FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-K
February 26, 2009

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

Form 10-K

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

For the fiscal year ended December 31, 2008

Commission File No.: 0-50231

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

Fannie Mae

Federally chartered corporation *(State or other jurisdiction of incorporation or organization)*	**52-0883107** *(I.R.S. Employer Identification No.)*
3900 Wisconsin Avenue, NW Washington, DC *(Address of principal executive offices)*	**20016** *(Zip Code)*

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, without par value	New York Stock Exchange Chicago Stock Exchange
8.25% Non-Cumulative Preferred Stock, Series T, stated value $25 per share	New York Stock Exchange
8.75% Non-Cumulative Mandatory Convertible Preferred Stock, Series 2008-1, stated value $50 per share	New York Stock Exchange
Fixed-to-Floating Rate Non-Cumulative Preferred Stock, Series S, stated value $25 per share	New York Stock Exchange

7.625% Non-Cumulative Preferred Stock, Series R, stated value $25 per share	**New York Stock Exchange**
6.75% Non-Cumulative Preferred Stock, Series Q, stated value $25 per share	**New York Stock Exchange**
Variable Rate Non-Cumulative Preferred Stock, Series P, stated value $25 per share	**New York Stock Exchange**
5.50% Non-Cumulative Preferred Stock, Series N, stated value $50 per share	**New York Stock Exchange**
4.75% Non-Cumulative Preferred Stock, Series M, stated value $50 per share	**New York Stock Exchange**
5.125% Non-Cumulative Preferred Stock, Series L, stated value $50 per share	**New York Stock Exchange**
5.375% Non-Cumulative Preferred Stock, Series I, stated value $50 per share	**New York Stock Exchange**
5.81% Non-Cumulative Preferred Stock, Series H, stated value $50 per share	**New York Stock Exchange**
Variable Rate Non-Cumulative Preferred Stock, Series G, stated value $50 per share	**New York Stock Exchange**
Variable Rate Non-Cumulative Preferred Stock, Series F, stated value $50 per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

Variable Rate Non-Cumulative Preferred Stock, Series O, stated value $50 per share
(Title of class)
5.375% Non-Cumulative Convertible Series 2004-1 Preferred Stock, stated value $100,000 per share
(Title of class)
5.10% Non-Cumulative Preferred Stock, Series E, stated value $50 per share
(Title of class)
5.25% Non-Cumulative Preferred Stock, Series D, stated value $50 per share
(Title of class)

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

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

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(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 Act). Yes o No þ

The aggregate market value of the common stock held by non-affiliates of the registrant computed by reference to the price at which the common stock was last sold on June 30, 2008 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $20,932 million.

As of January 31, 2009, there were 1,091,230,272 shares of common stock of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

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MD&A TABLE REFERENCE

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PART I

We have been under conservatorship since September 6, 2008. As conservator, the Federal Housing Finance Agency (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. We describe the conservatorship and its impact on our business under Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities below.

Because of the complexity of our business and the industry in which we operate, we have included in this annual report on Form 10-K a glossary under Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) Glossary of Terms Used in This Report.

Item 1. Business

OVERVIEW

Fannie Mae is a government-sponsored enterprise (GSE) that was chartered by Congress in 1938 to support liquidity and stability in the secondary mortgage market, where existing mortgage loans are purchased and sold. We securitize mortgage loans originated by lenders in the primary mortgage market into mortgage-backed securities that we refer to as Fannie Mae MBS, which can then be bought and sold in the secondary mortgage market. We describe the securitization process under Business Segments Single-Family Credit Guaranty Business Mortgage Securitizations below. We also participate in the secondary mortgage market by purchasing mortgage loans (often referred to as whole loans) and mortgage-related securities, including our own Fannie Mae MBS, for our mortgage portfolio. We also make other investments that increase the supply of affordable housing. Under our charter, we may not lend money directly to consumers in the primary mortgage market.

We are subject to government oversight and regulation. Our regulators include FHFA, the Department of Housing and Urban Development (HUD), the Securities and Exchange Commission (SEC), and the Department of the Treasury (Treasury). We reference the Office of Federal Housing Enterprise Oversight (OFHEO), FHFA s predecessor, in this report with respect to actions taken by our safety and soundness regulator prior to the creation of FHFA on July 30, 2008.

Although we are a corporation chartered by the U.S. Congress, and although our conservator is a U.S. government agency and Treasury owns our senior preferred stock and a warrant to purchase our common stock, the U.S. government does not guarantee, directly or indirectly, our securities or other obligations. Our common stock is listed on the New York Stock Exchange (NYSE) and traded under the symbol FNM. We describe the impact of our failure to satisfy one of the NYSE s standards for continued listing of our common stock under Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities New York Stock Exchange Listing below. Our debt securities are actively traded in the over-the-counter market.

MARKET OVERVIEW

Mortgage and housing market conditions worsened progressively and dramatically through 2008 and credit concerns and the liquidity crisis affected the general capital markets. The housing market downturn that began in the second half of 2006 and progressed through 2007 significantly worsened in 2008. During 2008, the nation experienced significant declines in new and existing home sales, housing starts and mortgage originations. Overall housing demand decreased over the past year due to an economic recession that began in December 2007 and a significant reduction in the availability of credit. Continued high housing supply due to the slowdown in demand, low availability of credit, and increase in mortgage foreclosures put downward pressure on home prices. Home prices declined approximately 9% in 2008, as measured from the fourth quarter of 2007 to the fourth quarter of 2008 based on our home price index, which is the greatest decline since our home price index s inception in 1975. As a result of declining home values, many home values fell below the amount of the mortgage owed on the home, leaving many borrowers unable to sell their homes or refinance their mortgage loans. These challenging market and economic conditions caused a significant

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increase in mortgage delinquencies, defaults and foreclosures during 2008. Moreover, high housing supply and increased job losses have started to put pressure on the rental housing market.

Our business operates within the U.S. residential mortgage market, and therefore, we consider the amount of U.S. residential mortgage debt outstanding to be the best measure of the size of our overall market. As of September 30, 2008, the latest date for which information was available, the amount of U.S. residential mortgage debt outstanding was estimated by the Federal Reserve to be approximately $12.1 trillion (including $11.2 trillion of single-family mortgages). Our mortgage credit book of business, which includes mortgage assets we hold in our investment portfolio, our Fannie Mae MBS held by third parties and credit enhancements that we provide on mortgage assets, was $3.1 trillion as of September 30, 2008, or approximately 26% of total U.S. residential mortgage debt outstanding.

With weak housing activity and national home price declines, growth in total U.S. residential mortgage debt outstanding slowed to an estimated annual rate of 0.5% in the first nine months of 2008 (the most recent available data), compared with 7.7% over the first nine months of 2007, and 12.7% over the first nine months of 2006. We expect residential mortgage debt outstanding to shrink by approximately 0.2% in 2009. See Item 1A Risk Factors for a description of the risks associated with the housing market downturn and continued home price declines.

The continuing downturn in the housing and mortgage markets has been affected by, and has had an effect on, challenging conditions that exist across the global financial markets. This adverse market environment intensified in the second half of 2008 and was characterized by increased illiquidity in the credit markets, wider credit spreads, lower business and consumer confidence, and concerns about corporate earnings and the solvency of many financial institutions. Conditions in the financial services industry were particularly difficult. In the second half of 2008, we and Freddie Mac were placed into conservatorship, Lehman Brothers Holdings Inc. (Lehman Brothers) filed for bankruptcy, and a number of major U.S. financial institutions consolidated or received financial assistance from the U.S. government. During 2008, the FDIC was appointed receiver for 25 U.S. banks. Real gross domestic product, or GDP, growth slowed to 1.3% in 2008 with a decline of 3.8% in the fourth quarter. The unemployment rate increased from 4.9% at the end of 2007 to 7.2% at the end of 2008.

Since the second half of 2008, the U.S. government took a number of actions intended to strengthen market stability, improve the strength of financial institutions, and enhance market liquidity. These actions included the following:

On July 30, 2008, Congress passed the Housing and Economic Recovery Act of 2008 (HERA) which, among other things, authorized the Secretary of the Treasury to purchase GSE debt, equity and other securities.

On September 7, 2008, the Treasury Secretary announced a program to purchase GSE mortgage-backed securities in the open market pursuant to its authority under HERA. Treasury began purchasing Fannie Mae MBS under this program in September 2008. This authority expires on December 31, 2009.

On September 19, 2008, the Federal Reserve Board announced enhancements to its existing liquidity facilities, including plans to purchase from primary dealers short-term debt obligations issued by us, Freddie Mac and the 12 Federal Home Loan Banks (FHLBs).

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008, or Stabilization Act, which authorized the Secretary of the Treasury to establish a Troubled Assets Relief Program, or TARP, to purchase up to $700 billion in troubled assets (including mortgage loans and mortgage-backed securities) from financial institutions. As of February 13, 2009, Treasury had committed a total of $305.8 billion under TARP, including $276.0 billion in capital investments in U.S. financial institutions.

On October 7, 2008, the Federal Reserve Board announced the creation of a commercial paper funding facility that would fund purchases of commercial paper of three-month maturity from eligible issuers in an effort to provide additional liquidity to the short-term debt markets.

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On October 14, 2008, the Federal Deposit Insurance Corporation (FDIC) announced a temporary liquidity guarantee program pursuant to which it would guarantee, until June 30, 2012, the senior debt issued on or before June 30, 2009 by all FDIC-insured institutions and their holding companies, as well as deposits in non-interest-bearing accounts held in FDIC-insured institutions.

On November 25, 2008, the Federal Reserve announced a new program to purchase up to $100 billion in direct obligations of us, Freddie Mac, and the FHLBs, along with up to $500 billion in mortgage-backed securities guaranteed by us, Freddie Mac and the Government National Mortgage Association (Ginnie Mae). The Federal Reserve began purchasing our debt and MBS under this program in January 2009.

On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (2009 Stimulus Act), a $787 billion economic stimulus package aimed at lifting the economy out of recession.

On February 18, 2009, the Obama Administration announced the Homeowner Affordability and Stability Plan (HASP) as part of the administration s strategy to get the economy back on track. The Administration announced that key components of the plan are (1) providing access to low-cost refinancing for responsible homeowners suffering from falling home prices, (2) creating a $75 billion homeowner stability initiative to reach up to three to four million at-risk homeowners and (3) supporting low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.

EXECUTIVE SUMMARY

We have been in conservatorship, with FHFA acting as our 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. Following FHFA placing us into conservatorship, a variety of factors that affect our business, results of operations, financial condition, liquidity, net worth, corporate structure, management, business strategies and objectives, and controls and procedures changed materially. We discuss the rights and powers of the conservator and the provisions of our agreements with Treasury in more detail below under Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities.

Our Executive Summary presents the most significant factors on which management and the conservator are focused in operating and evaluating our business and financial position and prospects, including recent significant changes in our business operations and strategies. More specifically, we discuss:

our business objectives and strategy, including the decision to make providing liquidity, stability and affordability in the mortgage market the highest priority and, in particular, our focused efforts on foreclosure prevention and helping homeowners;

our 2008 results of operations, including our $58.7 billion loss for 2008 and our net worth deficit of approximately $15.2 billion at year-end, resulting in a request from our conservator to Treasury for an investment of this amount under the senior preferred stock purchase agreement;

the recently announced Homeowner Affordability and Stability Plan, our role in that plan, and its anticipated impact on us;

the continuing deterioration of the performance of our mortgage credit book of business and the potential additional pressure placed on that performance by our foreclosure prevention efforts;

- ***the funding challenges we experienced in 2008, the impact of debt market events on our debt maturity profile and the resulting increase in our refinancing risk; and***

- ***the likelihood that, in the future, we will need Treasury to make additional investments in the company under the senior preferred stock purchase agreement.***

For an explanation of terms we use in this executive summary without definition, please see our glossary of terms included in Part II Item 7 MD&A Glossary of Terms Used in This Report.

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Management of Our Business

Business Objectives and Strategy

FHFA, in its role as conservator, has overall management authority over our business but has delegated specified oversight authorities to our Board of Directors. The conservator also has delegated authority to our management to conduct our day-to-day operations. The Board of Directors and management are in consultation with the conservator in establishing the strategic direction for the company, and the conservator has approved the company s current business objectives and strategy.

We face a variety of different, and potentially conflicting, objectives, including:

- providing liquidity, stability and affordability in the mortgage market;
- immediately providing additional assistance to this market and to the struggling housing market;
- limiting the amount of the investment Treasury must make under the senior preferred stock purchase agreement in order to eliminate a net worth deficit;
- returning to long-term profitability; and
- protecting the interests of the taxpayers.

These objectives create conflicts in strategic and day-to-day decision-making that could lead to less than optimal outcomes for one or more, or possibly all, of these objectives. For example, limiting the amount of funds Treasury must invest in us pursuant to the senior preferred stock purchase agreement in order to eliminate a net worth deficit could require us to constrain some of our business activities, including activities that provide liquidity, stability and affordability to the mortgage market. Conversely, to the extent we increase our efforts, or undertake new activities, to assist the mortgage market, our financial results are likely to suffer, and we may be less effective in limiting Treasury s future investments in us under the senior preferred stock purchase agreement. We regularly consult with and receive direction from our conservator on how to balance these objectives.

Currently, we are primarily focusing on:

- providing liquidity, stability and affordability in the mortgage market; and
- immediately providing additional assistance to this market and to the struggling housing market.

More specifically, in pursuit of these objectives, we have concentrated our efforts on keeping people in their homes and preventing foreclosures. In addition, we have remained active in the secondary mortgage market through our guaranty business. The essence of this strategy is to build liquidity and affordability in the mortgage market, while efficiently creating and implementing successful foreclosure prevention approaches. Currently, one of the principal ways in which we are focusing on these objectives is through our participation in HASP, which we describe in more detail below. Focusing on these objectives is likely to contribute to further deterioration in both our results of operations and our net worth, which in turn would both increase the amount that Treasury will be required to invest in us under the senior preferred stock purchase agreement and inhibit our ability to return to long-term profitability. We therefore consult regularly with our conservator on how to balance these objectives against potentially competing considerations, such as limiting the amount of Treasury s investment in us and returning to long-term profitability.

Homeowner Affordability and Stability Plan

On February 18, 2009, the Obama Administration announced the Homeowner Affordability and Stability Plan. HASP includes several different elements that impact and involve us:

Loan Modification Program. Under HASP, we will offer to financially struggling homeowners loan modifications that reduce their monthly principal and interest payments on their mortgages. This program will be conducted in accordance with HASP requirements for borrower eligibility. The program seeks to provide a uniform, consistent regime that servicers would use in modifying loans to prevent foreclosures.

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Under the program, servicers that service loans held in Fannie Mae MBS trusts or in our portfolio will be incented to reduce at-risk borrowers monthly mortgage payments to as little as 31% of monthly income, which may be achieved through a variety of methods, including interest rate reductions, principal forbearance and term extensions. Although HASP contemplates that some servicers will also make use of principal reduction to achieve reduced payments for borrowers, we do not currently anticipate that principal reduction will be used in modifying our loans. We will bear the full cost of these modifications and will not receive a reimbursement from Treasury. Servicers will be paid incentive fees both when they originally modify a loan, and over time, if the modified loan remains current. Borrowers whose loans are modified through this program will also accrue monthly incentive payments that will be applied to reduce their principal as they successfully make timely payments over a period of five years. Fannie Mae, rather than Treasury, will bear the costs of these servicer and borrower incentive fees. As the details of this program continue to develop, there may be additional incentive fees and other costs that we will bear.

Program Administrator. We will play a role in administering HASP on behalf of Treasury. This will include implementing the guidelines and policies within which the loan modification program will operate, both for our own servicers and for servicers of non-agency loans that participate in the program. We will also maintain records and track the performance of modified loans, both for our own loans, as well as for loans of non-agency issuers that will participate in this program. Lastly, we will calculate and remit the subsidies and incentive payments to non-agency borrowers, servicers and investors who participate in the program. Treasury will reimburse us for the expenses we incur in connection with providing these services.

Streamlined Refinancing Initiative. Under HASP, we will help borrowers who have mortgages with current loan-to-value ratios up to 105% to refinance their mortgages without obtaining new mortgage insurance in excess of what was already in place. We have worked with our conservator and regulator, FHFA, to provide us the flexibility to implement this element of HASP. Through the initiative, we will offer this refinancing option only for qualifying mortgage loans we hold in our portfolio or that we guarantee. We will continue to hold the portion of the credit risk not covered by mortgage insurance for refinanced loans under this initiative. By March 4, 2009 we expect to release guidelines describing the details of this initiative and we expect to implement this initiative in the second quarter of 2009 which will bring efficiencies to the refinance process for lenders and borrowers.

Treasury has announced that it expects to issue guidelines for the national loan modification program, including our loan modification program described above, by March 4, 2009. Given that the nature of both the loan modification and streamlined refinance programs is unprecedented and the details of these programs are still under development at this time, it is difficult for us to predict the full extent of our activities under the programs and how those will impact us, the response rates we will experience, or the costs that we will incur. However, to the extent that our servicers and borrowers participate in these programs in large numbers, it is likely that the costs we incur associated with modifications of loans held in our portfolio or in Fannie Mae MBS trusts as well as the borrower and servicer incentive fees associated with them, will be substantial, and these programs would therefore likely have a material adverse effect on our business, results of operations, financial condition and net worth.

We expect that our efforts under HASP will replace the previously announced Streamlined Modification Program.

Other Programs to Provide Stability and Affordability Through Our Homeowner Assistance and Foreclosure Prevention Initiatives

In addition to our expected efforts under HASP, and in light of our objectives and strategy, during 2008 and 2009 (and prior to the announcement of HASP), we adopted or expanded a variety of initiatives designed to provide assistance to homeowners and prevent foreclosures, including the initiatives listed in the following table.

Initiative	Description	Objective
Suspension of Foreclosures *(effective 11/26/08 1/31/09, 2/17/09 3/6/09)* and Suspension of Evictions *(effective 11/26/08 3/6/09)*	Suspension of foreclosure sales and of evictions of occupants (renters or owners) of single-family homes we own	To aid borrowers facing foreclosure (or tenants of properties subject to foreclosure). During the suspension period, we engaged in a concentrated effort to implement foreclosure prevention measures. We have now extended these periods through March 6, 2009 to allow us to implement the recently announced HASP
New and Amended Single-Family Trust Documents (*announced 12/8/08*)	Trust documents govern how and when a loan can be purchased out of an MBS trust. New and revised trust documents provide greater flexibility to help borrowers with loans securitized into our MBS trusts by extending permitted forbearance and repayment plan periods for loans in most trusts and permitting earlier removal of delinquent loans from trusts created on or after January 1, 2009	To provide servicers with added flexibility in designing workouts, and to help delinquent borrowers stay in homes
HomeSaver Advance *(announced 6/16/08)*	Provides an unsecured loan to qualified borrowers to cure the payment defaults on a first mortgage loan. Originally available only to borrowers who had missed three or more payments; now available for any qualified borrower regardless of number of payments missed	To help delinquent borrowers bring mortgages current (without requiring the purchase of a loan out of an MBS trust). Removing the requirement for three missed payments permits servicers to assist qualified borrowers earlier in the process
National REO Rental Program *(announced 1/13/09)*	Permits existing, qualified renters to lease the property at market rate while the property is marketed for sale or provides financial assistance for the tenant s transition to new housing should they choose to vacate the property	To provide continued housing opportunity for qualified renters in Fannie Mae-owned foreclosed properties to stay in their homes, while the property is marketed, and to promote neighborhood stabilization

Second Look Program *(initiated 10/08)*	Review of seriously delinquent loans by our personnel to confirm that the borrower has been contacted and that workout options have been offered before a foreclosure sale is completed	To confirm that all workout options are explored for seriously delinquent borrowers and limit foreclosures
Reminder to servicers of availability of pre-foreclosure sales and deeds-in-lieu of foreclosure as a foreclosure alternative *(preexisting)*	Permits the sale (pre-foreclosure or short sale) or transfer (deed-in-lieu) of the home without completing a foreclosure sale	To permit earlier sales of the home in order to avoid potential adverse impact of further declines in home value and terminate further mortgage costs

The principal purposes of these initiatives are: to help stabilize the mortgage market; to limit foreclosures and keep people in their homes; and to help stabilize communities.

The actions we are taking and the initiatives we have introduced to assist homeowners and limit foreclosures are significantly different from our historical approach to delinquencies, defaults and problem loans. In addition, many of these efforts are relatively new and are being applied more broadly and in ways that we have not previously applied them. As a result, it will take time for us to assess and provide statistical information both on the relative success of these efforts and their effect on our results of operations and financial condition. Our early experience indicates that a number of our programs may not be achieving results either as rapidly as we had expected or in the ways that we had expected, and we are working with our conservator to reassess these programs in order to both help us best fulfill our objective of helping homeowners and the mortgage market, and to determine their effectiveness and priority with respect to the recently announced HASP. As we assess these programs, we may expand, eliminate or modify these programs in the future. We have included data relating to our borrower loss mitigation activities for 2008 and prior periods in Part II Item 7 Risk Management Credit Risk Management Mortgage Credit Risk Management.

Because approximately 92% of our guaranty book of business is made up of single-family conventional mortgage loans that we own or that are in guaranteed Fannie Mae MBS and because the number of seriously delinquent loans is significantly higher for our single-family mortgage credit guaranty book, we have focused our credit loss reduction and foreclosure prevention efforts primarily on these single-family conventional loans. The recently announced HASP is consistent with that focus. We have developed a variety of options for providing assistance, rather than relying on a one size fits all approach, in recognition that no single solution will resolve the varied problems facing homeowners who currently need assistance or who may need assistance in the future. As we implement these new initiatives, however, we face a variety of challenges that have limited the early success of our initiatives.

One challenge we face is the current unpredictability of consumer behavior. As a result, in introducing new programs, we have little historical data that we can use either as a basis for predicting consumer impact, response and acceptance rates, or to identify consumer behavior that is not consistent with historical patterns. To address this challenge, we monitor and assess on a regular basis both our workout initiatives and our understanding of borrowers needs in the current market environment so that we will be in a position to offer solutions designed to have the highest possible success rate.

A second challenge we face is the stress that the current market environment has placed on servicer resources. Because we implement all of our homeowner assistance programs through servicers and depend on them to implement our initiatives effectively, limitations on servicer capacity and capabilities can significantly limit both the success of our initiatives and the amount of flexibility that can be offered within and among various initiatives. We therefore are focusing our efforts on accommodating servicers resource constraints by creating and offering streamlined solutions for borrowers that are relatively easy both to explain and to implement. We also have increased the number of our own personnel that we place onsite in the offices of our largest servicers in order to enhance the servicers capacity in the face of their increasingly heavy workload.

Third, we are experiencing challenges in creating initiatives that will permit homeowners who face debt pressure from a variety of sources in addition to mortgage loan payments to manage all of their debt payments successfully. Other types of consumer debt and obligations arise from a variety of sources, including second mortgages, credit card debt, loans to purchase an automobile, property insurance, and real estate taxes. Because we generally only have the ability to affect a homeowner s obligations relating to his or her first lien mortgage loan, we expect that, in many cases, we may not be able to offer sufficient assistance to permit the homeowner to continue to meet all existing obligations.

Finally, we believe that, during the current crisis, one of the key elements for successfully assisting homeowners and preventing foreclosures is to reach troubled and potentially troubled borrowers earlier in the delinquency process. We are working to develop effective ways to achieve this earlier intervention, which we believe is necessary to accelerate positive change in the current mortgage market.

Before the modification of a loan that is held in an MBS trust becomes effective, we generally purchase the loan from the trust. When we do, we are required by generally accepted accounting principles (GAAP) to record the loan on our consolidated balance sheet at its current market value, rather than the loan amount, and recognize a loss for any difference between the loan amount and the market value of the loan. As we work aggressively to assist homeowners and implement the loan modification provisions of HASP, we expect that the number of loans we modify will increase substantially during 2009 and beyond. Some portion of the loans

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that we permanently modify will not thereafter perform successfully but instead will again default, resulting in a foreclosure or requiring further modification at a later time.

For a discussion of various factors that may adversely affect the success of our homeowner assistance and foreclosure prevention programs, as well as our financial condition and results of operations, refer to Item 1A Risk Factors.

Providing Mortgage Market Liquidity

In addition to our borrower support efforts, our work to support lenders and provide mortgage market liquidity includes the following:

Ongoing provision of liquidity to the mortgage markets. During the fourth quarter of 2008, we purchased or guaranteed an estimated $113.3 billion in new business, measured by unpaid principal balance, consisting primarily of single-family mortgages and provided financing for approximately 468,000 conventional single-family loans. Our purchase of approximately $35.0 billion of new and existing multifamily loans during 2008 helped to finance approximately 577,000 multifamily units.

Cancellation of planned delivery fee increase. In October 2008, we canceled a planned 25 basis point increase in our adverse market delivery charge on mortgage loans.

Partnership with Federal Home Loan Bank of Chicago. On October 7, 2008, we announced that we had entered into an agreement with the Federal Home Loan Bank of Chicago under which we have committed to purchase 15-year and 30-year fixed-rate mortgage loans that the Bank has acquired from its member institutions through its Mortgage Partnership Finance® (MPF®) program, which helps make affordable mortgages available to working families across the country. This arrangement is designed to allow us to expand our efforts to a broader market and provide additional liquidity to the mortgage market while prudently managing risk.

Reduced fees for our real estate mortgage investment conduits (REMICs). In September 2008, we reduced the fees for our REMICs by 15%.

Relaxing restrictions on institutions holding principal and interest payments on our behalf in response to an FDIC rule change. In October 2008, the FDIC announced a rule change that lowered our risk of loss if a party holding principal and interest payments on our behalf in custodial depository accounts failed. In response to this rule change, we curtailed or reversed actions we had been taking for several months prior to October to reduce our risk. These prior actions included reducing the amount of our funds permitted to be held with mortgage servicers, requiring more frequent remittances of funds and moving funds held with our largest counterparties from custodial accounts to trust accounts.

Summary of Our Financial Results for 2008

We recorded a net loss of $58.7 billion and a diluted loss per share of $24.04 for 2008. Our results for 2008 were driven primarily by escalating credit-related expenses, consisting primarily of additions to our combined loss reserves; significant fair value losses; investment losses from other-than-temporary impairment; and a non-cash charge of $21.4 billion in the third quarter of 2008 to establish a partial deferred tax asset valuation allowance. These results reflect the substantial challenges in the housing, mortgage and capital markets during 2008 and particularly during the second half of 2008, as well as the deepening economic recession and extremely challenging financial environment, both of which significantly intensified during the fourth quarter of 2008.

For the fourth quarter of 2008, we recorded a net loss of $25.2 billion and a diluted loss per share of $4.47, compared with a net loss of $29.0 billion and a diluted loss per share of $13.00 for the third quarter of 2008. The $3.8 billion decrease in our net loss for the fourth quarter of 2008 compared with the third quarter of 2008 was driven principally by our establishment during the third quarter of a deferred tax asset valuation allowance of $21.4 billion, more than offsetting the increase in fair value losses in our Capital Markets group to $12.3 billion during the fourth quarter of 2008, compared with $3.9 billion during the third quarter of 2008.

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Our mortgage credit book of business increased to $3.1 trillion as of December 31, 2008 from $2.9 trillion as of December 31, 2007, as we have continued to perform our chartered mission of helping provide liquidity to the mortgage markets. Our estimated market share of new single-family mortgage-related securities issuances was 41.7% for the fourth quarter of 2008, compared with 42.2% for the third quarter of 2008 and an average estimated market share of 45.4% for the year. Our estimated market share of new single-family mortgage-related securities issuances decreased during the second half of 2008 from the levels we achieved during the first half of 2008 primarily due to changes in our pricing and eligibility standards, which reduced our acquisition of higher risk loans, as well as changes in the eligibility standards of the mortgage insurance companies, which further reduced our acquisition of loans with high loan-to-value ratios and other high-risk features. In addition, the estimated market share of new single-family mortgage-related securities issuances that were guaranteed by Ginnie Mae (which primarily guarantees securities backed by FHA insured loans) increased significantly during 2008. The cumulative effect of these changes contributed to a reduction in our mortgage acquisitions during the second half of 2008, compared with the first half of the year.

We provide more detailed discussions of key factors affecting changes in our results of operations and financial condition in Part II Item 7 MD&A Consolidated Results of Operations, Part II Item 7 MD&A Business Segment Resu Part II Item 7 MD&A Consolidated Balance Sheet Analysis, Part II Item 7 MD&A Supplemental Non-GAAP Information Fair Value Balance Sheets, and Part II Item 7 MD&A Risk Management Credit Risk Management Mortgage Credit Risk Management Mortgage Credit Book of Business.

Credit Overview

We expect economic conditions and falling home prices to continue to negatively affect our credit performance in 2009, which will cause our credit losses to increase. Further, if economic conditions continue to decline, more borrowers will be unable to make their monthly mortgage payments, resulting in increased delinquencies and defaults, sharper declines in home prices and higher credit losses.

The credit statistics presented in Table 1 illustrate the deterioration in the credit performance of mortgage loans in our single-family guaranty book of business in 2007, and on a quarterly basis in 2008.

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

	2008					2007
	Q4	Q3	Q2	Q1	Total	Total
	(Dollars in millions)					
As of the end of each period:						
Serious delinquency rate[(2)]	2.42%	1.72%	1.36%	1.15%	2.42%	0.98%
On-balance sheet nonperforming loans[(3)]	$ 20,484	$ 14,148	$ 11,275	$ 10,947	$ 20,484	$ 10,067
Off-balance sheet nonperforming loans[(4)]	$ 98,428	$ 49,318	$ 34,765	$ 23,983	$ 98,428	$ 17,041
Foreclosed property inventory (number of properties)[(5)(6)]	63,538	67,519	54,173	43,167	63,538	33,729
During the period:						
Loan modifications (number of properties)[(7)]	6,276	5,262	10,190	11,521	33,249	26,421

HomeSaver Advance problem loan workouts (number of properties)[8]	25,783	27,267	16,742	1,151	70,943	
Foreclosed property acquisitions (number of properties)[6]	20,998	29,583	23,963	20,108	94,652	49,121
Single-family credit-related expenses[9]	$ 11,917	$ 9,215	$ 5,339	$ 3,254	$ 29,725	$ 5,003
Single-family credit losses[10]	$ 2,197	$ 2,164	$ 1,249	$ 857	$ 6,467	$ 1,331

(1) The single-family guaranty book of business consists of single-family mortgage loans held in our mortgage portfolio, single-family Fannie Mae MBS held in our mortgage portfolio, single-family Fannie Mae MBS held by third parties,

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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 guarantee.

(2) Calculated based on number of loans. We include all of the conventional single-family loans that we own and that back Fannie Mae MBS in the calculation of the single-family delinquency rate.

(3) Represents the total amount of nonaccrual loans, troubled debt restructurings, and first-lien loans associated with unsecured HomeSaver Advance loans inclusive of troubled debt restructurings and HomeSaver Advance first-lien loans on accrual status. A troubled debt restructuring is a modification to the contractual terms of a loan that results in a concession to a borrower experiencing financial difficulty.

(4) Represents unpaid principal balance of nonperforming loans in our outstanding and unconsolidated Fannie Mae MBS held by third parties, including first-lien loans associated with unsecured HomeSaver Advance loans that are not seriously delinquent.

(5) Reflects the number of single-family foreclosed properties we held in inventory as of the end of each period.

(6) Includes deeds in lieu of foreclosure.

(7) Modifications include troubled debt restructurings and other modifications to the contractual terms of the loan that do not result in concessions to the borrower. A troubled debt restructuring involves some economic concession to the borrower, and is the only form of modification in which we do not expect to collect the full original contractual principal and interest amount due under the loan, although other resolutions and modifications may result in our receiving the full amount due, or certain installments due, under the loan over a period of time that is longer than the period of time originally provided for under the loans.

(8) Represents number of first-lien loans associated with unsecured HomeSaver Advance loans.

(9) Consists of the provision for credit losses and foreclosed property expense.

(10) Consists of (a) charge-offs, net of recoveries and (b) foreclosed property expense for the reporting period. Interest forgone on single-family nonperforming loans in our mortgage portfolio is not reflected in our credit losses total. In addition, other-than-temporary impairment losses resulting from deterioration in the credit quality of our mortgage-related securities and accretion of interest income on single-family loans subject to SOP 03-3 are excluded from credit losses.

Through December 31, 2008, our Alt-A loans, as well as certain other higher risk loans, loans on properties in particular states, and loans originated in 2006 and 2007, contributed disproportionately to our worsening credit statistics. At this time, however, we are observing higher delinquency rates across our broader guaranty book of business as well.

Net Worth and Fair Value Deficit

Net Worth and Fair Value Deficit Amounts

Under our senior preferred stock purchase agreement with Treasury, Treasury generally has committed to provide us funds of up to $100 billion, on a quarterly basis, in the amount, if any, by which our total liabilities exceed our total assets, as reflected on our consolidated balance sheet, prepared in accordance with GAAP, for the applicable fiscal quarter. On February 18, 2009, in connection with the announcement of HASP, Treasury announced that it is amending the senior preferred stock purchase agreement with us to (1) increase its funding commitment from $100 billion to $200 billion, and (2) increase the size of our mortgage portfolio allowed under the agreement by $50 billion to $900 billion, with a corresponding increase in the allowable debt outstanding. In connection with announcing Treasury s planned amendments to the senior preferred stock purchase agreement, Secretary Geithner stated that Fannie Mae and Freddie Mac are critical to the functioning of the housing finance system in this country and play a key role in making mortgage rates affordable and maintaining the stability and liquidity of our mortgage market and that [t]he increased funding will provide forward-looking confidence in the mortgage market and enable Fannie Mae and Freddie Mac to carry out ambitious efforts to ensure mortgage affordability for responsible homeowners. Because an amended agreement has not been executed as of the date of this report, the following discussion of the senior preferred stock purchase agreement, as well as references to that agreement throughout this report, refer to the terms of the existing agreement, without reflecting these changes. We describe the terms of the senior preferred stock purchase agreement in more detail in Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements.

As a result of our net loss for the year ended December 31, 2008, our net worth (defined as the amount by which our total assets exceed our total liabilities, as reflected on our consolidated balance sheet prepared in accordance with GAAP), had a deficit of $15.2 billion as of December 31, 2008, a decrease of $59.3 billion from our net worth of $44.1 billion as of December 31, 2007. As of December 31, 2008, our fair value deficit (which represents a negative fair value of our net assets), as reflected in our consolidated non-GAAP fair value balance sheet, was $105.2 billion, a decrease of $142.5 billion from the fair value of our net assets as of December 31, 2007. The amount that Treasury will invest in us under the senior preferred stock purchase agreement is determined based on our GAAP balance sheet, rather than our non-GAAP fair value balance sheet. There are significant differences between our GAAP balance sheet and our non-GAAP fair value balance sheet, which we describe in greater detail in Part II Item 7 MD&A Supplemental Non-GAAP Information Fair Value Balance Sheets.

If current trends in the housing and financial markets continue or worsen, we expect that we also will have a net worth deficit in future periods, and therefore will be required to obtain additional funding from Treasury pursuant to the senior preferred stock purchase agreement.

Request for Treasury Investment

Under the Regulatory Reform Act, FHFA must place us into receivership if the Director of FHFA makes a written determination that our assets are, and during the preceding 60 days have been, less than our obligations. FHFA has notified us that the measurement period for such a determination begins no earlier than the date of the SEC filing deadline for our quarterly and annual financial statements and continues for a period of 60 days after that date. FHFA also has advised us that, if we receive an investment from Treasury during that 60-day period in order to eliminate our net worth deficit as of the prior period end in accordance with the senior preferred stock purchase agreement, the Director of FHFA will not make a mandatory receivership determination. The Director of FHFA submitted a request on February 25, 2009 to Treasury for $15.2 billion on our behalf under the terms of the senior preferred stock purchase agreement in order to eliminate our net worth deficit as of December 31, 2008. FHFA requested that Treasury provide the funds on or prior to March 31, 2009.

Significance of Net Worth Deficit, Fair Value Deficit and Combined Loss Reserves

Our net worth deficit, which is derived from our consolidated GAAP balance sheet, includes the combined loss reserves of $24.8 billion that we recorded in our consolidated balance sheet as of December 31, 2008. Our non-GAAP fair value balance sheet presents all of our assets and liabilities at fair value as of the balance sheet date, based on assumptions and management judgment, as described in more detail in Part II Item 7 MD&A Supplemental Non-GAAP Information Fair Value Balance Sheets and Part II Item 7 MD&A Critical Accounting Policies and Estimates. Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This is also sometimes referred to as the exit price. In determining fair value, we use a variety of valuation techniques and processes, which are described in more detail in Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Financial Instruments. In general, fair value incorporates the market s current view of the future, and that view is reflected in the current price of the asset or liability. However, future market conditions may be different from what the market has currently estimated and priced into these fair value measures.

Neither our combined loss reserves, as reflected on our consolidated GAAP balance sheet, nor our estimate of the fair value of our guaranty obligations, which we disclose in our consolidated non-GAAP fair value balance sheet, reflects our estimate of the future credit losses inherent in our existing guaranty book of business. Rather, our combined loss reserves reflect only probable losses that we believe we have already incurred as of the balance sheet date, while the fair value of our guaranty obligation is based not only on future expected credit losses over the life of the loans underlying our guarantees as of December 31, 2008, but also on the estimated profit that a market participant would require to assume that guaranty obligation. Because of the severe deterioration in the mortgage and credit markets, there is significant uncertainty regarding the full extent of future credit losses in the mortgage industry as a whole, as well as to any participant in the industry. Therefore, we are not currently providing guidance or other estimates of the credit losses that we will experience in the future.

Liquidity

We fund our purchases of mortgage loans primarily from the proceeds from sales of our debt securities. In September 2008, Treasury made available to us two additional sources of funding: the Treasury credit facility and the senior preferred stock purchase agreement, as described below in Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements.

During the second half of 2008, we began to experience significant deterioration in our access to the unsecured debt markets, particularly for long-term and callable debt, and in the yields on our debt as compared with relevant market benchmarks. These conditions, which became especially pronounced in October and November 2008, have had, and are continuing to have, adverse effects on our business and results of operations. Several factors contributed to the reduced demand for our debt securities, including continued severe market disruptions, market concerns about our capital position and the future of our business (including its future profitability, future structure, regulatory actions and agency status) and the extent of U.S. government support for our business.

On November 25, 2008, the Federal Reserve announced that it would purchase up to $100 billion in direct obligations of us, Freddie Mac and the FHLBs, and up to $500 billion in MBS guaranteed by us, Freddie Mac and Ginnie Mae. Since that time, the Federal Reserve has been supporting the liquidity of our debt as an active and significant purchaser of our long-term debt in the secondary market, and we have experienced noticeable improvement in spreads and in our access to the debt markets in January and February 2009. However, this recent improvement may not continue or may reverse. In addition, while distribution of recent issuances to international investors has been consistent with our distribution trends prior to mid-2007, we continue to experience reduced demand from international investors, particularly foreign central banks, compared with the historically high levels of demand we experienced from these investors between mid-2007 and mid-2008.

Because consistent demand for both our debt securities with maturities greater than one year and our callable debt was low between July and November 2008, we were forced to rely increasingly on short-term debt to fund our purchases of mortgage loans, which are by nature long-term assets. As a result, we will be required to refinance, or roll over, our debt on a more frequent basis, exposing us to an increased risk, particularly when market conditions are volatile, that demand will be insufficient to permit us to refinance our debt securities as necessary and to risks associated with refinancing under adverse credit market conditions. Further, we expect that our roll over, or refinancing, risk is likely to increase substantially as we approach year-end 2009 and the expiration of the Treasury credit facility. See Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Debt Funding Debt Funding Activity more information on our debt funding activities and risks posed by our current market challenges, and Item 1A Risk Factors for a discussion of the risks to our business posed by our reliance on the issuance of debt to fund our operations.

The Treasury credit facility and the senior preferred stock purchase agreement may provide additional sources of funding in the event that we cannot adequately access the unsecured debt markets. On February 25, 2009, the Director of FHFA submitted a request to Treasury on our behalf for $15.2 billion in funding under the terms of the senior preferred stock purchase agreement in order to eliminate our net worth deficit as of December 31, 2008. There are limitations on our ability to use either of these sources of funding, however, and we describe these limitations in Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Liquidity Contingency Plan.

In addition, although our liquidity contingency plan anticipates that we would use specified alternative sources of liquidity to the extent that we are unable to access the unsecured debt markets, we have uncertainty regarding our ability to execute on our liquidity contingency plan in the current market environment. See Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Liquidity Contingency Plan for a description of our liquidity contingency plan and the current uncertainties regarding that plan.

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Outlook

During the fourth quarter of 2008, our outlook for 2009 worsened.

Overall Market Conditions: We expect that the current crisis in the U.S. and global financial markets will continue, which will continue to adversely affect our financial results throughout 2009. We expect the unemployment rate to continue to increase as the economic recession continues. We expect to continue to experience home price declines and rising default and severity rates, all of which may worsen as unemployment rates continue to increase and if the U.S. continues to experience a broad-based recession. We expect mortgage debt outstanding to shrink by approximately 0.2% in 2009. We continue to expect the level of foreclosures and single-family delinquency rates to increase further in 2009.

Home Price Declines: Following a decline of approximately 9% in 2008, we expect that home prices will decline another 7% to 12% on a national basis in 2009. We now expect that we will experience a peak-to-trough home price decline of 20% to 30%, rather than the 15% to 19% decline we predicted last year. These estimates contain significant inherent uncertainty in the current market environment, due to historically unprecedented levels of uncertainty regarding a variety of critical assumptions we make when formulating these estimates, including: the effect of actions the federal government may take with respect to national economic recovery; the impact of those actions on home prices, unemployment, and the general economic environment; and the rate of unemployment and/or wage decline. 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 decline percentages, with steeper declines in certain areas such as Florida, California, Nevada and Arizona.

