trusts	(2,456)	(1,430)	(1,026)
Total mortgage loans	(2,029)	(124)	(1,905)
Mortgage-related securities	(1,305)	(1,292)	(13)
Elimination of Fannie Mae MBS held in portfolio	1,006	943	63
Total mortgage-related securities, net	(299)	(349)	50
Non-mortgage securities ⁽²⁾	8	7	1
Federal funds sold and securities purchased under agreements to resell or similar arrangements	(14)	(13)	(1)
Advances to lenders	3	9	(6)
Total interest income	(2,331)	(470)	(1,861)
Interest expense:			
Short-term debt	(12)	(32)	20
Long-term debt	(885)	554	(1,439)
Total short-term and long-term funding debt	(897)	522	(1,419)
Debt securities of consolidated trusts	(4,611)	(1,322)	(3,289)
Elimination of Fannie Mae MBS held in portfolio	1,006	943	63
Total debt securities of consolidated trusts held by third parties	(3,605)	(379)	(3,226)
Total interest expense	(4,502)	143	(4,645)
Net interest income	\$ 2,171	\$ (613)	\$ 2,784

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

⁽²⁾ Includes cash equivalents.

Net interest income increased in the first quarter of 2011, as compared with the first quarter of 2010, due to lower interest expense on debt, which was partially offset by lower interest income on loans and securities. The primary

drivers of this change were:

a reduction in the interest expense on debt of consolidated trusts as we purchased the majority of delinquent loans from our MBS trusts after the first quarter of 2010;

lower interest expense on funding debt as lower borrowing rates allowed us to replace higher-cost debt with lower-cost debt;

a decrease in volume of our mortgage securities, as we continue to manage our portfolio requirements; and

lower yields on mortgage loans as new business acquisitions continue to replace higher-yielding loans with loans issued at lower mortgage rates. The reduction in interest income on loans from lower yields was partially offset by a reduction in the amount of interest income not recognized for nonaccrual mortgage loans, due to a decline in the balance of nonaccrual loans on our condensed consolidated balance sheets as we continue to complete a high number of loan modifications and foreclosures.

For the first quarter of 2011, interest income that we did not recognize for nonaccrual mortgage loans, net of recoveries, was \$1.6 billion, which resulted in a 20 basis point reduction in net interest yield, compared with \$2.7 billion for the first quarter of 2010, which resulted in a 33 basis point reduction in net interest yield. Of

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the \$1.6 billion of interest income that we did not recognize for nonaccrual mortgage loans for the first quarter of 2011, \$1.4 billion was related to the unsecuritized mortgage loans that we owned during the period. Of the \$2.7 billion of interest income that we did not recognize for nonaccrual mortgage loans for the first quarter of 2010, \$566 million was related to the unsecuritized mortgage loans that we own.

For a discussion of the interest income from the assets we have purchased and the interest expense from the debt we have issued, see the discussion of our Capital Markets group's net interest income in Business Segment Results.

Fair Value Gains (Losses), Net

Table 9 presents the components of our fair value gains and losses.

Table 9: Fair Value Gains (Losses), Net

	For the Three Months Ended March 31, 2011 2010 (Dollars in millions)	
Risk management derivatives fair value gains (losses) attributable to:		
Net contractual interest expense accruals on interest rate swaps	\$ (635)	\$ (835)
Net change in fair value during the period	751	(1,326)
Total risk management derivatives fair value gains (losses), net	116	(2,161)
Mortgage commitment derivatives fair value gains (losses), net	23	(601)
Total derivatives fair value gains (losses), net	139	(2,762)
Trading securities gains, net	225	1,058
Other	(75)	(1)
Fair value gains (losses), net	\$ 289	\$ (1,705)
	2011	2010
5-year swap interest rate:		
As of January 1	2.18%	2.98%
As of March 31	2.47	2.73

Risk Management Derivatives Fair Value Gains (Losses), Net

We supplement our issuance of debt securities with derivative instruments to further reduce duration and prepayment risks. We recorded risk management derivative fair value gains in the first quarter of 2011 primarily as a result of an increase in the fair value of our pay-fixed derivatives due to an increase in swap interest rates during the first quarter of 2011, which was partially offset by fair value losses due to time decay on our purchased options.

We recorded risk management derivative losses in the first quarter of 2010 as a result of: (1) a decrease in implied interest rate volatility, which reduced the fair value of our purchased options; (2) a decrease in the fair value of our pay-fixed derivatives due to a decline in swap interest rates; and (3) time decay on our purchased options.

We present, by derivative instrument type, the fair value gains and losses on our derivatives for the three months ended March 31, 2011 and 2010 in Note 9, Derivative Instruments.

Mortgage Commitment Derivatives Fair Value Gains (Losses), Net

Commitments to purchase or sell some mortgage-related securities and to purchase single-family mortgage loans are generally accounted for as derivatives. For open mortgage commitment derivatives, we include

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changes in their fair value in our condensed consolidated statements of operations and comprehensive loss. When derivative purchase commitments settle, we include the fair value of the commitment on the settlement date in the cost basis of the loan or security we purchase. When derivative commitments to sell securities settle, we include the fair value of the commitment on the settlement date in the cost basis of the security we sell. Purchases of securities issued by our consolidated MBS trusts are treated as extinguishments of debt; we recognize the fair value of the commitment on the settlement date as a component of debt extinguishment gains and losses. Sales of securities issued by our consolidated MBS trusts are treated as issuances of consolidated debt; we recognize the fair value of the commitment on the settlement date as a component of debt in the cost basis of the debt issued.

We recognized gains on our mortgage commitments in the first quarter of 2011 primarily due to gains on commitments to sell mortgage-related securities as a result of a decrease in prices as interest rates increased during the commitment period.

We recognized losses on our mortgage commitments in the first quarter of 2010 primarily due to losses on commitments to sell mortgage-related securities as a result of an increase in prices as interest rates decreased during the commitment period.

Trading Securities Gains (Losses), Net

The gains from our trading securities in the first quarter of 2011 and 2010 were primarily driven by the narrowing of credit spreads on commercial mortgage-backed securities (CMBS); gains in the first quarter of 2010 were also driven by a decrease in interest rates.

Credit-Related Expenses

We refer to our provision for loan losses and the provision for guaranty losses collectively as our provision for credit losses. Credit-related expenses consist of our provision for credit losses and foreclosed property expense.

Provision for Credit Losses

Our total loss reserves provide for an estimate of credit losses incurred in our guaranty book of business as of each balance sheet date. We establish our loss reserves through the provision for credit losses for losses that we believe have been incurred and will eventually be reflected over time in our charge-offs. When we determine that a loan is uncollectible, typically upon foreclosure, we record a charge-off against our loss reserves. We record recoveries of previously charged-off amounts as a reduction to charge-offs, which results in an increase to our loss reserves.

Table 10 displays the components of our total loss reserves and our total fair value losses previously recognized on loans purchased out of MBS trusts reflected in our condensed consolidated balance sheets. Because these fair value losses lowered our recorded loan balances, we have fewer inherent losses in our guaranty book of business and consequently require lower total loss reserves. For these reasons, we consider these fair value losses as an effective reserve, apart from our total loss reserves, to the extent that we expect to realize credit losses on the acquired loans in the future. We estimate that approximately two-thirds of this amount, as of March 31, 2011, represents credit losses we expect to realize in the future and approximately one-third will eventually be recovered through our condensed consolidated statements of operations and comprehensive loss, primarily as net interest income if the loan cures or as foreclosed property income if the sale of the collateral exceeds the recorded investment in the credit-impaired loan. How much of these fair value losses we expect to realize as credit losses depends primarily on home prices and loss severity. We exclude these fair value losses from our credit loss calculation as described in Credit Loss Performance Metrics.

Table of Contents**Table 10: Total Loss Reserves**

	March 31, 2011	As of December 31, 2010
	(Dollars in millions)	
Allowance for loan losses	\$ 67,557	\$ 61,556
Reserve for guaranty losses ⁽¹⁾	257	323
Combined loss reserves	67,814	61,879
Allowance for accrued interest receivable	2,930	3,414
Allowance for preforeclosure property taxes and insurance receivable ⁽²⁾	1,356	958
Total loss reserves	72,100	66,251
Fair value losses previously recognized on acquired credit impaired loans ⁽³⁾	18,457	19,171
Total loss reserves and fair value losses previously recognized on acquired credit-impaired loans	\$ 90,557	\$ 85,422

(1) Amount included in Other liabilities in our condensed consolidated balance sheets.

(2) Amount included in Other assets in our condensed consolidated balance sheets.

(3) Represents the fair value losses on loans purchased out of MBS trusts reflected in our condensed consolidated balance sheets.

We refer to our allowance for loan losses and reserve for guaranty losses collectively as our combined loss reserves. We summarize the changes in our combined loss reserves in Table 11.

Table of Contents**Table 11: Allowance for Loan Losses and Reserve for Guaranty Losses (Combined Loss Reserves)**

	For the Three Months Ended March 31,					
	Of Fannie Mae	2011 Of Consolidated Trusts	Total	Of Fannie Mae	2010 Of Consolidated Trusts	Total
	(Dollars in millions)					
Changes in combined loss reserves:						
Allowance for loan losses:						
Beginning balance	\$ 48,530	\$ 13,026	\$ 61,556	\$ 8,078	\$ 1,847	\$ 9,925
Adoption of new accounting standards					43,576	43,576
Provision for loan losses	7,159	3,428	10,587	6,271	5,668	11,939
Charge-offs ⁽¹⁾	(5,705)	(448)	(6,153)	(1,705)	(3,455)	(5,160)
Recoveries	530	952	1,482	97	277	374
Transfers ⁽²⁾	3,207	(3,207)		13,855	(13,855)	
Net reclassifications ⁽³⁾	(13)	98	85	(921)	836	(85)
Ending balance ⁽⁴⁾	\$ 53,708	\$ 13,849	\$ 67,557	\$ 25,675	\$ 34,894	\$ 60,569
Reserve for guaranty losses:						
Beginning balance	\$ 323	\$	\$ 323	\$ 54,430	\$	\$ 54,430
Adoption of new accounting standards				(54,103)		(54,103)
Benefit for guaranty losses	(33)		(33)	(36)		(36)
Charge-offs	(35)		(35)	(61)		(61)
Recoveries	2		2	3		3
Ending balance	\$ 257	\$	\$ 257	\$ 233	\$	\$ 233
Combined loss reserves:						
Beginning balance	\$ 48,853	\$ 13,026	\$ 61,879	\$ 62,508	\$ 1,847	\$ 64,355
Adoption of new accounting standards				(54,103)	43,576	(10,527)
Total provision for credit losses	7,126	3,428	10,554	6,235	5,668	11,903
Charge-offs ⁽¹⁾	(5,740)	(448)	(6,188)	(1,766)	(3,455)	(5,221)
Recoveries	532	952	1,484	100	277	377
Transfers ⁽²⁾	3,207	(3,207)		13,855	(13,855)	
Net reclassifications ⁽³⁾	(13)	98	85	(921)	836	(85)
Ending balance ⁽⁴⁾	\$ 53,965	\$ 13,849	\$ 67,814	\$ 25,908	\$ 34,894	\$ 60,802

	March 31, 2011	As of December 31, 2010
Allocation of combined loss reserves:		
Balance at end of each period attributable to:		
Single-family	\$ 66,240	\$ 60,163
Multifamily	1,574	1,716
Total	\$ 67,814	\$ 61,879
Single-family and multifamily combined loss reserves as a percentage of applicable guaranty book of business:		
Single-family	2.29%	2.10%
Multifamily	0.83	0.91
Combined loss reserves as a percentage of:		
Total guaranty book of business	2.20%	2.03%
Total nonperforming loans	32.60	28.81

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- (1) Includes accrued interest of \$386 million and \$579 million for the three months ended March 31, 2011 and 2010, respectively.
- (2) Includes transfers from trusts for delinquent loan purchases.
- (3) Represents reclassification of amounts recorded in provision for loan losses and charge-offs that relate to allowances for accrued interest receivable and preforeclosure property taxes and insurance receivable from borrowers.
- (4) Includes \$412 million and \$903 million as of March 31, 2011 and 2010, respectively, for acquired credit-impaired loans.

The continued stress on a broad segment of borrowers from continued high levels of unemployment and underemployment and the prolonged decline in home prices have caused our total loss reserves to remain high for the past several quarters. Our total loss reserves increased in the first quarter of 2011 due to: (1) a decline in home prices and increase in initial charge-off severity during the period, (2) the number of loans that entered a trial modification period during the quarter, (3) a decline in future expected home prices and (4) loans continuing to remain delinquent for an extended period of time. Our provision for credit losses decreased in the first quarter of 2011 compared with the first quarter of 2010, primarily because our total loss reserves increased less in the first quarter of 2011 than in the first quarter of 2010.

Because of the substantial volume of loan modifications we completed and the number of loans that entered a trial modification period in 2010 and the first quarter of 2011, more than half of our total loss reserves is attributable to individual impairment rather than the collective reserve for loan losses. Individual impairment for a troubled debt restructuring (TDR) is based on the restructured loan s expected cash flows over the life of the loan, taking into account the effect of any concessions granted to the borrower, discounted at the loan s original effective interest rate. The model includes forward-looking assumptions using multiple scenarios of the future economic environment, including interest rates and home prices. Based on the structure of the modifications, in particular the size of the concession granted, and the performance of modified loans combined with the forward-looking assumptions used in our model, the allowance calculated for an individually impaired loan has generally been greater than the allowance that would be calculated under the collective reserve. Further, if we expect to recover our recorded investment in an individually impaired loan through probable foreclosure of the underlying collateral, we measure the impairment based on the fair value of the collateral. The loss reserve for a greater portion of our population of individually impaired loans was based on the fair value of the underlying collateral as of March 31, 2011 than as of March 31, 2010.

Additionally, while delinquency rates on loans in our single-family guaranty book of business have decreased, borrowers inability or unwillingness to make their mortgage payments, along with delays in foreclosures, continue to cause loans to remain seriously delinquent for an extended period of time as shown in Table 35: Delinquency Status of Single-Family Conventional Loans.

For additional discussion of our loan workout activities, delinquent loans and concentrations, see Risk Management Credit Risk Management Single-Family Mortgage Credit Risk Management Problem Loan Management. For a discussion of our charge-offs, see Credit Loss Performance Metrics.

Our balance of nonperforming single-family loans remained high as of March 31, 2011 due to both high levels of delinquencies and an increase in TDRs. When a TDR is executed, the loan status becomes current, but the loan will continue to be classified as a nonperforming loan as the loan is not performing in accordance with the original terms.

The composition of our nonperforming loans is shown in Table 12. For information on the impact of TDRs and other individually impaired loans on our allowance for loan losses, see Note 3, Mortgage Loans.

Table of Contents**Table 12: Nonperforming Single-Family and Multifamily Loans**

	As of	
	March 31, 2011	December 31, 2010
	(Dollars in millions)	
On-balance sheet nonperforming loans including loans in consolidated Fannie Mae MBS trusts:		
Nonaccrual loans	\$ 141,623	\$ 152,756
Troubled debt restructurings on accrual status ⁽¹⁾	66,342	61,907
Total on-balance sheet nonperforming loans	207,965	214,663
Off-balance sheet nonperforming loans in unconsolidated Fannie Mae MBS trusts ⁽²⁾	83	89
Total nonperforming loans	\$ 208,048	\$ 214,752
Accruing on-balance sheet loans past due 90 days or more ⁽³⁾	\$ 850	\$ 896

	For the Three Months Ended March 31, 2011	For The Year Ended December 31, 2010
	(Dollars in millions)	
Interest related to on-balance sheet nonperforming loans:		
Interest income forgone ⁽⁴⁾	\$ 2,827	\$ 8,185
Interest income recognized for the period ⁽⁵⁾	1,388	7,995

(1) Includes HomeSaver Advance first-lien loans on accrual status.

(2) Represents loans that would meet our criteria for nonaccrual status if the loans had been on-balance sheet. Includes HomeSaver Advance first-lien loans.

(3) Recorded investment in loans as of the end of each period that are 90 days or more past due and continuing to accrue interest. The majority of this amount consists of loans insured or guaranteed by the U.S. government and loans where we have recourse against the seller in the event of a default.

(4) Represents the amount of interest income that would have been recorded during the period for on-balance sheet nonperforming loans as of the end of each period had the loans performed according to their original contractual terms.

- (5) Represents interest income recognized during the period based on stated coupon rate for on-balance sheet loans classified as nonperforming as of the end of each period. Includes primarily amounts accrued while loan was performing and cash payments received on nonaccrual loans.

Foreclosed Property Expense (Income)

The shift to foreclosed property expense during the first quarter of 2011 from foreclosed property income during the first quarter of 2010 was primarily due to higher REO inventory as of March 31, 2011 compared with March 31, 2010 and an increase in valuation adjustments that reduced the value of our REO inventory. The foreclosed property income in the first quarter of 2010 was primarily due to the recognition of \$562 million in fees from the cancellation and restructuring of some of our mortgage insurance coverage; there were no such fees recognized in the first quarter of 2011. These fees represented an acceleration of, and discount on, claims to be paid pursuant to the coverage in order to reduce our future exposure to our mortgage insurers.