Our estimate of a 7% to 12% home price decline for 2009 compares with a home price decline of approximately 12% to 18% using the S&P/Case-Schiller index method, and our 20% to 30% peak-to-trough home price decline estimate compares with an approximately 33% to 46% peak-to-trough decline using the S&P/Case-Schiller index method. Our estimates differ from the S&P/Case-Schiller index in two principal ways: (1) our estimates weight expectations for each individual property by number of properties, whereas the S&P/Case-Schiller index weights expectations of home price declines based on property value, such that declines in home prices on higher priced homes will have a greater effect on the overall result; and (2) our estimates do not include sales of foreclosed homes because we believe that differing maintenance practices and the forced nature of the sales make them less representative of market values, whereas the S&P/Case-Schiller index includes foreclosed property sales. The S&P/Case-Schiller comparison numbers shown above are calculated using our models and assumptions, but modified to use these two factors (weighting of expectations based on property value and the inclusion 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-Schiller index is based only on publicly available data, which may be limited in certain geographies. Our comparative calculations to the S&P/Case-Schiller index provided above are not modified to account for this data pool difference.

Credit Losses and Loss Reserves: We continue to expect our credit loss ratio (which excludes SOP 03-3 fair value losses and HomeSaver Advance fair value losses) in 2009 will exceed our credit loss ratio in 2008. We also expect a significant increase in our SOP 03-3 fair value losses as we increase the number of loans we repurchase from MBS trusts in order to modify them. In addition, we expect significant continued increases in our combined loss reserves through 2009.

Liquidity: Although our access to the debt markets has improved noticeably since late November 2008, we expect continued pressure on our access to the debt markets throughout 2009 at economically attractive rates. Further, we expect the pressure will become increasingly great as we approach the expiration of the Treasury credit facility at the end of 2009. Pressure on our ability to access the debt markets at attractive rates, particularly our ability to issue long-term debt at attractive rates, increases our borrowing costs as well as our roll over risk, limits our ability to grow and to manage our market and liquidity risk effectively, and increases the likelihood that we may need to borrow under the Treasury credit facility.

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Uncertainty Regarding our Future Status and Profitability: We expect that we will experience adverse financial effects because of our strategy of concentrating our efforts on keeping people in their homes and preventing foreclosures, including our efforts under HASP, while remaining active in the secondary mortgage market. In addition, future activities that our regulators, other U.S. government agencies or Congress may request or require us to take to support the mortgage market and help borrowers may contribute to further deterioration in our results of operations and financial condition. In a statement issued on September 7, 2008, the then-Secretary of the Treasury stated that there is a consensus that we and Freddie Mac pose a systemic risk and that we could not continue in our then-current form.

BUSINESS SEGMENTS

We are organized in three complementary business segments: Single-Family Credit Guaranty, Housing and Community Development, and Capital Markets. The table below displays net revenues, net income (loss) and total assets for each of our business segments for the years ended December 31, 2008, 2007 and 2006.

Business Segment Summary Financial Information

	For the Year Ended December 31,		
	2008	**2007**	**2006**
	(Dollars in millions)		
Net revenues:[1]			
Single-Family Credit Guaranty	$ 9,434	$ 7,062	$ 6,079
Housing and Community Development	476	425	510
Capital Markets	7,526	3,718	5,432
Total	$ 17,436	$ 11,205	$ 12,021
Net income (loss):			
Single-Family Credit Guaranty	$ (27,101)	$ (858)	$ 2,044
Housing and Community Development	(2,189)	157	338
Capital Markets	(29,417)	(1,349)	1,677
Total	$ (58,707)	$ (2,050)	$ 4,059

	As of December 31,		
	2008	**2007**	**2006**
	(Dollars in millions)		
Total assets:			
Single-Family Credit Guaranty	$ 24,115	$ 23,356	$ 15,777
Housing and Community Development	10,994	15,094	14,100
Capital Markets	877,295	840,939	814,059
Total	$ 912,404	$ 879,389	$ 843,936

(1) Includes net interest income, guaranty fee income, trust management income, and fee and other income.

For information on the results of operations of our business segments, see Part II Item 7 MD&A Business Segment Results.

Single-Family Credit Guaranty Business

Our Single-Family Credit Guaranty, or Single-Family, business works with our lender customers to securitize single-family mortgage loans into Fannie Mae MBS and to facilitate the purchase of single-family mortgage loans for our mortgage portfolio. Single-family mortgage loans relate to properties with four or fewer residential units. Revenues in the segment are derived primarily from guaranty fees received as compensation for assuming the credit risk on the mortgage loans underlying single-family Fannie Mae MBS and on the single-family mortgage loans held in our portfolio.

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The aggregate amount of single-family guaranty fees we receive in any period depends on the amount of Fannie Mae MBS outstanding during that period and the applicable guaranty fee rates. The amount of Fannie Mae MBS outstanding at any time is primarily determined by the rate at which we issue new Fannie Mae MBS and by the repayment rate for the loans underlying our outstanding Fannie Mae MBS. Other factors affecting the amount of Fannie Mae MBS outstanding are the extent to which we purchase loans from our MBS trusts because of borrower defaults (with the amount of these purchases affected by rates of borrower defaults on the loans and the extent of loan modification programs in which we engage) and the extent to which servicers repurchase loans from us at our request because there was a breach in the representations and warranties provided upon delivery of the loans.

Mortgage Securitizations

Our most common type of securitization transaction is referred to as a lender swap transaction. Mortgage lenders that operate in the primary mortgage market generally deliver pools of mortgage loans to us in exchange for Fannie Mae MBS backed by these loans. After receiving the loans in a lender swap transaction, we place them in a trust that is established for the sole purpose of holding the loans separate and apart from our assets. We serve as trustee for the trust. We deliver to the lender (or its designee) Fannie Mae MBS that are backed by the pool of mortgage loans in the trust and that represent an undivided beneficial ownership interest in each of the loans. We guarantee to each MBS trust that we will supplement amounts received by the MBS trust as required to permit timely payment of principal and interest on the related Fannie Mae MBS. We retain a portion of the interest payment as the fee for providing our guaranty. Then, on behalf of the trust, we make monthly distributions to the Fannie Mae MBS certificateholders from the principal and interest payments and other collections on the underlying mortgage loans. For more information on our MBS trusts, see Part II Item 7 MD&A Off-Balance Sheet Arrangements and Variable Interest Entities.

We issue both single-class and multi-class Fannie Mae MBS. Single-class Fannie Mae MBS refers to Fannie Mae MBS where the investors receive principal and interest payments in proportion to their percentage ownership of the MBS issuance. Multi-class Fannie Mae MBS refers to Fannie Mae MBS, including REMICs, where the cash flows on the underlying mortgage assets are divided, creating several classes of securities, each of which represents a beneficial ownership interest in a separate portion of cash flows. Terms to maturity of some multi-class Fannie Mae MBS, particularly REMIC classes, may match or be shorter than the maturity of the underlying mortgage loans and/or mortgage-related securities. As a result, each of the classes in a multi-class Fannie Mae MBS may have a different coupon rate, average life, repayment sensitivity or final maturity. We also issue structured Fannie Mae MBS, which are multi-class Fannie Mae MBS or single-class Fannie Mae MBS that are resecuritizations of other single-class Fannie Mae MBS.

MBS Trusts

Each of our single-family MBS trusts operates in accordance with a trust agreement or an indenture. In most instances, a single-family MBS trust is also governed by an issue supplement documenting the formation of that MBS trust and the issuance of the Fannie Mae MBS by that trust. In December 2008, we established a new single-family master trust agreement that governs our single-family MBS trusts formed on or after January 1, 2009 and amended and restated our previous 2007 master trust agreement in order to provide greater flexibility to help borrowers with loans securitized in our MBS trusts. The trust agreements or the trust indenture, together with the issue supplement and any amendments, are the trust documents that govern an individual MBS trust.

In accordance with the terms of our single-family MBS trust documents, we have the option or, in some instances, the obligation, to purchase specified mortgage loans from an MBS trust. Our acquisition cost for these loans is the unpaid principal balance of the loan plus accrued interest. We generally purchase from the MBS trust any loan that we intend to modify prior to the time that the modification becomes effective. After we purchase the loan, we generally work with the borrower to modify the loan. Because we have established and are implementing a variety of strategies designed to permit modification of both whole loans that we own and loans in our MBS trusts, we expect that the number of loans we purchase from our MBS trusts will increase significantly. In the current market environment, an increase in the loans we purchase from our MBS

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trusts also will increase our losses because we are required by GAAP to record these loans on our balance sheet at their market value, rather than at the loan amount, and recognize a loss for the difference between the loan amount and the market value of the loan.

In deciding whether and when to purchase a loan from an MBS trust, we consider a variety of factors, including our legal ability or obligation to purchase loans under the terms of the trust documents; our mission and public policy; our loss mitigation strategies and the exposure to credit losses we face under our guaranty; our cost of funds; relevant market yields; the administrative costs associated with purchasing and holding the loan; counterparty exposure to lenders that have agreed to cover losses associated with delinquent loans; general market conditions; our statutory obligations under our Charter Act; and other legal obligations such as those established by consumer finance laws. The weight we give to these factors may change in the future depending on market circumstances and other factors. Refer to Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Financial Instruments Fair Value of Loans Purchased with Evidence of Credit Deterioration and Part II Item 7 MD&A Consolidated Results of Operations Credit-Related Expenses Provision Attributable to SOP 03-3 and HomeSaver Advance Fair Value Losses for a description of our accounting for delinquent loans purchased from MBS trusts and the effect of these purchases on our 2008 financial results.

Mortgage Acquisitions

We acquire single-family mortgage loans for securitization or for our investment portfolio through either our flow or bulk transaction channels. In our flow business, we enter into agreements that generally set agreed-upon guaranty fee prices for a lender s future delivery of individual loans to us over a specified time period. Our bulk business generally consists of transactions in which a defined set of loans are to be delivered to us in bulk, and we have the opportunity to review the loans for eligibility and pricing prior to delivery in accordance with the terms of the applicable contracts. Guaranty fees and other contract terms for our bulk mortgage acquisitions are typically negotiated on an individual transaction basis.

Mortgage Servicing

The servicing of the mortgage loans that are held in our mortgage portfolio or that back our Fannie Mae MBS is performed by mortgage servicers on our behalf. Typically, lenders who sell single-family mortgage loans to us service these loans for us. We require lenders to obtain our approval before selling servicing rights and obligations to other servicers.

Our mortgage servicers typically collect and deliver principal and interest payments, administer escrow accounts, monitor and report delinquencies, perform default prevention activities, evaluate transfers of ownership interests, respond to requests for partial releases of security, and handle proceeds from casualty and condemnation losses. Our mortgage servicers are the primary point of contact for borrowers and perform a key role in the effective implementation of our homeownership assistance initiatives, negotiation of workouts of troubled loans, and loss mitigation activities. If necessary, mortgage servicers inspect and preserve properties and process foreclosures and bankruptcies. Because we delegate the servicing of our mortgage loans to mortgage servicers and do not have our own servicing function, our ability to actively manage troubled loans that we own or guarantee may be limited. For more information on our homeownership assistance initiatives and a discussion of the risks associated with them, refer to Item 1A Risk Factors and Part II Item 7 MD&A Risk Management Credit Risk Management Mortgage Credit Risk Management Problem Loan Management and Foreclosure Prevention.

We compensate servicers primarily by permitting them to retain a specified portion of each interest payment on a serviced mortgage loan as a servicing fee. Servicers also generally retain prepayment premiums, assumption fees, late payment charges and other similar charges, to the extent they are collected from borrowers, as additional servicing compensation. We also compensate servicers for negotiating workouts on problem loans.

Refer to Item 1A Risk Factors and Part II Item 7 MD&A Risk Management Credit Risk Management Institutional Counterparty Credit Risk Management for a discussion of the risks associated with a default by a mortgage servicer and how we seek to manage those risks.

Housing and Community Development Business

Our Housing and Community Development, or HCD, business works with our lender customers to securitize multifamily mortgage loans into Fannie Mae MBS and to facilitate the purchase of multifamily mortgage loans for our mortgage portfolio. Multifamily mortgage loans relate to properties with five or more residential units, which may be apartment communities, cooperative properties or manufactured housing communities. Our HCD business also makes federal low-income housing tax credit (LIHTC) partnership, debt and equity investments to increase the supply of affordable housing. Revenues in the segment are derived from a variety of sources, including the (1) guaranty fees received as compensation for assuming the credit risk on the mortgage loans underlying multifamily Fannie Mae MBS and on the multifamily mortgage loans held in our portfolio, (2) transaction fees associated with the multifamily business and (3) bond credit enhancement fees. HCD s investments in rental housing projects eligible for LIHTC and other investments generate both tax credits and net operating losses that may reduce our federal income tax liability. Other investments in rental and for-sale housing generate revenue and losses from operations and the eventual sale of the assets. As described in Part II Item 7 MD&A Critical Accounting Policies and Estimates Deferred Tax Assets, we concluded that it is more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize all of our deferred tax assets. As a result, we are not currently making new LIHTC investments other than pursuant to commitments existing prior to 2008.

Mortgage Securitizations

Our HCD business generally creates multifamily Fannie Mae MBS in the same manner as our Single-Family business creates single-family Fannie Mae MBS. See Single-Family Credit Guaranty Business Mortgage Securitizations for a description of a typical lender swap securitization transaction.

MBS Trusts

Each of our multifamily MBS trusts operates in accordance with a trust agreement or an indenture. In most instances, a multifamily MBS trust is also governed by an issue supplement documenting the formation of that MBS trust and the issuance of the Fannie Mae MBS by that trust. In January 2009, we established a new multifamily master trust agreement that governs our multifamily MBS trusts formed on or after February 1, 2009 and amended and restated our previous 2007 master trust agreement to (i) establish specific criteria for the segregation and maintenance by our loan servicers of collateral reserve accounts, (ii) provide greater flexibility in dealing with defaulted loans held in a MBS trust, and (iii) make changes to our multifamily MBS trusts to conform with our single-family MBS trusts.

In accordance with the terms of our multifamily MBS trust documents, we have the option or, in some instances, the obligation, to purchase specified mortgage loans from an MBS trust. Our acquisition cost for these loans is the unpaid principal balance of the loan plus accrued interest. We generally purchase from the MBS trust any loan that we intend to modify prior to the time that the modification becomes effective. We typically exercise our option to purchase a loan from a multifamily MBS trust if the loan is delinquent, in whole or in part, as to four or more consecutive monthly payments. After we purchase the loan, we generally work with the borrower to modify the loan.

Mortgage Acquisitions

Our HCD business acquires multifamily mortgage loans for securitization or for our investment portfolio through either our flow or bulk transaction channels, in substantially the same manner as described under Single-Family Credit

Guaranty Business Mortgage Acquisitions.

Mortgage Servicing

As with the servicing of single-family mortgages, described under Single-Family Credit Guaranty Business Mortgage Servicing, multifamily mortgage servicing is typically performed by the lenders who sell the mortgages to us. In contrast to our single-family mortgage servicers, however, many of those lenders have agreed, as part of the multifamily delegated underwriting and servicing relationship we have with these lenders, to accept loss sharing under certain defined circumstances with respect to mortgages that they have sold to us and are servicing. Thus, multifamily loss sharing obligations are an integral part of our selling and servicing relationships with multifamily lenders. Consequently, transfers of multifamily servicing rights are infrequent and are carefully monitored by us to enforce our right to approve all servicing transfers. As a seller-servicer, the lender is also responsible for evaluating the financial condition of property owners, administering various types of agreements (including agreements regarding replacement reserves, completion or repair, and operations and maintenance), as well as conducting routine property inspections.

Affordable Housing Investments

Our HCD business helps to expand the supply of affordable housing by investing in rental and for-sale housing projects. Most of these are LIHTC investments. Our HCD business also makes equity investments in rental and for-sale housing, and participates in specialized debt financing. These investments are consistent with our focus on serving communities and improving access to affordable housing. As described in Part II Item 7 MD&A Critical Accounting Policies and Estimates Deferred Tax Assets, we concluded that it is more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize all of our deferred tax assets. As a result, we are currently recognizing only a small amount of tax benefits associated with tax credits and net operating losses in our financial statements. As a result of our tax position, we did not make any new LIHTC investments in 2008 other than pursuant to commitments existing prior to 2008. As we are limited in our use of the tax benefits related to our LIHTC investments, we will consider selling LIHTC investments, as we did in 2007 and 2008, if we conclude that the economic return from selling these investments is greater than the benefits we would receive from continuing to hold these investments. In addition, we have limited our new equity and specialized debt investments in 2008 as a result of unfavorable real estate market conditions.

For additional information regarding our investments in LIHTC partnerships and their impact on our financial results, refer to Part II Item 7 MD&A Consolidated Results of Operations Losses from Partnership Investments and Part II Item 7 MD&A Off-Balance Sheet Arrangements and Variable Interest Entities.

Capital Markets Group

Our Capital Markets group manages our investment activity in mortgage loans, mortgage-related securities and other investments, our debt financing activity, and our liquidity and capital positions. We fund our investments primarily through proceeds we receive from our issuance of debt securities in the domestic and international capital markets.

Our Capital Markets group generates most of its revenue from the difference, or spread, between the interest we earn on our mortgage assets and the interest we pay on the debt we issue to fund these assets. We refer to this spread as our net interest yield. Changes in the fair value of the derivative instruments and trading securities we hold impact the net income or loss reported by the Capital Markets group business segment. The net income or loss reported by the Capital Markets group is also affected by the impairment of available-for-sale securities.

Mortgage Investments

Our mortgage investments include both mortgage-related securities and mortgage loans. We purchase primarily conventional (that is, loans that are not federally insured or guaranteed) single-family fixed-rate or adjustable-rate, first lien mortgage loans, or mortgage-related securities backed by these types of loans. In addition, we purchase loans insured by the Federal Housing Administration (FHA), loans guaranteed by the Department of Veterans Affairs (VA), or loans guaranteed by the Rural Development Housing and Community Facilities

Program of the Department of Agriculture, manufactured housing loans, reverse mortgage loans, multifamily mortgage loans, subordinate lien mortgage loans (for example, loans secured by second liens) and other mortgage-related securities. Most of these loans are prepayable at the option of the borrower. Our investments in mortgage-related securities include structured mortgage-related securities such as REMICs. For information on our mortgage investments, including the composition of our mortgage investment portfolio by product type, refer to Part II Item 7 MD&A Consolidated Balance Sheet Analysis.

Investment Activities

Our Capital Markets group seeks to increase the liquidity of the mortgage market by maintaining a presence as an active investor in mortgage assets and, in particular, supports the liquidity and value of Fannie Mae MBS in a variety of market conditions.

The Capital Markets group s purchases and sales of mortgage assets in any given period generally are determined by the rates of return that we expect to earn on the equity capital underlying our investments. When we expect to earn returns greater than our other uses of capital, we generally will be an active purchaser of mortgage loans and mortgage-related securities. When we believe that few opportunities exist to deploy capital in mortgage investments, we generally will be a less active purchaser, and may be a net seller, of mortgage loans and mortgage-related securities.

Our investment activities during 2008 have been affected by turmoil in the capital markets. They were also affected by our applicable capital requirements and other regulatory constraints, as described below under Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Regulation and Oversight of Our Activities. Since September 2008, our investment activities have been affected by both the conservatorship and the limit on our debt under our agreement with Treasury. Our investment activities will also be affected by the limit on our portfolio as of December 31, 2009 under the senior preferred stock purchase agreement with Treasury, described below under Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Covenants Under Treasury Agreements, which includes a requirement that we reduce our mortgage portfolio by 10% per year beginning in 2010.

Debt Financing Activities

Our Capital Markets group funds its investments primarily through the issuance of debt securities in the domestic and international capital markets. In 2008, our debt financing activities were affected by weakness in the capital markets, regulatory constraints and other factors, including government activities in the financial services sector, as described in Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management.

Securitization Activities

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

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

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

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

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Customer Services

Our Capital Markets group provides our lender customers and their affiliates with services that include: offering to purchase a wide variety of mortgage assets, including non-standard mortgage loan products; segregating customer portfolios to obtain optimal pricing for their mortgage loans; and assisting customers with the hedging of their mortgage business. These activities provide a significant flow of assets for our mortgage portfolio, help to create a broader market for our customers and enhance liquidity in the secondary mortgage market.

CONSERVATORSHIP, TREASURY AGREEMENTS, OUR CHARTER AND REGULATION OF OUR ACTIVITIES

Conservatorship

On September 6, 2008, at the request of the Secretary of the Treasury, the Chairman of the Federal Reserve Board and the Director of FHFA, our Board of Directors adopted a resolution consenting to putting the company into conservatorship. After obtaining this consent, the Director of FHFA appointed FHFA as our conservator in accordance with the Federal Housing Finance Regulatory Reform Act (Regulatory Reform Act) and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act). The conservatorship is a statutory process designed to preserve and conserve our assets and property, and put the company in a sound and solvent condition. The powers of the conservator under the Regulatory Reform Act are summarized below.

The conservatorship has no specified termination date. There can be no assurance as to when or how the conservatorship will be terminated, whether we will continue to exist following conservatorship, or what changes to our business structure will be made during or following the conservatorship. In a statement issued on September 7, 2008, the then Secretary of the Treasury stated that there is a consensus that we and Freddie Mac pose a systemic risk and that we could not continue in our then current form. For more information on the risks to our business relating to the conservatorship and uncertainties regarding the future of our business, see Item 1A Risk Factors.

The table below presents a summary comparison of various features of our business immediately before we were placed into conservatorship and as of February 26, 2009.

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Topic	Before Conservatorship	As of February 26, 2009
Authority of Board of Directors, management and shareholders	Board of Directors with right to determine the general policies governing the operations of the corporation and exercise all power and authority of the company, except as vested in shareholders or as the Board chooses to delegate to management Directors with duties to shareholders Board of Directors delegated significant authority to management Shareholders with specified voting rights	FHFA, as conservator, succeeded to all of the power and authority of the Board of Directors, management and the shareholders The conservator has delegated authority to a newly constituted Board of Directors. The Board is required to consult with and obtain the consent of the conservator before taking action in specified areas. The conservator may modify or rescind this delegation at any time Directors do not have any duties to any person or entity except to the conservator. The conservator has delegated authority to management to conduct day-to-day operations so that the company can continue to operate in the ordinary course of business. The conservator retains overall management authority, including the authority to withdraw its delegations to management at any time Shareholders have no voting rights
Structure of Board of Directors	13 directors: 12 independent plus President and Chief Executive Officer; independent, non-executive Chairman of the Board Seven standing Board committees, including Audit Committee of which four of the five independent members were audit committee financial experts	10 directors: 9 independent plus President and Chief Executive Officer; independent, non-executive Chairman of the Board. Up to three additional Board members may be added by the Board subject to approval of the conservator Four standing Board committees, including Audit Committee of which three of the four independent members are audit committee financial experts
Capital	Statutory and regulatory capital requirements Capital classifications as to adequacy of capital issued by FHFA on quarterly basis	Capital requirements not binding Quarterly capital classifications by FHFA suspended
Net Worth(1)	Receivership mandatory under Regulatory Reform Act if FHFA makes a written determination that we have net	Conservator has directed management to focus, to the extent it does not conflict with our mission, on maintaining positive net

	worth deficit for 60 days	worth Receivership mandatory if FHFA makes a written determination that we have net worth deficit for 60 days(2)
Management Strategy	Maximize shareholder value over the long-term Fulfill our mission of providing liquidity, stability and affordability to the mortgage market	Directed to provide liquidity, stability and affordability in the mortgage market and immediately provide additional assistance to this market and the struggling housing market, and to the extent not in conflict with our mission, to maintain positive net worth No longer managed with a strategy to maximize common shareholder returns Focus on foreclosure prevention

(1) Our net worth refers to the amount by which our total assets exceed our total liabilities, as reflected on our consolidated balance sheet. Net worth is substantially the same as stockholders equity; however, net worth also includes the minority interests that third parties own in our consolidated subsidiaries (which was $157 million as of December 31, 2008), which is excluded from stockholders equity.

(2) If FHFA makes a written determination that we have a net worth deficit, then, if requested by FHFA (or by our Chief Financial Officer if we are not under conservatorship), Treasury is required to provide funds to us pursuant to the senior preferred stock purchase agreement. Treasury s funding commitment under that agreement is expected to enable us to maintain a positive net worth as long as Treasury has not yet invested the full amount provided for in that agreement. The Director of FHFA submitted a request on February 25, 2009 to Treasury for funds to eliminate our net worth deficit as of December 31, 2008. See Treasury Agreements Senior Preferred Stock Purchase Agreement and Related Issuance of Senior Preferred Stock and Common Stock Warrant below.

General Powers of the Conservator Under the Regulatory Reform Act

Upon its appointment, the conservator immediately succeeded to all rights, titles, powers and privileges of Fannie Mae, and of any shareholder, officer or director of Fannie Mae with respect to Fannie Mae and its assets, and succeeded to the title to the books, records and assets of any other legal custodian of Fannie Mae. The conservator has the power to take over our assets and operate our business with all the powers of our shareholders, directors and officers, and to conduct all business of the company.

The conservator may take any actions it determines are necessary and appropriate to carry on our business and preserve and conserve our assets and property. The conservator s powers include the ability to transfer or sell any of our assets or liabilities (subject to limitations and post-transfer notice provisions for transfers of qualified financial contracts (as defined below under Special Powers of the Conservator Under the Regulatory Reform Act Security Interests Protected; Exercise of Rights Under Qualified Financial Contracts)) without any approval, assignment of rights or consent of any party. The Regulatory Reform Act, however, provides that mortgage loans and mortgage-related assets that have been transferred to a Fannie Mae MBS trust must be held for the beneficial owners of the Fannie Mae MBS and cannot be used to satisfy our general creditors.

In connection with any sale or disposition of our assets, the conservator must conduct its operations to maximize the net present value return from the sale or disposition, to minimize the amount of any loss realized, and to ensure adequate competition and fair and consistent treatment of offerors. In addition, the conservator is required to maintain a full accounting of the conservatorship and make its reports available upon request to shareholders and members of the public.

We remain liable for all of our obligations relating to our outstanding debt securities and Fannie Mae MBS. In a Fact Sheet dated September 7, 2008, FHFA indicated that our obligations will be paid in the normal course of business during the conservatorship.

Special Powers of the Conservator Under the Regulatory Reform Act

Disaffirmance and Repudiation of Contracts

The conservator may disaffirm or repudiate contracts (subject to certain limitations for qualified financial contracts) that we entered into prior to its appointment as conservator if it determines, in its sole discretion, that performance of the contract is burdensome and that disaffirmation or repudiation of the contract promotes the orderly administration of our affairs. The Regulatory Reform Act requires FHFA to exercise its right to disaffirm or repudiate most contracts within a reasonable period of time after its appointment as conservator. As of February 26, 2009, the conservator had not determined whether or not a reasonable period of time had passed for purposes of the applicable provisions of the Regulatory Reform Act and, therefore, the conservator may still possess this right. As of February 26, 2009, the conservator has advised us that it has not disaffirmed or repudiated any contracts we entered into prior to its appointment as conservator.

We can, and have continued to, enter into and enforce contracts with third parties. The conservator has advised us that it has no intention of repudiating any guaranty obligation relating to Fannie Mae MBS because it views repudiation as incompatible with the goals of the conservatorship.

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In general, the liability of the conservator for the disaffirmance or repudiation of any contract is limited to actual direct compensatory damages determined as of September 6, 2008, which is the date we were placed into conservatorship. The liability of the conservator for the disaffirmance or repudiation of a qualified financial contract is limited to actual direct compensatory damages (which include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract and agreement claims) determined as of the date of the disaffirmance or repudiation. If the conservator disaffirms or repudiates any lease to or from us, or any contract for the sale of real property, the Regulatory Reform Act specifies the liability of the conservator.

Security Interests Protected; Exercise of Rights Under Qualified Financial Contracts

Notwithstanding the conservator s powers described above, the conservator must recognize legally enforceable or perfected security interests, except where such an interest is taken in contemplation of our insolvency or with the intent to hinder, delay or defraud us or our creditors. In addition, the Regulatory Reform Act provides that no person will be stayed or prohibited from exercising specified rights in connection with qualified financial contracts, including termination or acceleration (other than solely by reason of, or incidental to, the appointment of the conservator), rights of offset, and rights under any security agreement or arrangement or other credit enhancement relating to such contract. The term qualified financial contract means any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement and any similar agreement that FHFA determines by regulation, resolution or order to be a qualified financial contract.

Avoidance of Fraudulent Transfers

The conservator may avoid, or refuse to recognize, a transfer of any property interest of Fannie Mae or of any of our debtors, and also may avoid any obligation incurred by Fannie Mae or by any debtor of Fannie Mae, if the transfer or obligation was made (1) within five years of September 6, 2008, and (2) with the intent to hinder, delay, or defraud Fannie Mae, FHFA, the conservator or, in the case of a transfer in connection with a qualified financial contract, our creditors. To the extent a transfer is avoided, the conservator may recover, for our benefit, the property or, by court order, the value of that property from the initial or subsequent transferee, unless the transfer was made for value and in good faith. These rights are superior to any rights of a trust or any other party, other than a federal agency, under the U.S. bankruptcy code.

Modification of Statutes of Limitations

Under the Regulatory Reform Act, notwithstanding any provision of any contract, the statute of limitations with regard to any action brought by the conservator is (1) for claims relating to a contract, the longer of six years or the applicable period under state law, and (2) for tort claims, the longer of three years or the applicable period under state law, in each case, from the later of September 6, 2008 or the date on which the cause of action accrues. In addition, notwithstanding the state law statute of limitation for tort claims, the conservator may bring an action for any tort claim that arises from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to us, if the state s statute of limitations expired not more than five years before September 6, 2008.

Treatment of Breach of Contract Claims

Any final and unappealable judgment for monetary damages against the conservator for breach of an agreement executed or approved in writing by the conservator will be paid as an administrative expense of the conservator.

Attachment of Assets and Other Injunctive Relief

The conservator may seek to attach assets or obtain other injunctive relief without being required to show that any injury, loss or damage is irreparable and immediate.

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Subpoena Power

The Regulatory Reform Act provides the conservator with subpoena power for purposes of carrying out any power, authority or duty with respect to Fannie Mae.

Management of the Company Under Conservatorship

Upon our entry into conservatorship on September 6, 2008, FHFA, as conservator, succeeded to the powers of our officers and directors. Accordingly, at that time, the Board of Directors had neither the power nor the duty to manage, direct or oversee our business and affairs. Thereafter, the conservator authorized the officers of Fannie Mae to continue to function in their applicable designated duties and delegated authorities, subject to the direction and control of the conservator. On September 7, 2008, the conservator appointed Herbert M. Allison, Jr. as our President and Chief Executive Officer, effective immediately. On September 16, 2008, FHFA appointed Philip A. Laskawy as the new non-executive Chairman of our Board of Directors. On November 24, 2008, FHFA reconstituted our Board of Directors and directed us regarding the function and authorities of the Board of Directors. FHFA s delegation of authority to the Board became effective on December 19, 2008 when nine Board members, in addition to the non-executive Chairman, were appointed by FHFA. The conservator retains the authority to withdraw its delegations to the Board and to management at any time.

Our directors serve on behalf of the conservator and exercise their authority as directed by and with the approval, where required, of the conservator. Our directors do not have any duties to any person or entity except to the conservator. Accordingly, our directors 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.

The delegation of authority to the Board will remain in effect until modified or rescinded by the conservator. In addition, the conservator directed the Board to consult with and obtain the approval of the conservator before taking action in specified areas, as described in Part III Item 10 Directors, Executive Officers and Corporate Governance Corporate Governance Conservatorship and Delegation of Authority to Board of Directors.

Effect of Conservatorship on Shareholders

The conservatorship has had the following adverse effects on our common and preferred shareholders:

- the rights of the shareholders are suspended during the conservatorship. Accordingly, our common shareholders do not have the ability to elect directors or to vote on other matters during the conservatorship unless the conservator delegates this authority to them;

- the conservator has eliminated common and preferred stock dividends (other than dividends on the senior preferred stock issued to Treasury) during the conservatorship; and

- according to a statement made by the then Treasury Secretary on September 7, 2008, because we are in conservatorship, we will no longer be managed with a strategy to maximize common shareholder returns.

Treasury Agreements

The Regulatory Reform Act granted Treasury temporary authority (through December 31, 2009) to purchase any obligations and other securities issued by Fannie Mae on such terms and conditions and in such amounts as Treasury may determine, upon mutual agreement between Treasury and Fannie Mae. As of February 26, 2009, Treasury had used this authority as described below. By their terms, the senior preferred stock purchase agreement, senior preferred stock and warrant will continue to exist even if we are released from the conservatorship. For a description of the risks to our business relating to the Treasury agreements, refer to Item 1A Risk Factors.

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Senior Preferred Stock Purchase Agreement and Related Issuance of Senior Preferred Stock and Common Stock Warrant

Senior Preferred Stock Purchase Agreement

On September 7, 2008, we, through FHFA, in its capacity as conservator, and Treasury entered into a senior preferred stock purchase agreement, which was subsequently amended and restated on September 26, 2008. We refer to this agreement as the senior preferred stock purchase agreement. Pursuant to the agreement, we agreed to issue to Treasury (1) one million shares of Variable Liquidation Preference Senior Preferred Stock, Series 2008-2, which we refer to as the senior preferred stock, with an initial liquidation preference equal to $1,000 per share (for an aggregate liquidation preference of $1.0 billion), and (2) a warrant to purchase, for a nominal price, shares of common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis at the time the warrant is exercised, which we refer to as the warrant. The terms of the senior preferred stock and warrant are summarized in separate sections below. We did not receive any cash proceeds from Treasury at the time the senior preferred stock or the warrant was issued.

The senior preferred stock and warrant were issued to Treasury as an initial commitment fee in consideration of the commitment from Treasury to provide up to $100.0 billion in funds to us under the terms and conditions set forth in the senior preferred stock purchase agreement. The senior preferred stock purchase agreement provides that, on a quarterly basis, we generally may draw funds up to the amount, if any, by which our total liabilities exceed our total assets, as reflected on our consolidated balance sheet, prepared in accordance with GAAP, for the applicable fiscal quarter (referred to as the deficiency amount), provided that the aggregate amount funded under the agreement may not exceed $100.0 billion.

On February 18, 2009, Treasury announced that it is amending the senior preferred stock purchase agreement to increase its commitment from $100.0 billion to $200.0 billion and revise some of the covenants under the senior preferred stock purchase agreement. Because an amended agreement has not been executed as of the date of this report, the description of the senior preferred stock purchase agreement in this section is of the terms of the existing agreement.

The senior preferred stock purchase agreement provides that the deficiency amount will be calculated differently if we become subject to receivership or other liquidation process. The deficiency amount may be increased above the otherwise applicable amount upon our mutual written agreement with Treasury. In addition, if the Director of FHFA determines that the Director will be mandated by law to appoint a receiver for us unless our capital is increased by receiving funds under the commitment in an amount up to the deficiency amount (subject to the maximum amount that may be funded under the agreement), then FHFA, in its capacity as our conservator, may request that Treasury provide funds to us in such amount. The senior preferred stock purchase agreement also provides that, if we have a deficiency amount as of the date of completion of the liquidation of our assets, FHFA (or our Chief Financial Officer if we are not under conservatorship), may request funds from Treasury in an amount up to the deficiency amount (subject to the maximum amount that may be funded under the agreement).

At December 31, 2008, our total liabilities exceeded our total assets, as reflected on our consolidated balance sheet, by $15.2 billion. The Director of FHFA submitted a request on February 25, 2009 for funds from Treasury on our behalf under the terms of the senior preferred stock purchase agreement to eliminate our net worth deficit as of December 31, 2008. FHFA requested that Treasury provide the funds on or prior to March 31, 2009. The amounts we draw under the senior preferred stock purchase agreement will be added to the liquidation preference of the senior preferred stock, and no additional shares of senior preferred stock will be issued under the senior preferred stock purchase agreement.

In addition to the issuance of the senior preferred stock and warrant, beginning on March 31, 2010, we are required to pay a quarterly commitment fee to Treasury. This quarterly commitment fee will accrue from January 1, 2010. The fee, in an amount to be mutually agreed upon by us and Treasury and to be determined with reference to the market value of Treasury s funding commitment as then in effect, will be determined on or before December 31, 2009, and will be reset every five years. Treasury may waive the quarterly commitment fee for up to one year at a time, in its sole discretion, based on adverse conditions in the

U.S. mortgage market. We may elect to pay the quarterly commitment fee in cash or add the amount of the fee to the liquidation preference of the senior preferred stock.

The senior preferred stock purchase agreement provides that the Treasury s funding commitment will terminate under any of the following circumstances: (1) the completion of our liquidation and fulfillment of Treasury s obligations under its funding commitment at that time, (2) the payment in full of, or reasonable provision for, all of our liabilities (whether or not contingent, including mortgage guaranty obligations), or (3) the funding by Treasury of the maximum amount that may be funded under the agreement. In addition, Treasury may terminate its funding commitment and declare the senior preferred stock purchase agreement null and void if a court vacates, modifies, amends, conditions, enjoins, stays or otherwise affects the appointment of the conservator or otherwise curtails the conservator s powers. Treasury may not terminate its funding commitment under the agreement solely by reason of our being in conservatorship, receivership or other insolvency proceeding, or due to our financial condition or any adverse change in our financial condition.

The senior preferred stock purchase agreement provides that most provisions of the agreement may be waived or amended by mutual written agreement of the parties; however, no waiver or amendment of the agreement is permitted that would decrease Treasury s aggregate funding commitment or add conditions to Treasury s funding commitment if the waiver or amendment would adversely affect in any material respect the holders of our debt securities or guaranteed Fannie Mae MBS.

In the event of our default on payments with respect to our debt securities or guaranteed Fannie Mae MBS, if Treasury fails to perform its obligations under its funding commitment and if we and/or the conservator are not diligently pursuing remedies in respect of that failure, the holders of our debt securities or Fannie Mae MBS may file a claim in the United States Court of Federal Claims for relief requiring Treasury to fund to us the lesser of (1) the amount necessary to cure the payment defaults on our debt and Fannie Mae MBS and (2) the lesser of (a) the deficiency amount and (b) the maximum amount that may be funded under the agreement less the aggregate amount of funding previously provided under the commitment. Any payment that Treasury makes under those circumstances will be treated for all purposes as a draw under the senior preferred stock purchase agreement that will increase the liquidation preference of the senior preferred stock.

The senior preferred stock purchase agreement includes several covenants that significantly restrict our business activities, which are described below under Covenants Under Treasury Agreements Senior Preferred Stock Purchase Agreement Covenants.

Issuance of Senior Preferred Stock

Pursuant to the senior preferred stock purchase agreement, we issued one million shares of senior preferred stock to Treasury on September 8, 2008. The senior preferred stock was issued to Treasury in partial consideration of Treasury s commitment to provide up to $100.0 billion in funds to us under the terms set forth in the senior preferred stock purchase agreement.

Shares of the senior preferred stock have no par value, and had a stated value and initial liquidation preference equal to $1,000 per share for an aggregate liquidation preference of $1.0 billion. The liquidation preference of the senior preferred stock is subject to adjustment. Dividends that are not paid in cash for any dividend period will accrue and be added to the liquidation preference of the senior preferred stock. In addition, any amounts Treasury pays to us pursuant to its funding commitment under the senior preferred stock purchase agreement and any quarterly commitment fees that are not paid in cash to Treasury or waived by Treasury will be added to the liquidation preference of the senior preferred stock. Accordingly, the amount of the aggregate liquidation preference of the senior preferred stock will increase to $16.2 billion as a result of our expected draw, and will further increase by the amount of each additional draw on Treasury s funding commitment.

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Treasury, as holder of the senior preferred stock, is entitled to receive, when, as and if declared by our Board of Directors, out of legally available funds, cumulative quarterly cash dividends at the annual rate of 10% per year on the then-current liquidation preference of the senior preferred stock. As conservator and under our charter, FHFA also has authority to declare and approve dividends on the senior preferred stock. The initial dividend of approximately $31 million was declared by the conservator and paid in cash on December 31, 2008 for the period from but not including September 8, 2008 through and including December 31, 2008. As a result of the expected draw, our annualized aggregate dividend payment to Treasury, at the 10% dividend rate, will increase to $1.6 billion. If at any time we fail to pay cash dividends in a timely manner, then immediately following such failure and for all dividend periods thereafter until the dividend period following the date on which we have paid in cash full cumulative dividends (including any unpaid dividends added to the liquidation preference), the dividend rate will be 12% per year.

The senior preferred stock ranks ahead of our common stock and all other outstanding series of our preferred stock, as well as any capital stock we issue in the future, as to both dividends and rights upon liquidation. The senior preferred stock provides that we may not, at any time, declare or pay dividends on, make distributions with respect to, or redeem, purchase or acquire, or make a liquidation payment with respect to, any common stock or other securities ranking junior to the senior preferred stock unless (1) full cumulative dividends on the outstanding senior preferred stock (including any unpaid dividends added to the liquidation preference) have been declared and paid in cash, and (2) all amounts required to be paid with the net proceeds of any issuance of capital stock for cash (as described in the following paragraph) have been paid in cash. Shares of the senior preferred stock are not convertible. Shares of the senior preferred stock have no general or special voting rights, other than those set forth in the certificate of designation for the senior preferred stock or otherwise required by law. The consent of holders of at least two-thirds of all outstanding shares of senior preferred stock is generally required to amend the terms of the senior preferred stock or to create any class or series of stock that ranks prior to or on parity with the senior preferred stock.