Credit Loss Performance Metrics

Our credit-related expenses should be considered in conjunction with our credit loss performance. Our credit loss performance metrics, however, are not defined terms within GAAP and may not be calculated in the same manner as similarly titled measures reported by other companies. Because management does not view changes in the fair value of our mortgage loans as credit losses, we adjust our credit loss performance metrics for the impact associated with the acquisition of credit-impaired loans. We also exclude interest forgone on nonperforming loans in our mortgage portfolio, other-than-temporary impairment losses resulting from

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deterioration in the credit quality of our mortgage-related securities and accretion of interest income on acquired credit-impaired loans from credit losses.

Historically, management viewed our credit loss performance metrics, which include our historical credit losses and our credit loss ratio, as indicators of the effectiveness of our credit risk management strategies. As our credit losses are now at such high levels, management has shifted focus to our loss mitigation strategies and the reduction of our total credit losses and away from the credit loss ratio to measure performance. However, we believe that credit loss performance metrics may be useful to investors as the losses are presented as a percentage of our book of business and have historically been used by analysts, investors and other companies within the financial services industry. They also provide a consistent treatment of credit losses for on- and off-balance sheet loans. Moreover, by presenting credit losses with and without the effect of fair value losses associated with the acquisition of credit-impaired loans, investors are able to evaluate our credit performance on a more consistent basis among periods. Table 13 details the components of our credit loss performance metrics as well as our average single-family and multifamily default rate and initial charge-off severity rate.

Table 13: Credit Loss Performance Metrics

	For the Three Months Ended March 31, 2011		2010	
	Amount	Ratio ⁽¹⁾	Amount	Ratio ⁽¹⁾
	(Dollars in millions)			
Charge-offs, net of recoveries ⁽²⁾	\$ 4,704	61.2bp	\$ 4,844	62.9bp
Foreclosed property (income) expense ⁽²⁾	488	6.4	(19)	(0.2)
Credit losses including the effect of fair value losses on acquired credit-impaired loans	5,192	67.6	4,825	62.7
Less: Fair value losses resulting from acquired credit-impaired loans	(31)	(0.4)	(58)	(0.8)
Plus: Impact of acquired credit-impaired loans on charge-offs and foreclosed property expense	525	6.9	380	4.9
Credit losses and credit loss ratio	\$ 5,686	74.1bp	\$ 5,147	66.8bp
Credit losses attributable to:				
Single-family	\$ 5,604		\$ 5,062	
Multifamily	82		85	
Total	\$ 5,686		\$ 5,147	
Average single-family default rate		0.44%		0.46%
Average single-family initial charge-off severity rate ⁽³⁾		35.93%		35.40%
Average multifamily default rate		0.12%		0.09%
Average multifamily initial charge-off severity rate ⁽³⁾		36.85%		40.25%

(1)

Basis points are based on the annualized amount for each line item presented divided by the average guaranty book of business during the period.

- (2) In the first quarter of 2011, expenses relating to preforeclosure taxes and insurance were recorded as charge-offs. These expenses were recorded as foreclosed property expense in the first quarter of 2010. The impact of including these costs in charge-offs for the first quarter of 2011 was 5.7 basis points.
- (3) Single-family and multifamily rates exclude fair value losses on credit-impaired loans acquired from MBS trusts and any costs, gains or losses associated with REO after initial acquisition through final disposition; single-family rate excludes charge-offs from preforeclosure sales.

The increase in our credit losses is primarily due to an increase in foreclosed property expense. During the first quarter of 2010, we recognized \$562 million of fees from the cancellation and restructuring of some of our mortgage insurance as a reduction to foreclosed property expense; no such fees were received in the first quarter of 2011. In addition, while defaults remain high, defaults in the first quarter of 2011 were lower than

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they would have been due to delays caused by the servicer foreclosure process deficiencies and the resulting foreclosure pause.

Our 2009, 2010 and first quarter of 2011 vintages accounted for approximately 1% of our single-family credit losses for the first quarter of 2011. Typically, credit losses on mortgage loans do not peak until the third through fifth years following origination. We provide more detailed credit performance information, including serious delinquency rates by geographic region, statistics on nonperforming loans and foreclosure activity in Risk Management Credit Risk Management Mortgage Credit Risk Management.

Regulatory Hypothetical Stress Test Scenario

Under a September 2005 agreement with FHFA's predecessor, the Office of Federal Housing Enterprise Oversight, we are required to disclose on a quarterly basis the present value of the change in future expected credit losses from our existing single-family guaranty book of business from an immediate 5% decline in single-family home prices for the entire United States. Although other provisions of the September 2005 agreement were suspended in March 2009 by FHFA until further notice, this disclosure requirement was not suspended. For purposes of this calculation, we assume that, after the initial 5% shock, home price growth rates return to the average of the possible growth rate paths used in our internal credit pricing models. The sensitivity results represent the difference between future expected credit losses under our base case scenario, which is derived from our internal home price path forecast, and a scenario that assumes an instantaneous nationwide 5% decline in home prices.

Table 14 compares the credit loss sensitivities for the periods indicated for first lien single-family whole loans we own or that back Fannie Mae MBS, before and after consideration of projected credit risk sharing proceeds, such as private mortgage insurance claims and other credit enhancements.

Table 14: Single-Family Credit Loss Sensitivity⁽¹⁾

	As of	
	March 31, 2011	December 31, 2010
	(Dollars in millions)	
Gross single-family credit loss sensitivity	\$ 26,774	\$ 25,937
Less: Projected credit risk sharing proceeds	(2,581)	(2,771)
Net single-family credit loss sensitivity	\$ 24,193	\$ 23,166
Outstanding single-family whole loans and Fannie Mae MBS	\$ 2,815,575	\$ 2,782,512
Single-family net credit loss sensitivity as a percentage of outstanding single-family whole loans and Fannie Mae MBS	0.86%	0.83%

⁽¹⁾ Represents total economic credit losses, which consist of credit losses and forgone interest. Calculations are based on 97% of our total single-family guaranty book of business as of both March 31, 2011 and December 31, 2010. The mortgage loans and mortgage-related securities that are included in these estimates consist of: (a) single-family Fannie Mae MBS (whether held in our mortgage portfolio or held by third parties), excluding certain whole loan REMICs and private-label wraps; (b) single-family mortgage loans, excluding mortgages secured only by second liens, subprime mortgages, manufactured housing chattel loans and reverse mortgages;

and (c) long-term standby commitments. We expect the inclusion in our estimates of the excluded products may impact the estimated sensitivities set forth in this table.

Because these sensitivities represent hypothetical scenarios, they should be used with caution. Our regulatory stress test scenario is limited in that it assumes an instantaneous uniform 5% nationwide decline in home prices, which is not representative of the historical pattern of changes in home prices. Changes in home prices generally vary on a regional, as well as a local, basis. In addition, these stress test scenarios are calculated independently without considering changes in other interrelated assumptions, such as unemployment rates or other economic factors, which are likely to have a significant impact on our future expected credit losses.

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Financial Impact of the Making Home Affordable Program on Fannie Mae

Home Affordable Refinance Program

Because we already own or guarantee the original mortgages that we refinance under HARP, our expenses under that program consist mostly of limited administrative costs.

Home Affordable Modification Program

We incurred impairments related to loans that had entered a trial modification under the Home Affordable Modification Program (HAMP) of \$2.7 billion during the first quarter of 2011 compared with \$7.6 billion during the first quarter of 2010. These include impairments on loans that entered into a trial modification under the program but that have not yet received, or that have been determined to be ineligible for, a permanent modification under the program. These impairments have been included in the calculation of our provision for loan losses in our condensed consolidated results of operations and comprehensive loss. The impairments do not include the reduction in our collective loss reserves which occurred as a result of beginning to individually assess the loan for impairment upon entering a trial modification. Please see MD&A Consolidated Results of Operations Financial Impact of the Making Home Affordable Program on Fannie Mae in our 2010 Form 10-K for a detailed discussion on these impairments.

We paid or accrued incentive fees for servicers of \$80 million during the first quarter of 2011 compared with \$68 million during the first quarter of 2010. These fees were related to loans modified under HAMP, which we recorded as part of Other expenses. Borrower incentive payments are included in the calculation of our allowance for loan losses for individually impaired loans. Additionally, our expenses under HAMP also include administrative costs.

Overall Impact of the Making Home Affordable Program

Because of the unprecedented nature of the circumstances that led to the Making Home Affordable Program, we cannot quantify what the impact would have been on Fannie Mae if the Making Home Affordable Program had not been introduced. We do not know how many loans we would have modified under alternative programs, what the terms or costs of those modifications would have been, how many foreclosures would have resulted nationwide, and at what pace, or the impact on housing prices if the program had not been put in place. As a result, the amounts we discuss above are not intended to measure how much the program is costing us in comparison to what it would have cost us if we did not have the program at all.