We are not permitted to redeem the senior preferred stock prior to the termination of Treasury s funding commitment set forth in the senior preferred stock purchase agreement. Moreover, we are not permitted to pay down the liquidation preference of the outstanding shares of senior preferred stock except to the extent of (1) accrued and unpaid dividends previously added to the liquidation preference and not previously paid down; and (2) quarterly commitment fees previously added to the liquidation preference and not previously paid down. In addition, if we issue any shares of capital stock for cash while the senior preferred stock is outstanding, the net proceeds of the issuance must be used to pay down the liquidation preference of the senior preferred stock; however, the liquidation preference of each share of senior preferred stock may not be paid down below $1,000 per share prior to the termination of Treasury s funding commitment. Following the termination of Treasury s funding commitment, we may pay down the liquidation preference of all outstanding shares of senior preferred stock at any time, in whole or in part. If, after termination of Treasury s funding commitment, we pay down the liquidation preference of each outstanding share of senior preferred stock in full, the shares will be deemed to have been redeemed as of the payment date.

Issuance of Common Stock Warrant

Pursuant to the senior preferred stock purchase agreement, on September 7, 2008, we, through FHFA, in its capacity as conservator, issued a warrant to purchase common stock to Treasury. The warrant was issued to Treasury in partial consideration of Treasury s commitment to provide up to $100.0 billion in funds to us under the terms set forth in the senior preferred stock purchase agreement.

The warrant gives Treasury the right to purchase shares of our common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis on the date of exercise. The warrant may be exercised in whole or in part at any time on or before September 7, 2028, by delivery to us of: (a) a notice of exercise; (b) payment of the exercise price of $0.00001 per share; and (c) the warrant. If the market price of one share of our common stock is greater than the exercise price, then, instead of paying the exercise price, Treasury may elect to receive shares equal to the value of the warrant (or portion thereof being canceled) pursuant to the formula specified in the warrant. Upon exercise of the warrant, Treasury may assign the right to receive the shares of common stock issuable upon exercise to any other person. The warrant contains several covenants, which are described under Covenants Under Treasury Agreements Warrant Covenants.

As of February 26, 2009, Treasury has not exercised the warrant in whole or in part.

Treasury Credit Facility

On September 19, 2008, we entered into a lending agreement with Treasury under which we may request loans until December 31, 2009, which we refer to as the Treasury credit facility. Loans under the Treasury credit facility require approval from Treasury at the time of request. Treasury is not obligated under the credit facility to make, increase, renew or extend any loan to us. The credit facility does not specify a maximum amount that may be borrowed under the credit facility, but any loans made to us by Treasury pursuant to the credit facility must be collateralized by Fannie Mae MBS or Freddie Mac mortgage-backed securities. Refer to Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Liquidity Contingency Plan Treasury Credit Facility for a discussion of the collateral that we could pledge under the Treasury credit facility. Further, unless amended or waived by Treasury, the amount we may borrow under the credit facility is limited by the restriction under the senior preferred stock purchase agreement on incurring debt in excess of 110% of our aggregate indebtedness as of June 30, 2008. Our calculation of our aggregate indebtedness as of June 30, 2008, which has not been confirmed by Treasury, set this debt limit at $892.0 billion. As of January 31, 2009, we estimate that our aggregate indebtedness totaled $885.0 billion, significantly limiting our ability to issue additional debt.

The credit facility does not specify the maturities or interest rate of loans that may be made by Treasury under the credit facility. In a Fact Sheet regarding the credit facility published by Treasury on September 7, 2008, Treasury indicated that loans made pursuant to the credit facility will be for short-term durations and would in general be expected to be for less than one month but no shorter than one week. The Fact Sheet further indicated that the interest rate on loans made pursuant to the credit facility ordinarily will be based on the daily London Inter-bank Offer Rate, or LIBOR, for a similar term of the loan plus 50 basis points. Given that the interest rate we are likely to be charged under the credit facility will be significantly higher than the rates we have historically achieved through the sale of unsecured debt, use of the facility, particularly in significant amounts, would likely have a material adverse impact on our financial results.

As of February 26, 2009, we have not requested any loans or borrowed any amounts under the Treasury credit facility. For a description of the covenants contained in the credit facility, refer to Covenants Under Treasury Agreements Treasury Credit Facility Covenants below.

Covenants Under Treasury Agreements

The senior preferred stock purchase agreement, warrant and Treasury credit facility contain covenants that significantly restrict our business activities. These covenants, which are summarized below, include a prohibition on our issuance of additional equity securities (except in limited instances), a prohibition on the payment of dividends or other distributions on our equity securities (other than the senior preferred stock or warrant), a prohibition on our issuance of subordinated debt and a limitation on the total amount of debt securities we may issue. As a result, we can no longer obtain additional equity financing (other than pursuant to the senior preferred stock purchase agreement) and we are limited in the amount and type of debt financing we may obtain.

Senior Preferred Stock Purchase Agreement Covenants

The senior preferred stock purchase agreement provides that, until the senior preferred stock is repaid or redeemed in full, we may not, without the prior written consent of Treasury:

Declare or pay any dividend (preferred or otherwise) or make any other distribution with respect to any Fannie Mae equity securities (other than with respect to the senior preferred stock or warrant);

Redeem, purchase, retire or otherwise acquire any Fannie Mae equity securities (other than the senior preferred stock or warrant);

Sell or issue any Fannie Mae equity securities (other than the senior preferred stock, the warrant and the common stock issuable upon exercise of the warrant and other than as required by the terms of any binding agreement in effect on the date of the senior preferred stock purchase agreement);

Terminate the conservatorship (other than in connection with a receivership);

Sell, transfer, lease or otherwise dispose of any assets, other than dispositions for fair market value: (a) to a limited life regulated entity (in the context of a receivership); (b) of assets and properties in the ordinary course of business, consistent with past practice; (c) in connection with our liquidation by a receiver; (d) of cash or cash equivalents for cash or cash equivalents; or (e) to the extent necessary to comply with the covenant described below relating to the reduction of our mortgage assets beginning in 2010;

Incur indebtedness that would result in our aggregate indebtedness exceeding 110% of our aggregate indebtedness as of June 30, 2008;

Issue any subordinated debt;

Enter into a corporate reorganization, recapitalization, merger, acquisition or similar event; or

Engage in transactions with affiliates unless the transaction is (a) pursuant to the senior preferred stock purchase agreement, the senior preferred stock or the warrant, (b) upon arm s-length terms or (c) a transaction undertaken in the ordinary course or pursuant to a contractual obligation or customary employment arrangement in existence on the date of the senior preferred stock purchase agreement.

The senior preferred stock purchase agreement also provides that we may not own mortgage assets in excess of (a) $850.0 billion on December 31, 2009, or (b) on December 31 of each year thereafter, 90% of the aggregate amount of our mortgage assets as of December 31 of the immediately preceding calendar year, provided that we are not required to own less than $250.0 billion in mortgage assets. The covenant in the agreement prohibiting us from issuing debt in excess of 110% of our aggregate indebtedness as of June 30, 2008 likely will prohibit us from increasing the size of our mortgage portfolio to $850.0 billion, unless Treasury elects to amend or waive this limitation.

On February 18, 2009, Treasury announced that it is amending the senior preferred stock purchase agreement to increase the size of the mortgage portfolio allowed under the agreement by $50.0 billion to $900.0 billion, with a corresponding increase in the allowable debt outstanding. Because an amended agreement has not been executed as of the date of this report, this description of the covenants in the senior preferred stock purchase agreement is of the terms of the existing agreement, without these changes.

In addition, the senior preferred stock purchase agreement provides that we may not enter into any new compensation arrangements or increase amounts or benefits payable under existing compensation arrangements of any named executive officer (as defined by SEC rules) without the consent of the Director of FHFA, in consultation with the Secretary of the Treasury.

We are required under the senior preferred stock purchase agreement to provide annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K to Treasury in accordance with the time periods specified in the SEC s rules. In addition, our designated representative (which, during the conservatorship, is the conservator) is required to provide quarterly certifications to Treasury certifying compliance with the covenants contained in the senior preferred stock purchase agreement and the accuracy of the representations made pursuant to the agreement. We also are obligated to provide prompt notice to Treasury of the occurrence of specified events, such as the filing of a lawsuit that would reasonably be expected to have a material adverse effect.

As of February 26, 2009, we believe we were in compliance with the material covenants under the senior preferred stock purchase agreement.

Warrant Covenants

The warrant we issued to Treasury includes, among others, the following covenants:

- Our SEC filings under the Exchange Act will comply in all material respects as to form with the Exchange Act and the rules and regulations thereunder;
- We may not permit any of our significant subsidiaries to issue capital stock or equity securities, or securities convertible into or exchangeable for such securities, or any stock appreciation rights or other profit participation rights;
- We may not take any action that will result in an increase in the par value of our common stock;
- We may not take any action to avoid the observance or performance of the terms of the warrant and we must take all actions necessary or appropriate to protect Treasury s rights against impairment or dilution; and
- We must provide Treasury with prior notice of specified actions relating to our common stock, including setting a record date for a dividend payment, granting subscription or purchase rights, authorizing a recapitalization, reclassification, merger or similar transaction, commencing a liquidation of the company or any other action that would trigger an adjustment in the exercise price or number or amount of shares subject to the warrant.

The warrant remains outstanding through September 7, 2028. As of February 26, 2009, we believe we were in compliance with the material covenants under the warrant.

Treasury Credit Facility Covenants

The Treasury credit facility includes covenants requiring us, among other things:

- to maintain Treasury s security interest in the collateral, including the priority of the security interest, and take actions to defend against adverse claims;
- not to sell or otherwise dispose of, pledge or mortgage the collateral (other than Treasury s security interest);
- not to act in any way to impair, or to fail to act in a way to prevent the impairment of, Treasury s rights or interests in the collateral;
- promptly to notify Treasury of any failure or impending failure to meet our regulatory capital requirements;
- to provide for periodic audits of collateral held under borrower-in-custody arrangements, and to comply with certain notice and certification requirements;
- promptly to notify Treasury of the occurrence or impending occurrence of an event of default under the terms of the lending agreement; and
- to notify Treasury of any change in applicable law or regulations, or in our charter or bylaws, or certain other events, that may materially affect our ability to perform our obligations under the lending agreement.

The Treasury credit facility expires on December 31, 2009. As of February 26, 2009, we believe we were in compliance with the material covenants under the Treasury credit facility.

Effect of Treasury Agreements on Shareholders

The agreements with Treasury have materially limited the rights of our common and preferred shareholders (other than Treasury as holder of the senior preferred stock). The senior preferred stock purchase agreement

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and the senior preferred stock and warrant issued to Treasury pursuant to the agreement have had the following adverse effects on our common and preferred shareholders:

- the senior preferred stock ranks senior to the common stock and all other series of preferred stock as to both dividends and distributions upon dissolution, liquidation or winding up of the company;

- the senior preferred stock purchase agreement prohibits the payment of dividends on common or preferred stock (other than the senior preferred stock) without the prior written consent of Treasury; and

- the warrant provides Treasury with the right to purchase shares of our common stock equal to up to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis on the date of exercise for a nominal price, thereby substantially diluting the ownership in Fannie Mae of our common shareholders at the time of exercise. Until Treasury exercises its rights under the warrant or its right to exercise the warrant expires on September 7, 2028 without having been exercised, the holders of our common stock continue to have the risk that, as a group, they will own no more than 20.1% of the total voting power of the company. Under our charter, bylaws and applicable law, 20.1% is insufficient to control the outcome of any vote that is presented to the common shareholders. Accordingly, existing common shareholders have no assurance that, as a group, they will be able to control the election of our directors or the outcome of any other vote after the conservatorship ends.

As described above and in Item 1A Risk Factors, the Treasury agreements also impact our business in ways that indirectly affect our common and preferred shareholders.

New York Stock Exchange Listing

As of February 26, 2009, our common stock continues to trade on the NYSE. We received a notice from the NYSE on November 12, 2008 that we had failed to satisfy one of the NYSE s standards for continued listing of our common stock because the average closing price of our common stock during the 30 consecutive trading days ended November 12, 2008 had been less than $1.00 per share.

On November 26, 2008, we advised the NYSE of our intent to cure this deficiency by May 11, 2009. At that time, we also advised the NYSE that, if necessary to cure the deficiency by that date, and subject to the approval of Treasury, we might undertake a reverse stock split, in which we would combine some specified number of shares of our common stock into a single share of our common stock. We are working internally and with the conservator to determine the specific action or actions that we will take.

If our share price and our average share price for the 30 consecutive trading days preceding May 11, 2009 is not at or above $1.00 as of May 11, 2009, the NYSE rules provide that the NYSE will initiate suspension and delisting procedures for our common stock. At that time, we expect that the NYSE also would delist all classes of our preferred stock. For a description of the risks to our business if the NYSE were to delist our common and preferred stock, refer to Item 1A Risk Factors.

Charter Act

We are a shareholder-owned corporation, originally established in 1938, organized and existing under the Federal National Mortgage Association Charter Act, as amended, which we refer to as the Charter Act or our charter. The Charter Act sets forth the activities that we are permitted to conduct, authorizes us to issue debt and equity securities, and describes our general corporate powers. The Charter Act states that our purpose is to:

- provide stability in the secondary market for residential mortgages;

respond appropriately to the private capital market;

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

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

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

Loan Standards

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

Principal Balance Limitations. Our charter permits us to purchase and securitize conventional mortgage loans secured by either a single-family or multifamily property. Single-family conventional mortgage loans are generally subject to maximum original principal balance limits. The principal balance limits are often referred to as conforming loan limits and are established each year based on the national average price of a one-family residence. The conforming loan limit for a one-family residence was $417,000 for 2008.

The Economic Stimulus Act of 2008 temporarily increased our conforming loan limits in high-cost areas for loans originated between July 1, 2007 and December 31, 2008, which we refer to as jumbo-conforming loans. For a one-family residence, the loan limit increased to 125% of the area s median house price, up to a maximum of $729,750. Higher original principal balance limits apply to mortgage loans secured by two- to four-family residences and also to loans in Alaska, Hawaii, Guam and the Virgin Islands. In July 2008, HERA was signed into law. This legislation provided permanent authority for the GSEs to use higher loan limits in high-cost areas effective January 1, 2009. These limits will be set annually by FHFA.

In November 2008, FHFA announced that the conforming loan limit for a one-unit property would remain $417,000 for 2009 for most areas in the United States, but specified higher limits in certain cities and counties. Loan limits for two-, three-, and four-unit properties in 2009 also remain at 2008 levels. Following the provisions of HERA, FHFA has set loan limits for high-cost areas in 2009. These limits are set equal to 115% of local median house prices and cannot exceed 150% of the standard limit, which is $625,500 for one-unit homes in the contiguous United States. The 2009 maximum conforming limits remain higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands. No statutory limits apply to the maximum original principal balance of multifamily mortgage loans that we purchase or securitize. In addition, the Charter Act imposes no maximum original principal balance limits on loans we purchase or securitize that are insured by the FHA or guaranteed by the VA, home improvement loans, and loans secured by manufactured housing.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009, which included a provision that returns the conforming loan limits for loans originated in 2009 to those limits established in the Economic Stimulus Act of 2008 (except in a limited number of areas where the limits established by HERA were greater).

Loan-to-Value and Credit Enhancement Requirements. The Charter Act generally requires credit enhancement on any conventional single-family mortgage loan that we purchase or securitize if it has a loan-to-value ratio over 80% at the time of purchase. We also do not purchase or securitize second lien single-family mortgage loans when the combined loan-to-value ratio exceeds 80%, unless the second lien mortgage loan has credit enhancement in accordance with the requirements of the Charter Act. The credit enhancement required by our charter may take the form of one or more of the following: (i) insurance or a guaranty by a qualified insurer; (ii) a seller s agreement to repurchase or replace any mortgage loan in default (for such period and under such circumstances as we may require); or (iii) retention by the seller of at least a 10% participation interest in the mortgage loans. We do not adjust the loan-to-value ratio of loans bearing credit enhancement to reflect that credit enhancement. On February 19, 2009, in conjunction with the announcement of HASP, FHFA determined that, until June 10, 2010, we may refinance borrowers with mortgages that we hold or guarantee into new mortgages, without the need for these borrowers to obtain additional credit enhancement (such as private mortgage insurance) on their refinanced loans in excess of what was already in place. The credit enhancement requirement under the Charter Act may hinder our ability to refinance mortgage loans that we do not already own or guarantee where mortgage insurance or other credit enhancement is not available. Regardless of loan-to-value ratio, the Charter Act does not require us to obtain credit enhancement to purchase or securitize loans insured by the FHA or guaranteed by the VA, home improvement loans or loans secured by manufactured housing.

Other Charter Act Provisions

The Charter Act has the following additional provisions.

Issuances of Our Securities. The Charter Act authorizes us, upon approval of the Secretary of the Treasury, to issue debt obligations and mortgage-related securities. Neither the U.S. government nor any of its agencies guarantees, directly or indirectly, our debt or mortgage-related securities. At the discretion of the Secretary of Treasury, Treasury may purchase our obligations up to a maximum of $2.25 billion outstanding at any one time. In addition, the Charter Act, as amended by the Regulatory Reform Act, provides Treasury with expanded temporary authority to purchase our obligations and securities in unlimited amounts (up to the national debt limit) until December 31, 2009. We describe Treasury s investment in our securities pursuant to this authority above under Treasury Agreements.

Exemptions for Our Securities. Securities we issue are exempted securities under laws administered by the SEC, except that as a result of the Regulatory Reform Act, our equity securities are not treated as exempted securities for purposes of Sections 12, 13, 14 or 16 of the Securities Exchange Act of 1934, or the Exchange Act. Consequently, we are required to file periodic and current reports with the SEC, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. However, we are not required to file registration statements with the SEC with respect to offerings of our securities pursuant to this exemption.

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

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

Regulation and Oversight of Our Activities

As a federally chartered corporation, we are subject to Congressional legislation and oversight. As a company under conservatorship, our primary regulator has management authority over us in its role as our conservator. The Regulatory Reform Act established FHFA as an independent agency with general supervisory and regulatory authority over Fannie Mae, Freddie Mac and the 12 FHLBs. FHFA assumed the duties of our former regulators, OFHEO and HUD, with respect to safety and soundness and mission oversight of Fannie Mae and Freddie Mac. HUD remains our regulator with respect to fair lending matters. We reference OFHEO in this report with respect to actions taken by our safety and soundness regulator prior to the creation of FHFA on July 30, 2008. As applicable, we reference HUD in this section with respect to actions taken by our mission regulator prior to the creation of FHFA on July 30, 2008. Our regulators also include the SEC and Treasury.

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Regulatory Reform Act

The Regulatory Reform Act was signed into law on July 30, 2008, and became effective immediately. This legislation provided FHFA with safety and soundness authority that is stronger than the authority that was available to OFHEO, and that is comparable to and in some respects broader than that of the federal banking agencies. The legislation gave FHFA the authority, even if we had not been placed into conservatorship, to raise capital levels above statutory minimum levels, regulate the size and content of our portfolio, and approve new mortgage products. The legislation also gave FHFA the authority to place the GSEs into conservatorship or receivership under conditions set forth in the statute. We expect that FHFA will continue to implement the various provisions of the legislation over the next several months. In general, we remain subject to regulations, orders and determinations that existed prior to the enactment of the Regulatory Reform Act until new ones are issued or made. Below are some key provisions of the Regulatory Reform Act.

Safety and Soundness Provisions

Conservatorship and Receivership. The legislation gave FHFA enhanced authority to place us into conservatorship, based on certain specified grounds. Pursuant to this authority, FHFA placed us into conservatorship on September 6, 2008. The legislation also gave FHFA new authority to place us into receivership at the discretion of the Director of FHFA, based on certain specified grounds, at any time, including directly from conservatorship. Further, FHFA must place us into receivership if it determines that our liabilities have exceeded our assets for 60 days, or we have not been paying our debts as they become due for 60 days.

Capital. FHFA has broad authority to establish risk-based capital standards to ensure that we operate in a safe and sound manner and maintain sufficient capital and reserves. FHFA also has broad authority to increase the level of our required minimum capital and to establish capital or reserve requirements for specific products and activities, so as to ensure that we operate in a safe and sound manner. On October 9, 2008, FHFA announced that our capital requirements will not be binding during the conservatorship. We describe our capital requirements below under Capital Adequacy Requirements. Pursuant to its new authority under the Regulatory Reform Act, FHFA has announced that it will be revising our minimum capital and risk-based capital requirements.

Portfolio. FHFA is required to establish standards governing our portfolio holdings, to ensure that they are backed by sufficient capital and consistent with our mission and safe and sound operations. FHFA is also required to monitor our portfolio and, in some circumstances, may require us to dispose of or acquire assets. On January 30, 2009, FHFA published an interim final rule adopting, as the standard for our portfolio holdings, the portfolio cap established by the senior preferred stock purchase agreement described under Treasury Agreements Covenants under Treasury Agreements, as it may be amended from time to time. The interim final rule is effective for as long as we remain subject to the terms and obligations of the senior preferred stock purchase agreement.

Prompt Corrective Action. FHFA has prompt corrective action authority, including the discretionary authority to change our capital classification under certain circumstances and to restrict our growth and activities if we are not adequately capitalized.

Enforcement Powers. FHFA has enforcement powers, including cease-and-desist authority, authority to impose civil monetary penalties, and authority to suspend or remove directors and management.

Mission Provisions

Products and Activities. We are required, with some exceptions, to obtain the approval of FHFA before we initially offer a product. The process for obtaining FHFA s approval includes a 30-day public notice and comment period relating to the product. A product may be approved only if it is authorized by our charter, in the public interest, and consistent with the safety and soundness of the enterprise and the mortgage finance system. We must provide written notice to FHFA before commencing any new activity.

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Affordable Housing Allocations. The legislation requires us to make annual allocations to fund government affordable housing programs, based on the dollar amount of our total new business purchases, at the rate of 4.2 basis points per dollar. FHFA must issue regulations prohibiting us from redirecting the cost of our allocations, through increased charges or fees, or decreased premiums, or in any other manner, to the originators of mortgages that we purchase or securitize. The legislation requires FHFA to temporarily suspend our allocation upon finding that it is contributing or would contribute to our financial instability; is causing or would cause us to be classified as undercapitalized; or is preventing or would prevent us from successfully completing a capital restoration plan. On November 13, 2008, we received notice from FHFA that it was suspending our allocation until further notice.

Affordable Housing Goals and Duty to Serve. The legislation restructured our affordable housing goals. We discuss our affordable housing goals below under Housing Goals and Subgoals.

<u>*Temporary Provisions*</u>

Enhanced Authority of U.S. Treasury to Purchase GSE Securities. The Secretary of the Treasury has long had authority to purchase up to $2.25 billion of our obligations. The legislation provides the Secretary of the Treasury with additional temporary authority to purchase our obligations and other securities in unlimited amounts (up to the national debt limit) and on terms that the Secretary may determine, subject to our agreement. This expanded authority expires on December 31, 2009. We describe Treasury s investment in our securities pursuant to this authority above under Treasury Agreements.

Consultation with the Federal Reserve Board Chairman. Until December 31, 2009, FHFA must consult with the Chairman of the Federal Reserve Board on risks posed by the GSEs to the financial system before taking certain regulatory actions such as issuance of regulations regarding capital or portfolio, or appointment of a conservator or receiver.

<u>*Other Provisions*</u>

Conforming Loan Limits. The legislation permanently increased our conforming loan limit in high cost areas, to the lower of 115% of the median home price for comparable properties in the area, or 150% of the otherwise applicable loan limit (currently $625,500). This provision became effective on January 1, 2009. The 2009 Stimulus Act further increased our loan limits in high cost areas for loans originated in 2009 as described under Charter Act Loan Standards Principal Balance Limitations.

Executive Compensation. The legislation directs FHFA to prohibit us from providing unreasonable or non-comparable compensation to our executive officers. FHFA may at any time review the reasonableness and comparability of an executive officer s compensation and may require us to withhold any payment to the officer during such review. In addition, under the Regulatory Reform Act, FHFA, as our regulator, has the power to approve, disapprove or modify executive compensation until December 31, 2009. However, during the conservatorship, FHFA, as conservator, has succeeded to all the powers of the Board and management. FHFA has delegated to the Board the authority to approve compensation for most officers and employees, and has retained approval rights for compensation for certain senior officers.

Under the Regulatory Reform Act, FHFA is also authorized to prohibit or limit certain golden parachute and indemnification payments to directors, officers, and certain other parties. In September 2008, the Director of FHFA notified us that severance and certain other payments contemplated in the employment contract of Daniel H. Mudd, our former President and Chief Executive Officer, are golden parachute payments within the meaning of the Regulatory Reform Act and should not be paid, effective immediately. In January 2009, FHFA issued final regulations relating to golden parachute payments, under which FHFA may limit golden parachute payments as defined, and that set forth factors to be considered by the Director of FHFA in acting upon his authority to limit these payments.

Board of Directors. The legislation provides that our Board shall consist of 13 persons elected by the shareholders, or such other number as the Director of FHFA determines appropriate. Our Board shall at all times have as members at least one person from the homebuilding, mortgage lending, and real estate industries, and at least one person from an organization representing consumer or community interests or one person who has demonstrated a career commitment to the provision of housing for low-income households. Upon our entry into conservatorship, FHFA succeeded to all the rights and powers of our Board of Directors. FHFA reconstituted our Board on November 24, 2008 and appointed a Board of Directors with specific delegated authorities that became effective on December 19, 2008, as described above Conservatorship Management of the Company Under Conservatorship.

Exam Authority and Expenses. FHFA, in its role as our regulator, has agency examination authority, and we are required to submit to FHFA annual and quarterly reports on our financial condition and results of operations. FHFA is authorized to levy annual assessments on us, Freddie Mac and the FHLBs, to the extent authorized by Congress, to cover FHFA s reasonable expenses.

Housing Goals and Subgoals

Since 1993, we have been subject to housing goals, which have been set as a percentage of the total number of dwelling units underlying our total mortgage purchases, and have been intended to expand housing opportunities (1) for low- and moderate-income families, (2) in HUD-defined underserved areas, including central cities and rural areas, and (3) for low-income families in low-income areas and for very low-income families, which is referred to as special affordable housing. In addition, in 2004, HUD established three home purchase subgoals that have been expressed as percentages of the total number of mortgages we purchase that finance the purchase of single-family, owner-occupied properties located in metropolitan areas. Since 1995, we have also been required to meet a subgoal for multifamily special affordable housing that is expressed as a dollar amount. The Regulatory Reform Act changed the structure of the housing goals beginning in 2010, and gave FHFA the authority to set and enforce the housing goals.

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

The following table compares our performance against the housing goals and subgoals for 2008, 2007 and 2006. The 2006 and 2007 performance results are final results that were validated by HUD and FHFA, respectively. The 2008 performance results are preliminary results that we have not finalized and that also have not yet been validated by FHFA.

Housing Goals and Subgoals Performance

	2008		**2007**		**2006**	
	Result(1)	**Goal**	**Result(1)**	**Goal**	**Result(1)**	**Goal**
Housing goals:(2)						
Low- and moderate-income housing	53.6%	56.0%	55.5%	55.0%	56.9%	53.0%
Underserved areas	39.4	39.0	43.4	38.0	43.6	38.0
Special affordable housing	26.0	27.0	26.8	25.0	27.8	23.0
Housing subgoals:						
Home purchase subgoals:(3)						
Low- and moderate-income housing	38.9%	47.0%	42.1%	47.0%	46.9%	46.0%
Underserved areas	30.4	34.0	33.4	33.0	34.5	33.0
Special affordable housing	13.6	18.0	15.5	18.0	18.0	17.0
	$ 13.42	$ 5.49	$ 19.84	$ 5.49	$ 13.31	$ 5.49

Multifamily special affordable housing
subgoal
($ in billions)[4]

(1) Results presented for 2008 are preliminary and reflect our best estimates as of the date of this report. These results may differ from the results we report in our Annual Housing Activities Report for 2008. Some results differ from the results we reported in our Annual Housing Activities Reports for 2007 and 2006.

(2) Goals are expressed as a percentage of the total number of dwelling units financed by eligible mortgage loan purchases during the period.

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

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

As shown by the table above, we met all of our housing goals and subgoals in 2006. In 2007, we met each of our three housing goals and two of the four subgoals. However, we did not meet our low- and moderate-income housing and special affordable housing home purchase subgoals in 2007. In April 2008, HUD notified us of its determination that achievement of these subgoals was not feasible, primarily due to reduced housing affordability and turmoil in the mortgage market, which reduced the share of the conventional conforming primary home purchase market that would qualify for these subgoals. As a result, we were not required to submit a housing plan.

Declining market conditions and the increased goal levels in 2008 made meeting our housing goals and subgoals even more challenging than in 2007 or in previous years. Based on preliminary calculations, we believe we did not meet the low- and moderate-income and special affordable housing goals, or any of the home purchase subgoals. We are in close contact with FHFA regarding our performance. The housing goals are subject to enforcement by the Director of FHFA. If FHFA finds that the goals were feasible, we may become subject to a housing plan that could require us to take additional steps that could have an adverse effect on our profitability. The housing plan must describe the actions we will take to meet the goal in the next calendar year and be approved by FHFA. The potential penalties for failure to comply with housing plan requirements are a cease-and-desist order and civil money penalties.

The Regulatory Reform Act restructured our affordable housing goals and created a new duty for us and Freddie Mac to serve three underserved markets manufactured housing, affordable housing preservation, and rural housing. With respect to these markets, we are required to provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families. Both the restructured goals and the new duty to serve take effect in 2010. The Regulatory Reform Act provides that the housing goals established for 2008 will remain in effect for 2009, except that by April 2009, FHFA must review the 2009 goals to determine their feasibility given the market conditions current at such time and, after seeking public comment for up to 30 days, FHFA may make appropriate adjustments to the 2009 goals consistent with such market conditions.

See Item 1A Risk Factors for a description of how changes we have made to our business strategies in order to meet our housing goals and subgoals have increased our credit losses and may reduce our profitability.

OFHEO Consent Order

During 2008, we were subject to a consent order that we entered into with OFHEO in May 2006. Concurrently with OFHEO s release of its final report of a special examination of our accounting policies and practices, internal controls, financial reporting, corporate governance, and other matters, we agreed to OFHEO s issuance of a consent order that resolved open matters relating to their investigation of us. Under the consent order, we neither admitted nor denied any wrongdoing. Effective March 1, 2008, OFHEO removed the limitation on the size of our portfolio under the consent order. In March 2008, OFHEO announced that we were in full compliance with the consent order, and OFHEO lifted the consent order effective May 6, 2008. Before we were placed into conservatorship in September 2008, we remained subject to the requirement that we maintain a capital surplus over our statutory minimum capital requirement. The capital surplus requirement was reduced from 30% to 20% in March 2008, and reduced further to 15% upon the completion of our capital raise in May 2008. On October 9, 2008, FHFA announced that our existing capital requirements will not be binding during the conservatorship.

Capital Adequacy Requirements

The 1992 Act establishes capital adequacy requirements. The statutory capital framework incorporates two different quantitative assessments of capital a minimum capital requirement and a risk-based capital requirement. The minimum capital requirement is ratio-based, while the risk-based capital requirement is based on simulated stress test performance. The 1992 Act requires us to maintain sufficient capital to meet both of these requirements in order to be classified as adequately capitalized.

Under the Regulatory Reform Act, FHFA has the authority to make a discretionary downgrade of our capital adequacy classification should certain safety and soundness conditions arise that could impact future capital adequacy. On October 9, 2008, FHFA announced that it was exercising its discretionary authority to classify us as undercapitalized as of June 30, 2008. Although we met the statutory capital requirements to be classified as adequately capitalized as of June 30, 2008, FHFA made its decision based on the factors described in Liquidity and Capital Management Capital Management Regulatory Capital. However, at the same time, FHFA announced that our existing statutory and FHFA-directed regulatory capital requirements will not be binding during the conservatorship. FHFA has directed us, during the time we are under conservatorship, to focus on managing to a positive net worth, provided that it is not inconsistent with our mission objectives. Pursuant to its authority under the Regulatory Reform Act, FHFA has announced that it will be revising our minimum capital and risk-based capital requirements.

Under the Regulatory Reform Act, a capital classification of undercapitalized requires us to submit a capital restoration plan and imposes certain restrictions on our asset growth and ability to make capital distributions. FHFA may also take various discretionary actions with respect to us if we are classified as undercapitalized, including requiring us to acquire new capital. FHFA has advised us that, because we are under conservatorship, we will not be subject to these corrective action requirements.

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

- 2.50% of on-balance sheet assets;
- 0.45% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and
- up to 0.45% of other off-balance sheet obligations, which may be adjusted by the Director of FHFA under certain circumstances.

For information on the amounts of our core capital and our statutory minimum capital requirement as of December 31, 2008 and 2007, see Part II Item 7 MD&A Liquidity and Capital Management Capital Management Regulatory Capital.

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

Our total capital base is used to meet our risk-based capital requirement. Total capital is defined by statute as the sum of our core capital plus the total allowance for loan losses and reserve for guaranty losses in connection with Fannie Mae MBS, less the specific loss allowance (that is, the allowance required on individually-impaired loans). Each quarter, our regulator runs a detailed profile of our book of business through the stress test simulation model. The model generates cash flows and financial statements to evaluate our risk and measure our capital adequacy during the ten-year stress horizon. FHFA has stated that it does not intend to report our risk-based capital level during the conservatorship.

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

1.25% of on-balance sheet assets;

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

up to 0.25% of other off-balance sheet obligations, which may be adjusted by the Director of FHFA under certain circumstances.

FHFA has stated that it does not intend to report our critical capital level during the conservatorship.

OUR CUSTOMERS

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

During 2008, approximately 1,000 lenders delivered mortgage loans to us, either for securitization or for purchase. We purchase a significant portion of our single-family mortgage loans from several large mortgage lenders. During 2008, our top five lender customers, in the aggregate, accounted for approximately 66% of our single-family business volume, compared with 56% in 2007. Three lender customers each accounted for 10% or more of our single-family business volume for 2008: Bank of America Corporation, Citigroup and Wells Fargo & Company, including each of their respective affiliates.

Our top lender customer is Bank of America Corporation, which acquired Countrywide Financial Corporation on July 1, 2008. Our single-family business volume from the two companies has decreased compared to 2007. Bank of America Corporation and its affiliates, following the acquisition of Countrywide Financial Corporation, accounted for approximately 19% of our single-family business volume in the second half of 2008. For 2007, Countrywide Financial Corporation and its affiliates accounted for approximately 28% of our single-family business volume and Bank of America Corporation accounted for approximately 4% of our single-family business volume.

Due to increasing consolidation within the mortgage industry, as well as a number of mortgage lenders having gone out of business since late 2006, we, as well as our competitors, seek business from a decreasing number of large mortgage lenders. As we become more reliant on a smaller number of lender customers, our negotiating leverage with these customers decreases, which could diminish our ability to price our products and services optimally. In addition, many of our lender customers are experiencing financial and liquidity problems that may affect the volume of business they are able to generate. We discuss these and other risks that this customer concentration poses to our business in Item 1A Risk Factors.

COMPETITION

Historically, our competitors have included Freddie Mac, Ginnie Mae (which primarily guarantees securities backed by FHA-insured loans), the FHLBs, FHA, financial institutions, securities dealers, insurance companies, pension funds, investment funds and other investors. During 2008, almost all of our competitors, other than Freddie Mae, Ginnie Mae and the FHLBs, have ceased their activities in the residential mortgage finance business.

We compete to purchase mortgage assets in the secondary market both for our investment portfolio and for securitization into Fannie Mae MBS. Competition for the acquisition of mortgage assets is affected by many factors, including the supply of residential mortgage loans offered for sale in the secondary market by loan originators and other market participants, the current demand for mortgage assets from mortgage investors, and the credit risk and prices associated with available mortgage investments.

We also compete for the issuance of mortgage-related securities to investors. Before the current market downturn, there was a significant increase in the issuance of mortgage-related securities by non-agency issuers, which caused a decrease in our share of the market for new issuances of single-family mortgage-related securities from 2003 to 2006. Non-agency issuers, also referred to as private-label issuers, are those issuers of mortgage-related securities other than agency issuers Fannie Mae, Freddie Mac and Ginnie Mae. The mortgage and credit market disruption led many investors to curtail their purchases of private-label mortgage-related securities in favor of mortgage-related securities backed by GSE guarantees or government guarantees (through Ginnie Mae). During 2008, we also experienced increased competition from Ginnie Mae (which primarily guarantees mortgage-related securities backed by FHA-insured loans), as issuance of single-family mortgage-related securities was predominately isolated to securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. As a result of these changes in investor demand, our estimated market share of new single-family mortgage-related securities issuance increased from approximately 24.6% for the fourth quarter of 2006 to approximately 48.5% for the fourth quarter of 2007, but then decreased to approximately 41.7% for the fourth quarter of 2008. In comparison, Ginnie Mae s market share of new single-family mortgage-related securities issuance was approximately 3.6%, 9.0% and 37.8% for the fourth quarter of 2006, 2007 and 2008, respectively. Our estimates of market share are based on publicly available data and exclude previously securitized mortgages.

We also compete for low-cost debt funding with institutions that hold mortgage portfolios, including Freddie Mac and the FHLBs. In recent months, the Federal Reserve has been supporting the liquidity of our debt as an active and significant purchaser of our long-term debt in the secondary market. See Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Debt Funding for a discussion of our debt funding.

EMPLOYEES

As of December 31, 2008, we employed approximately 5,800 personnel, including full-time and part-time employees, term employees and employees on leave.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file reports, proxy statements and other information with the SEC. We make available free of charge through our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all other SEC reports and amendments to those reports as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC. Our Web site address is www.fanniemae.com. Materials that we file with the SEC are also available from the SEC s Web site, www.sec.gov. In addition, these materials may be inspected, without charge, and copies may be obtained at prescribed rates, at the SEC s Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also request copies of any filing from us, at no cost, by calling the Fannie Mae Fixed-Income Securities Helpline at (800) 237-8627 or (202) 752-7115 or by writing to Fannie Mae, Attention: Fixed-Income Securities, 3900 Wisconsin Avenue, NW, Area 2H-3S, Washington, DC 20016.

We are providing our Web site addresses and the Web site address of the SEC solely for your information. Information appearing on our Web site or on the SEC s Web site is not incorporated into this annual report on Form 10-K.

FORWARD-LOOKING STATEMENTS

This report includes statements that constitute forward-looking statements within the meaning of Section 21E of the Exchange Act. In addition, our senior management may from time to time make forward-looking statements orally to analysts, investors, the news media and others. Forward-looking statements often include words such as expect, anticipate, intend, plan, believe, seek, estimate, forecast, project, would, should, could, may,

Among the forward-looking statements in this report are statements relating to:

Our expectation that the current crisis in the U.S. and global financial markets will continue, which will continue to adversely affect our financial results throughout 2009;

Our expectation that the unemployment rate will continue to increase;

Our expectation of the continued deterioration of the U.S. housing market, continued home price declines and rising delinquency, default and severity rates;

Our expectation that mortgage debt outstanding will shrink by approximately 0.2% in 2009;

Our expectation that the level of foreclosures and single-family delinquency rates will continue to increase in 2009;

Our expectation that home prices will decline 7% to 12% on a national basis in 2009, and that there will be a peak-to-trough decline in home prices of 20% to 30%;

Our expectation that there will be significant regional variation in national home price decline percentages, with steeper declines in certain areas such as Florida, California, Nevada and Arizona;

Our expectation that economic conditions and falling home prices will continue to negatively affect our credit performance in 2009, which will cause our credit losses to increase;

Our expectation that our credit loss ratio in 2009 will exceed our credit loss ratio in 2008;

Our expectation of a significant increase in our SOP 03-3 fair value losses as we increase the number of loans we repurchase from MBS trusts in order to modify them;

Our expectation of significant continued increases in our combined loss reserves through 2009;

Our expectation of continued pressure on our access to the debt markets throughout 2009 at economically attractive rates, which we believe will become increasingly great as we approach the expiration of the Treasury credit facility at the end of 2009;

Our expectation that the roll over, or refinancing, risk on our unsecured debt is likely to increase substantially as we approach year-end 2009 and the expiration of the Treasury credit facility;

Our expectation that we will continue to experience adverse financial effects because of our strategy of concentrating our efforts on keeping people in their homes and preventing foreclosures, including our efforts under HASP, while remaining active in the secondary mortgage market;

Our expectation that future activities that our regulators, other U.S. government agencies or Congress may request or require us to take to support the mortgage market and help borrowers may contribute to further deterioration in our results of operations and financial condition;

Our expectation that the Federal Reserve will continue to purchase our long-term debt and MBS in the secondary market;

Our expectations with respect to our role in HASP, the elements of the HASP programs, the timing of our implementation of HASP programs, and the impact of these programs on our business, results of operations, financial condition and net worth;

Our expectation that we also will have a net worth deficit in future periods, and therefore will be required to obtain additional funding from Treasury pursuant to the senior preferred stock purchase agreement;

Our intention to use the funds we receive from Treasury under the senior preferred stock purchase agreement to repay our debt obligations;

Our belief that we will not be required to make a minimum contribution to our qualified pension plan in 2009;

Our belief that measures we have taken in 2008 and 2009 will significantly improve the credit profile of our single-family acquisitions;

Our belief that our problem loan management strategies may help in reducing our long-term credit losses;

Our expectation that our acquisitions of Alt-A mortgage loans will continue to be minimal in future periods;

Our expectation that we will substantially increase our loan workout activity in 2009 relative to 2008;

Our plan to continue to increase staffing levels in divisions of the company that focus on our foreclosure prevention efforts;

Our belief that the early re-performance statistics related to loans modified during 2008 are likely to change, perhaps materially;

Our belief that our liquidity contingency plan is unlikely to be sufficient to provide us with alternative sources of liquidity for 90 days;

Our belief that the requirement under the senior preferred stock purchase agreement that we reduce our mortgage portfolio by 10% per year beginning in 2010 may have an adverse impact on our future net interest income;

Our expectation that we will have the necessary technology and operational capabilities in place to support the securitization of a portion of our whole loans during the second quarter of 2009;

Our expectation that Treasury s funding commitment under the senior preferred stock purchase agreement will enable us to maintain a positive net worth as long as Treasury has not yet invested the full amount provided for in that agreement;

Our expectation that the loans we are now acquiring will generally have a lower credit risk, notwithstanding economic conditions, relative to the loans we acquired in 2006, 2007 and early 2008;

Our belief that the market crisis will continue to adversely affect the liquidity and financial condition of our institutional counterparties and our lender counterparties;

Our belief that recent government actions to provide liquidity and other support to specified financial market participants may help to improve the financial condition and liquidity position of a number of our institutional counterparties;

Our belief that announced mergers of a number of our institutional counterparties, if completed, will improve the financial condition of these institutional counterparties and help to reduce our counterparty risk;

Our belief that we are likely to incur further losses on our investments in Alt-A and subprime private-label mortgage-related securities, including on those that are currently rated AAA;

Our intention to continue to sell non-mortgage-related securities in our cash and other investments portfolio from time to time as market conditions permit;

Our intention to hold the majority of our mortgage assets to maturity to realize the contractual cash flows;

Our intention to complete the remediation of the weakness in our internal control over financial reporting relating to our other-than-temporary-impairment assessment process for private-label mortgage-related securities by September 30, 2009;

Our belief that it is likely we will not remediate the material weakness in our disclosure controls and procedures while we are under conservatorship; and

Our belief that our deferred tax assets related to unrealized losses recorded in AOCI on our available-for-sale securities are recoverable.

Forward-looking statements reflect our management s expectations or predictions of future conditions, events or results based on various assumptions and management s estimates of trends and economic factors in the markets in which we are active, as well as our business plans. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. Our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. There are a number of factors that could cause actual conditions, events or results to differ materially from those described in the forward-looking statements contained in this report, including, but not limited to our ability to maintain a positive net worth; adverse effects from activities we undertake to support the mortgage market and help borrowers; the investment by Treasury and its effect on our business; future amendments and guidance by the Financial Accounting Standards Board (FASB); changes in the structure and regulation of the financial services industry, including government efforts to bring about an economic recovery; our ability to access the debt capital markets; the conservatorship and its effect on our business (including our business strategies and practices); further disruptions in the housing, credit and stock markets; the level and volatility of interest rates and credit spreads; the adequacy of credit reserves; pending government investigations and litigation; changes in management; the accuracy of subjective estimates used in critical accounting policies; and those factors described in this report, including those factors described in Item 1A Risk Factors of this report.

Readers are cautioned to place forward-looking statements in this report or that we make from time to time into proper context by carefully considering the factors discussed in Item 1A Risk Factors. These forward-looking statements are representative only as of the date they are made, and we undertake no obligation to update any forward-looking statement as a result of new information, future events or otherwise, except as required under the federal securities laws.

Item 1A. Risk Factors

This section identifies specific risks that should be considered carefully in evaluating our business. The risks described in Risks Relating to Our Business are specific to us and our business, while those described in Risks Relating to Our Industry relate to the industry in which we operate. Refer to Part II Item 7 MD&A Risk Management for a more detailed description of the primary risks to our business and how we seek to manage those risks.

Any of these factors could materially adversely affect our business, financial condition, results of operations, liquidity and net worth, and could cause our actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report. However, these are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, results of operations, liquidity and net worth.

RISKS RELATING TO OUR BUSINESS

We may not be able to achieve or maintain a positive net worth, which would result in requests for additional investment by Treasury.

Under the Regulatory Reform Act, FHFA must place us into receivership if the Director of FHFA makes a written determination that we have a net worth deficit (which means that our assets are less than our obligations) for a period of 60 days. Our ability to maintain a positive net worth has been adversely affected by market conditions and volatility. At December 31, 2008, our total liabilities exceeded our total assets by $15.2 billion, as reflected on our consolidated balance sheet. As a result, we will have to draw on Treasury s commitment under the senior preferred stock purchase agreement. We expect the market conditions that contributed to our net loss for each quarter of 2008 to continue and possibly worsen in 2009, and therefore to continue to adversely affect our net worth resulting in additional draws on Treasury s commitment. Factors that could adversely affect our net worth for future periods include factors that we can affect as well as factors that we have no control over, such as: additional net losses; continued declines in home prices; increases in our credit and interest rate risk profiles; adverse changes in interest rates or implied volatility; adverse changes in option-adjusted spreads; impairments of private-label mortgage-related securities; counterparty downgrades; downgrades of private-label mortgage-related securities; changes in GAAP; and actions taken by FHFA, Treasury or Congress relating to our business, the mortgage industry or the financial services industry. In addition, actions we take to help homeowners, such as increasing our purchases of loans out of MBS trusts and modifying loans are likely to adversely affect our net worth in future periods.

We are subject to mortgage credit risk. We expect increases in borrower delinquencies and defaults on mortgage loans that we own or that back our guaranteed Fannie Mae MBS to continue to materially and adversely affect our business, results of operations, financial condition, liquidity and net worth.

We are exposed to mortgage credit risk relating to both the mortgage loans that we hold in our investment portfolio and the mortgage loans that back our guaranteed Fannie Mae MBS because borrowers may fail to make required payments of principal and interest on their mortgage loans, exposing us to the risk of credit losses and credit-related expenses.

Conditions in the housing and financial markets worsened dramatically during 2008 and have continued to worsen during the first quarter of 2009, contributing to a deterioration in the credit performance of our book of business, including higher serious delinquency rates, default rates and average loan loss severities on the mortgage loans we hold or that back our guaranteed Fannie Mae MBS, as well as a substantial increase in our inventory of foreclosed properties. Increases in delinquencies, default rates and severities cause us to experience higher credit-related expenses. In addition, deteriorating economic conditions have negatively affected the credit performance of our book of business. These worsening credit performance trends have been most notable in certain of our higher risk loan categories, states and vintages, although the recession has also begun to affect the credit performance of our broader book of business. We present detailed information about the risk characteristics of our conventional single-family mortgage credit book of business in Part II Item 7 MD&A Risk Management Credit Risk Management Mortgage Credit Risk Management and we present detailed information on our credit-related expenses, credit losses and results of operations for 2008 in Part II Item 7 MD&A Consolidated Results of Operations.

We expect that these adverse credit performance trends will continue and may accelerate, particularly if we continue to experience national and regional declines in home prices, a recessionary economic environment and rising unemployment in the United States.

The credit losses we experience in future periods as a result of the housing and economic crisis are likely to be larger, perhaps substantially larger, than our current combined loss reserves and will adversely affect our business, results of operations, financial condition, liquidity and net worth.

Our combined loss reserves, as reflected on our consolidated balance sheet, do not reflect our estimate of the future credit losses inherent in our existing guaranty book of business. Rather, pursuant to GAAP, they reflect only the probable losses that we believe we have already incurred as of the balance sheet date. Accordingly, although we believe that our credit losses will increase in the future due to the worsening housing and economic crisis, higher unemployment and other negative trends, we are not permitted under GAAP to reflect these future trends in our loss reserve calculations. Because of the housing and economic crisis, there is significant uncertainty regarding the full extent of our future credit losses. The credit losses we experience in future periods will adversely affect our business, results of operations, financial condition, liquidity and net worth.

We are in conservatorship and the impact of the conservatorship on the management of our business may materially and adversely affect our business, financial condition, results of operations, liquidity and net worth.

When FHFA was appointed as our conservator, it immediately succeeded to: (1) all of our rights, titles, powers and privileges, and that of any shareholder, officer or director of Fannie Mae with respect to us and our assets; and (2) title to the books, records and assets of any other legal custodian of Fannie Mae. As a result, we are currently under the control of our conservator. The conservatorship has no specified termination date; we do not know when or how it will be terminated. In addition, our directors do not have any duties to any person or entity except to the conservator. Accordingly, our directors 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.

The then Secretary of the Treasury and the Director of FHFA stated that the conservatorship was implemented to help restore confidence in Fannie Mae and Freddie Mac, enhance their capacity to fulfill their mission, and mitigate the systemic risk that has contributed directly to the instability in the current market. We do not know whether the objectives will change, what actions FHFA and Treasury may take or cause us to take in pursuit of their objectives, and whether the actions taken will achieve those objectives. Under the Regulatory Reform Act, as conservator, FHFA may take such action as may be necessary to put the regulated entity in a sound and solvent condition. We have no control over FHFA s actions, or the actions it may direct us to take.

FHFA is also conservator of Freddie Mac, our primary competitor. We do not know the impact on our business of FHFA s serving as conservator of Freddie Mac. In addition, under the Regulatory Reform Act, FHFA may take any action authorized by the statute which FHFA determines is in its best interests or our best interests, in its sole discretion.

Under the Regulatory Reform Act, FHFA can direct us to enter into contracts or enter into contracts on our behalf. Further, FHFA, as conservator, generally has the power to transfer or sell any of our assets or liabilities and may do so without the approval, assignment or consent of any party. We describe the powers of the conservator in Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Conservatorship, the terms of the senior preferred stock purchase agreement in Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Senior Preferred Stock Purchase Agreement and Related Issuance of Senior Preferred Stock and Common Stock Warrant and the covenants contained in the senior preferred stock purchase agreement in Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Covenants Under Treasury Agreements Senior Preferred Stock Purchase Agreement Covenants. Our lack of overall control over our business may adversely affect our business, financial condition, results of operations, liquidity and net worth.

Our multiple roles in the recently announced Homeowner Affordability and Stability Plan is likely to increase our costs and place burdens on our resources.

On February 18, 2009, the Obama Administration announced HASP. Under HASP, we will work with our servicers to offer at-risk borrowers loan modifications that reduce their monthly principal and interest payments on their mortgages, and we will act as the program administrator. In addition, under HASP, we will launch a streamlined refinancing initiative that will allow borrowers who have mortgages with current loan-to-value ratios up to 105% to refinance their loans to a lower rate without obtaining new mortgage insurance in excess of what was already in place. Given that the nature of both the loan modification and streamlined refinance programs is unprecedented and the details of these programs are still under development at this time, it is difficult for us to predict the full extent of our activities under the programs and how those activities will impact us, the response rates we will experience, or the costs that we will incur. However, to the extent that borrowers and our servicers participate in these programs in large numbers, it is likely that the costs we incur associated with the modifications of loans in our guaranty book of business, as well as the borrower and servicer incentive fees associated with them, will be substantial, and these programs would therefore likely have a material adverse effect on our business, results of operations, financial condition and net worth. In addition, our role as program administrator for the modification program is expected to be substantial, requiring significant levels of internal resources and management attention, which may therefore be shifted away from current corporate initiatives. This shift could have a material adverse effect on our business, results of operations, financial condition and net worth.

Our efforts to pursue our mission and meet our mission-related goals may adversely affect our business, results of operations, financial condition, liquidity and net worth.

Prior to the conservatorship, our business was managed with a strategy to maximize shareholder returns. However, our conservator has directed us to focus primarily on fulfilling our mission of providing, liquidity, stability and affordability to the mortgage market and to provide assistance to struggling homeowners. In support of this focus on our mission, we may take, or be directed by the conservator to take, a variety of actions that could adversely affect our economic returns, possibly significantly, such as: increasing our purchase of loans that pose a higher credit risk; reducing our guaranty fees; refraining from foreclosing on seriously delinquent loans; increasing our purchases of loans out of MBS trusts in order to modify them; and modifying loans to extend the maturity, lower the interest rate or reduce the amount of principal owed by the borrower. For example, since November 2008 we suspended foreclosure sales and the eviction of occupants from our foreclosed properties in an effort to provide assistance to struggling homeowners. These activities may adversely affect our economic returns, in both the short term and long term. These activities also create risks to our business and are likely to have an adverse effect on our business, results of operations, financial condition, liquidity and net worth.

In addition to FHFA, other government agencies or Congress may also ask us to undertake significant efforts in pursuit of our mission. For example, on February 18, 2009, the Obama Administration announced HASP. Under HASP, we will work with our servicers to offer at-risk borrowers loan modifications that reduce their monthly principal and interest payments on their mortgages, and we will act as the program administrator. In addition, under HASP, we will launch a streamlined refinancing initiative that will allow borrowers who have mortgage loans with current loan-to-value ratios up to 105% to refinance their loans to a lower rate without obtaining new mortgage insurance in excess of what was already in place. To the extent that borrowers and our servicers participate in these programs in large numbers, it is likely that the costs we incur associated with the modifications of loans in our guaranty book of business, as well as the borrower and servicer incentive fees associated with them, will be substantial, and these programs would therefore likely have a material adverse effect on our business, results of operations, financial condition and net worth. We do not know what additional actions FHFA, other agencies of the U.S. government, or Congress may direct us to take in the future.

In addition, our efforts to fulfill our housing goals and subgoals have contributed to our losses because these efforts often resulted in our purchase of higher risk loans, on which we typically incur proportionately more credit losses than on other types of loans. Accordingly, these efforts have contributed to our higher credit losses and may lead to further increases in our credit losses.

The conservatorship has no specified termination date, and the future structure of our business following termination of the conservatorship is uncertain.

We do not know when or how the conservatorship will be terminated or what changes to our business structure will be made during or following the termination of the conservatorship. We do not know whether we will exist in the same or a similar form or continue to conduct our business as we did before the conservatorship, or whether the conservatorship will end in receivership. We can give no assurance that we will remain a shareholder-owned company. At the time we were placed into conservatorship, the then

Secretary of the Treasury indicated that there is a consensus that we and Freddie Mac pose a systemic risk and that we cannot continue in our current form.

Under the Regulatory Reform Act, the appointment of FHFA as the receiver of Fannie Mae would immediately terminate the conservatorship. The consequences of our being placed into receivership are described in the following risk factor. If we are not placed into receivership and the conservatorship is terminated, our business will remain subject to the restrictions of the senior preferred stock purchase agreement, unless it is amended by mutual agreement of us and Treasury. The restrictions on our business under the senior preferred stock purchase agreement are described in Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Covenants Under Treasury Agreements Senior Preferred Stock Purchase Agreement Covenants.

Our regulator is authorized or required to place us into receivership under specified conditions, which would result in the liquidation of our assets and could have a material adverse effect on holders of our common stock, preferred stock, debt securities and Fannie Mae MBS.

Under the Regulatory Reform Act, FHFA must place us into receivership if the Director of FHFA makes a written determination that our assets are less than our obligations or if we have not been paying our debts, in either case, for a period of 60 days. Because of our net worth deficit as of December 31, 2008, and continuing trends in the housing and financial markets, we will need funding from Treasury in order to avoid a trigger of mandatory receivership. In addition, we could be put in receivership at the discretion of the Director of FHFA at any time for other reasons, including conditions that FHFA has already asserted existed at the time the Director of FHFA placed us into conservatorship. These include: a substantial dissipation of assets or earnings due to unsafe or unsound practices; the existence of an unsafe or unsound condition to transact business; an inability to meet our obligations in the ordinary course of business; a weakening of our condition due to unsafe or unsound practices or conditions; critical undercapitalization; the likelihood of losses that will deplete substantially all of our capital; or by consent. A receivership would terminate the conservatorship. In addition to the powers FHFA has as conservator, the appointment of FHFA as our receiver would terminate all rights and claims that our shareholders and creditors may have against our assets or under our charter arising as a result of their status as shareholders or creditors, except for their right to payment, resolution or other satisfaction of their claims as permitted under the Regulatory Reform Act. Unlike a conservatorship, the purpose of which is to conserve our assets and return us to a sound and solvent condition, the purpose of a receivership is to liquidate our assets and resolve claims against us.

In the event of a liquidation of our assets, only after paying the secured and unsecured claims against the company (including repaying all outstanding debt obligations), the administrative expenses of the receiver and the liquidation preference of the senior preferred stock, would any liquidation proceeds be available to repay the liquidation preference on any other series of preferred stock. Finally, only after the liquidation preference on all series of preferred stock is repaid would any liquidation proceeds be available for distribution to the holders of our common stock. There can be no assurance that there would be sufficient proceeds to repay the liquidation preference of any series of our preferred stock or to make any distribution to the holders of our common stock. To the extent we are placed in receivership and do not or cannot fulfill our guaranty to the holders of our Fannie Mae MBS, they could become unsecured creditors of ours with respect to claims made under our guaranty.

The investment by Treasury significantly restricts our business activities and requires that we pay substantial dividends and fees, which could adversely affect our business, financial condition, results of operations, liquidity and net worth. By its terms, Treasury s investment in our business is indefinite and may be permanent.

Under our senior preferred stock purchase agreement with Treasury, Treasury generally has committed to provide us funds, on a quarterly basis, of up to $100 billion, in the amount, if any, by which our total liabilities exceed our total assets, as reflected on our consolidated balance sheet, prepared in accordance with GAAP, for the applicable fiscal quarter. On February 18, 2009, Treasury announced that it is amending the senior preferred stock purchase agreement to (1) increase its funding commitment from $100 billion to

$200 billion and (2) increase the size of the mortgage portfolio allowed under the agreement by $50 billion to $900 billion, with a corresponding increase in the allowable debt outstanding. Because an amended agreement has not been executed as of the date of this report, the following discussion of the senior preferred stock purchase agreement refers to the terms of that existing agreement, without these changes.

Cost of Treasury Investment. Beginning in 2010, we are obligated to pay a quarterly commitment fee to Treasury in exchange for its continued funding commitment under the senior preferred stock purchase agreement. This fee has not yet been established and could be substantial. We are also required to pay dividends on the senior preferred stock at a rate of 10% per year (or 12% in specified circumstances) based on the liquidation preference of the stock. As a result of our expected draw on Treasury s funding commitment, our annualized aggregate dividend payment to Treasury, at the 10% dividend rate, will increase to $1.6 billion. The amount of the aggregate liquidation preference will increase to $16.2 billion as a result of our expected draw. The aggregate liquidation preference of the senior preferred stock will increase further by the amount of each additional draw on Treasury s funding commitment. The liquidation preference may also increase by the amount of each unpaid dividend if we fail to pay any required dividend and by the amount of each unpaid quarterly commitment fee if we fail to pay any required commitment fee. Because dividends on the senior preferred stock are paid based on the then-current liquidation preference of the stock, any further increases in the liquidation preference will increase the amount of the dividends payable, and the increase may be substantial. If the dividends payable are substantial, it could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth. Moreover, increases in the liquidation preference of the senior preferred stock will make it more difficult for us to achieve self-sustaining profitability in the future.

Restrictions Relating to Covenants. The senior preferred stock purchase agreement we entered into with Treasury includes a number of covenants that significantly restrict our business activities. We cannot, without the prior written consent of Treasury: pay dividends; sell, issue, purchase or redeem Fannie Mae equity securities; sell, transfer, lease or otherwise dispose of assets other than for fair market value in specified situations; engage in transactions with affiliates other than on arm s-length terms or in the ordinary course of business; issue subordinated debt; or incur indebtedness that would result in our aggregate indebtedness exceeding 110% of our aggregate indebtedness as of June 30, 2008. We provide a detailed description of these covenants in Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Covenants Under Treasury Agreements Senior Preferred Stock Purchase Agreement Covenants. The restrictions imposed by these covenants could adversely affect our business, financial condition, results of operations, liquidity and net worth.

Mortgage Portfolio Cap. Pursuant to the senior preferred stock purchase agreement, we are not permitted to increase the size of our mortgage portfolio to more than $850.0 billion through the end of 2009, and beginning in 2010 we are required to reduce the size of our mortgage portfolio by 10% per year (based on the size of the portfolio on December 31 of the prior year) until it reaches $250.0 billion. This mortgage portfolio cap may force us to sell mortgage assets at unattractive prices and may prevent us from purchasing mortgage assets at attractive prices. Moreover, the interest income we generate from the mortgage assets we hold in our portfolio is a primary source of our revenue, which we expect will be reduced as the size of our portfolio is reduced. As a result, this mortgage portfolio cap could have a material adverse effect on our business, financial condition, results of operations, liquidity and net worth.

Indefinite Nature of Treasury Investment. We have issued to Treasury one million shares of senior preferred stock and a warrant to purchase shares of our common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis on the date of exercise. The senior preferred stock will remain outstanding until Treasury s funding commitment is terminated and the liquidation preference on the senior preferred stock is fully repaid. Treasury s funding commitment will terminate under any of the following circumstances: (1) the completion of our liquidation and fulfillment of Treasury s obligations under its funding commitment at that time, (2) the payment in full of, or the reasonable provision for, all of our liabilities (whether or not contingent, including mortgage guaranty obligations), or (3) the funding by Treasury of $100.0 billion under the commitment. The warrant will remain exercisable through September 7, 2028. Accordingly, even if the conservatorship is terminated, the U.S. government will have an equity ownership stake in our company so long as the senior preferred stock is outstanding, the warrant is exercisable or the

U.S. government holds shares of our common stock issued upon exercise of the warrant. These terms of Treasury s investment effectively eliminate our ability to raise equity capital from private sources. Moreover, our draw under Treasury s funding commitment, and the required dividend payment thereon could permanently impair our ability to build independent sources of capital and will make it more difficult for us to achieve self-sustaining profitability in the future.

Treasury s funding commitment may not be sufficient to keep us in a solvent condition.

Under the senior preferred stock purchase agreement, Treasury has made a commitment to provide up to $100 billion in funding as needed to help us maintain a positive net worth, and on February 18, 2009, Treasury announced that it is amending the agreement to increase its commitment from $100 billion to $200 billion. The amended agreement has not been executed as of the date of this report. On February 25, 2009, the Director of FHFA submitted a request for $15.2 billion under the funding commitment due to our net worth deficit as of December 31, 2008. The amount of Treasury s funding commitment will continue to be reduced by any amounts we receive under the commitment for future periods, as well as by any dividends or quarterly commitment fee that we do not pay in cash. If we continue to experience substantial losses in future periods or to the extent that we experience a liquidity crisis that prevents us from accessing the unsecured debt markets, this commitment may not be sufficient to keep us in solvent condition or from being placed into receivership. The announced amendment to increase the commitment of $200 billion reduces, but does not eliminate, this risk.

We may not be able to rely on the Treasury credit facility in the event of a liquidity crisis.

Treasury is not obligated by the terms of the Treasury credit facility to make any loans to us. In addition, we must provide collateral securing any loan that Treasury makes to us under the Treasury credit facility in the form of Fannie Mae MBS or Freddie Mac mortgage-backed securities. Treasury may reduce the value assigned to the collateral by whatever amount Treasury determines, and may request additional collateral. In addition, Treasury may require that we immediately repay, on demand, any one or more of the loans outstanding under the Treasury credit facility, regardless of the originally scheduled maturity date of the loan. Loans also become immediately due and payable upon the occurrence of specified events of default, which includes our receivership. Upon the occurrence of any event of default, Treasury may pursue specified remedies, including sale of the collateral we provided. If Treasury requires us to repay immediately loans made to us pursuant to the Treasury credit facility, there can be no assurance that we will be able to make those payments or borrow sufficient funds from alternative sources to make those payments. In addition, the forced sale of our collateral could adversely affect our business, financial condition, results of operations, liquidity and net worth.

The conservatorship and investment by Treasury have had, and will continue to have, a material adverse effect on our common and preferred shareholders.

No voting rights during conservatorship. The rights and powers of our shareholders are suspended during the conservatorship. The conservatorship has no specified termination date. During the conservatorship, our common shareholders do not have the ability to elect directors or to vote on other matters unless the conservator delegates this authority to them.

Dividends to common and preferred shareholders, other than Treasury, have been eliminated. The conservator has eliminated common and preferred stock dividends (other than dividends on the senior preferred stock) during the conservatorship. In addition, under the terms of the senior preferred stock purchase agreement, dividends may not be paid to common or preferred shareholders (other than the senior preferred stock) without the consent of Treasury, regardless of whether we are in conservatorship.

Liquidation preference of senior preferred stock will increase, potentially substantially. The senior preferred stock ranks prior to our common stock and all other series of our preferred stock, as well as any capital stock we issue in the future, as to both dividends and distributions upon liquidation. Accordingly, if we are liquidated, the senior preferred stock is entitled to its then-current liquidation preference, plus any accrued but unpaid dividends, before any distribution is made to the holders of our common stock or other preferred stock. As of February 26, 2009, the liquidation preference on the senior preferred stock was $1.0 billion; however, it

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will increase to $16.2 billion as a result of our expected draw on Treasury s funding commitment. The liquidation preference could increase substantially as we draw on Treasury s funding commitment, if we do not pay dividends owed on the senior preferred stock or if we do not pay the quarterly commitment fee under the senior preferred stock purchase agreement. If we are liquidated, there may not be sufficient funds remaining after payment of amounts to our creditors and to Treasury as holder of the senior preferred stock to make any distribution to holders of our common stock and other preferred stock.

Warrant may substantially dilute investment of current shareholders. If Treasury exercises its warrant to purchase shares of our common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis, the ownership interest in the company of our then existing common shareholders will be substantially diluted. It is possible that private shareholders will not own more than 20.1% of our total common equity for the duration of our existence.

Market price and liquidity of our common and preferred stock has substantially declined and may not recover. After our entry into conservatorship, the market price for our common stock declined substantially (from approximately $7 per share immediately before the conservatorship to less than $1 per share after the conservatorship) and the investments of our common and preferred shareholders have lost substantial value. Our common and preferred stock may never recover their value and could be delisted from the NYSE as described below under *Noncompliance with NYSE rules could result in the delisting of our common and preferred stock from the NYSE.* In addition, we do not know if or when we will pay dividends on those shares in the future.

No longer managed for the benefit of shareholders. According to a statement made by the then Secretary of the Treasury on September 7, 2008, because we are in conservatorship, we will no longer be managed with a strategy to maximize shareholder returns.

We do not know when or how the conservatorship will be terminated, and if or when the rights and powers of our shareholders, including the voting powers of our common shareholders, will be restored. Moreover, even if the conservatorship is terminated, by their terms, we remain subject to the senior preferred stock purchase agreement, senior preferred stock and warrant, which can only be cancelled or modified by mutual consent of Treasury and the conservator. For a description of additional restrictions on and risks to our shareholders, see Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Conservatorship Effect of Conservatorship on Shareholders and Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements Effect of Treasury Agreements on Shareholders.

During the second half of 2008, our ability to access the debt capital markets, particularly the long-term or callable debt markets, was limited. Similar limitations in future periods could have a material adverse effect on our ability to fund our operations and on our costs, liquidity, business, results of operations, financial condition and net worth.

Our ability to operate our business, meet our obligations and generate net interest income depends primarily on our ability to issue substantial amounts of debt frequently, with a variety of maturities and call features and at attractive rates. In July 2008, market concerns about our capital position, the future of our business (including future profitability, future structure, regulatory actions and agency status) and the extent of U.S. government support for our business began to severely negatively affect our access to the unsecured debt markets, particularly for long-term or callable debt, and increase the yields on our debt as compared to relevant market benchmarks. In October and November 2008, we experienced further deterioration in our access to the long-term debt market and a significant increase in the yields on our debt as compared to relevant market benchmarks. In addition, in recent months we have relied on the Federal Reserve as an active and significant purchaser of our long-term debt in the secondary market.

There can be no assurance that the recent improvement in our access to funding will continue. We describe our access to the debt markets in Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Debt Funding.

If our ability to access the debt capital markets is limited in future periods, we would likely need to meet our funding needs by issuing short-term debt, increasingly exposing us to the risk of increasing interest rates, adverse credit market conditions and insufficient demand for our debt to meet our refinancing needs. This

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would increase the likelihood that we would need to rely on our liquidity contingency plan, obtain funds under the Treasury credit facility, or possibly be unable to repay our debt obligations as they become due. In the current market environment, we have significant uncertainty regarding our ability to carry out our liquidity contingency plans.

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

- the public s perception of the risks to and financial prospects of our business, industry or the markets in general;
- our corporate and regulatory structure, including our status as a GSE under conservatorship;
- the commitment of Treasury to provide funding to us;
- legislative or regulatory actions relating to our business, including any actions that would affect our GSE status or add additional requirements that would restrict or reduce our ability to issue debt;
- other actions by the U.S. Government, such as the FDIC s guarantee of corporate debt instruments and the Federal Reserve s program to purchase GSE debt and MBS;
- our credit ratings, including rating agency actions relating to our credit ratings;
- our financial results and changes in our financial condition;
- significant events relating to our business or industry;
- the preferences of debt investors;
- the breadth of our investor base;
- prevailing conditions in the capital markets;
- foreign exchange rates;
- interest rate fluctuations;
- the rate of inflation;
- competition from other debt issuers;
- general economic conditions in the U.S. and abroad; and
- broader trade and political considerations among the U.S. and other countries.

Foreign investors hold a significant portion of our debt securities and are an important source of funding for our business. The willingness of foreign investors to purchase and hold our debt securities may be influenced by many factors, including changes in the world economy, changes in foreign-currency exchange rates, regulatory and political factors, as well as the availability of and preferences for other investments. Foreign investors are also significant purchasers of mortgage-related securities, and changes in the strength and stability of foreign demand for mortgage-related securities could affect the overall market for those securities and the returns available to us on our portfolio investments. If foreign investors divest a significant portion of their holdings, our funding costs may increase. We have experienced reduced demand from international investors, particularly foreign central banks, compared with the historically high levels of demand we experienced from these investors between mid-2007 and mid-2008. The willingness of foreign investors to purchase or hold our debt securities, as well as our mortgage-related securities, and any changes to such willingness, may materially affect our liquidity, earnings, financial condition and net worth.

In addition, our increased reliance on short-term debt, combined with limitations on the availability of a sufficient volume of reasonably priced derivative instruments to hedge that short-term debt position, may have an adverse impact on our duration and interest rate risk management positions. See Part II Item 7 MD&A Risk Management Interest Rate Risk Management and Other Market Risks for more information regarding our interest rate risk management activities. Due to current financial market conditions and concerns about our business, we expect this trend toward dependence on short-term debt and increased roll over risk to continue. See Part II Item 7 Liquidity and Capital Management Liquidity Management Debt Funding Outstanding Debt for information on the maturity profile of our debt. To the extent the market for our debt securities has improved due to the Treasury credit facility being made available to us, we believe that the actual and perceived risk that we will be unable to refinance our debt as it becomes due remains and is likely to increase substantially as we progress toward December 31, 2009, which is the date on which the Treasury credit facility terminates.

Pursuant to our senior preferred stock purchase agreement with Treasury, we may not incur indebtedness that would result in our aggregate indebtedness exceeding 110% of our aggregate indebtedness as of June 30, 2008 and we may not incur any subordinated indebtedness. Our calculation of our aggregate indebtedness as of June 30, 2008, which has not been confirmed by Treasury, set this debt limit at $892.0 billion. We calculate aggregate indebtedness as the unpaid principal balance of our debt outstanding, or in the case of zero coupon bonds, at maturity and exclude basis adjustments and debt from consolidations. As of January 31, 2009, we estimate that our aggregate indebtedness totaled $885.0 billion, significantly limiting our ability to issue additional debt.

If we are unable to issue both short- and long-term debt securities at attractive rates and in amounts sufficient to operate our business and meet our obligations, it would have a continuing material adverse effect on our liquidity, earnings, financial condition and net worth.

Our liquidity contingency plan may not provide sufficient liquidity to operate our business and meet our obligations in the event that we cannot access the debt capital markets.

We maintain a liquidity policy, which includes a liquidity contingency plan that is intended to allow us to meet all of our cash obligations for 90 days without relying upon the issuance of unsecured debt. This plan is described in Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Liquidity Contingency Plan. In advers market conditions, such as the ones we are currently experiencing, our ability to meet that 90-day plan is likely to be significantly impaired and our ability to repay maturing indebtedness and fund our operations could be significantly impaired. Within the 90-day time frame contemplated by our liquidity contingency plan, we depend on continuous access to secured financing in the repurchase and securities lending markets to continue our operations. That access could be impaired by numerous factors that are specific to Fannie Mae, such as the conservatorship, our historical lack of reliance on repurchase arrangements, and operational risks, and factors that are not specific to Fannie Mae, such as the rapidly declining market values for assets and the severe disruption of the financial markets that has been ongoing. Our ability to sell mortgage assets and other assets may also be impaired, or be subject to a greater reduction in value if other market participants are seeking to sell similar assets at the same time.

Future amendments and guidance from the FASB are expected to impact our accounting treatment, which could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

On September 15, 2008, the FASB issued an exposure draft of a proposed statement of financial accounting standards, *Amendments to FASB Interpretation No. 46(R),* and an exposure draft of a proposed statement of financial accounting standards, *Accounting for Transfer of Financial Assets-an amendment of FASB Statement No. 140*. The proposed amendments to SFAS 140 would eliminate the concept of qualified special purpose entities (QSPEs). Additionally, the amendments to FIN 46R would replace the current consolidation model

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with a different model. Refer to Part II Item 7 MD&A Off-Balance Sheet Arrangements and Variable Interest Entities for a description of our MBS trusts as QSPEs. The FASB s proposed amendments are not final and may be revised before final rules are issued. The proposed amendments would be effective for new transfers of financial assets and to all variable interest entities on or after January 1, 2010.

If the QSPE concept is eliminated from SFAS 140, all of our securitization structures that are currently QSPEs will have to be evaluated under FIN 46R for consolidation. Currently, we evaluate the MBS trusts used in our securitizations to determine whether they are QSPEs. If they are QSPEs, we do not consolidate them if we do not have the unilateral ability to dissolve them. FASB s proposal would potentially require consolidation of the loans and debt of our MBS trusts onto our balance sheet.

As of December 31, 2008, we had issued over $2.5 trillion of Fannie Mae MBS. Although we cannot at this time predict the content of the final amendments, we may be required to consolidate the assets and liabilities of some or all of these MBS trusts. If we are required to consolidate the assets and liabilities of some or all of these MBS trusts, these assets and liabilities would initially be reported at fair value under the FASB s currently proposed rules. If the fair value of those assets is substantially less than the fair value of the corresponding liabilities (which would be the case under current market conditions), our net worth would be severely impacted and Treasury s funding commitment may not be sufficient to prevent our mandatory receivership. However, at the FASB s January 28, 2009 meeting, a tentative decision was reached that the incremental assets and liabilities to be consolidated upon adoption should be recognized at their carrying values, and the FASB indicated that fair value would only be permitted if determining the carrying value is not practicable. As a result of this tentative decision, we could also experience a reduction in our net worth.

In addition, under our existing regulatory capital standards, which are currently suspended while we are in conservatorship, the amount of capital that we are required to hold for obligations reported on our balance sheet is significantly higher than the amount of capital that we are required to hold for the guarantees that we provide to the MBS trusts. Accordingly, if we are required to consolidate the assets and liabilities of our MBS trusts, we would be required to increase capital to satisfy regulatory capital requirements unless legislation is passed or FHFA adopts new capital standards that alter this requirement. If we do not have enough capital to meet these higher regulatory capital requirements, we could incur penalties and also could be subject to further restrictions on our activities and operations, or to investigation and enforcement actions by the FHFA. Under the Regulatory Reform Act, the FHFA may place us into receivership if it classifies us as critically undercapitalized. Moreover, changes to the accounting treatment for securitizations may impact the market for securitizations, which could weaken demand for, and reduce the liquidity of, our Fannie Mae MBS.

Finally, implementation of these proposed changes would fundamentally alter our financial reporting model, requiring significant operational and systems changes. Depending on the implementation date ultimately required by FASB, it may be difficult or impossible for us to make all such changes in a controlled manner by the effective date. Failure to make such changes by the effective date could have a material adverse impact on us, including our ability to prepare timely financial reports. In addition, making such changes in a compressed time frame would divert resources from other ongoing corporate initiatives, which could have a material adverse impact on us. We cannot predict what the final amendments to SFAS 140 and FIN 46R will be, nor can we predict whether we will be required to consolidate all, some or none of the assets and liabilities of our MBS trusts, or the effect of a consolidation of those assets and liabilities on our securitization activities, results of operations or net worth. Further, we cannot predict the impact that these or other amendments or guidance of the FASB that may be adopted in the future may have on our accounting policies and methods, which are fundamental to how we report our financial condition and results of operations.

A decrease in our credit ratings would have an adverse effect on our ability to issue debt on reasonable terms, which could reduce our earnings and materially adversely affect our ability to conduct our normal business

operations and our liquidity, financial condition and results of operations.

Our borrowing costs and our access to the debt capital markets depend in large part on the high credit ratings on our senior unsecured debt. Our ratings are subject to revision or withdrawal at any time by the rating agencies. Factors such as the amount of our net losses, deterioration in our financial condition, actions by

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governmental entities or others, and sustained declines in our long-term profitability could adversely affect our credit ratings. The reduction in our credit ratings could increase our borrowing costs, limit our access to the capital markets and trigger additional collateral requirements under our derivatives contracts and other borrowing arrangements. It may also reduce our earnings and materially adversely affect our liquidity, our ability to conduct our normal business operations, our financial condition and results of operations. Our credit ratings and ratings outlook are included in Part II Item 7 MD&A Liquidity and Capital Management Liquidity Management Credit Ratings.

We have experienced significant management changes and we may lose a significant number of valuable employees, which could have a material adverse effect on our ability to do business and our results of operations.

Since late August 2008, several of our senior executive officers have left the company or their positions, including our former President and Chief Executive Officer, Executive Vice President and Chief Financial Officer, General Counsel, Chief Business Officer, Chief Risk Officer and Chief Technology Officer. FHFA appointed our new President and Chief Executive Officer at the commencement of the conservatorship, and we hired a new Chief Financial Officer on November 24, 2008. There have also been several internal management changes to fill key positions and the company continues to recruit members of its senior management team. It may take time for the new management team to be hired or retained and to become sufficiently familiar with our business and each other to effectively develop and implement our business strategies. This turnover in key management positions could harm our financial performance and results of operations. Management attention may be diverted from regular business concerns by reorganizations and the need to operate under this new framework.

In addition, the success of our business strategy depends on the continuing service of our employees. The conservatorship and the actions taken by Treasury and the conservator to date, or that may be taken by them or other government agencies in the future, may have an adverse effect on the retention and recruitment of employees and others in management. For example, pursuant to the senior preferred stock purchase agreement, we may not enter into any new compensation arrangements or increase amounts or benefits payable under existing compensation arrangements of any named executive officer (as defined by SEC rules) without the consent of the Director of FHFA, in consultation with the Secretary of the Treasury. Limitations on executive compensation may adversely affect our ability to recruit and retain well-qualified employees. If we lose a significant number of employees and are not able to quickly recruit and train new employees, it could negatively affect customer relationships and goodwill, and could have a material adverse effect on our ability to do business and our results of operations.

We are subject to pending government investigations and civil litigation. If it is determined that we engaged in wrongdoing, or if any material litigation is decided against us, we could be required to pay substantial judgments, settlements or other penalties.

We are subject to investigations by the Department of Justice and the SEC, and are a party to a number of lawsuits. We are unable at this time to estimate our potential liability in these matters, but may be required to pay substantial judgments, settlements or other penalties and incur significant expenses in connection with these investigations and lawsuits, which could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth. In addition, responding to requests for information in these investigations and lawsuits may divert significant internal resources away from managing our business. More information regarding these investigations and lawsuits is included in Item 3 Legal Proceedings and Notes to Consolidated Financial Statements Note 21, Commitments and Contingencies.

The material weaknesses in our internal control over financial reporting could result in errors in our reported results or disclosures that are not complete or accurate, which could have a material adverse effect on our business and operations.

As described in Part II Item 9A Controls and Procedures, management has determined that, as of the date of this filing, we have ineffective disclosure controls and procedures and two material weaknesses in our internal control over financial reporting. These weaknesses could result in errors in our reported results or disclosures that are not complete or accurate, which could have a material adverse effect on our business and operations.

One of these material weaknesses relates specifically to the impact of the conservatorship on our disclosure controls and procedures. Because we are under the control of FHFA, some of the information that we may need to meet our disclosure obligations may be solely within the knowledge of FHFA. As our conservator, FHFA has the power to take actions without our knowledge that could be material to our shareholders and other stakeholders, and could significantly affect our financial performance or our continued existence as an ongoing business. Because FHFA currently functions as both our regulator and our conservator, there are inherent structural limitations on our ability to design, implement, test or operate effective disclosure controls and procedures relating to information within FHFA s knowledge. As a result, we have not been able to update our disclosure controls and procedures in a manner that adequately ensures the accumulation and communication to management of information known to FHFA that is needed to meet our disclosure obligations under the federal securities laws, including disclosures affecting our financial statements. Given the structural nature of this material weakness, it is likely that we will not remediate this weakness while we are under conservatorship.

Noncompliance with NYSE rules could result in the delisting of our common and preferred stock from the NYSE.

We received notice from the NYSE on November 12, 2008 that we failed to satisfy one of the NYSE s standards for continued listing of our common stock because the average closing price of our common stock during the 30 consecutive trading days ended November 12, 2008 had been less than $1.00 per share. Under applicable NYSE rules, we now have until May 11, 2009, subject to supervision by the NYSE, to bring our share price as of May 11, 2009 and our average share price for the 30 consecutive trading days preceding May 11, 2009, above $1.00. If we fail to do so, the NYSE rules provide that the NYSE will initiate suspension and delisting procedures. We have advised the NYSE that we intend to cure this deficiency by May 11, 2009, and that, subject to the approval of Treasury, we might undertake a reverse stock split. However, a reverse stock split, or other action, may not be sufficient to cure this deficiency.

If the NYSE were to delist our common and preferred stock, it likely would result in a significant decline in the trading volume and liquidity of our common stock and of the classes of our preferred stock listed on the NYSE. We also expect that the suspension and delisting of our common stock would lead to decreases in analyst coverage and market-making activity relating to our common stock, as well as reduced information about trading prices and volume. As a result, it could become significantly more difficult for our shareholders to sell their shares at prices comparable to those in effect prior to delisting or at all.

We may experience further losses and write-downs relating to our investment securities, which could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

We experienced a significant increase in losses and write-downs relating to our investment securities in 2008, as well as credit rating downgrades relating to these securities. A substantial portion of these losses and write-downs related to our investments in private-label mortgage-related securities backed by Alt-A and subprime mortgage loans and CMBS. Due to the continued deterioration in home prices and continued increases in mortgage loan delinquencies, defaults and credit losses in the subprime and Alt-A sectors, we expect to incur further losses on our investments in private-label mortgage-related securities, including on those that continue to be AAA-rated. See Part II Item 7 MD&A Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities Investments in Private-Label Mortgage-Related Securities for detailed information on our investments in private-label securities backed by Alt-A and subprime loans.