BUSINESS SEGMENT RESULTS

Results of our three business segments are intended to reflect each segment as if it were a stand-alone business. Under our segment reporting structure, the sum of the results for our three business segments does not equal our condensed consolidated results of operations as we separate the activity related to our consolidated trusts from the results generated by our three segments. In addition, because we apply accounting methods that differ from our condensed consolidated results for segment reporting purposes, we include an eliminations/adjustments category to reconcile our business segment results and the activity related to our consolidated trusts to our condensed consolidated results of operations. We describe the management reporting and allocation process used to generate our segment results in our 2010 Form 10-K in Notes to Consolidated Financial Statements Note 15, Segment Reporting. We are working on reorganizing our company by function rather than by business in order to improve our operational efficiencies and effectiveness. When we begin operating under a functional structure, we may change some of our management reporting and how we report our business segment results.

In this section, we summarize our segment results for the first quarters of 2011 and 2010 in the tables below and provide a comparative discussion of these results. This section should be read together with our comparative discussion of our condensed consolidated results of operations in Consolidated Results of Operations. See Note 10, Segment Reporting of this report for a reconciliation of our segment results to our condensed consolidated results.

Table of Contents**Single-Family Business Results**

Table 15 summarizes the financial results of our Single-Family business for the periods indicated. The primary sources of revenue for our Single-Family business are guaranty fee income and fee and other income. Expenses primarily include credit-related expenses, net interest expense and administrative expenses.

Table 15: Single-Family Business Results

	For the Three Months Ended March 31,		
	2011	2010	Variance
	(Dollars in millions)		
Statement of operations data:⁽¹⁾			
Net interest expense	\$ (898)	\$ (1,945)	\$ 1,047
Guaranty fee income ⁽²⁾	1,871	1,768	103
Credit-related expenses ⁽³⁾	(11,106)	(11,926)	820
Other expenses ⁽⁴⁾	(586)	(513)	(73)
Loss before federal income taxes	(10,719)	(12,616)	1,897
Benefit (provision) for federal income taxes	(2)	51	(53)
Net loss attributable to Fannie Mae	\$ (10,721)	\$ (12,565)	\$ 1,844
Other key performance data:			
Single-family effective guaranty fee rate (in basis points) ⁽⁵⁾	26.0	24.4	
Single-family average charged guaranty fee on new acquisitions (in basis points) ⁽⁶⁾	26.1	26.9	
Average single-family guaranty book of business ⁽⁷⁾	\$ 2,881,300	\$ 2,893,988	
Single-family Fannie Mae MBS issues ⁽⁸⁾	\$ 166,673	\$ 124,358	

(1) Certain prior period amounts have been reclassified to conform to the current period presentation.

(2) Guaranty fee income is included in fee and other income in our condensed consolidated statements of operations and comprehensive loss.

(3) Consists of the provision for loan losses, provision for guaranty losses and foreclosed property income or expense.

(4) Consists of investment gains and losses, fee and other income, administrative expenses and other expenses.

(5) Calculated based on annualized Single-Family segment guaranty fee income divided by the average single-family guaranty book of business, expressed in basis points.

(6) Calculated based on the average contractual fee rate for our single-family guaranty arrangements entered into during the period plus the recognition of any upfront cash payments ratably over an estimated average life, expressed in basis points.

- (7) Consists of single-family mortgage loans held in our mortgage portfolio, single-family mortgage loans held by consolidated trusts, single-family Fannie Mae MBS issued from unconsolidated trusts held by either third parties or within our retained portfolio, and other credit enhancements that we provide on single-family mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty.
- (8) Reflects unpaid principal balance of Fannie Mae MBS issued and guaranteed by the Single-Family segment during the period. The three months ended March 31, 2010 includes Housing Finance Agency (HFA) new issue bond program issuances of \$3.1 billion. There were no HFA new issue bond program issuances in 2011.

Net Interest Expense

Net interest expense for the Single-Family business segment includes: (1) the cost to reimburse the Capital Markets group for interest income not recognized for loans in our mortgage portfolio on nonaccrual status; (2) the cost to reimburse MBS trusts for interest income not recognized for loans in consolidated trusts on nonaccrual status; (3) cash payments received on loans that have been placed on nonaccrual status; and (4) an allocated cost of capital charge among our three business segments. Net interest expense decreased in the first quarter of 2011 compared with the first quarter of 2010 primarily due to a significant decrease in interest

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income not recognized for loans on nonaccrual status because of a decline in the number of loans on nonaccrual status.

Guaranty Fee Income

Guaranty fee income increased in the first quarter of 2011 compared with the first quarter of 2010 due to an increase in the amortization of risk-based pricing adjustments.

Our average single-family guaranty book of business was relatively flat period over period despite our continued high market share because of the decline in U.S. residential mortgage debt outstanding. There were fewer new mortgage originations due to weakness in the housing market and an increase in liquidations due to the high level of foreclosures. Our estimated market share of new single-family mortgage-related securities issuances, which is based on publicly available data and excludes previously securitized mortgages, remained high at 48.6% for the first quarter of 2011.

Credit-Related Expenses

Single-family credit-related expenses decreased in the first quarter of 2011 compared with the first quarter of 2010, primarily because our total single-family loss reserves increased less in the first quarter of 2011 compared with the first quarter of 2010.

Credit-related expenses and credit losses in the Single-Family business represent the substantial majority of our consolidated totals. We provide additional information on our credit-related expenses in Consolidated Results of Operations Credit-Related Expenses.

Multifamily Business Results

Table 16 summarizes the financial results of our Multifamily business for the periods indicated. The primary sources of revenue for our Multifamily business are guaranty fee income and fee and other income. Expenses and other items that impact income or loss primarily include credit-related expenses, administrative expenses and net operating losses from our partnership investments.

Table of Contents**Table 16: Multifamily Business Results**

	For the Three Months Ended March 31,		
	2011	2010	Variance
	(Dollars in millions)		
Statement of operations data:			
Guaranty fee income ⁽¹⁾	\$ 209	\$ 194	\$ 15
Fee and other income	58	35	23
Losses from partnership investments ⁽²⁾	(12)	(58)	46
Credit-related income ⁽³⁾	64	42	22
Other expenses ⁽⁴⁾	(67)	(101)	34
Income before federal income taxes	252	112	140
Provision for federal income taxes	(5)	(13)	8
Net income attributable to Fannie Mae	\$ 247	\$ 99	\$ 148
Other key performance data:			
Multifamily effective guaranty fee rate (in basis points) ⁽⁵⁾	44.0	41.8	
Credit loss performance ratio (in basis points) ⁽⁶⁾	17.3	18.3	
Average multifamily guaranty book of business ⁽⁷⁾	\$ 190,012	\$ 185,703	
Multifamily new business volumes ⁽⁸⁾	5,024	4,162	
Multifamily units financed from new business volumes ⁽⁹⁾	83,000	61,000	
Fannie Mae multifamily MBS issuances ⁽¹⁰⁾	8,581	4,073	
Fannie Mae multifamily structured securities issuances (issued by Capital Markets group) ⁽¹¹⁾	1,400	1,821	
Additional net interest income earned on Fannie Mae multifamily mortgage loans and MBS (included in Capital Markets Group's results) ⁽¹²⁾	230	205	
Average Fannie Mae multifamily mortgage loans and MBS in Capital Markets Group's portfolio ⁽¹³⁾	114,375	117,709	
		As of	
	March 31,	December 31,	
	2011	2010	
	(Dollars in millions)		
Multifamily serious delinquency rate	0.64%	0.71%	
Percentage of guaranty book of business with credit enhancement	90	89	
Fannie Mae percentage of total multifamily mortgage debt outstanding ⁽¹⁴⁾	20.5	20.1	
Fannie Mae multifamily MBS outstanding ⁽¹⁵⁾	\$ 83,145	\$ 77,251	

(1)

Guaranty fee income is included in fee and other income in our condensed consolidated statements of operations and comprehensive loss.

- (2) Losses from partnership investments is included in other expenses in our condensed consolidated statements of operations and comprehensive loss.
- (3) Consists of the benefit for loan losses, benefit for guaranty losses and foreclosed property expense.
- (4) Consists of net interest income or expense, investment gains, other income or expenses, and administrative expenses.
- (5) Calculated based on annualized Multifamily segment guaranty fee income divided by the average multifamily guaranty book of business, expressed in basis points.
- (6) Calculated based on the annualized credit losses divided by the average multifamily guaranty book of business, expressed in basis points.
- (7) Consists of multifamily mortgage loans held in our mortgage portfolio, multifamily mortgage loans held by consolidated trusts, multifamily Fannie Mae MBS issued from unconsolidated trusts held by either third parties or within our retained portfolio, and other credit enhancements that we provide on multifamily mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty.

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- (8) Reflects unpaid principal balance of Fannie Mae MBS issued (excluding portfolio securitizations) and loans purchased during the period. The three months ended March 31, 2010 includes \$1.0 billion of HFA new issue bond program issuances. There were no HFA new issue bond program issuances for the three months ended March 31, 2011.
- (9) Excludes HFA new issue bond program.
- (10) Reflects unpaid principal balance of Fannie Mae MBS issued during the period. Includes: (a) issuances of new MBS volumes, (b) \$3.5 billion of Fannie Mae portfolio securitization transactions and (c) \$119 million of conversion of adjustable rate loans to fixed rate loans and DMBS securities to MBS securities for the three months ended March 31, 2011. There were no Fannie Mae portfolio securitizations transactions or conversions of adjustable rate loans to fixed rate loans and DMBS securities to MBS securities for the three months ended March 31, 2010.
- (11) Reflects original unpaid principal balance of out-of-portfolio structured securities issuances by our Capital Markets Group.
- (12) Interest expense estimate based on allocated duration matched funding costs. Net interest income was reduced by guaranty fees allocated to Multifamily from the Capital Markets Group on multifamily loans in Fannie Mae's portfolio.
- (13) Based on unpaid principal balance.
- (14) Includes mortgage loans and Fannie Mae MBS issued and guaranteed by the Multifamily segment. Information as of March 31, 2011 is through December 31, 2010 and is based on the Federal Reserve's March 2011 mortgage debt outstanding release, the latest date for which the Federal Reserve has estimated mortgage debt outstanding for multifamily residences. Information as of December 31, 2010 is through September 30, 2010.
- (15) Includes \$23.4 billion and \$19.9 billion of Fannie Mae multifamily MBS held in the mortgage portfolio, the vast majority of which have been consolidated to loans in our condensed consolidated balance sheet, as of March 31, 2011 and December 31, 2010, respectively; and \$1.4 billion of bonds issued by HFAs as of both March 31, 2011 and December 31, 2010.

Guaranty Fee Income

Multifamily guaranty fee income increased in the first quarter of 2011 compared with the first quarter of 2010 primarily due to higher fees charged on new acquisitions in recent years. New acquisitions with higher guaranty fees have become an increasingly large part of our book of business.

Credit-Related Income

Multifamily credit-related income increased in the first quarter of 2011 compared with the first quarter of 2010 primarily due to a modest decrease in the allowance for loan losses as the multifamily sector continued to show improvement.

Multifamily credit losses were relatively flat period over period at \$82 million in the first quarter of 2011 compared with \$85 million in the first quarter of 2010. While national multifamily market fundamentals improved during the first quarter of 2011, certain local markets and properties continue to exhibit weak fundamentals. As a result, we may

continue to experience losses commensurate with 2010 levels for the remainder of 2011 despite generally improving market fundamentals.

Capital Markets Group Results

Table 17 summarizes the financial results of our Capital Markets group for the periods indicated. Following the table we discuss the Capital Markets group's financial results and describe the Capital Markets group's mortgage portfolio. For a discussion on the debt issued by the Capital Markets group to fund its investment activities, see Liquidity and Capital Management. For a discussion on the derivative instruments that Capital Markets uses to manage interest rate risk, see Consolidated Balance Sheet Analysis Derivative Instruments in this report and Risk Management Market Risk Management, Including Interest Rate Risk Management Derivative Instruments and Notes to Consolidated Financial Statements Note 10, Derivative Instruments and Hedging Activities in our 2010 Form 10-K. The primary sources of revenue for our Capital Markets group are net interest income and fee and other income. Expenses and other items that impact income or loss primarily include fair value gains and losses, investment gains and losses, allocated guaranty fee expense, other-than-temporary impairment and administrative expenses.

Table of Contents**Table 17: Capital Markets Group Results**

	For the Three Months Ended March 31,		
	2011	2010	Variance
	(Dollars in millions)		
Statement of operations data:			
Net interest income ⁽¹⁾	\$ 3,710	\$ 3,057	\$ 653
Investment gains, net ⁽²⁾	870	792	78
Net other-than-temporary impairments	(44)	(236)	192
Fair value gains (losses), net ⁽³⁾	218	(1,186)	1,404
Fee and other income	75	104	(29)
Other expenses ⁽⁴⁾	(553)	(423)	(130)
Income before federal income taxes	4,276	2,108	2,168
Benefit for federal income taxes	5	29	(24)
Net income attributable to Fannie Mae	\$ 4,281	\$ 2,137	\$ 2,144

(1) Includes \$2.0 billion and \$795 million of contractual interest, excluding recoveries, on nonaccrual loans received from the Single-Family segment for the three months ended March 31, 2011 and 2010, respectively. Capital Markets net interest income is reported based on the mortgage-related assets held in the segment's portfolio and excludes interest income on mortgage-related assets held by consolidated MBS trusts that are owned by third parties and the interest expense on the corresponding debt of such trusts.

(2) We include the securities that we own regardless of whether the trust has been consolidated in reporting of gains and losses on securitizations and sales of available-for-sale securities.

(3) Fair value gains or losses on trading securities include the trading securities that we own, regardless of whether the trust has been consolidated.

(4) Includes allocated guaranty fee expense, debt extinguishment gains or losses, net, administrative expenses, and other income or expenses. Gains or losses related to the extinguishment of debt issued by consolidated trusts are excluded from the Capital Markets group's results because purchases of securities are recognized as such.

Net Interest Income

The Capital Markets group reports interest income and amortization of cost basis adjustments only on securities and loans that are held in our portfolio. For mortgage loans held in our mortgage portfolio, when interest income is no longer recognized in accordance with our nonaccrual accounting policy, the Capital Markets group recognizes interest income reimbursements that the group receives, primarily from Single-Family, for the contractual interest due. The interest expense recognized on the Capital Markets group's statement of operations is limited to our funding debt, which is reported as Debt of Fannie Mae in our condensed consolidated balance sheets. Net interest expense also

includes a cost of capital charge allocated among the three business segments.

The Capital Markets group's net interest income increased in the first quarter of 2011 compared with the first quarter of 2010 primarily due to a decline in funding costs as we replaced higher cost debt with lower cost debt. This increase of net interest income was partially offset by a decline in interest income from our mortgage portfolio. Although our mortgage portfolio loan balance increased, the reduction of our mortgage securities balance and increase in the balance of nonperforming loans, mainly loans modified in a TDR and our purchases of delinquent loans from MBS trusts, caused the yield on our portfolio and our interest income to decline. The reimbursements of contractual interest due on nonaccrual loans, from the Single-Family business, were a significant portion of the Capital Markets group's interest income during the first quarter of 2011. However, the increase in these reimbursements was offset by the decline in interest income on our mortgage-related securities because our securities portfolio balance has declined.

Additionally, Capital Markets' net interest income and net interest yield increased in the first quarter of 2011 and 2010 as a result of funds we received from Treasury under the senior preferred stock purchase agreement

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because the cash received was used to reduce our debt and the cost of these funds is included in dividends rather than interest expense.

We supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. The effect of these derivatives, in particular the periodic net interest expense accruals on interest rate swaps, is not reflected in Capital Markets net interest income but is included in our results as a component of Fair value gains (losses), net and is shown in Table 9: Fair Value Gains (Losses), Net. If we had included the economic impact of adding the net contractual interest accruals on our interest rate swaps in our Capital Markets interest expense, Capital Markets net interest income would have decreased by \$635 million in the first quarter of 2011 compared with an \$835 million decrease in the first quarter of 2010.

Net Other-Than-Temporary Impairments

The net other-than-temporary impairments recognized by the Capital Markets group is generally consistent with the amount reported in our condensed consolidated results of operations. See Note 5, Investments in Securities for information on our other-than-temporary impairments by major security type and primary drivers for other-than-temporary impairments recorded in the first quarter of 2011.

Fair Value Gains (Losses), Net

The derivative gains and losses that are reported for the Capital Markets group are consistent with the same gains and losses reported in our condensed consolidated results of operations. We discuss details of these components of fair value gains and losses in Consolidated Results of Operations Fair Value Gains (Losses), Net.

The gains on our trading securities for the segment during the first quarter of 2011 were attributable to a narrowing of spreads on CMBS, partially offset by losses on agency MBS due to an increase in interest rates during the period.

The gains on our trading securities for the segment during the first quarter of 2010 were attributable to a narrowing of spreads on CMBS and decreases in interest rates during the period.

The Capital Markets Group's Mortgage Portfolio

The Capital Markets group's mortgage portfolio consists of mortgage-related securities and mortgage loans that we own. Mortgage-related securities held by Capital Markets include Fannie Mae MBS and non-Fannie Mae mortgage-related securities. The Fannie Mae MBS that we own are maintained as securities on the Capital Markets group's balance sheets. Mortgage-related assets held by consolidated MBS trusts are not included in the Capital Markets group's mortgage portfolio.