We also incurred significant losses during the second half of 2008 relating to the non-mortgage investment securities in our cash and other investments portfolio, primarily as a result of a substantial decline in the market value of these assets due to the financial market crisis. The fair value of the investment securities we hold may be further adversely affected by continued deterioration in the housing and financial markets, additional ratings downgrades or other events. Further losses and write-downs relating to our investment

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securities could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

Market illiquidity also has increased the amount of management judgment required to value certain of our securities. If we were to sell any of these securities, the price we ultimately realize will depend on the demand and liquidity in the market at that time and may be materially lower than the value at which we carry these securities on our balance sheet. Any of these factors could require us to take further write-downs in the value of our investment portfolio and incur material impairment of assets, which would have an adverse effect on our business, results of operations, financial condition, liquidity and net worth.

Our business with many of our institutional counterparties is critical and heavily concentrated. If one or more of our institutional counterparties defaults on its obligations to us or becomes insolvent, we could experience substantial losses and it could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

We face the risk that one or more of our institutional counterparties may fail to fulfill their contractual obligations to us. That risk has escalated significantly as a result of the current financial market crisis. Our primary exposures to institutional counterparty risk are with: mortgage servicers that service the loans we hold in our mortgage portfolio or that back our Fannie Mae MBS; third-party providers of credit enhancement on the mortgage assets that we hold in our mortgage portfolio or that back our Fannie Mae MBS, including mortgage insurers, lenders with risk sharing arrangements, and financial guarantors; issuers of securities held in our cash and other investments portfolio; and derivatives counterparties.

The challenging mortgage and credit market conditions have adversely affected, and will likely continue to adversely affect, the liquidity and financial condition of our institutional counterparties. One or more of these institutions may default in its obligations to us for a number of reasons, such as changes in financial condition that affect their credit ratings, a reduction in liquidity, operational failures or insolvency. The financial difficulties that a number of our institutional counterparties are currently experiencing may negatively affect the ability of these counterparties to meet their obligations to us and the amount or quality of the products or services they provide to us. A default by a counterparty with significant obligations to us could result in significant financial losses to us and could materially adversely affect our ability to conduct our operations, which would adversely affect our business, results of operations, financial condition, liquidity and net worth. For example, we incurred significant losses during the third quarter of 2008 in connection with Lehman Brothers entry into bankruptcy. For a description of these losses, refer to Part II Item 7 MD&A Risk Management Credit Risk Management Institutional Counterparty Credit Risk Management.

In addition, we routinely execute a high volume of transactions with counterparties in the financial services industry. Many of these transactions expose us to credit risk relating to the possibility of a default by our counterparties. In addition, to the extent these transactions are secured, our credit risk may be exacerbated to the extent that the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to it. We have exposure to these financial institutions in the form of unsecured debt instruments, derivative transactions and equity investments. As a result, we could incur losses relating to defaults under these instruments or relating to impairments to the carrying value of our assets represented by these instruments. These losses could materially and adversely affect our business, results of operations, financial condition, liquidity and net worth.

Moreover, many of our counterparties provide several types of services to us. Many of our lender customers or their affiliates also act as mortgage servicers, custodial depository institutions and document custodians for us. Accordingly, if one of these counterparties were to become insolvent or otherwise default on its obligations to us, it could harm our business and financial results in a variety of ways. Refer to Part II Item 7 MD&A Risk

Management Credit Risk Management Institutional Counterparty Credit Risk Management for a detailed description of the business concentration and risk posed by each type of counterparty.

We depend on our mortgage insurer counterparties to provide services that are critical to our business. If one or more of these counterparties defaults on its obligations to us or becomes insolvent, it could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

Increases in mortgage insurance claims due to higher credit losses in recent periods have adversely affected the financial results and condition of many mortgage insurers. The insurer financial strength ratings of almost all of our major mortgage insurer counterparties have been downgraded to reflect their weakened financial condition. This condition creates an increased risk that these counterparties will fail to fulfill their obligations to reimburse us for claims under insurance policies.

If the financial condition of one or more of these mortgage insurer counterparties deteriorates further, it could result in an increase in our loss reserves and the fair value of our guaranty obligations if we determine it is probable that we would not collect all of our claims from the affected mortgage insurer, which could adversely affect our business, results of operations, financial condition, liquidity and net worth. In addition, if a mortgage insurer implements a run-off plan in which the insurer no longer enters into new business or is placed into receivership by its regulator, the quality and speed of their claims processing could deteriorate. Following Triad Guaranty Insurance Corporation s announced run-off of its business, we suspended Triad as a qualified provider of mortgage insurance. As a result, we experienced an additional increase in our concentration risk with our remaining mortgage insurer counterparties.

If other mortgage insurer counterparties stopped entering into new business with us or became insolvent, or if we were no longer willing to conduct business with one or more of our existing mortgage insurer counterparties, it is likely we would further increase our concentration risk with the remaining mortgage insurers in the industry.

As the volume of loan defaults has increased, the volume of mortgage insurer investigations for fraud and misrepresentation has also increased. In turn, the volume of cases where the mortgage insurer has rescinded coverage for servicer violation of policy terms has increased. In these cases, we generally require that the servicer repurchase the loan or indemnify us against loss resulting from the rescission of coverage, but as the volume of these repurchases and indemnifications increase, so does the risk that affected servicers will not be able to meet these obligations.

We are generally required pursuant to our charter to obtain credit enhancement on conventional single-family mortgage loans that we purchase or securitize with loan-to-value ratios over 80% at the time of purchase. Accordingly, if we are no longer able or willing to conduct business with some of our primary mortgage insurer counterparties, or these counterparties restrict their eligibility requirements for high loan-to-value ratio loans, and we do not find suitable alternative methods of obtaining credit enhancement for these loans, we may be restricted in our ability to purchase loans with loan-to-value ratios over 80% at the time of purchase. For example, where mortgage insurance or other credit enhancement is not available, we may be hindered in our ability to refinance borrowers whose loans we do not own or guarantee into more affordable loans. In addition, in the current environment, many mortgage insurers have stopped insuring new mortgages with loan-to-value ratios over 95%. The unavailability of suitable credit enhancement could negatively impact our ability to pursue new business opportunities relating to high loan-to-value ratio loans and therefore harm our competitive position and our earnings, and our ability to meet our housing goals.

The success of our efforts to keep people in homes, as well as the re-performance rate of loans we modify, may be limited by our reliance on third parties to service our mortgage loans.

We enter into servicing agreements with mortgage servicers, pursuant to which we delegate the servicing of our mortgage loans. These mortgage servicers, or their agents and contractors, typically are the primary point of contact for borrowers, and we rely on these mortgage servicers to identify and contact troubled borrowers as early as possible, to assess the situation and offer appropriate options for resolving the problem and to successfully implement a solution for the borrower. The demands placed on experienced mortgage loan servicers to service defaulted loans have increased significantly across the industry, straining servicer capacity. The recently announced HASP will also impact servicer resources. To the extent that mortgage servicers are hampered by limited resources or other factors, they may be unable to conduct their servicing activities in a manner that fully accomplishes our objectives within the timeframe we desire. As a practical matter, however, our ability to augment our servicers efforts is limited; we do not have any significant internal ability to assist servicers and, at this time, we have been unable to identify additional external servicing capacity. For these reasons, our ability to actively manage the troubled loans that we own or guarantee, and to implement our homeownership assistance and foreclosure prevention efforts quickly and effectively may be limited by our reliance on our mortgage servicers.

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

Our ability to generate revenue from the purchase and securitization of mortgage loans depends on our ability to acquire a steady flow of mortgage loans from the originators of those loans. We acquire a significant portion of our mortgage loans from several large mortgage lenders. During 2008, our top five lender customers accounted for approximately 66% of our single-family business volume, and three of our customers each accounted for greater than 10% of our single-family business volume. Accordingly, maintaining our current business relationships and business volumes with our top lender customers is critical to our business.

We enter into mortgage purchase volume commitments with many of our lender customers that are negotiated annually to provide for a minimum level of mortgage volume that these customers will deliver to us. In July 2008, Bank of America Corporation completed its acquisition of Countrywide Financial Corporation. As a result, Bank of America Corporation and its affiliates accounted for approximately 19% of our single-family business volume in the second half of 2008.

The mortgage industry has been consolidating and a decreasing number of large lenders originate most single-family mortgages. The loss of business from any one of our major lender customers could adversely affect our market share, our revenues and the liquidity of Fannie Mae MBS, which in turn could have an adverse effect on their market value. In addition, as we become more reliant on a smaller number of lender customers, our negotiating leverage with these customers decreases, which could diminish our ability to price our products optimally.

In addition, many of our lender customers are experiencing, or may experience in the future, financial and liquidity problems that may affect the volume of business they are able to generate. If any of our key lender customers significantly reduces the volume or quality of mortgage loans that the lender delivers to us or that we are willing to buy from them, we could lose significant business volume that we might be unable to replace, which could adversely affect our business and result in a decrease in our market share and revenues. In addition, a significant reduction in the volume of mortgage loans that we securitize could reduce the liquidity of Fannie Mae MBS, which in turn could have an adverse effect on their market value.

We rely on internal models to manage risk and to make business decisions. Our business could be adversely affected if those models fail to produce reliable results.

We make significant use of business and financial models to measure and monitor our risk exposures and to manage our business. For example, we use models to measure and monitor our exposures to interest rate, credit and other market risks, and to forecast credit losses. The information provided by these models is used in making business decisions relating to strategies, initiatives, transactions, pricing and products.

Models are inherently imperfect predictors of actual results because they are based on historical data available to us and our assumptions about factors such as future loan demand, prepayment speeds, default rates, severity rates, home price trends and other factors that may overstate or understate future experience. Our models could produce unreliable results for a number of reasons, including invalid or incorrect assumptions underlying the models, the need for manual adjustments in response to rapid changes in economic conditions, incorrect coding of the models, incorrect data being used by the models or inappropriate application of a model to products or events outside of the model s intended use. In particular, models are less dependable when the economic environment is outside of historical experience, as has been the case in recent months.

The dramatic changes in the housing, credit and capital markets have required frequent adjustments to our models and the application of greater management judgment in the interpretation and adjustment of the results produced by our models. This application of greater management judgment reflects the need to take into account updated information while continuing to maintain controlled processes for model updates, including model development, testing, independent validation, and implementation. As a result of the time and resources, including technical and staffing resources, that are required to perform these processes effectively, it may not be possible to replace existing models quickly enough to ensure that they will always properly account for the impacts of recent information and actions.

If our models fail to produce reliable results on an ongoing basis, we may not make appropriate risk management or business decisions, including decisions affecting loan purchases, management of credit losses and risk, guaranty fee pricing, asset and liability management and the management of our net worth, and any of those decisions could adversely affect our earnings, liquidity, net worth and financial condition. Furthermore, any strategies we employ to attempt to manage the risks associated with our use of models may not be effective.

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

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in applying many of these accounting policies and methods so that these policies and methods comply with GAAP and reflect management s judgment of the most appropriate manner to report our financial condition and results of operations. In some cases, management must select the appropriate accounting policy or method from two or more alternatives, any of which might be reasonable under the circumstances but might affect the amounts of assets, liabilities, revenues and expenses that we report. See Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies for a description of our significant accounting policies.

We have identified four accounting policies as critical to the presentation of our financial condition and results of operations. These accounting policies are described in Part II Item 7 MD&A Critical Accounting Policies and Estimates. We believe these policies are critical because they require management to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. Due to the complexity of these critical accounting policies, our accounting methods relating to these policies involve substantial use of models. Models are inherently imperfect predictors of actual results because they are based on assumptions, including assumptions about future events. Our models may not include assumptions that reflect very positive or very negative market conditions and, accordingly, our actual results could differ significantly from those generated by our models. As a result, the estimates that we use to prepare our financial statements, as well as our estimates of our future results of operations, may be inaccurate, potentially significantly.

We may be required to establish an additional valuation allowance against our deferred tax assets, which could materially adversely affect our results of operations, financial condition and net worth.

As of December 31, 2008, we had approximately $3.9 billion in net deferred tax assets on our consolidated balance sheet related to unrealized losses recorded through accumulated other comprehensive income (loss) (AOCI) on our available-for-sale securities as of December 31, 2008. Deferred tax assets refer to assets on our consolidated balance sheet that are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and to tax credits. The realization of our deferred tax assets is dependent upon the generation of sufficient future taxable income.

As described in Part II Item 7 MD&A Critical Accounting Policies and Estimates Deferred Tax Assets, during the third quarter of 2008, we concluded it was more likely than not that we would not

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generate sufficient taxable income in the foreseeable future to realize all of our deferred tax assets, so we established a partial deferred tax valuation allowance. We currently believe that our remaining deferred tax assets are recoverable because we have the intent and ability to hold these securities until recovery of the carrying value.

We will continue to monitor all available evidence related to our ability to utilize our remaining deferred tax assets. If in a future period we determine that we no longer have the intent or the ability to hold our available-for-sale securities until recovery of the carrying value, we would record an additional valuation allowance against these deferred tax assets, which could have a material adverse effect on our results of operations, financial condition and net worth.

Changes in option-adjusted spreads or interest rates, or our inability to manage interest rate risk successfully, could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth.

We fund our operations primarily through the issuance of debt and invest our funds primarily in mortgage-related assets that permit the mortgage borrowers to prepay the mortgages at any time. These business activities expose us to market risk, which is the risk of loss from adverse changes in market conditions. Our most significant market risks are interest rate risk and option-adjusted spread risk. We describe these risks in more detail in Part II Item 7 MD&A Risk Management Interest Rate Risk Management and Other Market Risks. Changes in interest rates affect both the value of our mortgage assets and prepayment rates on our mortgage loans.

Changes in interest rates could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth. Our ability to manage interest rate risk depends on our ability to issue debt instruments with a range of maturities and other features, including call features, at attractive rates and to engage in derivative transactions. We must exercise judgment in selecting the amount, type and mix of debt and derivative instruments that will most effectively manage our interest rate risk. In the second half of 2008, and particularly in October and November 2008, our ability to issue callable debt deteriorated, and we therefore have been required to increase our use of derivatives to manage interest rate risk. The amount, type and mix of financial instruments that are available to us may not offset possible future changes in the spread between our borrowing costs and the interest we earn on our mortgage assets.

As described in Part II Item 7 MD&A Risk Management Interest Rate Risk Management and Other Market Risks, the volatility and disruption in the credit markets during the past year, which reached unprecedented levels during the second half of 2008, have created a number of challenges for us in managing our market-related risks. As a result of our extremely limited ability to issue callable debt or long-term debt in October and November 2008, we relied primarily on a combination of short-term debt, interest rate swaps and swaptions to fund mortgage purchases and to manage our interest rate risk. Although there has been improvement in our ability to issue debt since 2008 year end, there can be no assurance that this improvement will continue. The extreme levels of market volatility have resulted in a higher level of volatility in the interest rate risk profile of our net portfolio and led us to take more frequent rebalancing actions.

Our business is subject to laws and regulations that restrict our activities and operations, which may adversely affect our business, results of operations, financial condition, liquidity and net worth.

As a federally chartered corporation, we are subject to the limitations imposed by the Charter Act, extensive regulation, supervision and examination by FHFA, and regulation by other federal agencies, including Treasury, HUD and the SEC. As a company under conservatorship, our primary regulator has management authority over us in its role as our conservator. We are also subject to many laws and regulations that affect our business, including those regarding taxation and privacy. In addition, the policy, approach or regulatory philosophy of these agencies can materially affect our business.

FHFA, other government agencies, or Congress may ask us to undertake significant efforts in pursuit of our mission. For example, on February 18, 2009, the Obama Administration announced HASP. As described above, our efforts under HASP will be substantial. To the extent that Fannie Mae servicers and borrowers participate in these programs in large numbers, it is likely that the costs we incur associated with the modifications of loans in our guaranty book of business, as well as the borrower and servicer incentive fees associated with them, will be substantial, and these programs would therefore likely have a material adverse effect on our business, results of operations, financial condition and net worth. We do not know what other actions other agencies of the U.S. government, as well as Congress may direct us to take in the future.

Additionally, the Charter Act defines our permissible business activities. For example, we may not purchase single-family loans in excess of the conforming loan limits. In addition, under the Charter Act, our business is limited to the U.S. housing finance sector. As a result of these limitations on our ability to diversify our operations, our financial condition and earnings depend almost entirely on conditions in a single sector of the U.S. economy, specifically, the U.S. housing market. Our substantial reliance on conditions in the U.S. housing market may adversely affect the investment returns we are able to generate.

The current housing goals and subgoals for our business require that a specified portion of our mortgage purchases during each calendar year relate to the purchase or securitization of mortgage loans that finance housing for low- and moderate-income households, housing in underserved areas and qualified housing under the definition of special affordable housing. Many of these goals and subgoals increased in 2008 over 2007 levels. These increases in goal levels and recent housing and mortgage market conditions, particularly the significant changes in the housing market that began in the third quarter of 2007, have made it increasingly challenging and expensive to meet our housing goals and subgoals. Based on preliminary calculations, we believe we did not meet several of our housing goals or any of the home purchase subgoals for 2008. If our efforts to meet the housing goals and special affordable housing subgoals prove to be insufficient and FHFA finds that the goals were feasible, we may become subject to a housing plan that could require us to take additional steps that could have an adverse effect on our profitability. The potential penalties for failure to comply with housing plan requirements are a cease-and-desist order and civil money penalties. The Regulatory Reform Act set the goals for 2009 at 2008 levels, but directed FHFA to determine whether these levels are feasible for 2009. We will not know what the final goal levels will be until FHFA announces them.

Our business faces significant operational risks and an operational failure could materially adversely affect our business, results of operations, financial condition, liquidity and net worth.

Shortcomings or failures in our internal processes, people or systems could have a material adverse effect on our risk management, liquidity, financial condition and results of operations; disrupt our business; and result in legislative or regulatory intervention, damage to our reputation and liability to customers. For example, our business is dependent on our ability to manage and process, on a daily basis, a large number of transactions across numerous and diverse markets. These transactions are subject to various legal and regulatory standards. We rely on the ability of our employees and our internal financial, accounting, cash management, data processing and other operating systems, as well as technological systems operated by third parties, to process these transactions and to manage our business. The steps we have taken and are taking to enhance our technology and operational controls and organizational structure may not be effective to manage these risks and may create additional operational risk as we execute these enhancements.

Due to events relating to the conservatorship, including changes in management, employees and business practices, our operational risk may increase and could result in business interruptions and financial losses. In addition, due to events that are wholly or partially beyond our control, these employees or third parties could engage in improper or unauthorized actions, or these systems could fail to operate properly, which could lead to financial losses, business disruptions, legal and regulatory sanctions, and reputational damage.

On February 18, 2009, the Obama Administration announced HASP. We will act as the program administrator for the loan modification program under HASP. Our role is expected to be substantial, requiring significant levels of internal resources and management attention, which may therefore be shifted away from current corporate initiatives. This shift could have a material adverse effect on our business, results of operations, financial condition and net worth.

Mortgage fraud could result in significant financial losses and harm to our reputation.

Because we use a process of delegated underwriting in which lenders make specific representations and warranties about the characteristics of the single-family mortgage loans we purchase and securitize, we do not independently verify most borrower information that is provided to us. This exposes us to the risk that one or more of the parties involved in a transaction (the borrower, seller, broker, appraiser, title agent, lender or servicer) will engage in fraud by misrepresenting facts about a mortgage loan. We have experienced financial losses resulting from mortgage fraud. In the future, we may experience significant financial losses and reputational damage as a result of mortgage fraud.

RISKS RELATING TO OUR INDUSTRY

A continuing, or broader, decline in U.S. home prices or activity in the U.S. housing market would negatively impact our business, results of operations, financial condition, liquidity and net worth.

We expect the continued deterioration of the U.S. housing market and national decline in home prices in 2009 to result in increased delinquencies and defaults on the mortgage assets we own and that back our guaranteed Fannie Mae MBS. Further, the features of a significant portion of mortgage loans made in recent years, including loans with adjustable interest rates that may reset to higher payments either once or throughout their term, and loans that were made based on limited or no credit or income documentation, also increase the likelihood of future increases in delinquencies or defaults on mortgage loans. An increase in delinquencies or defaults will result in a higher level of credit losses and credit-related expenses, which in turn will reduce our earnings and adversely affect our net worth and financial condition.

Our business volume is affected by the rate of growth in total U.S. residential mortgage debt outstanding and the size of the U.S. residential mortgage market. The rate of growth in total U.S. residential mortgage debt outstanding has declined substantially in response to the reduced activity in the housing market and declines in home prices, and we expect mortgage debt outstanding to decrease by 0.2% in 2009. A decline in the rate of growth in mortgage debt outstanding reduces the unpaid principal balance of mortgage loans available for us to purchase or securitize, which in turn could reduce our net interest income and guaranty fee income. Even if we are able to increase our share of the secondary mortgage market, it may not be sufficient to make up for the decline in the rate of growth in mortgage originations, which could adversely affect our results of operations and financial condition.

Changes in general market and economic conditions in the United States and abroad have materially adversely affected, and may continue to materially adversely affect, our business, results of operations, financial condition, liquidity and net worth.

Our earnings and financial condition may continue to be materially adversely affected by unfavorable market and economic conditions in the United States and abroad. These conditions include the disruption of the international credit markets, weakness in the U.S. financial markets and national economy and local economies in the United States and economies of other countries with investors that hold our debt, short-term and long-term interest rates, the value of the U.S. dollar compared with the value of foreign currencies, the rate of inflation, fluctuations in both the debt and equity capital markets, high unemployment rates and the lack of economic recovery from the credit crisis. These conditions are beyond our control and may change suddenly and dramatically.

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

- the economic recession and rising unemployment in the United States, either as a whole or in specific regions of the country, has decreased homeowner demand for mortgage loans and increased the number of homeowners who become delinquent or default on their mortgage loans. The increase in delinquencies and defaults has resulted in a higher level of credit losses and credit-related expenses and reduced our earnings. In addition, the credit crisis has reduced the amount of mortgage loans being originated.

Decreased homeowner demand for mortgage loans and reduced mortgage originations could reduce our guaranty fee income, net interest income and the fair value of our mortgage assets;

the credit crisis has increased the risk that our counterparties will default on their obligations to us or become insolvent, resulting in a reduction in our earnings and thereby adversely affecting our net worth and financial condition;

the credit crisis has reduced international demand for debt securities issued by U.S. financial institutions; and

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

Our business is subject to economic, legislative and regulatory uncertainty as a result of the current disruption in the housing and mortgage markets.

The mortgage credit markets continue to experience difficult conditions and volatility. The disruption has adversely affected the U.S. economy in general and the housing and mortgage markets in particular and likely will continue to do so. These deteriorating conditions in the mortgage market resulted in a decrease in availability of corporate credit and liquidity within the mortgage industry and have caused disruptions to normal operations of major mortgage originators, including some of our largest customers. These conditions resulted in less liquidity, greater volatility, widening of credit spreads and a lack of price transparency. We operate in these markets and are subject to potential adverse effects on our results of operations and financial condition due to our activities involving securities, mortgages, derivatives and mortgage commitments with our customers.

In addition, a variety of legislative, regulatory and other proposals have been introduced or adopted in an effort to address the disruption, which could adversely affect our business, results of operations, financial condition, liquidity and net worth. For example, on February 18, 2009, the Obama Administration announced HASP. Our efforts under HASP will be substantial, and are likely to have a material adverse effect on our business, results of operations, financial condition and net worth. In addition, President Obama supported congressional efforts to allow bankruptcy judges to reduce or cram down the difference between what a borrower owes on a mortgage and the home s current value. The Committee on the Judiciary of the U.S. House of Representatives approved such legislation on January 27, 2009. If this proposal becomes law, it could substantially increase our credit losses and investment losses. Further, these and other actions that may be taken by the U.S. government to address the disruption may not effectively bring about the intended economic recovery.

Defaults by large financial institutions and insurance companies under agreements or instruments with other financial institutions and insurance companies could materially and adversely affect the general market and our business, results of operations, financial condition, liquidity and net worth.

The financial soundness of many large financial institutions, including insurance companies, is interrelated with the credit, trading or other relationships among and between these financial institutions. As a result, concerns about, or a default or threatened default by, one financial institution could lead to significant market-wide liquidity problems, losses or defaults by other financial institutions. During the second half of 2008, investor confidence in financial institutions fell dramatically. In September and October 2008, we and Freddie Mac were placed into conservatorship, Lehman Brothers declared bankruptcy, and other major U.S. financial institutions were acquired or required assistance from the U.S. government. If the financial condition of large financial institutions continues to deteriorate or additional institutions fail, investor confidence will continue to fall, which may adversely impact investor confidence in us (including in our debt and MBS issuances). We may be particularly impacted by concerns related to Freddie

Mac. There can be no assurance that the actions being taken by the U.S. government to improve the financial markets will improve the liquidity in the credit markets or result in lower credit spreads, and the current illiquidity and wide credit spreads may worsen.

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Continued turbulence in the U.S. and international markets and economy may adversely affect our liquidity and financial condition and the willingness of certain counterparties and customers to do business with us or each other. If these or similar conditions continue or worsen, financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which we interact on a daily basis, may be adversely affected, which could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth.

The financial services industry is undergoing significant structural changes, and is subject to significant and changing regulation. We do not know how these changes will affect our business.

The financial services industry is undergoing significant structural changes. In 2008, all of the major independent investment banks were either acquired, declared bankruptcy, or changed their status to bank holding companies. In September 2008, we and Freddie Mac were placed into conservatorship, which effectively placed us under the control of the U.S. government. In light of current conditions in the U.S. financial markets and economy, regulators and legislatures have increased their focus on the regulation of the financial services industry. A number of proposals for legislation regulating the financial services industry are being introduced in Congress and in state legislatures and the number may increase.

We are unable to predict whether any of these proposals will be implemented or in what form, or whether any additional or similar changes to statutes or regulations, including the interpretation or implementation thereof, will occur in the future. Actions by regulators of the financial services industry, including actions related to limits on executive compensation, impact the retention and recruitment of management. In addition, the actions of Treasury, the FDIC, the Federal Reserve and international central banking authorities directly impact financial institutions cost of funds for lending, capital raising and investment activities, which could increase our borrowing costs or make borrowing more difficult for us. Changes in monetary policy are beyond our control and difficult to anticipate.

The financial market crisis has also resulted in several mergers or announced mergers of a number of our most significant institutional counterparties. The increasing consolidation of the financial services industry will increase our concentration risk to counterparties in this industry, and we will become more reliant on a smaller number of institutional counterparties, which both increases our risk exposure to any individual counterparty and decreases our negotiating leverage with these counterparties.

The structural changes in the financial services industry and any legislative or regulatory changes could affect us in substantial and unforeseeable ways and could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth. In particular, these changes could affect our ability to issue debt and may reduce our customer base.

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

The occurrence of a major natural disaster, terrorist attack or health epidemic in the United States could increase our delinquency rates and credit losses in the affected region or regions, which could have a material adverse effect on our business, results of operations, financial condition, liquidity and net worth.

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own our principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, as well as additional Washington, DC facilities at 3939 Wisconsin Avenue, NW and 4250 Connecticut Avenue, NW. We also own two office facilities in Herndon, Virginia, as well as two additional facilities located in Reston, Virginia, and Urbana, Maryland. These owned facilities contain a total of approximately 1,459,000 square feet of space. We lease the land underlying the 4250 Connecticut Avenue building pursuant to a ground lease that automatically renews on July 1, 2029 for an additional 49 years unless we elect to terminate the lease by providing notice to the landlord of our decision to terminate at least one year prior to the automatic renewal date. In addition, we lease approximately 429,000 square feet of office space, including a conference center, at 4000 Wisconsin Avenue, NW, which is adjacent to our principal office. The present lease term for the office space at 4000 Wisconsin Avenue expires in April 2013 and we have one additional 5-year renewal option remaining under the original lease. The lease term for the conference center at 4000 Wisconsin Avenue expires in April 2018. We also lease an additional approximately 392,000 square feet of office space at four locations in Washington, DC, Virginia and Maryland. We maintain approximately 508,000 square feet of office space in leased premises in Pasadena, California; Atlanta, Georgia; Chicago, Illinois; Philadelphia, Pennsylvania; and two facilities in Dallas, Texas.

Item 3. Legal Proceedings

This item describes our material legal proceedings. In addition to the matters specifically described in this item, we are involved in a number of legal and regulatory proceedings that arise in the ordinary course of business that do not have a material impact on our business. Litigation claims and proceedings of all types are subject to many factors that generally cannot be predicted accurately.

We record reserves for claims and lawsuits when they are probable and reasonably estimable. We presently cannot determine the ultimate resolution of the matters described below. For matters where the likelihood or extent of a loss is not probable or cannot be reasonably estimated, we have not recognized in our consolidated financial statements the potential liability that may result from these matters. If one or more of these matters is determined against us, it could have a material adverse effect on our earnings, liquidity and financial condition.

Securities Class Action Lawsuits

In re Fannie Mae Securities Litigation

Beginning on September 23, 2004, 13 separate complaints were filed by holders of certain of our securities against us, as well as certain of our former officers, in three federal district courts. All of the cases were consolidated and/or transferred to the U.S. District Court for the District of Columbia. The court entered an order naming the Ohio Public Employees Retirement System and State Teachers Retirement System of Ohio as lead plaintiffs. The lead plaintiffs filed a consolidated complaint on March 4, 2005 against us and certain of our former officers, which complaint was subsequently amended on April 17, 2006 and on August 14, 2006. The lead plaintiffs second amended complaint added KPMG LLP and Goldman, Sachs & Co. as additional defendants. The lead plaintiffs allege that the defendants made materially false and misleading statements in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and SEC Rule 10b-5 promulgated thereunder, largely with respect to accounting statements that were inconsistent with the GAAP requirements relating to hedge accounting and the amortization of premiums and discounts. The lead plaintiffs contend that the alleged fraud resulted in artificially inflated prices for our common stock and seek unspecified compensatory damages, attorneys fees, and other fees and costs.

On January 7, 2008, the court issued an order that certified the action as a class action, and appointed the lead plaintiffs as class representatives and their counsel as lead counsel. The court defined the class as all purchasers of

Fannie Mae common stock and call options and all sellers of publicly traded Fannie Mae put options during the period from April 17, 2001 through December 22, 2004.

On April 16, 2007, KPMG LLP, our former outside auditor and a co-defendant in the shareholder class action suit, filed cross-claims against us in this action for breach of contract, fraudulent misrepresentation, fraudulent inducement, negligent misrepresentation and contribution. KPMG amended these cross-claims on February 25, 2008. KPMG is seeking unspecified compensatory, consequential, restitutionary, rescissory and punitive damages, including purported damages related to legal costs, exposure to legal liability, costs and expenses of responding to investigations related to our accounting, lost fees, attorneys fees, costs and expenses.

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

On October 17, 2008, FHFA, as conservator for Fannie Mae, intervened in the consolidated shareholder class action (as well as in the consolidated ERISA litigation and the shareholder derivative lawsuits pending in the U.S. District Court for the District of Columbia) and filed a motion to stay those cases. On October 20, 2008, the Court issued an order staying the cases until January 6, 2009. Upon expiration of the stay, discovery in those cases resumed.

Securities Class Action Lawsuits Pursuant to the Securities Act of 1933

Beginning on August 7, 2008, a series of shareholder lawsuits were filed under the Securities Act against underwriters of issuances of certain Fannie Mae common and preferred stock. Two of these lawsuits were also filed against us and one of those two was also filed against certain former Fannie Mae officers and directors. While the factual allegations in these cases vary to some degree, these plaintiffs generally allege that defendants misled investors by understating the company s need for capital, causing putative class members to purchase shares at artificially inflated prices. Their complaints allege similar violations of Section 12(a)(2) of the Securities Act, and seek rescission, damages, interest, costs, attorneys and experts fees, and other equitable and injunctive relief. On November 12, 2008, we filed a motion with the Judicial Panel on Multidistrict Litigation to transfer and coordinate each of these actions with the other recently filed section 10(b), section 12(a)(2) and ERISA actions. The Panel granted our motion on February 11, 2009, and all of these cases are now pending before in the U.S. District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings. On February 13, 2009, the district court entered an order appointing Tennessee Consolidated Retirement System as lead plaintiff on behalf of purchasers of preferred stock, and appointing the Massachusetts Pension Reserves Investment Management Board and the Boston Retirement Board as lead plaintiffs on behalf of common stockholders. Each individual case is described more fully below. We believe we have valid defenses to the claims in these lawsuits and intend to defend against these lawsuits vigorously.

Krausz v. Fannie Mae, et al.

On September 11, 2008, Malka Krausz filed a complaint in New York Supreme Court against Fannie Mae, former officers Daniel H. Mudd and Stephen M. Swad, and underwriters Lehman Brothers, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., Goldman Sachs & Co. and J.P. Morgan Securities, Inc. The complaint was filed on behalf of purchasers of Fannie Mae s Fixed-to-Floating Rate Non-Cumulative Preferred Stock, Series S (referred to as the Series S Preferred Stock) pursuant to an offering that closed on December 11, 2007. The complaint alleges that defendants misled investors by understating our need for capital, causing putative class members to purchase shares at artificially inflated prices. The complaint contends further that the defendants violated Sections 12(a)(2) and 15 of the Securities Act. The complaint also asserts claims for common law fraud and negligent misrepresentation. The plaintiff seeks rescission of the purchases, damages, costs, including attorneys , accountants and experts fees, and other unspecified relief. On October 6, 2008, this case was removed to the U.S. District Court for the Southern District of New York, where it is currently pending. On October 14, 2008, we, along with certain of the other defendants, filed a motion to dismiss this case. That motion is fully briefed and remains pending.

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Kramer v. Fannie Mae, et al.

On September 26, 2008, Daniel Kramer filed a securities class action complaint in the Superior Court of New Jersey, Law Division, Bergen County, against Fannie Mae, Merrill Lynch, Pierce, Fenner & Smith Inc., Citigroup Global Markets Inc., Morgan Stanley & Co. Inc., UBS Securities LLC, Wachovia Capital Markets LLC, Moody s Investors Services, Inc., The McGraw-Hill Companies, Inc., Standard & Poor s Ratings Services and Fitch Ratings, Inc. The complaint was filed on behalf of purchasers of Fannie Mae s Series S Preferred Stock and/or Fannie Mae s 8.25% Non-cumulative Preferred Stock, Series T (referred to as the Series T Preferred Stock) issued pursuant to an offering that closed on May 13, 2008. The complaint alleges that the defendants violated Section 12(a)(2) of the Securities Act. The plaintiff seeks rescission of the purchases, damages, costs, including attorneys , accountants and experts fees, and other unspecified relief. On October 27, 2008, this lawsuit was removed to the U.S. District Court for the District of New Jersey. Plaintiff filed a motion to remand back to state court on November 17, 2008, which is now fully briefed and remains pending. FHFA, as conservator for Fannie Mae, filed a motion to intervene and for a stay on November 21, 2008, which has been fully briefed and remains pending. On February 11, 2009, the Judicial Panel on Multidistrict Litigation transferred this case to the U.S. District Court for the Southern District of New York.

Securities Class Action Lawsuits Pursuant to the Securities Exchange Act of 1934

On September 8, 2008, the first of several shareholder lawsuits was filed under the Exchange Act against certain current and former Fannie Mae officers and directors, underwriters of issuances of certain Fannie Mae common and preferred stock, and, in one case, Fannie Mae. While the factual allegations in these cases vary to some degree, the plaintiffs generally allege that defendants misled investors by understating the company s need for capital, causing putative class members to purchase shares at artificially inflated prices. The plaintiffs generally allege similar violations of Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act, and seek damages, interest, costs, attorneys and experts fees, and injunctive and other unspecified equitable relief. On November 12, 2008, we filed a motion with the Judicial Panel on Multidistrict Litigation to transfer and coordinate each of these actions with all of the other recently filed section 10(b), section 12(a)(2) and ERISA suits. The Panel granted our motion on February 11, 2009, and all of these cases are now pending in the U.S. District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings. On February 13, 2009, the district court entered an order appointing the Tennessee Consolidated Retirement System as lead plaintiff on behalf of purchasers of our preferred stock, and appointing the Massachusetts Pension Reserves Investment Management Board and the Boston Retirement Board as lead plaintiffs on behalf of our common stockholders. Each individual case is described more fully below. We believe we have valid defenses to the claims in these lawsuits and intend to defend against these lawsuits vigorously.

Genovese v. Ashley, et al.

On September 8, 2008, John A. Genovese filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen B. Ashley, Robert J. Levin, Daniel H. Mudd and Stephen Swad. Fannie Mae was not named as a defendant. The complaint was filed on behalf of all persons who purchased or otherwise acquired the publicly traded securities of Fannie Mae between November 16, 2007 and September 5, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiff seeks damages, interest, costs, attorneys fees, and injunctive and other unspecified equitable relief.

Gordon v. Ashley, et al.

On September 11, 2008, Hilda Gordon filed a securities class action complaint in the U.S. District Court for the Southern District of Florida against certain current and former officers and directors. Fannie Mae was not named as a defendant. The complaint was filed on behalf of all persons who purchased or otherwise acquired the publicly traded securities of Fannie Mae between November 16, 2007 and September 11, 2008. In addition to alleging that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act, the complaint also alleges that they violated the Florida Deceptive and Unfair Trade Practices Act. The plaintiff seeks damages, interest, costs, attorneys fees, and injunctive and other unspecified equitable relief. On February 11, 2009, the Judicial Panel on Multidistrict Litigation transferred this case to the U.S. District Court for the Southern District of New York.

Crisafi v. Merrill Lynch, et al.

On September 16, 2008, Nicholas Crisafi and Stella Crisafi, Trustees FBO the Crisafi Inter Vivos Trust, filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen B. Ashley, Robert J. Levin, Daniel H. Mudd and Stephen Swad, as well as underwriters Citigroup Global Markets, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., Morgan Stanley & Co., Inc., UBS Securities LLC and Wachovia Capital Markets LLC. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s Series T Preferred Stock, from May 13, 2008 to September 6, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiffs seek compensatory damages, including interest, and costs and expenses, including attorneys and experts fees.

Fogel Capital Mgmt. v. Fannie Mae, et al.

On September 18, 2008, Fogel Capital Management, Inc. filed a securities class action complaint in the U.S. District Court for the Southern District of New York against Fannie Mae and certain current and former officers and directors. The complaint s factual allegations and claims for relief are based on purchases of Fannie Mae s Series S Preferred Stock, but the plaintiff purports to bring the suit on behalf of purchasers of all Fannie Mae securities from November 9, 2007 through September 5, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiff seeks compensatory damages, including interest, costs and expenses, including attorneys and experts fees, and injunctive and other unspecified equitable relief.

Jesteadt v. Ashley, et al.

On September 24, 2008, Leonard and Grace Jesteadt filed a securities class action complaint in the U.S. District Court for the Western District of Pennsylvania against certain current and former officers and directors. Fannie Mae was not named as a defendant. The complaint was filed on behalf of all persons who purchased or otherwise acquired the publicly traded securities of Fannie Mae between November 16, 2007 and September 24, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiffs seek permanent injunctive relief, compensatory damages, including interest, costs and expenses, including attorneys and experts fees. On February 11, 2009, the Judicial Panel on Multidistrict Litigation transferred this case to the U.S. District Court for the Southern District of New York.

Sandman v. J.P. Morgan Securities, Inc., et al.

On September 29, 2008, Dennis Sandman filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen B. Ashley, Robert J. Levin, Daniel H. Mudd and Stephen Swad, and underwriters Banc of America Securities LLC, Goldman Sachs & Co., J.P. Morgan Securities, Inc., Lehman Brothers, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Inc. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s 8.75% Non-Cumulative Mandatory Convertible Preferred Stock Series 2008-1 from May 14, 2008 to September 5, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiff seeks compensatory damages, including interest, and costs and expenses, including attorneys and experts fees.

Frankfurt v. Lehman Bros., Inc., et al.

On October 7, 2008, plaintiffs David L. Frankfurt, the Frankfurt Family Ltd., The David Frankfurt 2000 Family Trust and the David Frankfurt 2002 Family Trust filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen Ashley, Daniel Mudd, Stephen Swad and Robert Levin, and underwriters Lehman Brothers, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., J.P. Morgan Securities, Inc. and Goldman Sachs & Co. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s Series S Preferred Stock from December 11, 2007 to September 5, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiffs seek compensatory damages, including interest, and reasonable costs and expenses, including attorneys and experts fees.

Schweitzer v. Merrill Lynch, et al.

On October 8, 2008, plaintiffs Stephen H. Schweitzer and Linda P. Schweitzer filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen B. Ashley, Daniel H. Mudd, Stephen M. Swad and Robert J. Levin, and underwriters Merrill Lynch, Pierce, Fenner & Smith, Inc., Goldman Sachs & Co., J.P. Morgan Securities, Inc., Banc of America Securities LLC, Bear, Stearns & Co., Citigroup Global Markets, Inc., Deutsche Bank Securities, Inc., Morgan Stanley & Co., Inc. and UBS Securities LLC. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s Series S Preferred Stock in or traceable to the offering of Series S Preferred Stock that closed December 11, 2007, through September 5, 2008. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiffs seek compensatory damages, including interest, and reasonable costs and expenses, including attorneys and experts fees.

Williams v. Ashley, et al.

On October 10, 2008, plaintiffs Lynn Williams and SteveAnn Williams filed a securities class action complaint in the U.S. District Court for the Southern District of New York against certain current and former officers and directors. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s Series S Preferred Stock, from December 6, 2007 through September 5, 2008. The complaint alleges that defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiffs seek compensatory damages, including interest, and reasonable costs and expenses, including attorneys and experts fees.

Securities Class Action Lawsuit Pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934

Jarmain v. Merrill Lynch, et al.