We are restricted by our senior preferred stock purchase agreement with Treasury in the amount of mortgage assets that we may own. Beginning on each December 31 and thereafter, we are required to reduce our mortgage assets to 90% of the maximum allowable amount that we were permitted to own as of December 31 of the immediately preceding calendar year, until the amount of our mortgage assets reaches \$250 billion. The maximum allowable amount of mortgage assets we may own was reduced to \$810 billion as of December 31, 2010 and will be reduced to \$729 billion as of December 31, 2011. As of March 31, 2011, we owned \$757.6 billion in mortgage assets, compared with \$788.8 billion as of December 31, 2010.

Table 18 summarizes our Capital Markets group's mortgage portfolio activity for the periods indicated.

Table of Contents**Table 18: Capital Markets Group's Mortgage Portfolio Activity⁽⁴⁾**

	For the Three Months Ended March 31, 2011 2010 (Dollars in millions)	
Total Capital Markets mortgage portfolio, beginning balance as of January 1	\$ 788,771	\$ 772,728
Mortgage loans:		
Beginning balance as of January 1	427,074	281,162
Purchases	38,074	70,561
Securitizations ⁽²⁾	(23,983)	(14,254)
Liquidations ⁽³⁾	(19,309)	(7,192)
Mortgage loans, ending balance as of March 31	421,856	330,277
Mortgage securities:		
Beginning balance as of January 1	\$ 361,697	\$ 491,566
Purchases ⁽⁴⁾	5,090	29,186
Securitizations ⁽²⁾	23,983	14,254
Sales	(35,426)	(79,784)
Liquidations ⁽³⁾	(19,582)	(20,690)
Mortgage securities, ending balance as of March 31	335,762	434,532
Total Capital Markets mortgage portfolio, ending balance as of March 31	\$ 757,618	\$ 764,809

(1) Based on unpaid principal balance.

(2) Includes portfolio securitization transactions that do not qualify for sale treatment under the accounting standards on the transfers of financial assets.

(3) Includes scheduled repayments, prepayments, foreclosures and lender repurchases.

(4) Includes purchases of Fannie Mae MBS issued by consolidated trusts.

Table 19 shows the composition of the Capital Markets group's mortgage portfolio as of March 31, 2011 and December 31, 2010.

Table of Contents**Table 19: Capital Markets Group's Mortgage Portfolio Composition⁽¹⁾**

	As of	
	March 31, 2011	December 31, 2010
	(Dollars in millions)	
Capital Markets group's mortgage loans:		
Single-family loans		
Government insured or guaranteed	\$ 51,348	\$ 51,783
Conventional:		
Long-term, fixed-rate	239,723	237,096
Intermediate-term, fixed-rate	10,721	11,446
Adjustable-rate	29,496	31,526
Total single-family conventional	279,940	280,068
Total single-family loans	331,288	331,851
Multifamily loans		
Government insured or guaranteed	413	431
Conventional:		
Long-term, fixed-rate	4,180	4,413
Intermediate-term, fixed-rate	67,375	71,010
Adjustable-rate	18,600	19,369
Total multifamily conventional	90,155	94,792
Total multifamily loans	90,568	95,223
Total Capital Markets group's mortgage loans	421,856	427,074
Capital Markets group's mortgage-related securities:		
Fannie Mae	238,330	260,429
Freddie Mac	15,659	17,332
Ginnie Mae	1,170	1,425
Alt-A private-label securities	21,590	22,283
Subprime private-label securities	17,653	18,038
CMBS	24,844	25,052
Mortgage revenue bonds	12,008	12,525
Other mortgage-related securities	4,508	4,613
Total Capital Markets group's mortgage-related securities⁽²⁾	335,762	361,697
Total Capital Markets group's mortgage portfolio	\$ 757,618	\$ 788,771

- (1) Based on unpaid principal balance.
- (2) The fair value of these mortgage-related securities was \$339.8 billion and \$365.8 billion as of March 31, 2011 and December 31, 2010, respectively.

The Capital Markets group's mortgage portfolio decreased from December 31, 2010 to March 31, 2011 primarily due to sales and liquidations, partially offset by purchases of delinquent loans from MBS trusts. We expect our mortgage portfolio to continue to decrease due to the restrictions on the amount of mortgage assets we may own under the terms of our senior preferred stock purchase agreement with Treasury.

We purchased approximately 113,000 delinquent loans with an unpaid principal balance of approximately \$20 billion from our single-family MBS trusts in the first quarter of 2011. The total unpaid principal balance of nonperforming loans in the Capital Markets group's mortgage portfolio was \$231.3 billion as of March 31, 2011. This population includes loans that have been modified and have been classified as TDRs as well as unmodified delinquent loans that are on nonaccrual status in our condensed consolidated financial statements.

We expect to continue to purchase loans from MBS trusts as they become four or more consecutive monthly payments delinquent subject to market conditions, economic benefit, servicer capacity, and other factors

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including the limit on the mortgage assets that we may own pursuant to the senior preferred stock purchase agreement. As of March 31, 2011, the total unpaid principal balance of all loans in single-family MBS trusts that were delinquent as to four or more consecutive monthly payments was \$6.8 billion. In April 2011, we purchased approximately 32,000 delinquent loans with an unpaid principal balance of \$5.7 billion from our single-family MBS trusts.

CONSOLIDATED BALANCE SHEET ANALYSIS

The section below provides a discussion of our condensed consolidated balance sheets as of the dates indicated. You should read this section together with our condensed consolidated financial statements, including the accompanying notes.

Table 20 presents a summary of our condensed consolidated balance sheets as of March 31, 2011 and December 31, 2010.

Table 20: Summary of Condensed Consolidated Balance Sheets

	March 31, 2011	As of December 31, 2010	Variance
	(Dollars in millions)		
Assets			
Cash and cash equivalents and federal funds sold and securities purchased under agreements to resell or similar arrangements	\$ 46,081	\$ 29,048	\$ 17,033
Restricted cash	36,730	63,678	(26,948)
Investments in securities ⁽¹⁾	146,648	151,248	(4,600)
Mortgage loans			
Of Fannie Mae	402,711	407,482	(4,771)
Of consolidated trusts	2,614,903	2,577,794	37,109
Allowance for loan losses	(67,557)	(61,556)	(6,001)
Mortgage loans, net of allowance for loan losses	2,950,057	2,923,720	26,337
Other assets ⁽²⁾	47,526	54,278	(6,752)
Total assets	\$ 3,227,042	\$ 3,221,972	\$ 5,070
Liabilities and equity (deficit)			
Debt			
Of Fannie Mae	\$ 761,187	\$ 780,044	\$ (18,857)
Of consolidated trusts	2,447,589	2,416,956	30,633
Other liabilities ⁽³⁾	26,684	27,489	(805)
Total liabilities	3,235,460	3,224,489	10,971
Senior preferred stock	91,200	88,600	2,600
Other equity (deficit) ⁽⁴⁾	(99,618)	(91,117)	(8,501)

Total stockholders' equity (deficit)	(8,418)	(2,517)	(5,901)
Total liabilities and stockholders' deficit	\$ 3,227,042	\$ 3,221,972	\$ 5,070

- (1) Includes \$33.5 billion as of March 31, 2011 and \$32.8 billion as of December 31, 2010 of non-mortgage-related securities that are included in our other investments portfolio, which we present in Table 31: Cash and Other Investments Portfolio.
- (2) Consists of accrued interest receivable, net; acquired property, net; and other assets.
- (3) Consists of accrued interest payable, federal funds purchased and securities sold under agreements to repurchase, and other liabilities.
- (4) Consists of preferred stock, common stock, additional paid-in capital, accumulated deficit, accumulated other comprehensive loss, treasury stock, and noncontrolling interest.

Table of Contents**Cash and Other Investments Portfolio**

Cash and cash equivalents and federal funds sold and securities purchased under agreements to resell or similar arrangements are included in our cash and other investments portfolio. See [Liquidity and Capital Management](#) [Liquidity Management](#) [Cash and Other Investments Portfolio](#) for additional information on our cash and other investments portfolio.

Restricted Cash

Restricted cash primarily includes cash payments received by the servicer or consolidated trusts due to be remitted to the MBS certificateholders. Our restricted cash decreased in the first quarter of 2011 primarily due to a decline in the volume of refinance activity as interest rates increased, resulting in a decrease in unscheduled payments received.

Investments in Mortgage-Related Securities

Our investments in mortgage-related securities are classified in our condensed consolidated balance sheets as either trading or available-for-sale and are measured at fair value. Unrealized and realized gains and losses on trading securities are included as a component of [Fair value gains \(losses\), net](#) and unrealized gains and losses on available-for-sale securities are included in [Other comprehensive income](#) in our condensed consolidated statements of operations and comprehensive loss. Realized gains and losses on available-for-sale securities are recognized when securities are sold in [Investment gains, net](#) in our condensed consolidated statements of operations and comprehensive loss. See [Note 5, Investments in Securities](#) for additional information on our investments in mortgage-related securities, including the composition of our trading and available-for-sale securities at amortized cost and fair value and the gross unrealized gains and losses related to our available-for-sale securities as of March 31, 2011. Table 21 presents the fair value of our investments in mortgage-related securities, including trading and available-for-sale securities, as of March 31, 2011 and December 31, 2010.

Table 21: Summary of Mortgage-Related Securities at Fair Value

	March 31, 2011	As of December 31, 2010
	(Dollars in millions)	
Mortgage-related securities:		
Fannie Mae	\$ 27,774	\$ 30,226
Freddie Mac	16,557	18,322
Ginnie Mae	1,315	1,629
Alt-A private-label securities	15,350	15,573
Subprime private-label securities	11,207	11,513
CMBS	25,867	25,608
Mortgage revenue bonds	11,148	11,650
Other mortgage-related securities	3,947	3,974
Total	\$ 113,165	\$ 118,495

Investments in Private-Label Mortgage-Related Securities

We classify private-label securities as Alt-A, subprime, multifamily or manufactured housing if the securities were labeled as such when issued. We have also invested in private-label subprime mortgage-related securities that we have securitized to include our guaranty (wraps).

The continued negative impact of the current economic environment, including sustained weakness in the housing market and high unemployment, has adversely affected the performance of our Alt-A and subprime private-label securities. The unpaid principal balance of our investments in Alt-A and subprime securities was \$39.6 billion as of March 31, 2011, of which \$32.0 billion was rated below investment grade. Table 22

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presents the fair value of our investments in Alt-A and subprime private-label securities and an analysis of the cumulative losses on these investments as of March 31, 2011. As of March 31, 2011, we had realized actual cumulative principal shortfalls of approximately 3% of the total cumulative credit losses reported in this table and reflected in our condensed consolidated financial statements.

Table 22: Analysis of Losses on Alt-A and Subprime Private-Label Mortgage-Related Securities

	Unpaid Principal Balance	Fair Value	As of March 31, 2011		
			Total Cumulative Losses ⁽¹⁾ (Dollars in millions)	Noncredit Component ⁽²⁾	Credit Component ⁽³⁾
Trading securities: ⁽⁴⁾					
Alt-A private-label securities	\$ 2,991	\$ 1,658	\$ (1,287)	\$ (124)	\$ (1,163)
Subprime private-label securities	2,724	1,547	(1,176)	(268)	(908)
Total	\$ 5,715	\$ 3,205	\$ (2,463)	\$ (392)	\$ (2,071)
Available-for-sale securities:					
Alt-A private-label securities	\$ 18,599	\$ 13,692	\$ (5,107)	\$ (1,645)	\$ (3,462)
Subprime private-label securities ⁽⁵⁾	15,298	9,660	(5,678)	(1,449)	(4,229)
Total	\$ 33,897	\$ 23,352	\$ (10,785)	\$ (3,094)	\$ (7,691)
Grand Total	\$ 39,612	\$ 26,557	\$ (13,248)	\$ (3,486)	\$ (9,762)

(1) Amounts reflect the difference between the fair value and unpaid principal balance net of unamortized premiums, discounts and certain other cost basis adjustments.

(2) Represents the estimated portion of the total cumulative losses that is noncredit-related. We have calculated the credit component based on the difference between the amortized cost basis of the securities and the present value of expected future cash flows. The remaining difference between the fair value and the present value of expected future cash flows is classified as noncredit-related.

(3) For securities classified as trading, amounts reflect the estimated portion of the total cumulative losses that is credit-related. For securities classified as available-for-sale, amounts reflect the estimated portion of total cumulative other-than-temporary credit impairment losses, net of accretion, that are recognized in earnings.

(4) Excludes resecuritizations, or wraps, of private-label securities backed by subprime loans that we have guaranteed and hold in our mortgage portfolio as Fannie Mae securities.

(5) Includes a wrap transaction that has been partially consolidated on our balance sheet, which effectively resulted in a portion of the underlying structure of the transaction being accounted for and reported as available-for-sale securities.

Table 23 presents the 60 days or more delinquency rates and average loss severities for the loans underlying our Alt-A and subprime private-label mortgage-related securities for the most recent remittance period of the current reporting quarter. The delinquency rates and average loss severities are based on available data provided by Intex Solutions, Inc. (Intex) and CoreLogic, LoanPerformance (CoreLogic). We also present the average credit enhancement and monoline financial guaranteed amount for these securities as of March 31, 2011. Based on the stressed condition of some of our financial guarantors, we believe some of these counterparties will not fully meet their obligation to us in the future. See Risk Management Credit Risk Management Institutional Counterparty Credit Risk Management Financial Guarantors for additional information on our financial guarantor exposure and the counterparty risk associated with our financial guarantors.

Table of Contents**Table 23: Credit Statistics of Loans Underlying Alt-A and Subprime Private-Label Mortgage-Related Securities (Including Wraps)**

	As of March 31, 2011					Monoline Financial Guaranteed Amount ⁽⁶⁾	
	Unpaid Principal Balance Available- for- Trading	Wraps ⁽¹⁾	³ 60 Days Delinquent ⁽²⁾⁽³⁾ (Dollars in millions)	Average Loss Severity ⁽³⁾⁽⁴⁾	Average Credit Enhancement ⁽³⁾⁽⁵⁾		
Private-label mortgage-related securities backed by:⁽⁷⁾							
Alt-A mortgage loans:							
Option ARM Alt-A mortgage loans:							
2004 and prior	\$	\$ 511	\$	33.1%	64.5%	18.2%	\$
2005		1,375		45.0	57.4	43.0	268
2006		1,335		46.5	65.8	32.3	144
2007	2,078			45.9	61.7	59.5	752
Other Alt-A mortgage loans:							
2004 and prior		6,704		10.2	46.8	12.4	13
2005	90	4,347	129	24.4	57.0	6.6	
2006	67	4,201		30.6	59.8	1.8	
2007	756		194	44.4	67.2	30.2	314
2008 ⁽⁸⁾		126					
Total Alt-A mortgage loans:	2,991	18,599	323				1,491
Subprime mortgage loans:							
2004 and prior ⁽⁹⁾		2,159	652	24.8	70.4	60.4	674
2005 ⁽⁸⁾		197	1,440	44.6	73.9	58.1	229
2006		12,303		49.7	78.0	19.6	52
2007	2,724	639	5,728	50.2	76.1	23.6	182
Total subprime mortgage loans:	2,724	15,298	7,820				1,137
Total Alt-A and subprime mortgage loans:	\$ 5,715	\$ 33,897	\$ 8,143				\$ 2,628

(1) Represents our exposure to private-label Alt-A and subprime mortgage-related securities that have been resecured (or wrapped) to include our guarantee.

- (2) Delinquency data provided by Intex, where available, for loans backing Alt-A and subprime private-label mortgage-related securities that we own or guarantee. The reported Intex delinquency data reflect information from March 2011 remittances for February 2011 payments. For consistency purposes, we have adjusted the Intex delinquency data, where appropriate, to include all bankruptcies, foreclosures and REO in the delinquency rates.
- (3) The average delinquency, severity and credit enhancement metrics are calculated for each loan pool associated with securities where Fannie Mae has exposure and are weighted based on the unpaid principal balance of those securities.
- (4) Severity data obtained from CoreLogic, where available, for loans backing Alt-A and subprime private-label mortgage-related securities that we own or guarantee. The CoreLogic severity data reflect information from March 2011 remittances for February 2011 payments. For consistency purposes, we have adjusted the severity data, where appropriate.
- (5) Average credit enhancement percentage reflects both subordination and financial guarantees. Reflects the ratio of the current amount of the securities that will incur losses in the securitization structure before any losses are allocated to securities that we own or guarantee. Percentage generally calculated based on the quotient of the total unpaid principal balance of all credit enhancements in the form of subordination or financial guarantee of the security divided by the total unpaid principal balance of all of the tranches of collateral pools from which credit support is drawn for the security that we own or guarantee.
- (6) Reflects amount of unpaid principal balance supported by financial guarantees from monoline financial guarantors.

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- (7) Vintages are based on series date and not loan origination date.
- (8) The unpaid principal balance includes private-label REMIC securities that have been resecuritized totaling \$126 million for the 2008 vintage of other Alt-A loans and \$20 million for the 2005 vintage of subprime loans. These securities are excluded from the delinquency, severity and credit enhancement statistics reported in this table.
- (9) Includes a wrap transaction that has been partially consolidated on our balance sheet, which effectively resulted in a portion of the underlying structure of the transaction being accounted for and reported as available-for-sale securities.

Mortgage Loans

The increase in mortgage loans, net of an allowance for loan losses in the first quarter of 2011 was primarily driven by securitization activity from our lender swap and portfolio securitization programs, partially offset by scheduled principal paydowns and prepayments. For additional information on our mortgage loans, see Note 3, Mortgage Loans. For additional information on the mortgage loan purchase and sale activities reported by our Capital Markets group, see Business Segment Results Capital Markets Group Results.