On October 3, 2008, Brian Jarmain filed a securities class action complaint in the U.S. District Court for the Southern District of New York against former officers and directors Stephen B. Ashley, Robert J. Levin, Daniel H. Mudd and Stephen M. Swad, and underwriters Citigroup Global Markets, Inc., Merrill Lynch, Pierce, Fenner & Smith, Inc., Morgan Stanley & Co., Inc., UBS Securities LLC and Wachovia Capital Markets LLC. Fannie Mae was not named as a defendant. The complaint was filed on behalf of purchasers of Fannie Mae s Series T Preferred Stock from May 13, 2008 to September 6, 2008. The complaint alleges violations of both Section 12(a)(2) of the Securities Act and Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Exchange Act. The plaintiff seeks compensatory damages, including interest, fees and expenses, including attorneys and experts fees, and injunctive and other unspecified equitable and relief. On November 12, 2008, we filed a motion with the Judicial Panel on Multidistrict Litigation to transfer and coordinate this action with all of the other recently filed section 10(b), section 12(a)(2) and ERISA suits. The Panel granted our motion on February 11, 2009, and this case is now pending in the U.S. District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings. On February 13, 2009, the district court entered an order appointing Tennessee Consolidated Retirement System as lead plaintiff on behalf of purchasers of preferred stock, and appointing the Massachusetts Pension Reserves Investment Management Board and the Boston Retirement Board as lead plaintiffs on behalf of common stockholders.

Shareholder Derivative Lawsuits

In re Fannie Mae Shareholder Derivative Litigation

Beginning on September 28, 2004, ten plaintiffs filed twelve shareholder derivative actions in three different federal district courts and the Superior Court of the District of Columbia against certain of our current and former officers and directors and against us as a nominal defendant. All of these shareholder derivative actions have been consolidated into the U.S. District Court for the District of Columbia and the court entered an order naming Pirelli Armstrong Tire Corporation Retiree Medical Benefits Trust and Wayne County Employees Retirement System as co-lead plaintiffs. A consolidated complaint was filed on September 26, 2005 against certain of our current and former officers and directors and against us as a nominal defendant. The consolidated complaint alleges that the defendants purposefully misapplied GAAP, maintained poor internal controls, issued a false and misleading proxy statement and falsified documents to cause our financial performance to appear smooth and stable, and that Fannie Mae was harmed as a result. The claims are for breaches of the duty of care, breach of fiduciary duty, waste, insider trading, fraud, gross mismanagement, violations of the Sarbanes-Oxley Act of 2002 and unjust enrichment. The plaintiffs seek unspecified compensatory damages, punitive damages, attorneys fees, and other fees and costs, as well as injunctive relief directing us to adopt certain proposed corporate governance policies and internal controls.

The lead plaintiffs filed an amended complaint on September 1, 2006, which added certain third parties as defendants. The amended complaint also added allegations concerning the nature of certain transactions between these entities and Fannie Mae, and added additional allegations from OFHEO s May 2006 report on its special investigation of Fannie Mae and from a report by the law firm of Paul, Weiss, Rifkind & Garrison LLP on its investigation of Fannie Mae. On May 31, 2007, the court dismissed this consolidated lawsuit in its entirety against all defendants. On June 27, 2007, plaintiffs filed a Notice of Appeal with the U.S. Court of Appeals for the District of Columbia. On April 16, 2008, the Court of Appeals granted lead plaintiffs motion to file a second amended complaint, which added only additional jurisdictional allegations.

On August 8, 2008, the U.S. Court of Appeals for the D.C. Circuit upheld the District Court s dismissal of the consolidated derivative action. On September 4, 2008, the plaintiffs filed a motion for rehearing en banc. On September 10, 2008, the Court of Appeals issued an order calling for a response to the petition to be filed by September 25, 2008. On September 24, 2008, we filed a motion to invoke the 45-day stay available under 12 U.S.C. § 4617(b)(1) due to the conservatorship. On September 29, 2008, the Court granted our motion and held the case in abeyance pending further order of the Court; and further directed the parties to file motions to govern on November 10, 2008. On November 10, 2008, FHFA filed a motion to govern further proceedings, to substitute itself, as conservator, for the appellants and to dismiss the petition for rehearing. Defendants also filed a motion to continue to hold the briefing on Plaintiffs petition for rehearing en banc in abeyance, pending the resolution of FHFA s Motion to Substitute the Conservator in Place of the Shareholder Plaintiffs-Appellants and to Withdraw the Petition for Panel Rehearing or Rehearing En Banc. On December 24, 2008, the Court granted FHFA s motion, and denied plaintiff s motion. On February 9, 2009, the Court of Appeals entered its mandate affirming the District Court s dismissal.

On September 20, 2007, James Kellmer, a shareholder who had filed one of the derivative actions that was consolidated into the consolidated derivative case, filed a motion in the U.S. District Court for District of Columbia for clarification or, in the alternative, for relief of judgment from the Court s May 31, 2007 Order dismissing the consolidated case. Mr. Kellmer s motion seeks clarification that the Court s May 31, 2007 dismissal order does not apply to his January 10, 2005 action, and that his case can now proceed. This motion is pending.

On June 29, 2007, Mr. Kellmer also filed a new derivative action in the U.S. District Court for the District of Columbia. Mr. Kellmer s new complaint alleges that he made a demand on the Board of Directors on September 24, 2004, and that this new action should now be allowed to proceed. On December 18, 2007,

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Mr. Kellmer filed an amended complaint that narrowed the list of named defendants to certain of our current and former directors, Goldman Sachs Group, Inc. and us, as a nominal defendant. The factual allegations in Mr. Kellmer s 2007 amended complaint are largely duplicative of those in the amended consolidated complaint and his amended complaint s claims are based on theories of breach of fiduciary duty, indemnification, negligence, violations of the Sarbanes-Oxley Act of 2002 and unjust enrichment. His amended complaint seeks unspecified money damages, including legal fees and expenses, disgorgement and punitive damages, as well as injunctive relief.

In addition, on July 6, 2007, Arthur Middleton filed a derivative action in the U.S. District Court for the District of Columbia that is also based on Mr. Kellmer s alleged September 24, 2004 demand. This complaint names as defendants certain of our current and former officers and directors, the Goldman Sachs Group, Inc., Goldman, Sachs & Co. and us, as a nominal defendant. The allegations in this new complaint are essentially identical to the allegations in the amended consolidated complaint referenced above, and this plaintiff seeks identical relief.

On July 27, 2007, Mr. Kellmer filed a motion to consolidate these two new derivative cases and to be appointed lead counsel. We filed a motion to dismiss Mr. Middleton s complaint for lack of standing on October 3, 2007, and a motion to dismiss Mr. Kellmer s 2007 complaint for lack of subject matter jurisdiction on October 12, 2007. These motions are fully briefed and remain pending. In addition, on October 17, 2008, FHFA, as conservator for Fannie Mae, intervened in the *Kellmer* and *Middleton* actions and filed a motion to stay each. On October 20, 2008, the Court issued an order staying these cases until January 6, 2009. On February 2, 2009, FHFA filed motions to substitute itself for plaintiffs Messrs. Kellmer and Middleton. On February 13, 2009, Mr. Kellmer filed an opposition to FHFA s motion to substitute.

Arthur Derivative Litigation

On November 26, 2007, Patricia Browne Arthur filed a shareholder derivative action in the U.S. District Court for the District of Columbia against certain of our current and former officers and directors and against us as a nominal defendant. The complaint alleges that the defendants wrongfully failed to disclose our exposure to the subprime mortgage crisis and that this failure artificially inflated our stock price and allowed certain of the defendants to profit by selling their shares based on material inside information; and that the Board improperly authorized the company to buy back $100 million in shares while the stock price was artificially inflated. The complaint alleges that the defendants violated Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Securities Exchange Act of 1934. It also alleges breaches of fiduciary duties; misappropriation of information; waste of corporate assets; and unjust enrichment. The plaintiff seeks damages on behalf of the company; corporate governance changes; equitable relief in the form of attaching, impounding or imposing a constructive trust on the individual defendants assets; restitution; and attorneys fees and costs. On October 17, 2008, FHFA, as conservator for Fannie Mae, intervened in this action and filed a motion to stay. On October 20, 2008, the Court issued an order staying this case until January 6, 2009. On February 2, 2009, FHFA filed a motion to substitute itself for plaintiff Ms. Arthur. On February 13, 2009, Ms. Arthur filed an opposition to FHFA s motion to substitute.

Agnes Derivative Litigation

On June 25, 2008, L. Jay Agnes filed a shareholder derivative complaint in the U.S. District Court for the District of Columbia against certain of our current and former directors and officers, Fannie Mae as a nominal defendant, Washington Mutual, Inc., Kerry K. Killinger; Countrywide Financial Corporation and its subsidiaries and/or affiliates, Countrywide Home Loans, Inc., Countrywide Home Equity Loan Trust, and Countrywide Bank, FSB, LandSafe, Inc., Angelo R. Mozilo; First American Corporation, First American eAppraiseIt, Anthony R. Merlo, Jr. and Goldman Sachs Group, Inc.

The complaint alleges two general categories of derivative claims purportedly on our behalf against the current and former Fannie Mae officer and director defendants. First, it alleges illegal accounting manipulations occurring from approximately 1998 through 2004, or pre-2005 claims, which is based on the May 2006 OFHEO Report and is largely duplicative of the allegation contained in the existing derivative actions. Second,

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it makes allegations similar to those in the *Arthur Derivative Litigation* that was filed in November 2007 and described above. Specifically the complaint contends that the current and former Fannie Mae officer and director defendants irresponsibly engaged in highly speculative real estate transactions and concealed the extent of the Company s exposure to the subprime mortgage crisis, while wasting Company assets by causing it to repurchase its own shares at inflated prices at the same time that certain defendants sold their personally held shares. Based upon these allegations, the complaint asserts causes of action against the current and former Fannie Mae officer and director defendants for breach of fiduciary duty, indemnification, negligence, unjust enrichment and violations of Section 304 of the Sarbanes-Oxley Act of 2002.

In addition, Mr. Agnes asserts a direct claim on his own behalf under Section 14(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9 based upon allegations that the Company s 2008 Proxy Statement was intentionally false and misleading and concealed material facts in order that members of the Board could remain in control of the company.

The complaint seeks a declaration that the current and former officer and director defendants breached their fiduciary duties; a declaration that the election of directors pursuant to the 2008 Proxy Statement is null and void; a new election of directors; an accounting for losses and damages to us as a result of the alleged misconduct; disgorgement; unspecified compensatory damages; punitive damages; attorneys fees, and other fees and costs; as well as injunctive relief directing us to reform our corporate governance and internal control procedures. On October 17, 2008, FHFA, as conservator for Fannie Mae, intervened in this action and filed a motion to stay. On October 20, 2008, the Court issued an order staying this case until January 6, 2009. On January 18, 2009, the Court entered an order extending the time for all defendants, except Washington Mutual, Inc., to respond to the complaint through May 5, 2009. On February 2, 2009, FHFA filed a motion to substitute itself for Mr. Agnes with respect to Mr. Agnes derivative claims, and to consolidate Mr. Agnes direct claim with those in *In re Fannie Mae Securities Litigation* described above. On February 13, 2009, Mr. Agnes filed an opposition to FHFA s motion to substitute.

ERISA Actions

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

On October 14, 2004, David Gwyer filed a proposed class action complaint in the U.S. District Court for the District of Columbia. Two additional proposed class action complaints were filed by other plaintiffs on May 5, 2005 and May 10, 2005. These cases are based on the Employee Retirement Income Security Act of 1974 (ERISA) and name us, our Board of Directors Compensation Committee and certain of our former and current officers and directors as defendants. These cases were consolidated on May 24, 2005 in the U.S. District Court for the District of Columbia and a consolidated complaint was filed on June 16, 2005. The plaintiffs in this consolidated ERISA-based lawsuit purport to represent a class of participants in our Employee Stock Ownership Plan (ESOP) between January 1, 2001 and the present. Their claims are based on alleged breaches of fiduciary duty relating to accounting matters. The plaintiffs seek unspecified damages, attorneys fees, and other fees and costs, and other injunctive and equitable relief. On June 29, 2005, defendants filed a motion to dismiss, which the Court denied on May 8, 2007. On July 23, 2007, the Compensation Committee of our Board of Directors filed a motion to dismiss, which the Court denied on July 17, 2008.

On October 17, 2008, FHFA intervened in the consolidated case (as well as in the consolidated shareholder class action and the shareholder derivative lawsuits pending in the U.S. District Court for the District of Columbia) and filed a motion to stay those cases. On October 20, 2008, the Court issued an order staying the cases until January 6, 2009. Upon expiration of the stay, discovery in those cases resumed.

Moore v. Fannie Mae, et al.

On October 23, 2008, Mary P. Moore filed a proposed class action complaint in the U.S. District Court for the District of Columbia against our Board of Directors Compensation Committee, our Benefits Plans Committee, and certain current and former Fannie Mae officers and directors. This case is based on ERISA. Plaintiff alleges that defendants, as fiduciaries of Fannie Mae s ESOP, breached their duties to ESOP participants and beneficiaries with regards to the ESOP s investment in Fannie Mae common stock when it was no longer prudent to continue to do so. Plaintiff purports to represent a class of participants and beneficiaries of the ESOP whose accounts invested in Fannie Mae common stock beginning April 17, 2007. The complaint alleges that the defendants breached purported fiduciary duties with respect to the ESOP. The plaintiff seeks unspecified damages, attorneys fees, and other fees and costs and injunctive and other equitable relief. On November 12, 2008, we filed a motion with the Judicial Panel of Multidistrict Litigation to transfer and coordinate this action with all of the other recently filed section 10(b), section 12(a)(2) and ERISA suits. The Panel granted our motion on February 11, 2009, and this case is now pending in the U.S. District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings. On February 13, 2009, the district court entered an order appointing Tennessee Consolidated Retirement System as lead plaintiff on behalf of purchasers of preferred stock, and appointing the Massachusetts Pension Reserves Investment Management Board and the Boston Retirement Board as lead plaintiffs on behalf of common stockholders. On January 8, 2009, Moore filed a joint motion with David Gwyer in the U.S. District Court for the District of Columbia to, among other things, consolidate this action with *Gwyer II* and for the appointment on an interim basis of co-lead counsel. The defendants filed a response on January 27, 2009 arguing that their motion was premature. On February 9, 2009, the U.S. District Court for the District of Columbia entered an order extending the time for defendants to respond to Ms. Moore s complaint until April 14, 2009.

Gwyer v. Fannie Mae Compensation Committee, et al. (Gwyer II)

On November 25, 2008, David Gwyer filed a proposed class action complaint in the U.S. District Court for the District of Columbia against our Board of Directors Compensation Committee, our Benefits Plans Committee, and certain current and former Fannie Mae officers and directors. This case is based on ERISA. Plaintiff alleges that defendants, as fiduciaries of Fannie Mae s ESOP, breached their duties to ESOP participants and beneficiaries with regards to the ESOP s investment in Fannie Mae common stock when it was no longer prudent to continue to do so. Plaintiff purports to represent a class of participants and beneficiaries of the ESOP whose accounts invested in Fannie Mae common stock beginning April 17, 2007. The complaint alleges that the defendants breached purported fiduciary duties with respect to the ESOP. The plaintiff seeks unspecified damages, attorneys fees, and other fees and costs and injunctive and other equitable relief. On December 12, 2008, we filed notice of a potential tag-along action with the Judicial Panel on Multidistrict Litigation to transfer and coordinate this action with all of the other recently filed section 10(b), section 12(a)(2) and ERISA suits. On February 11, 2009, the Panel ruled on the underlying motion to transfer and consolidate, and on February 20, 2009, the Panel issued a conditional transfer order transferring this case to the U.S. District Court for the Southern District of New York and allowing the plaintiff until March 9, 2009 to file an opposition to the transfer. On January 8, 2009, Gwyer filed a joint motion with Mary P. Moore to, among other things, consolidate this action with *Moore v. Fannie Mae, et al.* and for the appointment on an interim basis of co-lead counsel. The defendants filed a response on January 27, 2009 arguing that their motion was premature. On February 9, 2009, the U.S. District Court for the District of Columbia entered an order extending the time for defendants to respond to Mr. Gwyer s complaint until April 14, 2009.

Weber v. Mudd, et al.

On December 3, 2008, Kristen Weber filed a proposed class action complaint in the U.S. District Court for the Southern District of New York against certain current and former Fannie Mae officers and directors. This case is based on ERISA. Plaintiff alleges that the defendants, as fiduciaries of Fannie Mae s ESOP, breached their duties to ESOP participants and beneficiaries with regards to the ESOP s investment in Fannie Mae common stock when it was no longer prudent to continue to do so. Plaintiff purports to represent a class of participants and beneficiaries of the ESOP whose accounts invested in Fannie Mae common stock beginning November 9, 2007. The complaint alleges that the defendants breached purported fiduciary duties with respect to the ESOP. The plaintiff seeks unspecified damages, attorneys fees, and other fees and costs and injunctive and other equitable relief. On December 9, 2008, plaintiff voluntarily dismissed this action.

Antitrust Lawsuits

In re G-Fees Antitrust Litigation

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

We and Freddie Mac filed a motion to dismiss on October 11, 2005. On October 29, 2008, the court denied our motion to dismiss in part and granted it in part. On November 13, 2008, FHFA as conservator for both us and Freddie Mac, filed a motion to intervene and stay the case. On that day the Court entered an order granting FHFA s motion to intervene and stayed the case until April 1, 2009.

Escrow Litigation

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

A complaint was filed against us in the U.S. District Court for the Eastern District of Texas (Texarkana Division) on June 2, 2004, in which plaintiffs purport to represent a class of multifamily borrowers whose mortgages are insured under Sections 221(d)(3), 236 and other sections of the National Housing Act and are held or serviced by us. The complaint identified as a proposed class low- and moderate-income apartment building developers who maintained uninvested escrow accounts with us or our servicer. Plaintiffs Casa Orlando Apartments, Ltd., Jasper Housing Development Company and the Porkolab Family Trust No. 1 allege that we violated fiduciary obligations that they contend we owed to borrowers with respect to certain escrow accounts and that we were unjustly enriched. In particular, plaintiffs contend that, starting in 1969, we misused these escrow funds and are therefore liable for any economic benefit we received from the use of these funds. The plaintiffs seek a return of any profits, with accrued interest, earned by us related to the escrow accounts at issue, as well as attorneys fees and costs. Our motions to dismiss and for summary judgment with respect to the statute of limitations were denied.

Plaintiffs filed an amended complaint on December 16, 2005. On January 3, 2006, plaintiffs filed a motion for class certification, which is fully briefed and remains pending.

Fees Litigation

Okrem v. Fannie Mae, et al.

A complaint was filed on January 2, 2009 against us, Washington Mutual, FSB, the law firm of Zucker, Goldberg & Ackerman and other unnamed parties in the U.S. District Court for the District of New Jersey, in which plaintiffs purport to represent a class of borrowers who had home loans that were foreclosed upon and were either held or serviced by Fannie Mae or Washington Mutual and were charged attorneys fees and other costs, which they contend were in excess of amounts actually incurred and/or in excess of the amount permitted by law. An amended complaint was filed on February 1, 2009, which made some technical amendments and substituted Washington Mutual Bank for Washington Mutual, FSB. Plaintiffs contend that the defendants were engaged in a scheme to overcharge defaulting borrowers of residential mortgages. The amended complaint contains claims under theories of breach of contract, negligence, breach of duty of good faith and fair dealing, unjust enrichment, unfair and deceptive acts or practices, violations of the New Jersey Consumer Fraud Act, violations of New Jersey state court rules, and violations of the New Jersey Truth-In-Consumer Contract, Warranty and Notice Act. The plaintiffs seek $15 million in damages as well as punitive, exemplary, enhanced and treble damages, restitution, disgorgement, certain equitable relief and their fees and costs.

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Former Management Arbitration

Former CFO Arbitration

On July 8, 2008, our former Chief Financial Officer and Vice Chairman, J. Timothy Howard, initiated an arbitration proceeding against Fannie Mae before a Federal Arbitration, Inc. panelist. Mr. Howard claimed that he was entitled to salary continuation under his employment agreement because, in December 2004, he allegedly terminated his employment with Fannie Mae for Good Reason, as defined in his employment agreement, effective January 31, 2005. The parties stipulated that should Mr. Howard prevail on his salary continuation claim, the damages awarded on that claim would be approximately $1.7 million plus any interest deemed appropriate by the arbitrator under applicable law. We also reserved the discretion, in this arbitration, to pursue counterclaims against Mr. Howard growing out of Mr. Howard s service as Chief Financial Officer and Vice Chairman of the company s Board of Directors. Pursuant to Mr. Howard s employment agreement, we advanced his reasonably incurred legal fees and expenses that resulted from the arbitration.

Discovery took place and, on November 18, 2008, an arbitration hearing was held. On December 11, 2008, the arbitrator ruled in favor of Mr. Howard, and awarded him the stipulated amount with interest from the date of the award. On January 23, 2009, Fannie Mae filed a counterclaim seeking recovery of Mr. Howard s 2003 annual incentive plan bonus of approximately $1.2 million plus prejudgment interest. On February 5, 2009, the arbitrator issued an order granting Mr. Howard prejudgment interest on the award.

Investigation by the Securities and Exchange Commission

On September 26, 2008, we received notice of an ongoing investigation into Fannie Mae by the SEC regarding certain accounting and disclosure matters. We are cooperating fully with this investigation. On January 8, 2009, the SEC issued a formal order of investigation.

Investigation by the Department of Justice

On September 26, 2008, we received notice of an ongoing federal investigation by the United States Attorney for the Southern District of New York into certain accounting, disclosure and corporate governance matters. In connection with that investigation, Fannie Mae received a Grand Jury subpoena for documents. That subpoena was subsequently withdrawn. However, we have been informed that the Department of Justice is continuing an investigation. We are cooperating fully with this investigation.

Committee on Oversight and Government Reform Hearing

On October 20, 2008, we received a letter from Henry A. Waxman, Chairman of the Committee on Oversight and Government Reform of the House of Representatives of the Congress of the United States that the Committee had scheduled a hearing related to the financial conditions at Fannie Mae and Freddie Mac, the conservatorships and the GSEs roles in the ongoing financial crisis. The letter requested documents and information concerning, among other things, risk and risk assessments, losses, subprime and other loans, capital, and accounting issues. The Committee held its hearing on December 9, 2008.

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

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is publicly traded on the New York and Chicago stock exchanges and is identified by the ticker symbol FNM. The transfer agent and registrar for our common stock is Computershare, P.O. Box 43078, Providence, Rhode Island 02940.

Common Stock Data

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

Quarter	High	Low	Dividend
2007			
First quarter	$ 60.44	$ 51.88	$ 0.40
Second quarter	69.94	53.30	0.50
Third quarter	70.57	56.19	0.50
Fourth quarter	68.60	26.38	0.50
2008			
First quarter	$ 40.20	$ 18.25	$ 0.35
Second quarter	32.31	19.23	0.35
Third quarter	19.96	0.35	0.05
Fourth quarter	1.83	0.30	

Dividends

The table above under Common Stock Data presents the dividends we declared on our common stock from the first quarter of 2007 through and including the fourth quarter of 2008. In January 2008, the Board of Directors reduced the common stock dividend to $0.35 per share, beginning with the first quarter of 2008. In August 2008, the Board of Directors further reduced the common stock dividend to $0.05 per share for the third quarter of 2008.

The conservator announced on September 7, 2008 that we would not pay any dividends on the common stock or on any series of outstanding preferred stock. In addition, the senior preferred stock purchase agreement prohibits us from declaring or paying any dividends on Fannie Mae equity securities (other than the senior preferred stock) without the prior written consent of Treasury. We were permitted to pay previously declared but unpaid dividends on our outstanding preferred stock for the third quarter.

An initial cash dividend of approximately $31 million was declared by the conservator and paid on December 31, 2008 to Treasury as holder of the senior preferred stock, for the period from but not including September 8, 2008 through and including December 31, 2008. If at any time we fail to pay cash dividends in a timely manner, then immediately following such failure and for all dividend periods thereafter until the dividend period following the date on which we have paid in cash full cumulative dividends (including any unpaid dividends added to the liquidation preference), the dividend rate will increase from the annual rate of 10% per year on the then-current liquidation preference of the senior preferred stock to 12% per year. Dividends on the senior preferred stock that are not paid in cash for any dividend period will accrue and be added to the liquidation preference of the senior preferred stock. See Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements, Item 7 MD&A Liquidity and Capital Management Capital Management Capital Activity, and Notes to Consolidated Financial Statements Note 17, Stockholders Equity (Deficit) for information on restrictions on our ability to pay dividends.

Prior to the conservatorship, annual dividends declared on the shares of our preferred stock outstanding totaled $1.0 billion for the three quarters ended September 30, 2008. See Notes to Consolidated Financial Statements Note 17, Stockholders Equity (Deficit) for detailed information on our preferred stock dividends.

Holders

As of January 31, 2009, we had approximately 20,000 registered holders of record of our common stock, including holders of our restricted stock. In addition, as of January 31, 2009, Treasury held a warrant giving it the right to purchase shares of our common stock equal to 79.9% of the total number of shares of our common stock outstanding on a fully diluted basis on the date of exercise.

Recent Sales of Unregistered Securities

First Quarter 2008

Information about sales and issuances of our unregistered securities during the quarter ended March 31, 2008 was provided in our quarterly report on Form 10-Q for the quarter ended March 31, 2008, filed with the SEC on May 6, 2008.

Second Quarter 2008

Information about sales and issuances of our unregistered securities during the quarter ended June 30, 2008 was provided in our quarterly report on Form 10-Q for the quarter ended June 30, 2008, filed with the SEC on August 8, 2008.

Third Quarter 2008

Information about sales and issuances of our unregistered securities during the quarter ended September 30, 2008 was provided in our quarterly report on Form 10-Q for the quarter ended September 30, 2008, filed with the SEC on November 10, 2008.

Fourth Quarter 2008

We previously provided stock compensation to employees and members of the Board of Directors under the Fannie Mae Stock Compensation Plan of 1993 and the Fannie Mae Stock Compensation Plan of 2003 (the Plans).

During the quarter ended December 31, 2008, we did not issue restricted stock in consideration of services rendered or to be rendered. Under the terms of the senior preferred stock purchase agreement, we are prohibited from selling or issuing our equity interests other than as required by (and pursuant to) the terms of a binding agreement in effect on September 7, 2008 without the prior written consent of Treasury. During the quarter ended December 31, 2008, 7,549 restricted stock units vested, as a result of which 5,083 shares of common stock were issued and 2,466 shares of common stock that otherwise would have been issued were withheld by us in lieu of requiring the recipients to pay us the withholding taxes due upon vesting. All of these restricted stock units were granted prior to September 7, 2008. Restricted stock units granted under the Plans typically vest in equal annual installments over three or four years beginning on the first anniversary of the date of grant. Each restricted stock unit represents the right to receive a share of common stock at the time of vesting. As a result, restricted stock units are generally similar to restricted stock, except that restricted stock units do not confer voting rights on their holders. All restricted stock units were granted to persons who were employees or members of the Board of Directors of Fannie Mae.

In addition, during the quarter ended December 31, 2008, 15,490,568 shares of common stock were issued upon conversion of 10,053,599 shares of 8.75% Non-Cumulative Mandatory Convertible Preferred Stock,

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Series 2008-1, at the option of the holders pursuant to the terms of the preferred stock. All series of preferred stock, other than the senior preferred stock, were issued prior to September 7, 2008.

The securities we issue are exempted securities under laws administered by the SEC to the same extent as securities that are obligations of, or are guaranteed as to principal and interest by, the United States, except that, under the Regulatory Reform Act, our equity securities are not treated as exempted securities for purposes of Section 12, 13, 14 or 16 of the Exchange Act. As a result, we do not file registration statements or prospectuses with the SEC under the Securities Act with respect to our securities offerings.

Information about Certain Securities Issuances by Fannie Mae

Pursuant to SEC regulations, public companies are required to disclose certain information when they incur a material direct financial obligation or become directly or contingently liable for a material obligation under an off-balance sheet arrangement. The disclosure must be made in a current report on Form 8-K under Item 2.03 or, if the obligation is incurred in connection with certain types of securities offerings, in prospectuses for that offering that are filed with the SEC.

Fannie Mae s securities offerings are exempted from SEC registration requirements, except that, under the Regulatory Reform Act, our equity securities are not treated as exempted securities for purposes of Section 12, 13, 14 or 16 of the Exchange Act. As a result, we are not required to and do not file registration statements or prospectuses with the SEC under the Securities Act with respect to our securities offerings. To comply with the disclosure requirements of Form 8-K relating to the incurrence of material financial obligations, we report our incurrence of these types of obligations either in offering circulars or prospectuses (or supplements thereto) that we post on our Web site or in a current report on Form 8-K, in accordance with a no-action letter we received from the SEC staff. In cases where the information is disclosed in a prospectus or offering circular posted on our Web site, the document will be posted on our Web site within the same time period that a prospectus for a non-exempt securities offering would be required to be filed with the SEC.

The Web site address for disclosure about our debt securities is www.fanniemae.com/debtsearch. From this address, investors can access the offering circular and related supplements for debt securities offerings under Fannie Mae s universal debt facility, including pricing supplements for individual issuances of debt securities.

Disclosure about our off-balance sheet obligations pursuant to some of the MBS we issue can be found at www.fanniemae.com/mbsdisclosure. From this address, investors can access information and documents about our MBS, including prospectuses and related prospectus supplements.

We are providing our Web site address solely for your information. Information appearing on our Web site is not incorporated into this annual report on Form 10-K.

Purchases of Equity Securities by the Issuer

The following table shows shares of our common stock we repurchased during the fourth quarter of 2008.

	Total	Average	Total Number of Shares Purchased as Part of Publicly	Maximum Number of Shares that May Yet be

	Number of Shares Purchased[(1)]	Price Paid per Share	Announced Program[(2)]	Purchased Under the Program[(3)]
			(Shares in thousands)	
2008				
October 1-31	12	$ 1.43		55,785
November 1-30	8	0.62		54,117
December 1-31	12	0.70		52,949
Total	32			

(1) Consists of shares of common stock reacquired from employees to pay an aggregate of approximately $30,000 in withholding taxes due upon the vesting of previously issued restricted stock. Does not include 10,053,599 shares of Mandatory Convertible Preferred Stock, Series 2008-1 received from holders upon conversion of the preferred shares.

(2) On January 21, 2003, we publicly announced that the Board of Directors had approved a share repurchase program (the General Repurchase Authority) under which we could purchase in open market transactions the sum of (a) up to 5% of the shares of common stock outstanding as of December 31, 2002 (49.4 million shares) and (b) additional shares to offset stock issued or expected to be issued under our employee benefit plans. No shares were repurchased during the fourth quarter of 2008 pursuant to the General Repurchase Authority. The General Repurchase Authority has no specified expiration date. Under the terms of the senior preferred stock purchase agreement, we are prohibited from purchasing Fannie Mae common stock without the prior written consent of Treasury. As a result of this prohibition, we do not intend to make further purchases under the General Repurchase Authority at this time.

(3) Consists of the total number of shares that may yet be purchased under the General Repurchase Authority as of the end of the month, including the number of shares that may be repurchased to offset stock that may be issued pursuant to awards outstanding under our employee benefit plans. Repurchased shares are first offset against any issuances of stock under our employee benefit plans. To the extent that we repurchase more shares in a given month than have been issued under our plans, the excess number of shares is deducted from the 49.4 million shares approved for repurchase under the General Repurchase Authority. See Notes to Consolidated Financial Statements Note 14, Stock-Based Compensation Plans, for information about shares issued, shares expected to be issued, and shares remaining available for grant under our employee benefit plans. Shares that remain available for grant under our employee benefit plans are not included in the amount of shares that may yet be purchased reflected in the table above.

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Item 6. Selected Financial Data

The selected consolidated financial data presented below is summarized from our results of operations for the five-year period ended December 31, 2008, as well as selected consolidated balance sheet data as of the end of each year within this five-year period. Certain prior period amounts have been reclassified to conform to the current period presentation. This data should be reviewed in conjunction with the audited consolidated financial statements and related notes and with Item 7 MD&A included in this annual report on Form 10-K.

	For the Year Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars in millions, except per share amounts)				
Statement of operations data:[1]					
Net interest income	$ 8,782	$ 4,581	$ 6,752	$ 11,505	$ 18,081
Guaranty fee income	7,621	5,071	4,250	4,006	3,715
Losses on certain guaranty contracts		(1,424)	(439)	(146)	(111)
Investment losses, net	(7,220)	(867)	(691)	(892)	(390)
Trust management income[2]	261	588	111		
Fair value losses, net[3]	(20,129)	(4,668)	(1,744)	(4,013)	(12,532)
Administrative expenses	(1,979)	(2,669)	(3,076)	(2,115)	(1,656)
Credit-related expenses[4]	(29,809)	(5,012)	(783)	(428)	(363)
Other income (expenses), net[5]	(1,004)	(87)	244	(98)	(157)
(Provision) benefit for federal income taxes	(13,749)	3,091	(166)	(1,277)	(1,024)
Net (loss) income	(58,707)	(2,050)	4,059	6,347	4,967
Preferred stock dividends and issuance costs at redemption	(1,069)	(513)	(511)	(486)	(165)
Net (loss) income available to common stockholders	(59,776)	(2,563)	3,548	5,861	4,802
Per common share data:					
Earnings (loss) per share:					
Basic	$ (24.04)	$ (2.63)	$ 3.65	$ 6.04	$ 4.95
Diluted	(24.04)	(2.63)	3.65	6.01	4.94
Weighted-average common shares outstanding:					
Basic[6]	2,487	973	971	970	970
Diluted	2,487	973	972	998	973
Cash dividends declared per share	$ 0.75	$ 1.90	$ 1.18	$ 1.04	$ 2.08
New business acquisition data:					
Fannie Mae MBS issues acquired by third parties[7]	$ 434,711	$ 563,648	$ 417,471	$ 465,632	$ 462,542
Mortgage portfolio purchases[8]	196,645	182,471	185,507	146,640	262,647
New business acquisitions	$ 631,356	$ 746,119	$ 602,978	$ 612,272	$ 725,189

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	As of December 31,				
	2008	2007	2006	2005	2004
	(Dollars in millions)				
Balance sheet data:					
Investments in securities:					
Trading	$ 90,806	$ 63,956	$ 11,514	$ 15,110	$ 35,287
Available-for-sale	266,488	293,557	378,598	390,964	532,095
Mortgage loans:					
Loans held for sale	13,270	7,008	4,868	5,064	11,721
Loans held for investment, net of allowance	412,142	396,516	378,687	362,479	389,651
Total assets	912,404	879,389	841,469	831,686	1,018,188
Short-term debt	330,991	234,160	165,810	173,186	320,280
Long-term debt	539,402	562,139	601,236	590,824	632,831
Total liabilities	927,561	835,271	799,827	792,263	979,210
Senior preferred stock	1,000				
Preferred stock	21,222	16,913	9,108	9,108	9,108
Total stockholders equity (deficit)	(15,314)	44,011	41,506	39,302	38,902
Regulatory capital data:					
Net worth surplus (deficit)[9]	$ (15,157)	$ 44,118	$ 41,642	$ 39,423	$ 38,978
Book of business data:					
Mortgage portfolio[10]	$ 792,196	$ 727,903	$ 728,932	$ 737,889	$ 917,209
Fannie Mae MBS held by third parties[11]	2,289,459	2,118,909	1,777,550	1,598,918	1,408,047
Other guarantees[12]	27,809	41,588	19,747	19,152	14,825
Mortgage credit book of business[13]	$ 3,109,464	$ 2,888,400	$ 2,526,229	$ 2,355,959	$ 2,340,081
Guaranty book of business[14]	$ 2,975,710	$ 2,744,237	$ 2,379,986	$ 2,219,201	$ 2,167,433
Credit quality:					
Nonperforming loans[15]	$ 119,232	$ 27,156	$ 13,846	$ 14,194	$ 11,734
Combined loss reserves	24,753	3,391	859	724	745
Combined loss reserves as a percentage of total guaranty book of business	0.83%	0.12%	0.04%	0.03%	0.03%
Combined loss reserves as a percentage of total nonperforming loans	20.76	12.49	6.20	5.10	6.35

	For the Year Ended December 31,				
	2008	2007	2006	2005	2004

Performance ratios:					
Net interest yield[16]	1.03%	0.57%	0.85%	1.31%	1.86%
Average effective guaranty fee rate (in basis points)[17]	31.0 bp	23.7bp	22.2 bp	22.3bp	21.8bp
Credit loss ratio (in basis points)[18]	22.7bp	5.3bp	2.2bp	1.1bp	1.0bp
Return on assets[19]*	(6.77)%	(0.30)	0.42%	0.63%	0.47%
Return on equity[20]*	(1,704.3)	(8.3)	11.3	19.5	16.6
Equity to assets[21]*	2.7	4.9	4.8	4.2	3.5
Dividend payout[22]	N/A	N/A	32.4	17.2	42.1
Earnings to combined fixed charges and preferred stock dividends and issuance costs at redemption	N/A	0.89:1	1.12:1	1.23:1	1.22:1

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

(2) We began separately reporting the revenues from trust management fees in our consolidated statements of operations effective November 2006. We previously included these revenues as a component of interest income. We have not reclassified prior period amounts to conform to the current period presentation.

(3) Consists of the following: (a) derivatives fair value gains (losses), net; (b) trading securities gains (losses), net; (c) hedged mortgage assets gains (losses), net; (d) debt foreign exchange gains (losses), net; and (e) debt fair value gains (losses), net.

(4) Consists of provision for credit losses and foreclosed property expense.

(5) Consists of the following: (a) debt extinguishment gains (losses), net; (b) losses from partnership investments; and (c) fee and other income.

(6) Includes for 2008 the weighted-average shares of common stock that would be issuable upon the full exercise of the warrant issued to Treasury from the date of conservatorship through the end of the year. Because the warrant s exercise price of $0.00001 per share is considered non-substantive (compared to the market price of our common stock), the warrant was evaluated based on its substance over form. It was determined to have characteristics of non-voting common stock, and thus included in the computation of basic earnings (loss) per share.

(7) Reflects unpaid principal balance of Fannie Mae MBS issued and guaranteed by us during the reporting period less: (a) securitizations of mortgage loans held in our mortgage portfolio during the reporting period and (b) Fannie Mae MBS purchased for our mortgage portfolio during the reporting period.

(8) Reflects unpaid principal balance of mortgage loans and mortgage-related securities we purchased for our investment portfolio during the reporting period. Includes acquisition of mortgage-related securities accounted for as the extinguishment of debt because the entity underlying the mortgage-related securities has been consolidated in our consolidated balance sheet. Includes capitalized interest beginning in 2006.

(9) Total assets less total liabilities.

(10) Unpaid principal balance of mortgage loans and mortgage-related securities (including Fannie Mae MBS) held in our portfolio.

(11) Reflects unpaid principal balance of Fannie Mae MBS held by third-party investors. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.

(12) Primarily includes long-term standby commitments we have issued and single-family and multifamily credit enhancements we have provided and that are not otherwise reflected in the table.

(13) Reflects unpaid principal balance of the following: (a) mortgage loans held in our mortgage portfolio; (b) Fannie Mae MBS held in our mortgage portfolio; (c) non-Fannie Mae mortgage-related securities held in our investment portfolio; (d) Fannie Mae MBS held by third parties; and (e) other credit enhancements that we provide on mortgage assets. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.

(14) Reflects unpaid principal balance of the following: (a) mortgage loans held in our mortgage portfolio; (b) Fannie Mae MBS held in our mortgage portfolio; (c) Fannie Mae MBS held by third parties; and (d) other credit enhancements that we provide on mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty. The principal balance of resecuritized Fannie Mae MBS is included only once in the reported amount.

(15)

Consists of on-balance sheet nonperforming loans held in our mortgage portfolio and off-balance sheet nonperforming loans in Fannie Mae MBS held by third parties. Prior to 2008, the nonperforming loans that we reported consisted of on-balance sheet nonperforming loans and did not include off-balance nonperforming loans in Fannie Mae MBS held by third parties. We have revised previously reported amounts to reflect the current period presentation.

(16) Calculated based on net interest income for the reporting period divided by the average balance of total interest-earning assets during the period, expressed as a percentage.

(17) Calculated based on guaranty fee income for the reporting period divided by average outstanding Fannie Mae MBS and other guarantees during the period, expressed in basis points.

(18) Consists of (a) charge-offs, net of recoveries and (b) foreclosed property expense for the reporting period divided by the average guaranty book of business during the period, expressed in basis points. Refer to Item 7 MD&A Consolidated Results of Operations Credit-Related Expenses Credit Loss Performance Metrics for information on the change we made in calculating our credit loss ratio effective January 1, 2007. Our credit loss ratios for periods prior to 2007 have been revised to reflect this change.

(19) Calculated based on net income (loss) available to common stockholders for the reporting period divided by average total assets during the period, expressed as a percentage. This ratio is a measure that is generally used to evaluate how effectively a company deploys assets.

(20) Calculated based on net income (loss) available to common stockholders for the reporting period divided by average outstanding common equity during the period, expressed as a percentage. This ratio is a measure that is generally used to evaluate a company s efficiency in generating profit from equity.

(21) Calculated based on average stockholders equity divided by average total assets during the reporting period, expressed as a percentage. This ratio is a measure that is generally used to evaluate the extent to which a company is using long-term funding to finance its assets and its longer term solvency.

(22) Calculated based on common dividends declared during the reporting period divided by net income available to common stockholders for the reporting period, expressed as a percentage.