Debt Instruments

Debt of Fannie Mae is the primary means of funding our mortgage investments. Debt of consolidated trusts represents our liability to third-party beneficial interest holders when we have included the assets of a corresponding trust in our condensed consolidated balance sheets. We provide a summary of the activity of the debt of Fannie Mae and a comparison of the mix between our outstanding short-term and long-term debt as of March 31, 2011 and 2010 in Liquidity and Capital Management Liquidity Management Debt Funding. Also see Note 8, Short-Term Borrowings and Long-Term Debt for additional information on our outstanding debt.

The increase in debt of consolidated trusts in the first quarter of 2011 was primarily driven by sales of Fannie Mae MBS, which are accounted for as reissuances of debt of consolidated trusts in our condensed consolidated balance sheets, since the MBS certificates are transferred from our ownership to a third party.

Derivative Instruments

We supplement our issuance of debt with interest rate related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. We aggregate, by derivative counterparty, the net fair value gain or loss, less any cash collateral paid or received, and report these amounts in our condensed consolidated balance sheets as either assets or liabilities.

Our derivative assets and liabilities consist of these risk management derivatives and our mortgage commitments. We refer to the difference between the derivative assets and derivative liabilities recorded in our condensed consolidated balance sheets as our net derivative asset or liability. We present, by derivative instrument type, the estimated fair value of derivatives recorded in our condensed consolidated balance sheets and the related outstanding notional amounts as of March 31, 2011 and December 31, 2010 in Note 9, Derivative Instruments. Table 24 provides an analysis of the factors driving the change from December 31, 2010 to March 31, 2011 in the estimated fair value of our net derivative liability related to our risk management derivatives recorded in our condensed consolidated balance sheets.

Table of Contents**Table 24: Changes in Risk Management Derivative Assets (Liabilities) at Fair Value, Net**

	For the Three Months Ended March 31, 2011 (Dollars in millions)
Net risk management derivative liability as of December 31, 2010	\$ (789)
Effect of cash payments:	
Fair value at inception of contracts entered into during the period ⁽¹⁾	58
Fair value at date of termination of contracts settled during the period ⁽²⁾	308
Net collateral received	(705)
Periodic net cash contractual interest payments ⁽³⁾	391
Total cash payments	52
Statement of operations impact of recognized amounts:	
Net contractual interest expense accruals on interest rate swaps	(635)
Net change in fair value during the period	751
Risk management derivatives fair value gains, net	116
Net risk management derivative liability as of March 31, 2011	\$ (621)

- (1) Cash receipts from sale of derivative option contracts increase the derivative liability recorded in our condensed consolidated balance sheets. Cash payments made to purchase derivative option contracts (purchased option premiums) increase the derivative asset recorded in our condensed consolidated balance sheets.
- (2) Cash payments made to terminate derivative contracts reduce the derivative liability recorded in our condensed consolidated balance sheets. Primarily represents cash paid (received) upon termination of derivative contracts.
- (3) Interest is accrued on interest rate swap contracts based on the contractual terms. Accrued interest income increases our derivative asset and accrued interest expense increases our derivative liability. The offsetting interest income and expense are included as components of derivatives fair value gains (losses), net in our condensed consolidated statements of operations and comprehensive loss. Net periodic interest receipts reduce the derivative asset and net periodic interest payments reduce the derivative liability. Also includes cash paid (received) on other derivatives contracts.

For additional information on our derivative instruments, see Consolidated Results of Operations Fair Value Gains (Losses), Net, Risk Management Market Risk Management, Including Interest Rate Risk Management and Note 9, Derivative Instruments.

Stockholders Deficit

Our net deficit increased in the first quarter of 2011. See Table 25 in Supplemental Non-GAAP Information Fair Value Balance Sheets for details of the change in our net deficit.

SUPPLEMENTAL NON-GAAP INFORMATION FAIR VALUE BALANCE SHEETS

As part of our disclosure requirements with FHFA, we disclose on a quarterly basis supplemental non-GAAP consolidated fair value balance sheets, which reflect our assets and liabilities at estimated fair value.

Table 25 summarizes changes in our stockholders' deficit reported in our GAAP condensed consolidated balance sheets and in the fair value of our net assets in our non-GAAP consolidated fair value balance sheets for the three months ended March 31, 2011. The estimated fair value of our net assets is calculated based on the difference between the fair value of our assets and the fair value of our liabilities, adjusted for noncontrolling interests. We use various valuation techniques to estimate fair value, some of which incorporate internal assumptions that are subjective and involve a high degree of management judgment. We describe the specific valuation techniques used to determine fair value and disclose the carrying value and fair value of our financial assets and liabilities in Note 13, Fair Value.

Table of Contents**Table 25: Comparative Measures GAAP Change in Stockholders Deficit and Non-GAAP Change in Fair Value of Net Assets (Net of Tax Effect)**

	For the Three Months Ended March 31, 2011 (Dollars in millions)	
<u>GAAP consolidated balance sheets:</u>		
Fannie Mae stockholders deficit as of December 31, 2010 ⁽¹⁾	\$	(2,599)
Total comprehensive loss		(6,290)
Capital transactions: ⁽²⁾		
Funds received from Treasury under the senior preferred stock purchase agreement		2,600
Senior preferred stock dividends		(2,216)
Capital transactions, net		384
Other		6
Fannie Mae stockholders deficit as of March 31, 2011 ⁽¹⁾	\$	(8,499)
<u>Non-GAAP consolidated fair value balance sheets:</u>		
Estimated fair value of net assets as of December 31, 2010	\$	(120,294)
Capital transactions, net		384
Change in estimated fair value of net assets, excluding capital transactions		(11,231)
Decrease in estimated fair value of net assets, net		(10,847)
Estimated fair value of net assets as of March 31, 2011	\$	(131,141)

(1) Our net worth, as defined under the senior preferred stock purchase agreement, is equivalent to the Total deficit amount reported in our condensed consolidated balance sheets. Our net worth, or total deficit, consists of Total Fannie Mae's stockholders' equity (deficit) and Noncontrolling interests reported in our condensed consolidated balance sheets.

(2) Represents capital transactions, which are reported in our condensed consolidated financial statements.

The \$11.2 billion decrease in the fair value of our net assets, excluding capital transactions, during the first quarter of 2011 was attributable to:

A net decrease in the fair value due to credit-related items principally related to declining actual and expected home prices as well as a decrease in the estimated rate of prepayments, which increased the expected life of the guaranty book of business and increased expected credit losses. This net decrease due to credit-related items was partially offset by

An increase in the fair value of the net portfolio attributable to the positive impact of the spread between mortgage assets and associated debt and derivatives.

Cautionary Language Relating to Supplemental Non-GAAP Financial Measures

In reviewing our non-GAAP consolidated fair value balance sheets, there are a number of important factors and limitations to consider. The estimated fair value of our net assets is calculated as of a particular point in time based on our existing assets and liabilities. It does not incorporate other factors that may have a significant impact on our long-term fair value, including revenues generated from future business activities in which we expect to engage, the value from our foreclosure and loss mitigation efforts or the impact that legislation or potential regulatory actions may have on us. As a result, the estimated fair value of our net assets presented in our non-GAAP consolidated fair value balance sheets does not represent an estimate of our net realizable value, liquidation value or our market value as a whole. Amounts we ultimately realize from the disposition of assets or settlement of liabilities may vary materially from the estimated fair values presented in our non-GAAP consolidated fair value balance sheets.

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In addition, the fair value of our net assets attributable to common stockholders presented in our fair value balance sheet does not represent an estimate of the value we expect to realize from operating the company or what we expect to draw from Treasury under the terms of our senior preferred stock purchase agreement, primarily because:

The estimated fair value of our credit exposures significantly exceeds our projected credit losses as fair value takes into account certain assumptions about liquidity and required rates of return that a market participant may demand in assuming a credit obligation. Because we do not intend to have another party assume the credit risk inherent in our book of business, and therefore would not be obligated to pay a market premium for its assumption, we do not expect the current market premium portion of our current estimate of fair value to impact future Treasury draws;

The fair value balance sheet does not reflect amounts we expect to draw in the future to pay dividends on the senior preferred stock; and

The fair value of our net assets reflects a point in time estimate of the fair value of our existing assets and liabilities, and does not incorporate the value associated with new business that may be added in the future.

The fair value of our net assets is not a measure defined within GAAP and may not be comparable to similarly titled measures reported by other companies.

Supplemental Non-GAAP Consolidated Fair Value Balance Sheets

We present our non-GAAP fair value balance sheets in Table 26 below.

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Table 26: Supplemental Non-GAAP Consolidated Fair Value Balance Sheets

	As of March 31, 2011	As of December 31, 2010
	GAAP	GAAP
	Carrying	
	Fair Value	