Note:

* Average balances for purposes of ratio calculations are based on balances at the beginning of the year and at the end of each respective quarter for 2008 and 2007. Average balances for purposes of ratio calculations for all other years are based on beginning and end of year balances.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with our consolidated financial statements as of December 31, 2008 and related notes. Readers should also review carefully Part I Item 1 Business Executive Summary for the most significant factors on which management and the conservator are focusing in operating and evaluating our business and financial position and prospects, including recent significant changes in our business operations and strategies. In addition, readers should review carefully Part I Item 1 Business Forward-Looking Statements and Part I Item 1A R Factors for a description of the forward-looking statements in this report and a discussion of the factors that might cause our actual results to differ, perhaps materially, from these forward-looking statements. Please refer to Glossary of Terms Used in This Report for an explanation of key terms used throughout this discussion.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We describe our most significant accounting policies in Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies.

We have identified four of our accounting policies as critical because they involve significant judgments and assumptions about highly complex and inherently uncertain matters and the use of 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 of Financial Instruments
- Other-than-temporary Impairment of Investment Securities
- Allowance for Loan Losses and Reserve for Guaranty Losses
- Deferred Tax Assets

We evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. Management has discussed each of these significant accounting policies, including the related estimates and judgments, with the Audit Committee of the Board of Directors. We rely on a number of valuation and risk models as the basis for some of the amounts recorded in our financial statements. Many of these models involve significant assumptions and have certain limitations. See Part I Item 1A Risk Factors for a discussion of the risks associated with the use of models.

Fair Value of Financial Instruments

The use of fair value to measure our financial instruments is fundamental to our financial statements and is a critical accounting estimate because we account for and record a substantial portion of our assets and liabilities at fair value. As we discuss more fully in Notes to Consolidated Financial Statements Note 20, Fair Value of Financial Instruments, we adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157) effective January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value and outlines a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as an exit price). In determining fair value, we use various valuation techniques. We disclose the carrying value and fair value of our financial assets and liabilities and describe the specific valuation techniques used to determine the fair value of these financial instruments in Notes to Consolidated Financial Statements Note 20, Fair Value of Financial Instruments.

In September 2008, the SEC and FASB issued joint guidance providing clarification of issues surrounding the determination of fair value measurements under the provisions of SFAS 157 in the current market environment. In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active,* which amended SFAS 157 to

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provide an illustrative example of how to determine the fair value of a financial asset when the market for that financial asset is not active. The SEC and FASB guidance did not have an impact on our application of SFAS 157.

We generally consider a market to be inactive if the following conditions exist: (1) there are few transactions for the financial instruments; (2) the prices in the market are not current; (3) the price quotes we receive vary significantly either over time or among independent pricing services or dealers; and (4) there is a limited availability of public market information.

SFAS 157 establishes a three-level fair value hierarchy for classifying financial instruments that is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. The three levels of the SFAS 157 fair value hierarchy are described below:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs, other than quoted prices in active markets for identical assets or liabilities.

Level 3: Unobservable inputs.

Each asset or liability is assigned to a level based on the lowest level of any input that is significant to the fair value measurement.

The majority of our financial instruments carried at fair value fall within the level 2 category and are valued primarily utilizing inputs and assumptions that are observable in the marketplace, that can be derived from observable market data or that can be corroborated by recent trading activity of similar instruments with similar characteristics. For example, we generally request non-binding prices from at least four independent pricing services to estimate the fair value of our trading and available-for-sale investment securities at an individual security level. We use the average of these prices to determine the fair value. In the absence of such information or if we are not able to corroborate these prices by other available, relevant market information, we estimate their fair values based on single source quotations from brokers or dealers or by using internal calculations or discounted cash flow techniques that incorporate inputs, such as prepayment rates, discount rates and delinquency, default and cumulative loss expectations, that are implied by market prices for similar securities and collateral structure types. Because items classified as level 3 are valued using significant unobservable inputs, the process for determining the fair value of these items is generally more subjective and involves a high degree of management judgment and assumptions. These assumptions may have a significant effect on our estimates of fair value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition.

Fair Value Hierarchy Level 3 Assets and Liabilities

Our level 3 assets and liabilities consist primarily of financial instruments for which the fair value is estimated using valuation techniques that involve significant unobservable inputs because there is limited market activity and therefore little or no price transparency. Our level 3 financial instruments include certain mortgage- and asset-backed securities and residual interests, certain performing residential mortgage loans, nonperforming mortgage-related assets, our guaranty assets and buy-ups, our master servicing assets and certain highly structured, complex derivative instruments. As described in Consolidated Results of Operations Guaranty Fee Income, we use the term buy-ups to refer to upfront payments that we make to lenders to adjust the monthly contractual guaranty fee rate so that the pass-through coupon rates on Fannie Mae MBS are in more easily tradable increments of a whole or half percent.

The following discussion identifies the types of financial assets we hold within each balance sheet category that are based on level 3 inputs and the valuation techniques we use to determine their fair values, including key inputs and assumptions.

Trading and Available-for-Sale Investment Securities. Our financial instruments within these asset categories that are classified as level 3 primarily consist of mortgage-related securities backed by Alt-A loans, subprime loans and manufactured housing loans and mortgage revenue bonds. We have relied on external pricing services to estimate the fair value of these securities and validated those results with our internally-derived prices, which may incorporate spread, yield, or vintage and product matrices, and standard cash flow discounting techniques. The inputs we use in estimating these values are based on multiple factors, including market observations, relative value to other securities, and non-binding dealer quotations. When we are not able to corroborate vendor-based prices, we rely on management s best estimate of fair value.

Derivatives. Our derivative financial instruments that are classified as level 3 primarily consist of a limited population of certain highly structured, complex interest rate risk management derivatives. Examples include certain swaps with embedded caps and floors that reference non-standard indices. We determine the fair value of these derivative instruments using indicative market prices obtained from independent third parties. If we obtain a price from a single source and we are not able to corroborate that price, the fair value measurement is classified as level 3.

Guaranty Assets and Buy-ups. We determine the fair value of our guaranty assets and buy-ups based on the present value of the estimated compensation we expect to receive for providing our guaranty. We generally estimate the fair value using proprietary internal models that calculate the present value of expected cash flows. Key model inputs and assumptions include prepayment speeds, forward yield curves and discount rates that are commensurate with the level of estimated risk.

Fair value measurements related to financial instruments that are reported at fair value in our consolidated financial statements each period, such as our trading and available-for-sale securities and derivatives, are referred to as recurring fair value measurements. Fair value measurements related to financial instruments that are not reported at fair value each period, such as held-for-sale mortgage loans, are referred to non-recurring fair value measurements.

Table 2 presents a comparison, by balance sheet category, of the amount of financial assets carried in our consolidated balance sheets at fair value on a recurring basis and classified as level 3 as of December 31, 2008 and September 30, 2008. 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 2: Level 3 Recurring Financial Assets at Fair Value

Balance Sheet Category	**As of December 31, 2008**	**As of September 30, 2008**
	(Dollars in millions)	
Trading securities	$ 12,765	$ 14,173
Available-for-sale securities	47,837	53,323
Derivatives assets	362	280
Guaranty assets and buy-ups	1,083	1,866
Level 3 recurring assets	$ 62,047	$ 69,642
Total assets	$ 912,404	$ 896,615
Total recurring assets measured at fair value	$ 359,246	$ 363,689
Level 3 recurring assets as a percentage of total assets	7%	8%
Level 3 recurring assets as a percentage of total recurring assets measured at fair value	17%	19%
Total recurring assets measured at fair value as a percentage of total assets	39%	41%

Level 3 recurring assets totaled $62.0 billion, or 7% of our total assets, as of December 31, 2008, compared with $69.6 billion, or 8% of our total assets, as of September 30, 2008, and $41.3 billion, or 5% of our total assets, as of the beginning of 2008. The increase in assets classified as level 3 during 2008 resulted from the net transfer of approximately $38.4 billion in assets to level 3 from level 2, which was partially offset by liquidations during the period. These assets primarily consisted of private-label mortgage-related securities backed by Alt-A or subprime loans. The net transfers to level 3 from level 2 reflected the ongoing effects of the extreme disruption in the mortgage market and severe reduction in market liquidity for certain mortgage products, such as private-label mortgage-related securities backed by Alt-A or subprime loans. Because of the reduction in recently executed transactions and market price quotations for these instruments, the market inputs for these instruments are less observable.

Financial assets measured at fair value on a non-recurring basis and classified as level 3, which are not presented in the table above, include held-for-sale loans that are measured at lower of cost or fair value and that were written down to fair value during the period. Held-for-sale loans that were reported at fair value, rather than amortized cost, totaled $1.3 billion as of December 31, 2008. In addition, certain other financial assets carried at amortized cost that have been written down to fair value during the period due to impairment are classified as non-recurring. The fair value of these level 3 non-recurring financial assets, which primarily consisted of certain guaranty assets, LIHTC partnership investments and acquired property, totaled $22.4 billion as of December 31, 2008. Our LIHTC investments trade in a market with limited observable transactions. We determine the fair value of our LIHTC investments using internal models that estimate the present value of the expected future tax benefits (tax credits and tax deductions for net operating losses) expected to be generated from the properties underlying these investments. Our estimates are based on assumptions that other market participants would use in valuing these investments. The key assumptions used in our models, which require significant management judgment, include discount rates and projections related to the amount and timing of tax benefits. We compare the model results to the limited number of observed market transactions and make adjustments to reflect differences between the risk profile of the observed market transactions and our LITHC investments.

Financial liabilities measured at fair value on a recurring basis and classified as level 3 as of December 31, 2008 consisted of long-term debt with a fair value of $2.9 billion and derivatives liabilities with a fair value of $52 million.

Fair Value Control Processes

We have control processes that are designed to ensure that our fair value measurements are appropriate and reliable, that they are based on observable inputs wherever possible and that our valuation approaches are consistently applied and the assumptions used are reasonable. Our control processes consist of a framework that provides for a segregation of duties and oversight of our fair value methodologies and valuations and validation procedures.

Our Valuation Oversight Committee, which includes senior representation from business areas, our Enterprise Risk Office and our Finance Division, is responsible for reviewing and approving the valuation methodologies and pricing models used in our fair value measurements and any significant valuation adjustments, judgments, controls and results. Actual valuations are performed by personnel independent of our business units. Our Price Verification Group, which is an independent control group separate from the group that is responsible for obtaining the prices, also is responsible for performing monthly independent price verification. The Price Verification Group also performs independent reviews of the assumptions used in determining the fair value of products we hold that have material estimation risk because observable market-based inputs do not exist.

Our validation procedures are intended to ensure that the individual prices we receive are consistent with our observations of the marketplace and prices that are provided to us by pricing services or other dealers. We verify selected prices using a variety of methods, including comparing the prices to secondary pricing services, corroborating the prices by reference to other independent market data, such as non-binding broker or dealer quotations, relevant benchmark indices, and prices of similar instruments, checking prices for reasonableness based on variations from prices provided in previous periods, comparing prices to internally calculated expected prices and conducting relative value comparisons based on specific characteristics of securities. In addition, we compare our derivatives valuations to counterparty valuations as part of the collateral exchange process. We have formal discussions with the pricing services as part of our due diligence process in order to maintain a current understanding of the models and related assumptions and inputs that these vendors use in developing prices. The prices provided to us by independent pricing services reflect the existence of credit enhancements, including monoline insurance coverage, and the current lack of liquidity in the marketplace. If we determine that a price provided to us is outside established parameters, we will further examine the price, including having follow-up discussions with the specific pricing service or dealer. If we conclude that a price is not valid, we will adjust the price for various factors, such as liquidity, bid-ask spreads and credit considerations. These adjustments are generally based on available market evidence. In the absence of such evidence, management s best estimate is used. All of these processes are executed before we use the prices in the financial statement process.

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We continually refine our valuation methodologies as markets and products develop and the pricing for certain products becomes more or less transparent. While we believe our valuation methods are appropriate and consistent with those of other market participants, using different methodologies or assumptions to determine fair value could result in a materially different estimate of the fair value of some of our financial instruments.

The dislocation of historical pricing relationships between certain financial instruments persisted during 2008 due to the ongoing and deepening housing and financial market crisis. These conditions, which have resulted in greater market volatility, wider credit spreads and a lack of price transparency, have made the measurement of fair value more difficult and complex for some financial instruments, particularly for financial instruments for which there is no active market, such as our guaranty contracts and loans purchased with evidence of credit deterioration. Because of the significant judgment involved in measuring the fair value of these specific financial instruments and the complexity of the accounting for these items, we provide more detailed information below on our fair value measurement process and accounting.

Fair Value of Guaranty Obligations

When we issue Fannie Mae MBS, we record in our consolidated balance sheets a guaranty asset that represents the present value of cash flows expected to be received as compensation over the life of the guaranty. As guarantor of our Fannie Mae MBS issuances, we also recognize at inception of the guaranty the fair value of our obligation to stand ready to perform over the term of the guaranty. As described in Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies, we record this amount in our consolidated balance sheets as a component of Guaranty obligations. The fair value of our guaranty obligations consists of the following: (1) compensation to cover estimated default costs, including estimated unrecoverable principal and interest that will be incurred over the life of the underlying mortgage loans backing our Fannie Mae MBS; (2) estimated foreclosure-related costs; (3) estimated administrative and other costs related to our guaranty; and (4) an estimated market risk premium, or profit, that a market participant would require to assume the obligation.

Fair Value Measurement and Accounting Effective January 1, 2008

Effective January 1, 2008, as part of our implementation of SFAS 157, we changed our approach to measuring the fair value of our guaranty obligations. Specifically, we adopted a measurement approach that is based upon an estimate of the compensation that we would require to issue the same guaranty in a standalone arm s-length transaction with an unrelated party. For a guarantee issued in a lender swap transaction after December 31, 2007, we measure the fair value of the guaranty obligation at inception based on the fair value of the total compensation we expect to receive, which primarily consists of the guaranty fee, credit enhancements, buy-downs, risk-based price adjustments and our right to receive interest income during the float period in excess of the amount required to compensate us for master servicing. See Consolidated Results of Operations Guaranty Fee Income for a description of buy-downs and risk-based price adjustments. Because the fair value of the guaranty obligation at inception, for guaranty contracts issued after December 31, 2007, is equal to the fair value of the total compensation we expect to receive, we no longer recognize losses or record deferred profit at inception of our lender swap transactions, which represent the bulk of our guaranty transactions.

We also changed how we measure the fair value of our existing guaranty obligations to be consistent with our approach for measuring guaranty obligations at initial recognition. This change, which affects the fair value amounts disclosed in Supplemental Non-GAAP Information Fair Value Balance Sheets and in Notes to Consolidated Financial Statements Note 20, Fair Value of Financial Instruments, does not affect the amounts recorded in our results of operations or consolidated balance sheets. The fair value of any guaranty obligation measured after its initial recognition represents our estimate of a hypothetical transaction price we would receive if we were to issue our guaranty to an unrelated party in a standalone arm s-length transaction at the measurement date. We continue to use the models and inputs that we used prior to our adoption of SFAS 157 to estimate this fair value, which we calibrate to our current market pricing. The estimated fair value of our guaranty obligations as of each balance sheet date will always be greater than our estimate of future expected credit losses in our existing guaranty book of business as of that date because the fair value of

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our guaranty obligations includes an estimated market risk premium, or profit, that a market participant would require to assume our existing obligations.

Fair Value Measurement and Accounting Prior to January 1, 2008

Prior to January 1, 2008, we measured the fair value of the guaranty obligations that we recorded when we issued Fannie Mae MBS based on market information obtained from spot transaction prices. In the absence of spot transaction data, which was the case for the substantial majority of our guarantees, we used internal models to estimate the fair value of our guaranty obligations. We reviewed the reasonableness of the results of our models by comparing those results with available market information. Key inputs and assumptions used in our models included the amount of compensation required to cover estimated default costs, including estimated unrecoverable principal and interest that we expected to incur over the life of the underlying mortgage loans backing our Fannie Mae MBS, estimated foreclosure-related costs, estimated administrative and other costs related to our guaranty, and an estimated market risk premium, or profit, that a market participant of similar credit standing would require to assume the obligation. If our modeled estimate of the fair value of the guaranty obligation was more or less than the fair value of the total compensation received, we recognized a loss or recorded deferred profit, respectively, at inception of the guaranty contract.

The accounting for guarantees issued prior to January 1, 2008 is unchanged with our adoption of SFAS 157. Accordingly, the guaranty obligation amounts recorded in our consolidated balance sheets attributable to these guarantees will continue to be amortized in accordance with our established accounting policy. This change, however, affects how we determine the fair value of our existing guaranty obligations as of each balance sheet date. See Supplemental Non-GAAP Information Fair Value Balance Sheets and Notes to Consolidated Financial Statements Note 20, Fair Value of Financial Instruments for additional information regarding the impact of this change.

Following is an example to illustrate how losses recorded at inception on certain guaranty contracts issued prior to January 1, 2008 affect our earnings over time. Assume that within one of our guaranty contracts, we have an individual Fannie Mae MBS issuance for which the present value of the guaranty fees we expect to receive over time based on both a five-year contractual period and expected life of the fixed-rate loans underlying the MBS totals $100. Based on market expectations, we estimate that a market participant would require $120 to assume the risk associated with our guaranty of the principal and interest due to investors in the MBS trust. To simplify the accounting in our example, we assume that the expected life of the underlying loans remains the same over the five-year contractual period and the annual scheduled principal and interest loan payments are equal over the five-year period.

Accounting Upon Initial Issuance of MBS:

- We record a guaranty asset of $100, which represents the present value of the guaranty fees we expect to receive over time.
- We record a guaranty obligation of $120, which represents the estimated amount that a market participant would require to assume this obligation.
- We record the difference of $20, or the amount by which the guaranty obligation exceeds the guaranty asset, in our consolidated statements of operations as losses on certain guaranty contracts.

Accounting in Each of Years 1 to 5:

We collect $20 in guaranty fees per year, which represents one-fifth of the outstanding receivable amount, and record this amount as a reduction in the guaranty asset.

We reduce the guaranty obligation by a proportionate amount, or one-fifth, and record this amount, which totals $24, in our consolidated statements of operations as guaranty fee income.

	For the Years Ended						Cumulative
	0	**1**	**2**	**3**	**4**	**5**	**Effect**
Losses on certain guaranty contracts	$ (20)	$	$	$	$	$	$ (20)
Guaranty fee income		24	24	24	24	24	120
Pre-tax income	$ (20)	$ 24	$ 24	$ 24	$ 24	$ 24	$ 100

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As illustrated in the example, the $20 loss recognized at inception of the guaranty contract will be accreted into earnings over time as a component of guaranty fee income. For additional information on our accounting for guaranty transactions, which is more complex than the example presented, refer to Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies.

Prior to January 1, 2008, we based the fair value of the guaranty obligations that we recorded when we issued Fannie Mae MBS on market information obtained from spot transaction prices, when available. In the absence of spot transaction data, which was the case for the substantial majority of our guarantees, we estimated the fair value using internal models that project the future credit performance of the loans underlying our guaranty obligations under a variety of economic scenarios. Key inputs and assumptions used in these models that affected the fair value of our guaranty obligations were home price growth rates and an estimated market rate of return.

Effect on Credit-Related Expenses

As described in Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies, subsequent to the inception of our guaranty obligations, we establish a Reserve for guaranty losses through a recurring process by which the probable and estimable losses incurred on homogeneous pools of loans underlying our MBS trusts are recognized as of each balance sheet date in accordance with SFAS No. 5, *Accounting for Contingencies* (SFAS 5). We recognize incurred losses in our consolidated statements of operations as a part of our Provision for credit losses and as Foreclosed property expense. See Allowance for Loan Losses and Reserve for Guaranty Losses below for additional information on our loss reserve process. See Consolidated Results of Operations Credit-Related Expenses for a discussion of our credit-related expenses and credit losses.

Our loss reserves reflect only probable losses that we believe have been incurred as of the balance sheet date. They do not represent an estimate of future expected credit losses. In contrast, the estimated fair value of our guaranty obligations incorporates future expected credit losses plus an estimated profit. Because of the severe deterioration in the mortgage and credit markets, coupled with the current economic crisis, there is significant uncertainty regarding the full extent of future credit losses in the mortgage sector.

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Fair Value of Loans Purchased with Evidence of Credit Deterioration

We have the option to purchase delinquent loans underlying our Fannie Mae MBS trusts under specified conditions, which we describe in Item 1 Business Business Segments Single-Family Credit Guaranty Business MBS Trusts. The acquisition cost for loans purchased from MBS trusts is the unpaid principal balance of the loan plus accrued interest. We generally are required to purchase the loan if it is delinquent 24 consecutive months and is still in the MBS trust at that time. As long as the loan or REO property remains in the MBS trust, we continue to pay principal and interest to the MBS trust under the terms of our guaranty arrangement.

As described in Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies, when we purchase loans that are within the scope of SOP 03-3, we record our net investment in these seriously delinquent loans at the lower of the acquisition cost of the loan or the estimated fair value at the date of purchase. To the extent the acquisition cost exceeds the estimated fair value, we record a SOP 03-3 fair value loss charge-off against the Reserve for guaranty losses at the time we acquire the loan. We reduce the Guaranty obligation (in proportion to the Guaranty asset) as payments on the loans underlying our MBS are received, including those resulting from the purchase of seriously delinquent loans from MBS trusts, and report the reduction as a component of Guaranty fee income. These prepayments may cause an impairment of the Guaranty asset, which results in a proportionate reduction in the corresponding Guaranty obligation and recognition of income. We place acquired loans on nonaccrual status and classify them as nonperforming when we believe collectability of interest or principal on the loan is not reasonably assured. If we subsequently determine that the collectability of principal and interest is reasonably assured, we return the loan to accrual status. While the loan is on nonaccrual status, we do not recognize income on the loan. We apply any cash receipts towards the recovery of the interest receivable at acquisition and to past due principal payments. We may, however, subsequently recover a portion or the full amount of these SOP 03-3 fair value losses as discussed below.

To the extent that we have previously recognized an SOP 03-3 fair value loss, our recorded investment in the loan is less than the acquisition cost. Under SOP 03-3, the excess of the contractual cash flows of the loan over the estimated cash flows we expect to collect represents a nonaccretable difference that is not recognized in our earnings. If the estimated cash flows we expect to collect exceed the initial recorded investment in the loan, we accrete this excess amount into our earnings as a component of interest income over the life of the loan. If a seriously delinquent loan we purchase pays off in full, we recover the SOP 03-3 fair value loss as a component of interest income on the date of the payoff. If the loan is returned to accrual status, we recover the SOP 03-3 fair value loss over the contractual life of the loan as a component of net interest income (via an adjustment of the effective yield of the loan). If we foreclose upon a loan purchased from an MBS trust, we record a charge-off at foreclosure based on the excess of our recorded investment in the loan over the fair value of the collateral less estimated selling costs. Any charge-off recorded at foreclosure for SOP 03-3 loans recorded at fair value at acquisition would be lower than it would have been if we had recorded the loan at its acquisition cost. In some cases, the proceeds from the sale of the collateral may exceed our recorded investment in the loan, resulting in a gain.

Following is an example of how SOP 03-3 fair value losses, credit-related expenses and credit losses related to loans underlying our guaranty contracts are recorded in our consolidated financial statements. This example shows the accounting and effect on our financial statements of the following events: (a) we purchase a seriously delinquent loan subject to SOP 03-3 from an MBS trust; (b) we foreclose on this mortgage loan; and (c) we sell the foreclosed property that served as collateral for the loan. This example is based on the following assumptions:

- We purchase from an MBS trust a seriously delinquent loan that has an unpaid principal balance and accrued interest of $100 at a cost of $100. The estimated fair value at the date of purchase is $70.

We foreclose upon the mortgage loan and record the acquired REO property at the appraised fair value, net of estimated selling costs, which is $80.

We sell the REO property for $85.

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	Accounting Impact of Assumptions			
	Initial Purchase of Loan from Trust[(a)]	Subsequent Foreclosure[(b)]	Sale of Foreclosed Property[(c)]	Cumulative Earnings Impact
Consolidated Balance Sheet:				
Assets:				
Mortgage loans	$ 70	$ (70)	$	
Acquired property, net		80	(80)	
Liabilities:				
Reserve for guaranty losses beginning balance[(1)]	$	$	$	
Plus: Provision for credit losses attributable to SOP 03-3 fair value losses	30			
Less: Charge-offs related to initial purchase discount on SOP 03-3 loans	(30)			
Plus: Recoveries				
Reserve for guaranty losses ending balance[(1)]	$	$	$	
Consolidated Statement of Operations:				
Provision for credit losses attributable to SOP 03-3 fair value losses	$ (30)	$	$	$ (30)
Foreclosed property income (expense)		10	5	15
Net pre-tax income (loss) effect	$ (30)	$ 10	$ 5	$ (15)

(1) The adjustment to the Provision for credit losses is presented for illustrative purposes only. We actually determine our Reserve for guaranty losses by aggregating homogeneous loans into pools based on similar underlying risk characteristics in accordance with SFAS 5. Accordingly, we do not have a specific reserve or provision attributable to each delinquent loan purchased from an MBS trust.

As indicated in the example above, we would record the loan at the estimated fair value of $70 and record an SOP 03-3 fair value loss of $30 as a charge-off to the reserve for guaranty losses when we acquire the delinquent loan from the MBS trust. We record a provision for credit losses each period to adjust the reserve for guaranty losses to reflect the probable credit losses incurred on loans remaining in MBS trusts. Assuming all other things were equal, the SFAS 5 reserve for guaranty losses is reduced at period end because the purchased loan is no longer included in the population for which the SFAS 5 reserve is determined. Therefore, if the charge-off for the SOP 03-3 fair value loss is greater than the decrease in the reserve caused by removing the loan from the population subject to SFAS 5, an incremental loss will be recognized through the provision for credit losses in the period the loan is purchased. We would record the REO property acquired through foreclosure at the appraised fair value, net of estimated selling costs, of $80. Although we recorded an initial SOP 03-3 fair value loss of $30, the actual credit-related expense we experience on this loan would be $15, which represents the difference between the amount we paid for the loan and the amount we received from the sale of the acquired REO property, net of selling costs.

As described above, if a loan subject to SOP 03-3 cures, which means it returns to accrual status, pays off or is resolved through modification, long-term forbearance or a repayment plan, the SOP 03-3 fair value loss would be recovered over the life of the loan as a component of net interest income through an adjustment of the effective yield or upon full pay off of the loan. Conversely, if a loan remains in an MBS trust, we would continue to provide for incurred losses in our Reserve for guaranty losses.

Our estimate of the fair value of delinquent loans purchased from MBS trusts is based upon an assessment of what a market participant would pay for the loan at the date of acquisition. Prior to July 2007, we estimated the initial fair value of these loans using internal prepayment, interest rate and credit risk models that incorporated market-based inputs of certain key factors, such as default rates, loss severity and prepayment speeds. Beginning in July 2007, the mortgage markets experienced a number of significant events, including a dramatic widening of credit spreads for mortgage securities backed by higher risk loans, a large number of credit downgrades of higher risk mortgage-related securities, and a severe reduction in market liquidity for

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certain mortgage-related transactions. As a result of this extreme disruption in the mortgage markets, we concluded that our model-based estimates of fair value for delinquent loans were no longer aligned with the market prices for these loans. Therefore, we began obtaining indicative market prices from large, experienced dealers and used an average of these market prices to estimate the initial fair value of delinquent loans purchased from MBS trusts. These prices, which reflect the significant decline in the value of mortgage assets due to the deterioration in the housing and credit markets, have resulted in a substantial increase in the SOP 03-3 fair value loss we record when we purchase a delinquent loan from an MBS trust.

See Consolidated Results of Operations Credit-Related Expenses for a discussion of our SOP 03-3 fair value losses.

Other-than-temporary Impairment of Investment Securities

We evaluate available-for-sale securities in an unrealized loss position as of the end of each quarter for other-than-temporary impairment. This evaluation is based on an assessment of whether it is probable that we will not collect all of the contractual amounts due and our ability and intent to hold the securities in an unrealized loss position until they recover in value. Our evaluation requires management judgment and a consideration of many factors, including, but not limited to, the severity and duration of the impairment; recent events specific to the issuer and/or the industry to which the issuer belongs; and external credit ratings. Although an external rating agency action or a change in a security s external credit rating is one criterion in our assessment of other-than-temporary impairment, a rating action alone is not necessarily indicative of other-than-temporary impairment.

We employ models to assess the expected performance of our securities under hypothetical scenarios. These models consider particular attributes of the loans underlying our securities and assumptions about changes in the economic environment, such as home prices and interest rates, to predict borrower behavior and the impact on default frequency, loss severity and remaining credit enhancement. We use these models to estimate the expected cash flows (recoverable amount) from our securities in assessing whether it is probable that we will not collect all of the contractual amounts due. If the recoverable amount is less than the contractual principal and interest due, we may determine, based on this factor in combination with our assessment of other relevant factors, that the security is other-than-temporarily impaired. If we make that determination, the amount of other-than-temporary impairment is determined by reference to the security s current fair value, rather than the expected cash flows of the security. We write down any other-than-temporarily impaired available-for-sale security to its current fair value, record the difference between the amortized cost basis and the fair value as an other-than-temporary loss in our consolidated statements of operations and establish a new cost basis for the security based on the current fair value. The fair value measurement we use to determine the amount of other-than-temporary impairment to record may be less than the actual amount we expect to realize by holding the security to maturity. Accordingly, we may subsequently recover some other-than-temporary impairment amounts if we collect all of the contractual principal and interest payments due on the security or if we sell the security at an amount greater than its carrying value.

The guidelines we generally follow in determining whether a security is other-than-temporarily impaired are outlined below.

- We generally view changes in the fair value of our available-for-sale securities caused by movements in interest rates to be temporary and do not recognize other-than-temporary impairment on these securities.

- If we either decide to sell a security in an unrealized loss position or determine that a security in an unrealized loss position may be sold in future periods prior to recovery of the impairment, we identify the security as other-than-temporarily impaired in the period that we make the decision to sell or determine that the security may be sold.

For securities in an unrealized loss position resulting primarily from movements in interest rates, we generally do not recognize other-than-temporary impairment if we have the intent and ability to hold such securities until the earlier of recovery of the unrealized loss amounts or maturity.

For securities in an unrealized loss position due to factors other than movements in interest rates, such as the widening of credit spreads, we consider whether it is probable that we will not collect all of the contractual cash flows. If we determine that it is probable that we will not collect all of the contractual cash flows or we do not have the ability or the intent to hold the security until recovery, we consider the impairment to be other-than-temporary. For all other securities in an unrealized loss position, we have the ability and positive intent to hold the securities until the earlier of full recovery or maturity.

See Consolidated Balance Sheet Analysis Mortgage Investments Trading and Available-for-Sale Investment Securities Investments in Private-Label Mortgage-Related Securities for a discussion of other-than-temporary impairment recognized on our investments in Alt-A and subprime private-label securities.

Allowance for Loan Losses and Reserve for Guaranty Losses

We maintain an allowance for loan losses for loans in our mortgage portfolio classified as held-for-investment. We maintain a reserve for guaranty losses for loans that back Fannie Mae MBS we guarantee and loans that we have guaranteed under long-term standby commitments. We report the allowance for loan losses and reserve for guaranty losses as separate line items in the consolidated balance sheets. These amounts, which we collectively refer to as our combined loss reserves, represent our best estimate of credit losses incurred in our guaranty book of business as of the balance sheet date. We calculate our loss reserves using internally developed statistical loss curve models, and we use the same methodology to determine both our allowance for loan losses and reserve for guaranty losses, as the relevant factors affecting credit risk are the same.

To calculate the loss reserves for our single-family guaranty book of business, we aggregate homogeneous loans into pools based on common underlying risk characteristics, such as origination year and seasoning, original loan-to-value (LTV) ratio and loan product type. Based on the historical performance of the loans in our guaranty book of business, we develop loss curve models that reflect loan pools with similar risk attributes. We use these loss curve models to estimate how many loans will default (default rate). We then assess recent performance of these loan pools to estimate how much of the loans balances will be lost in the event of default (loss severity). If necessary, we may make adjustments to our historically developed assumptions to reflect our assessment of the current impact of economic factors not yet reflected in the historical data underlying our loss estimates, such as local and national economic trends, including rising unemployment rates; changes in underwriting standards or loss mitigation practices; and changes in the regulatory environment.

To calculate the loss reserves for our multifamily guaranty book of business, we individually evaluate loans that we believe may be at risk of impairment by assessing the risk profile, repayment prospects and the collateral values underlying the loan. We calculate a loss reserve for all other multifamily loans based on the historical loss experience of loans with similar risk characteristics.

Determining our combined loss reserves is complex and requires judgment by management about the effect of matters that are inherently uncertain. The key inputs and assumptions that drive our loss reserves include:

- loss severity trends;
- default experience;
- expected proceeds from credit enhancements, such as primary mortgage insurance;
- collateral valuation; and
- identification and assessment of the impact of current economic factors.

Changes in one or more of the key inputs or assumptions used in calculating our loss reserves could have a material impact on our loss reserves and provision for credit losses. We regularly update our loss forecast models to incorporate current loan performance data, monitor the delinquency and default experience of our homogenous loan pools, and adjust our underlying estimates and assumptions as necessary to reflect our view of current economic and market conditions. Although our loss reserve process benefits from extensive historical loan performance data, this process is subject to risks and uncertainties, including a reliance on historical loss information that may not be representative of current conditions. When market conditions change rapidly and dramatically, as they did during 2008, the historical loan performance underlying our models and loss estimates may not keep pace with changing market conditions. We address this risk by monitoring the delinquency and default experience of our homogenous loan pools and by considering the impact of current economic and market conditions. Our senior management is actively involved in the review and approval of our loss reserves. Our Enterprise Risk Office, through a designated Allowance for Loan

Losses Oversight Committee, reviews our loss reserve methodology on a quarterly basis and evaluates the adequacy of our loss reserves in the light of the factors described above.

As a result of the rapidly changing and deteriorating housing and credit market conditions during 2008 and 2007, and the sharp economic downturn during 2008, we have made recent changes in some of the key assumptions used in calculating our loss reserves. During 2007, we transitioned to a shorter historical time period of one-quarter to develop our average loss severity estimates. We previously had transitioned from using a two-year historical loss severity period to using a one-year historical loss severity period in late 2006. In addition, although our default rates generally are based on loss curves developed from available historical loan performance data dating back to 1980, we use a one-quarter look-back period to generate our default loss curve for loans originated in 2006 and 2007, and for Alt-A loans originated in 2005. We believe this shorter, more near-term loss curve better reflects the significantly higher default rates for these loans relative to the default rates for other loan product types.

In the fourth quarter of 2008, we made loan aggregation changes in our models to allow us to more directly capture the increased severity associated with loans originated in 2006 and 2007, and Alt-A loans originated in 2005. We also made adjustments to our model results to capture incremental losses not fully reflected in our models related to geographically concentrated areas that are experiencing severe stress as a result of significant home price declines and economic conditions. These changes, which had a significant adverse impact on our loss reserves, stemmed from: (1) higher severities and higher unpaid principal balance loan exposure at default relating to loans originated in 2006 and 2007, and Alt-A loans originated in 2005; (2) the sharp rise in unemployment rates in the second half of 2008 that is not yet fully reflected in our loan allowance model; and (3) the significant adverse impact of geographically concentrated stress, particularly in California, Florida, Nevada, Arizona and the Midwest. These changes accounted for approximately $3.9 billion of our combined loss reserves of $24.8 billion as of December 31, 2008.

The Provision for credit losses line item in our consolidated statements of operations represents the amount necessary to adjust the loss reserves each period to a level that management believes reflects estimated incurred losses as of the balance sheet date. We charge-off loans against our loss reserves when management determines that the loan is uncollectible, typically upon foreclosure of the loan, and record certain recoveries of previously charged off-amounts as an increase to the reserves. We provide additional information on our loss reserves and the impact of adjustments to our loss reserves on our consolidated financial statements in Consolidated Results of Operations Credit-Related Expenses and Notes to Consolidated Financial Statements Note 5, Allowance for Loan Losses and Reserve for Guaranty Losses.

Deferred Tax Assets

We recognize deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for tax credits. In the third quarter of 2008, we recorded a non-cash charge of $21.4 billion to establish a partial deferred tax asset valuation allowance. In the fourth quarter of 2008, we recorded an additional deferred tax asset valuation allowance of $9.4 billion, which represented the reserve for the tax benefit associated with the pre-tax loss we incurred in the fourth quarter of 2008. The additional $9.4 billion valuation allowance increased our total deferred tax asset valuation allowance to $30.8 billion as of December 31, 2008, resulting in a reduction in our net deferred tax assets to $3.9 billion as of December 31, 2008, compared with $13.0 billion as of December 31, 2007.

We evaluate our deferred tax assets for recoverability using a consistent approach that considers the relative impact of negative and positive evidence, including our historical profitability and projections of future taxable income. We are required to establish a valuation allowance for deferred tax assets and record a charge to income or stockholders equity if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we estimate future taxable income based on management-approved business plans and ongoing tax planning strategies. This process involves significant management judgment about assumptions that are subject to change from period to period based on changes in tax laws or variances between our projected operating performance, our actual results and other factors. Accordingly, we have included the assessment of a deferred tax asset valuation allowance as a critical accounting policy.

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As of September 30, 2008, we were in a cumulative book taxable loss position for more than a twelve-quarter period. For purposes of establishing a deferred tax valuation allowance, this cumulative book taxable loss position is considered significant, objective evidence that we may not be able to realize some portion of our deferred tax assets in the future. Our cumulative book taxable loss position was caused by the negative impact on our results from the weak housing and credit market conditions over the past year. These conditions deteriorated dramatically during the third quarter of 2008, causing a significant increase in our pre-tax loss for the third quarter of 2008, due in part to much higher credit losses, and downward revisions to our projections of future results. As a result of the current housing and financial market crisis, our projections of future credit losses have become more uncertain.

As of September 30, 2008, we concluded that it was more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize all of our deferred tax assets. Our conclusion was based on our consideration of the relative weight of the available evidence, including the rapid deterioration of market conditions discussed above, the uncertainty of future market conditions on our results of operations and significant uncertainty surrounding our future business model as a result of the placement of the company into conservatorship by FHFA on September 6, 2008. This negative evidence was the basis for the establishment of the partial deferred tax valuation allowance during 2008. We did not, however, establish a valuation allowance for the deferred tax asset related to unrealized losses recorded in AOCI on our available-for-sale securities. We believe this deferred tax amount, which totaled $3.9 billion as of December 31, 2008, is recoverable because we have the intent and ability to hold these securities until recovery of the unrealized loss amounts.

The amount of deferred tax assets considered realizable is subject to adjustment in future periods. We will continue to monitor all available evidence related to our ability to utilize our remaining deferred tax assets. If we determine that recovery is not likely because we no longer have the intent or ability to hold our available-for-sale securities until recovery of the unrealized loss amounts, we will record an additional valuation allowance against the deferred tax assets that we estimate may not be recoverable, which would further reduce our stockholders equity. In addition, our income tax expense in future periods will be increased or reduced to the extent of offsetting increases or decreases to our valuation allowance.

See Notes to Consolidated Financial Statements Note 12, Income Taxes of this report for additional information, including a detail on the components of our deferred tax assets and deferred tax liabilities as of December 31, 2008 and 2007.

CONSOLIDATED RESULTS OF OPERATIONS

Our business generates revenues from four principal sources: net interest income; guaranty fee income; trust management income; and fee and other income. Other significant factors affecting our results of operations include: fair value gains and losses; the timing and size of investment gains and losses; credit-related expenses; losses from partnership investments; administrative expenses and our effective tax rate. We expect high levels of period-to-period volatility in our results of operations and financial condition, principally due to changes in market conditions that result in periodic fluctuations in the estimated fair value of financial instruments that we mark-to-market through our earnings. These instruments include trading securities and derivatives not designated for hedge accounting. The estimated fair value of our trading securities and derivatives may fluctuate substantially from period to period because of changes in interest rates, credit spreads and expected interest rate volatility, as well as activity related to these financial instruments.

The section below provides a comparative discussion of our consolidated results of operations for the three-year period ended December 31, 2008. Following this section, we provide a discussion of our business segment results. Table 3 presents a condensed summary of our consolidated results of operations for 2008, 2007 and 2006 and selected market data that we believe are useful in evaluating changes in our results between periods.

Table 3: Condensed Consolidated Results of Operations and Selected Market Data[1]

	For the Year Ended December 31,			Variance			
				2008 vs. 2007		2007 vs. 2006	
	2008	2007	2006	$	%	$	%
	(Dollars in millions, except per share amounts)						
Net interest income	$ 8,782	$ 4,581	$ 6,752	$ 4,201	92%	$ (2,171)	(32)%
Guaranty fee income	7,621	5,071	4,250	2,550	50	821	19
Trust management income[2]	261	588	111	(327)	(56)	477	430
Fee and other income	772	965	908	(193)	(20)	57	6
Net revenues	**$ 17,436**	**$ 11,205**	**$ 12,021**	**$ 6,231**	**56%**	**$ (816)**	**(7)%**
Losses on certain guaranty contracts		(1,424)	(439)	1,424	100	(985)	(224)
Investment losses, net	(7,220)	(867)	(691)	(6,353)	(733)	(176)	(25)
Fair value losses, net[3]	(20,129)	(4,668)	(1,744)	(15,461)	(331)	(2,924)	(168)
Losses from partnership investments	(1,554)	(1,005)	(865)	(549)	(55)	(140)	(16)
Administrative expenses	(1,979)	(2,669)	(3,076)	690	26	407	13
Credit-related expenses[4]	(29,809)	(5,012)	(783)	(24,797)	(495)	(4,229)	(540)
Other non-interest expenses[5]	(1,294)	(686)	(210)	(608)	(89)	(476)	(227)
Income (loss) before federal income taxes and	(44,549)	(5,126)	4,213	(39,423)	(769)	(9,339)	(222)

extraordinary gains (losses)												
(Provision) benefit for federal income taxes		(13,749)		3,091		(166)		(16,840)	(545)		3,257	1,962
Extraordinary (losses) gains, net of tax effect		(409)		(15)		12		(394)	(2,627)		(27)	(225)
Net (loss) income	**$**	**(58,707)**	**$**	**(2,050)**	**$**	**4,059**	**$**	**(56,657)**	**(2,764)%**	**$**	**(6,109)**	**(151)%**
Diluted earnings (loss) per common share	**$**	**(24.04)**	**$**	**(2.63)**	**$**	**3.65**	**$**	**(21.41)**	**(814)%**	**$**	**(6.28)**	**(172)%**

(1) Certain prior period amounts have been reclassified to conform with the current period presentation in our consolidated statements of operations.

(2) We began separately reporting the revenues from trust management fees in our consolidated statements of operations effective November 2006. We previously included these revenues as a component of interest income.

(3) Consists of the following: (a) derivatives fair value gains (losses), net; (b) trading securities gains (losses), net; (c) hedged mortgage assets gains (losses), net; (d) debt foreign exchange gains (losses), net; and (e) debt fair value gains (losses), net.

(4) Consists of provision for credit losses and foreclosed property expense.

(5) Consists of the following: (a) debt extinguishment gains (losses), net; (b) minority interest in earnings (losses) of consolidated subsidiaries and (c) other expenses.

Net Interest Income

Net interest income represents the difference between interest income and interest expense and is a primary source of our revenue. Interest income consists of interest on our interest-earning assets, plus income from the accretion of discounts for assets acquired at prices below the principal value, less expense from the amortization of premiums for assets acquired at prices above the principal value. Interest expense consists of contractual interest on our interest-bearing liabilities and accretion and amortization of any cost basis adjustments, including premiums and discounts, which arise in conjunction with the issuance of our debt. Our net interest yield represents the difference between the yield on our interest-earning assets and the cost of our debt.

The amount of interest income and interest expense we recognize in the consolidated statements of operations is affected by our investment activity, our debt activity, asset yields and the cost of our debt. The size and composition of our investment portfolio and outstanding debt depends on investment strategies implemented by management as well regulatory requirements, the availability of investment capital and overall market conditions, including the availability of attractively priced investments and suitable financing to appropriately leverage our investment capital and manage our interest rate risk. Market conditions are influenced by, among other things, current levels of, and expectations for future levels of, interest rates, mortgage prepayments and market liquidity.

We expect net interest income and our net interest yield to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities. We supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. The effect of these derivatives, in particular the periodic net interest expense accruals on interest rate swaps, is not reflected in net interest income. See Fair Value Gains (Losses), Net for additional information. Table 4 presents an analysis of our net interest income and net interest yield for 2008, 2007 and 2006.

Table 4: Analysis of Net Interest Income and Yield

	For the Year Ended December 31,								
	2008			2007			2006		
	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance[1]	Interest Income/ Expense	Averag Rates Earned/P
	(Dollars in millions)								
erest-earning assets:									
rtgage loans[2]	$ 416,616	$ 22,692	5.45%	$ 393,827	$ 22,218	5.64%	$ 376,016	$ 20,804	5.53
rtgage securities	332,442	17,344	5.22	328,769	18,052	5.49	356,872	19,313	5.41
n-mortgage securities[3]	60,230	1,748	2.90	64,204	3,441	5.36	45,138	2,734	6.06
leral funds sold and urities purchased under eements to resell	41,991	1,158	2.76	15,405	828	5.37	13,376	641	4.79
vances to lenders	3,521	181	5.14	6,633	227	3.42	5,365	135	2.52
al interest-earning assets	$ 854,800	$ 43,123	5.04%	$ 808,838	$ 44,766	5.53%	$ 796,767	$ 43,627	5.48
erest-bearing liabilities:									
ort-term debt	$ 277,503	$ 7,806	2.81%	$ 176,071	$ 8,992	5.11%	$ 164,566	$ 7,724	4.69

ng-term debt	549,833	26,526	4.82	605,498	31,186	5.15	604,555	29,139	4.82
deral funds purchased l securities sold under eements to repurchase	428	9	2.10	161	7	4.35	320	12	3.75
tal interest-bearing bilities	$ 827,764	$ 34,341	4.15%	$ 781,730	$ 40,185	5.14%	$ 769,441	$ 36,875	4.79
pact of net non-interest ring funding	$ 27,036		0.14%	$ 27,108		0.18%	$ 27,326		0.16
t interest income/net erest yield[4]		$ 8,782	1.03%		$ 4,581	0.57%		$ 6,752	0.85
ected benchmark erest rates at end of ar:[5]									
nonth LIBOR			1.43%			4.70%			5.36
ear swap interest rate			1.47			3.82			5.17
ear swap interest rate			2.13			4.19			5.10
year Fannie Mae MBS coupon rate			3.89			5.51			5.79

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(1) Average balances were calculated based on the average of the amortized cost amounts at the beginning of the year and at the end of each month in the year for mortgage loans, advances to lenders, and short- and long-term debt for 2008 and 2007. Average balances for all other categories have been calculated based on a daily average for 2008 and 2007. Average balances were calculated based on the average of the amortized cost amounts at the beginning of the year and at the end of each quarter in the year for 2006.

(2) Average balance amounts include nonaccrual loans with an average balance totaling $10.3 billion, $6.5 billion and $6.7 billion for the years ended December 31, 2008, 2007 and 2006, respectively. Interest income includes interest income on loans purchased from MBS trusts subject to SOP 03-3, which totaled $634 million, $496 million and $361 million for 2008, 2007 and 2006, respectively. These interest income amounts included accretion of $158 million, $80 million and $43 million for 2008, 2007 and 2006 relating to a portion of the fair value losses recorded upon the purchase of SOP 03-3 loans.

(3) Includes cash equivalents.

(4) We compute net interest yield by dividing net interest income for the period by the average balance of our total interest-earning assets during the period.

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

Net interest income of $8.8 billion for 2008 reflected an increase of 92% over net interest income of $4.6 billion for 2007, driven by an 81% (46 basis points) expansion of our net interest yield to 1.03% and a 6% increase in our average interest-earning assets. Net interest income of $4.6 billion for 2007 reflected a decrease of 32% from net interest income of $6.8 billion in 2006, driven by a 33% (28 basis points) decline in our net interest yield to 0.57%, which was partially offset by a 2% increase in our average interest-earning assets.

Table 5 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.

Table 5: Rate/Volume Analysis of Net Interest Income

	2008 vs. 2007			2007 vs. 2006		
	Total Variance	Variance Due to:(1) Volume	Rate	Total Variance	Variance Due to:(1) Volume	Rate
	(Dollars in millions)					
Interest income:						
Mortgage loans(2)	$ 474	$ 1,258	$ (784)	$ 1,414	$ 999	$ 415
Mortgage securities	(708)	200	(908)	(1,261)	(1,540)	279
Non-mortgage securities(3)	(1,693)	(201)	(1,492)	707	1,050	(343)
Federal funds sold and securities purchased under agreements to resell	330	886	(556)	187	104	83
Advances to lenders	(46)	(132)	86	92	36	56
Total interest income	(1,643)	2,011	(3,654)	1,139	649	490
Interest expense:						

Short-term debt	(1,186)	3,873	(5,059)	1,268	561	707
Long-term debt	(4,660)	(2,760)	(1,900)	2,047	46	2,001
Federal funds purchased and securities sold under agreements to repurchase	2	7	(5)	(5)	(7)	2
Total interest expense	(5,844)	1,120	(6,964)	3,310	600	2,710
Net interest income	$ 4,201	$ 891	$ 3,310	$ (2,171)	$ 49	$ (2,220)

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

(2) Refer to footnote 2 in Table 4.

(3) Includes cash equivalents.

The 46 basis point increase in our net interest yield during 2008 was mainly driven by a 99 basis point reduction in the average cost of our debt to 4.15%, which more than offset the 49 basis point decline in the average yield on our interest-earning assets to 5.04%. The reduction in our borrowing costs was attributable to the general decline during 2008 in short-term borrowing rates, which fell to record lows of near zero at the end of 2008, and a shift in our funding mix to more short-term debt. In addition, we redeemed step-rate debt securities during the first half of 2008, which reduced our borrowing costs. Instead of having a fixed rate of interest for the life of the security, step-rate debt securities provide for the interest rate to increase at predetermined rates according to a specified schedule, resulting in increased interest payments. However, the interest expense on step-rate debt securities is recognized at a constant effective rate over the term of the security. Because we paid off these securities prior to maturity, we reversed a portion of the interest expense that we had previously accrued.

The 6% increase in our average interest-earning assets during 2008 was attributable to an increase in portfolio purchases during the year, particularly in the second quarter of 2008, as mortgage-to-debt spreads reached historic highs. OFHEO s reduction in our capital surplus requirement on March 1, 2008 provided us with more flexibility to take advantage of opportunities to purchase mortgage assets at attractive prices and spreads. However, the demand for our callable or longer-term debt was significantly reduced during the second half of 2008, which limited our ability to issue these debt securities at attractive rates. Because of these market conditions, as well as the limit on the amount of debt we are permitted to issue under the senior preferred stock purchase agreement, we increased our portfolio at a slower rate in the second half of 2008. The demand for our debt has improved since late November 2008, which allowed us to issue callable and longer-term debt in early 2009. However, there can be no assurance that this recent improvement will continue. In addition, under the senior preferred stock purchase agreement, we are subject to a mortgage portfolio cap of $850 billion through December 31, 2009. We are then required to reduce our mortgage portfolio by 10% per year beginning in 2010. These portfolio requirements may have an adverse impact on our future net interest income. For additional information on our portfolio investment and funding activity, see Consolidated Balance Sheet Analysis Mortgage Investments and Liquidity and Capital Management Liquidity Management Debt Funding. For a description of the Treasury agreements and terms, see Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements.

The reduction in our net interest income and compression of our net interest yield in 2007 was largely attributable to an increase in our short-term and long-term debt costs as we continued to replace, at higher interest rates, maturing debt that we had issued at lower interest rates during the preceding years. In addition, as discussed below, in November 2006, we began separately reporting as Trust management income the fees we receive from the interest earned on cash flows between the date of remittance of mortgage and other payments to us by servicers and the date of distribution of these payments to MBS certificateholders, which we refer to as float income. We previously reported these amounts as a component of Interest income. The reclassification of these fees reduced our net interest yield by approximately seven basis points in 2007.

Although we consider the periodic net contractual interest accruals on our interest rate swaps to be part of the cost of funding our mortgage investments, these amounts are not reflected in our net interest income and net interest yield. Instead, these amounts are included in our derivatives gains (losses) and reflected in our consolidated statements of operations as a component of Fair value losses, net. While we experienced a decrease in the average cost of our debt during 2008, we recorded net contractual interest expense on our interest rate swaps totaling $1.6 billion for 2008, as shown in Table 9 below. In comparison, we recorded net contractual interest income of $261 million for 2007 and interest expense of $111 million for 2006. The economic effect of the interest accruals on our interest rate swaps resulted in an increase in our funding costs of approximately 18 basis points for 2008, a reduction in our funding costs of approximately 3 basis points for 2007 and an increase in our funding costs of approximately 2 basis points for 2006.

Guaranty Fee Income

Guaranty fee income primarily consists of contractual guaranty fees related to both Fannie Mae MBS held in our portfolio and held by third-party investors, adjusted for the amortization of upfront fees over the estimated life of the loans underlying the MBS and impairment of guaranty assets, net of a proportionate reduction in the related guaranty obligation and deferred profit, and impairment of buy-ups (as defined below). The average effective guaranty fee rate reflects our average contractual guaranty fee rate adjusted for the impact of amortization of upfront fees and buy-up impairment.

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

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

Table 6 shows the components of our guaranty fee income, our average effective guaranty fee rate and Fannie Mae MBS activity for 2008, 2007 and 2006.

Table 6: Analysis of Guaranty Fee Income and Average Effective Guaranty Fee Rate[1]

	For the Year Ended December 31,										% Change	
		2008			2007			2006			2008 vs. 2007	2007 vs. 2006
		Amount	Rate[2]		Amount	Rate[2]		2006	Rate[2]			
	(Dollars in millions)											
Guaranty fee income/average effective guaranty fee rate, excluding certain fair value adjustments and buy-up impairment[3]	$	7,913	32.2bp	$	5,063	23.7bp	$	4,288	22.4bp		56%	18%
Net change in fair value of buy-ups and guaranty		(18)	(0.1)		24	0.1					(175)	

assets[4]												
Buy-up impairment		(274)	(1.1)		(16)	(0.1)		(38)	(0.2)		1,613	(58)
Guaranty fee income/average effective guaranty fee rate[5]	$	7,621	31.0bp	$	5,071	23.7bp	$	4,250	22.2bp		50%	19%
Average outstanding Fannie Mae MBS and other guarantees[6]	$	2,459,383		$	2,139,481		$	1,915,457			15%	12%
Fannie Mae MBS issues[7]		542,813			629,607			481,704			(14)	31

(1) Losses recognized at inception on certain guaranty contracts for periods prior to January 1, 2008 are excluded from guaranty fee income and the average effective guaranty fee rate; however, as described in footnote 5 below, the accretion of these losses into income over time is included in our guaranty fee income and average effective guaranty fee rate.

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

(3) Certain prior period amounts that previously were included as a component of Fee and other income have been reclassified to Guaranty fee income to conform to the current period presentation, which resulted in a change in the previously reported effective guaranty fee rates for 2006.

(4) Consists of the effect of the net change in fair value of buy-ups and guaranty assets from portfolio securitization transactions subsequent to January 1, 2007. We include the net change in fair value of buy-ups and guaranty assets from portfolio securitization transactions in Guaranty fee income in our consolidated statements of operations pursuant to our adoption of SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of SFAS 133 and SFAS 140* (SFAS 155). We prospectively adopted SFAS 155 effective January 1, 2007. Accordingly, we did not record a fair value adjustment in earnings during 2006.

(5) Losses recognized at inception on certain guaranty contracts for periods prior to January 1, 2008, which are excluded from guaranty fee income, are recorded as a component of our guaranty obligation. We accrete a portion of our guaranty obligation, which includes these losses, into income each period in proportion to the reduction in the guaranty asset for payments received. This accretion increases our guaranty fee income and reduces the related guaranty obligation. Effective January 1, 2008, we no longer recognize losses at inception of our guaranty contracts due to a change in our method for measuring the fair value of our guaranty obligations. Although we no longer recognize losses at inception of our guaranty contracts, we continue to accrete previously recognized losses into our guaranty fee income over the remaining life of the mortgage loans underlying the Fannie Mae MBS.

(6) Other guarantees includes $27.8 billion, $41.6 billion and $19.7 billion as of December 31, 2008, 2007 and 2006, respectively, related to long-term standby commitments we have issued and credit enhancements we have provided.

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

The 50% increase in guaranty fee income for 2008 resulted from a 15% increase in average outstanding Fannie Mae MBS and other guarantees, and a 31% increase in the average effective guaranty fee rate to 31.0 basis points from 23.7 basis points in 2007. The increase in average outstanding Fannie Mae MBS and other guarantees reflected our higher market share of mortgage-related securities issuances during 2008, as compared with 2007. We experienced this market share increase due in large part to the lack of competition from issuers of private-label mortgage-related securities as a result of the housing market crisis.

The increase in our average effective guaranty fee rate for 2008 was primarily due to the accelerated recognition of deferred amounts into income, as interest rates were generally lower in 2008 than in 2007, and the accretion of deferred amounts on guaranty contracts where we recognized losses at the inception of the contract, which totaled an estimated $1.1 billion for 2008, compared with $603 million for 2007. See Critical Accounting Policies and Estimates Fair Value of Financial Instruments for information on our accounting for these losses and the impact on our financial statements.

Our average effective guaranty fee rate for 2008 also was affected by guaranty fee pricing changes we implemented to address the current risks in the housing market. These pricing changes included an adverse market delivery charge of 25 basis points for all loans delivered to us, which became effective March 1, 2008. However, the average charged guaranty fee on new single-family business decreased to 28.0 basis points in 2008, from 28.6 basis points in 2007. The average charged guaranty fee represents the average contractual fee rate for our single-family guaranty arrangements plus the recognition of any upfront cash payments ratably over an estimated life of four years. The reduction in the average charged guaranty fee in 2008 reflected the shift in the composition of our guaranty book of business to a greater proportion of higher-quality, lower risk and lower guaranty fee mortgages, as we reduced our acquisitions of higher risk, higher fee product categories, such as Alt-A loans.

The 19% increase in guaranty fee income in 2007 from 2006 was driven by a 12% increase in average outstanding Fannie Mae MBS and other guarantees, and a 7% increase in the average effective guaranty fee rate to 23.7 basis points from 22.2 basis points. Although mortgage origination volumes fell during 2007, our market share of mortgage-related securities issuances increased due to the shift in the product mix of mortgage originations back to more traditional conforming products, which historically have accounted for the majority of our new business volume, and reduced competition from private-label issuers of mortgage-related securities. We increased our guaranty fee pricing for some loan types during 2007 to reflect the overall market increase in mortgage credit risk. These targeted pricing increases on new business contributed to the increase in our average effective guaranty fee rate for 2007.

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Trust Management Income

Trust management income consists of the fees we earn as master servicer, issuer and trustee for Fannie Mae MBS. We derive these fees from the interest earned on cash flows between the date of remittance of mortgage and other payments to us by servicers and the date of distribution of these payments to MBS certificateholders, which we refer to as float income. Prior to November 2006, funds received from servicers were maintained with our corporate assets and reported as a component of Interest income in our consolidated statements of operations. In November 2006, we made operational changes to segregate these funds from our corporate assets and began separately reporting this compensation as Trust management income in our consolidated statements of operations. Trust management income totaled $261 million, $588 million and $111 million for 2008, 2007 and 2006, respectively. The decrease in trust management income in 2008 was primarily attributable to the decline in short-term interest rates. The increase in trust management income in 2007 reflected the reclassification of these amounts from interest income.

Fee and Other Income

Fee and other income consists of transaction fees, technology fees and multifamily fees. These fees are largely driven by our business volume. Fee and other income totaled $772 million, $965 million and $908 million for 2008, 2007 and 2006, respectively.

The $193 million decrease in fee and other income in 2008 from 2007 was primarily attributable to lower multifamily fees due to lower multifamily loan prepayments in 2008. The $57 million increase in fee and other income in 2007 from 2006 was attributable to an increase in technology fees resulting from higher business volume.

Losses on Certain Guaranty Contracts

Effective January 1, 2008 with our adoption of SFAS 157, we no longer recognize losses or record deferred profit in our consolidated financial statements at inception of our guaranty contracts for MBS issued subsequent to December 31, 2007 because the estimated fair value of the guaranty obligation at inception now equals the estimated fair value of the total compensation received. For further discussion of this change, see Critical Accounting Policies and Estimates Fair Value of Financial Instruments Fair Value of Guaranty Obligations and Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies.

We recorded losses at inception on certain guaranty contracts totaling $1.4 billion and $439 million in 2007 and 2006, respectively. These losses reflected the increase in the estimated market risk premium that a market participant would require to assume our guaranty obligations due to the decline in home prices and deterioration in credit conditions. We will continue to accrete these losses into income over time as part of the accretion of the related guaranty obligation. This accretion is included as a component of our guaranty fee income. See Notes to Consolidated Financial Statements Note 8, Financial Guarantees and Master Servicing for additional information.

Investment Gains (Losses), Net

Investment gains and losses, net includes other-than-temporary impairment on available-for-sale securities; lower of cost or fair value adjustments on held-for-sale loans; gains and losses recognized on the securitization of loans or securities from our portfolio and from the sale of available-for-sale securities; and other investment losses. Investment gains and losses may fluctuate significantly from period to period depending upon our portfolio investment and securitization activities and changes in market and credit conditions that may result in other-than-temporary impairment. Table 7 details the components of investment gains and losses for 2008, 2007 and 2006.

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Table 7: Investment Gains (Losses), Net

	For the Year Ended December 31,		
	2008	2007	2006
	(Dollars in millions)		
Other-than-temporary impairment on available-for-sale securities[1]	$ (6,974)	$ (814)	$ (853)
Lower of cost or fair value adjustments on held for sale loans	(430)	(103)	(47)
Gains (losses) on Fannie Mae portfolio securitizations, net	49	(403)	152
Gains on sale of available-for-sale securities, net	387	703	106
Other investment losses, net	(252)	(250)	(49)
Investment losses, net	$ (7,220)	$ (867)	$ (691)

(1) Excludes other-than-temporary impairment on guaranty assets and buy-ups as these amounts are recognized as a component of guaranty fee income. Refer to Table 6: Analysis of Guaranty Fee Income and Average Effective Guaranty Fee Rate.

The $6.4 billion increase in investment losses in 2008 over 2007 was primarily attributable to an increase in other-than-temporary impairment on available-for-sale securities. The other-than-temporary impairment was principally related to Alt-A and subprime private-label securities, reflecting a reduction in expected cash flows due to an increase in expected defaults and loss severities on the mortgage loans underlying these securities. See Critical Accounting Policies and Estimates Other-than-temporary Impairment of Investment Securities and Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities Investments in Private-Label Mortgage Related Securities for additional information on impairment of our investment securities.

The $176 million increase in investment losses in 2007 over 2006 was primarily attributable to an increase in other investment losses, reflecting the sale of $1.9 billion of securities that triggered the derecognition of $17.3 billion of loans classified as held for investment and the recognition of $15.4 billion of securities. In conjunction with the recognition of the $15.4 billion of securities on our consolidated balance sheet, we also were required to record at fair value a related guaranty asset and guaranty obligation, which resulted in a loss that we reported as a component of other investment losses.

Fair Value Gains (Losses), Net

Fair value gains and losses, net consists of (1) derivatives fair value gains and losses, including gains and losses on derivatives designated as accounting hedges; (2) trading securities gains and losses; (3) fair value adjustments to the carrying value of mortgage assets designated for hedge accounting that are attributable to changes in interest rates; (4) foreign exchange gains and losses on our foreign-denominated debt; and (5) fair value gains and losses on certain debt securities carried at fair value. By presenting these items together in our consolidated results of operations, we are able to show the net impact of mark-to-market adjustments that generally result in offsetting gains and losses attributable to changes in interest rates.

Beginning in mid-April 2008, we implemented fair value hedge accounting with respect to a portion of our derivatives to hedge, for accounting purposes, the interest rate risk related to some of our mortgage assets, including mortgage loans classified as held for investment. Fair value hedge accounting allowed us to offset the fair value gains or losses on some of our derivative instruments against the corresponding fair value losses or gains attributable to changes in interest rates on the hedged mortgage assets. We implemented this hedging strategy to reduce the level of volatility in our earnings attributable to changes in interest rates for our interest rate risk management derivatives. However, our application of hedge accounting did not affect volatility in our financial results attributable to changes in credit spreads.

Following entry into conservatorship and the Treasury agreements, we changed our focus from reducing the volatility in our earnings attributable to changes in interest rates to maintaining a positive net worth. As a result of this change, we modified our hedge accounting strategy during the third quarter of 2008 to discontinue the application of hedge accounting for mortgage loans. Applying hedge accounting for these loans required that we record in earnings changes in the fair value of the loans attributable to changes in interest rates. These fair value changes offset some of the volatility in our earnings caused by fluctuations in the fair value of our derivatives. However, recording fair value adjustments on these loans introduced an additional element of volatility in our net worth. By discontinuing hedge accounting for these loans, we began accounting for the loans at amortized cost. We believe this change eliminated one factor that caused volatility in our net worth. During the fourth quarter of 2008, we discontinued all remaining hedge accounting.

Historically, we generally have expected that gains and losses on our trading securities, to the extent they are attributable to changes in interest rates, would offset a portion of the losses and gains on our derivatives because changes in the fair value of our trading securities typically moved inversely to changes in the fair value of our derivatives.

We seek to eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps that effectively convert debt denominated in a foreign currency to debt denominated in U.S. dollars. The foreign currency exchange gains and losses on our foreign-denominated debt are offset in part by corresponding losses and gains on foreign currency swaps.

Table 8 summarizes the components of fair value gains (losses), net for 2008, 2007 and 2006. We experienced significantly higher fair value losses in 2008, reflecting the widespread disruption in the mortgage and global financial markets. The increase in losses in 2008 over 2007 was driven by: (1) a decline in interest rates, which resulted in losses on our derivatives and gains on our hedged mortgage assets; (2) the significant widening of spreads, which resulted in losses on our trading securities; and (3) the distressed condition of several financial institutions, which resulted in significant write-downs of some of our non-mortgage investments. The increase in losses in 2007 over 2006 also reflected the impact of a decline in interest rates in 2007, which contributed to higher losses on our derivatives.

Table 8: Fair Value Gains (Losses), Net

	For the Year Ended December 31,		
	2008	2007	2006
	(Dollars in millions)		
Derivatives fair value losses, net[1]	$ (15,416)	$ (4,113)	$ (1,522)
Trading securities gains (losses) net[2]	(7,040)	(365)	8
Hedged mortgage assets gains, net[3]	2,154		
Fair value losses on derivatives, trading securities and hedged mortgage assets, net	(20,302)	(4,478)	(1,514)
Debt foreign exchange gains (losses), net	230	(190)	(230)
Debt fair value losses, net	(57)		
Fair value losses, net	$ (20,129)	$ (4,668)	$ (1,744)

(1) Includes losses of approximately $104 million in 2008 that resulted from the termination of our derivative contracts with a subsidiary of Lehman Brothers.

(2) Includes trading losses of $608 million in 2008 that resulted from the write-down to fair value of our investment in corporate debt securities issued by Lehman Brothers.

(3) Represents adjustments to the carrying value of mortgage assets designated for hedge accounting that are attributable to changes in interest rates.

Derivatives Fair Value Losses, Net

Derivative instruments are an integral part of our management of interest rate risk. We supplement our issuance of debt with derivative instruments to further reduce duration and prepayment risks. We generally are an end user of derivatives and our principal purpose in using derivatives is to manage our aggregate interest rate risk profile within prescribed risk parameters. We generally only use derivatives that are relatively liquid and straightforward to value. We consider the cost of derivatives used in our management of interest rate risk to be an inherent part of the cost of funding and hedging our mortgage investments and to be economically similar to the interest expense that we recognize on the debt we issue to fund our mortgage investments. We provide a more detailed discussion of our use of derivatives in Risk Management Interest Rate Risk Management and Other Market Risks Interest Rate Risk Management Strategies Derivative Instruments.

Table 9 presents, by type of derivative instrument, the fair value gains and losses on our derivatives for 2008, 2007 and 2006. Table 9 also includes an analysis of the components of derivatives fair value gains and losses

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attributable to net contractual interest accruals on our interest rate swaps, the net change in the fair value of terminated derivative contracts through the date of termination and the net change in the fair value of outstanding derivative contracts. The 5-year swap interest rate, which is shown below in Table 9, is a key reference interest rate that affects the fair value of our derivatives.

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

	For the Year Ended December 31,		
	2008	2007	2006
	(Dollars in millions)		
Risk management derivatives:			
Swaps:			
Pay-fixed	$ (64,764)	$ (12,065)	$ 2,181
Receive-fixed	44,553	5,928	(390)
Basis	(102)	91	26
Foreign currency[1]	(130)	111	105
Swaptions:			
Pay-fixed	(666)	(196)	(1,148)
Receive-fixed	6,153	1,956	(2,480)
Interest rate caps	(1)	5	100
Other[2][3]	(6)	12	6
Total risk management derivatives fair value losses, net	(14,963)	(4,158)	(1,600)
Mortgage commitment derivatives fair value gains (losses), net	(453)	45	78
Total derivatives fair value losses, net	$ (15,416)	$ (4,113)	$ (1,522)
Risk management derivatives fair value gains (losses) attributable to:			
Net contractual interest income (expense) on interest rate swaps	$ (1,576)	$ 261	$ (111)
Net change in fair value of terminated derivative contracts from end of prior period to date of termination[3]	(309)	(264)	(176)
Net change in fair value of outstanding derivative contracts, including derivative contracts entered into during the period	(13,078)	(4,155)	(1,313)
Total risk management derivatives fair value losses, net[4]	$ (14,963)	$ (4,158)	$ (1,600)

	2008	2007	2006
5-year swap rate:			
Quarter ended March 31	3.31%	4.99%	5.31%
Quarter ended June 30	4.26	5.50	5.65
Quarter ended September 30	4.11	4.87	5.08
Quarter ended December 31	2.13	4.19	5.10

(1) Includes the effect of net contractual interest income of approximately $9 million for 2008, and net contractual interest expense of approximately $59 million and $71 million for 2007 and 2006, respectively. The change in fair value of foreign currency swaps excluding this item resulted in a net loss of $139 million for 2008 and a net gain of $170 million and $176 million for 2007 and 2006, respectively.

(2) Includes MBS options, swap credit enhancements and mortgage insurance contracts.

(3) Includes losses of approximately $104 million for 2008, which resulted from the termination of our derivative contracts with a subsidiary of Lehman Brothers.

(4) Reflects net derivatives fair value losses, excluding mortgage commitments, recognized in the consolidated statements of operations.

The primary factors affecting the fair value of our derivatives include the following:

Changes in interest rates: Our derivatives, in combination with our debt issuances, are intended to offset changes in the fair value of our mortgage assets, which tend to increase in value when interest rates decrease and, conversely, decrease in value when interest rates rise. Because our derivatives portfolio predominately consists of pay-fixed swaps, we typically report declines in fair value as swap interest rates decrease and increases in fair value as swap interest rates increase.

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

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

Time value of purchased options: Intrinsic value and time value are the two primary components of an option s price. The intrinsic value is the amount that can be immediately realized by exercising the option the amount by which the market rate exceeds or is below the exercise, or strike rate, such that the option is in-the-money. The time value of an option is the amount by which the price of an option exceeds its intrinsic value. Time decay refers to the diminishing value of an option over time as less time remains to exercise the option. We have a significant amount of purchased options where the time value of the upfront premium we pay for these options decreases due to the passage of time relative to the expiration date of these options.

The increase in derivatives fair value losses to $15.4 billion in 2008 from $4.1 billion in 2007 was primarily attributable to the dramatic decline in swap interest rates, which decreased by 213 basis points during the second half of 2008, to 2.13% as of December 31, 2008. As indicated in Table 9, the decrease in swap interest rates resulted in substantial fair value losses on our pay-fixed swaps that exceeded the fair value gains on our receive-fixed swaps.

The increase in derivatives fair value losses to $4.1 billion in 2007 from $1.5 billion in 2006 reflected the impact of a decline in swap interest rates of 131 basis points during the second half of 2007, which resulted in fair value losses on our pay-fixed swaps that exceeded the fair value gains on our receive-fixed swaps. We experienced partially offsetting fair value gains on our option-based derivatives due to an increase in implied volatility during 2007.

Because derivatives are an important part of our interest rate risk management strategy, it is important to evaluate the impact of our derivatives in the context of our overall interest rate risk profile and in conjunction with the other offsetting mark-to-market gains and losses presented above in Table 8. For additional information on our use of derivatives to manage interest rate risk, including the economic objective of our use of various types of derivative instruments, changes in our derivatives activity and the outstanding notional amounts, see Risk Management Interest

Rate Risk Management and Other Market Risks Interest Rate Risk Management Strategies. See Consolidated Balance Sheet Analysis Derivative Instruments for a discussion of the effect of derivatives on our consolidated balance sheets.

Trading Securities Gains (Losses), Net

We recorded net losses on trading securities of $7.0 billion in 2008, net losses of $365 million in 2007 and net gains of $8 million in 2006. The variances between periods were partially due to an increase in securities classified as trading. Our portfolio of trading securities totaled $90.8 billion as of December 31, 2008, compared with $64.0 billion and $11.5 billion as of December 31, 2007 and 2006, respectively.

The primary driver of the increase in losses on trading securities in 2008 compared with 2007 was a continued and significant widening of spreads, particularly on private-label mortgage-related securities backed by Alt-A and subprime loans and commercial mortgage-backed securities (CMBS) backed by multifamily mortgage loans. In addition, we experienced losses on non-mortgage securities in our cash and other investments portfolio totaling $2.7 billion due to significant declines in the market value of these securities, particularly during the third quarter of 2008, due to the widespread financial market crisis. Approximately $809 million of these non-mortgage security losses related to investments in corporate debt securities issued by Lehman Brothers, Wachovia Corporation, Morgan Stanley and American International Group, Inc. (referred to as AIG). Our exposure to Lehman Brothers accounted for $608 million of the $809 million in losses.

The increase in losses on trading securities in 2007 compared with 2006 resulted from the widening of spreads, particularly related to private-label mortgage-related securities backed by Alt-A and subprime loans, that began in the second half of 2007.

We provide additional information on our trading and available-for-sale securities in Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities and disclose the sensitivity of changes in the fair value of our trading securities to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks Interest Rate Risk Metrics.

Hedged Mortgage Assets Gains (Losses), Net

Our hedge accounting relationships during 2008 consisted of pay-fixed interest rate swaps designated as fair value hedges of changes in the fair value, attributable to changes in the LIBOR benchmark interest rate, of specified mortgage assets. For these relationships, we included changes in the fair value of hedged mortgage assets attributable to changes in the benchmark interest rate in our assessment of hedge effectiveness. These fair value accounting hedges resulted in gains on the hedged mortgage assets of $2.2 billion for 2008, which were offset by losses of $2.2 billion on the pay-fixed swaps designated as hedging instruments. The losses on these pay-fixed swaps are included as a component of derivatives fair value gains (losses), net. We also recorded as a component of derivatives fair value gains (losses) the ineffectiveness, or the portion of the change in the fair value of our derivatives that was not effective in offsetting the change in the fair value of the designated hedged mortgage assets. We recorded losses of $94 million for 2008 attributable to ineffectiveness of our fair value hedges.

Because we discontinued hedge accounting during the fourth quarter of 2008, we did not have any derivatives designated as hedges as of December 31, 2008. We provide additional information on our application of hedge accounting during 2008 in Notes to Consolidated Financial Statements, Note 2 Summary of Significant Accounting Policies and Note 11 Derivative Instruments and Hedging Activities.

Losses from Partnership Investments

Our partnership investments, which primarily include investments in LIHTC partnerships as well as investments in other affordable rental and for-sale housing partnerships, totaled approximately $9.3 billion and $11.0 billion as of December 31, 2008 and 2007, respectively. These investments historically have played a significant role in advancing our affordable housing mission. We provide additional information about these investments in Part I Item 1 Business Business Segments Housing and Community Development Business.

Losses from partnership investments totaled $1.6 billion, $1.0 billion and $865 million in 2008, 2007 and 2006, respectively. The increase in losses in 2008 was primarily due to impairment charges of $510 million on our LIHTC partnership investments that we recorded during the second half of 2008. Our decision in the third quarter of 2008 to establish a deferred tax asset valuation allowance indicated that we may be unable to realize the future tax benefits generated by our LIHTC partnership investments. As a result, we determined that the potential loss on the carrying value of these investments was other than temporary. Accordingly, we recorded other-than-temporary impairment for LIHTC partnership investments that had a carrying value that exceeded the fair value in 2008. The losses on our LIHTC partnership investments in 2008 were partially offset by gains from the sale of two portfolios of investments in LIHTC partnerships. We also experienced an increase in operating losses and recorded other-than-temporary impairment on our investments in rental and for-sale affordable housing, attributable to the deepening economic downturn.

The increase in losses in 2007 related primarily to higher losses on our for-sale housing investments due to the deterioration in the housing market and higher net operating losses on our affordable rental housing partnership investments due to an increase in investments. These losses were partially offset by gains from the sale of two portfolios of investments in LIHTC partnerships.

Administrative Expenses

Administrative expenses include ongoing operating costs, such as salaries and employee benefits, professional services, occupancy costs and technology expenses. Administrative expenses totaled $2.0 billion, $2.7 billion and $3.1 billion for 2008, 2007 and 2006, respectively.

The $690 million decrease in administrative expenses in 2008 from 2007 reflected significant reductions in restatement and related regulatory expenses and a reduction in our ongoing operating costs due to efforts we undertook in 2007 to increase productivity and lower our administrative costs. In addition, we reversed amounts that we had previously accrued for 2008 bonuses in the third quarter of 2008. We have taken recent steps to realign our organization, personnel and resources to focus on our most critical priorities, which include providing liquidity to the mortgage market and preventing foreclosures. As part of this realignment, we reduced staffing levels in some areas of the company during early 2009; however, we plan to continue to increase staffing levels in other areas, particularly those divisions of the company that focus on our foreclosure-prevention efforts.

The $407 million decrease in administrative expenses in 2007 from 2006 also was due to a significant reduction in restatement and related regulatory expenses. This reduction was partially offset by an increase in our ongoing operating costs, resulting from costs associated with an early retirement program and various involuntary severance initiatives implemented in 2007, as well as costs associated with the significant investment we have made to enhance our organizational structure and systems.

Pension and other postretirement benefit expenses included in our administrative expenses totaled $95 million, $143 million and $137 million for 2008, 2007 and 2006, respectively. We disclose the key actuarial assumptions for our principal employee retirement benefit plans in Notes to Consolidated Financial Statements Note 15, Employee Retirement Benefits. We made contributions of $12 million to fund our nonqualified pension plans and other postretirement benefit plans during 2008. The funding status of our qualified pension plan shifted to a funding deficit of $222 million as of December 31, 2008, from a funding surplus of $44 million as of December 31, 2007. Based on the provisions of ERISA, we were not required to make a contribution to our qualified pension plan in 2008. We elected, however, to make a voluntary contribution to our qualified pension plan of $80 million in 2008 because of the significant reduction in the value of our plan assets during the year due to the dramatic decline in the global equity markets. Prior to enactment of the Pension Protection Act of 2006, the funding policy for our qualified pension plan was to contribute an amount equal to the required minimum contribution under ERISA and to maintain a funded status of 105% of the current liability as of January 1 of each year. We currently evaluate our funding policy in light of the Pension Protection Act requirements and the amendments to our plan that our Board of Directors approved in 2007, which were effective beginning with the 2008 plan year. We currently do not believe that we will be required to make a minimum contribution to our qualified pension plan in 2009; however, we will continue to monitor market conditions to determine whether we will make a voluntary contribution to our plan in 2009.

Credit-Related Expenses

Credit-related expenses included in our consolidated statements of operations consist of the provision for credit losses and foreclosed property expense. We detail the components of our credit-related expenses below in Table 10. The substantial increase in our credit-related expenses in 2008 and 2007 was attributable to significant increases in our provision for credit losses and foreclosed property expense, reflecting continued building of our loss reserves and increases in the level of net charge-offs due to the severe downturn in the housing market, coupled with broader economic weakness.

Table 10: Credit-Related Expenses

	For the Year Ended December 31,		
	2008	2007	2006
	(Dollars in millions)		
Provision for credit losses attributable to guaranty book of business	$ 25,522	$ 3,200	$ 385
Provision for credit losses attributable to SOP 03-3 and HomeSaver Advance fair value losses	2,429	1,364	204
Total provision for credit losses(1)	27,951	4,564	589
Foreclosed property expense	1,858	448	194
Credit-related expenses	$ 29,809	$ 5,012	$ 783

(1) Reflects total provision for credit losses reported in our consolidated statements of operations and in Table 11 below.

Provision Attributable to Guaranty Book of Business

Our allowance for loan losses and reserve for guaranty losses, which we collectively refer to as our combined loss reserves, provide for probable credit losses inherent in our guaranty book of business as of each balance sheet date. We build 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, we record the charge-off against our loss reserves. We record recoveries of previously charged-off amounts as a credit to our loss reserves. Table 11, which summarizes changes in our loss reserves for the five-year period ended December 31, 2008, details the provision for credit losses recognized in our consolidated statements of operations each period and the charge-offs recorded against our combined loss reserves.

Table 11: Allowance for Loan Losses and Reserve for Guaranty Losses

	As of December 31,				
	2008	2007	2006	2005	2004
	(Dollars in millions)				
Changes in combined loss reserves:					
Allowance for loan losses:					
Beginning balance	$ 698	$ 340	$ 302	$ 349	$ 290
Provision for credit losses[1]	4,022	658	174	124	174
Charge-offs[2]	(1,987)	(407)	(206)	(267)	(321)
Recoveries	190	107	70	96	131
Increase from the reserve for guaranty losses[4]					75
Ending balance[5]	$ 2,923	$ 698	$ 340	$ 302	$ 349
Reserve for guaranty losses:					
Beginning balance	$ 2,693	$ 519	$ 422	$ 396	$ 313
Provision for credit losses	23,929	3,906	415	317	178
Charge-offs[3][6]	(4,986)	(1,782)	(336)	(302)	(24)
Recoveries	194	50	18	11	4
Decrease to the allowance for loan losses[4]					(75)
Ending balance	$ 21,830	$ 2,693	$ 519	$ 422	$ 396
Combined loss reserves:					
Beginning balance	$ 3,391	$ 859	$ 724	$ 745	$ 603
Total provision for credit losses[1]	27,951	4,564	589	441	352
Charge-offs[2][3][6]	(6,973)	(2,189)	(542)	(569)	(345)
Recoveries	384	157	88	107	135
Ending balance[5]	$ 24,753	$ 3,391	$ 859	$ 724	$ 745
Allocation of combined loss reserves:					
Balance at end of each period attributable to:					
Single-family	$ 24,649	$ 3,318	$ 785	$ 647	$ 644
Multifamily	104	73	74	77	101
Total	$ 24,753	$ 3,391	$ 859	$ 724	$ 745
Single-family and multifamily loss reserve ratios:[7]					
Single-family loss reserves as a percentage of single-family guaranty book of business	0.88%	0.13%	0.03%	0.03%	0.03%
Multifamily loss reserves as a percentage of multifamily guaranty book of business	0.06	0.05	0.06	0.06	0.09

Combined loss reserves as a percentage of:					
Total guaranty book of business	0.83	0.12	0.04	0.03	0.03
Total nonperforming loans[8]	20.76	12.49	6.20	5.10	6.35

(1) Includes an increase in the allowance for loan losses for first-lien loans associated with unsecured HomeSaver Advance loans that are held in MBS trusts that are consolidated on our balance sheets.

(2) Includes accrued interest of $642 million, $128 million, $39 million, $24 million and $29 million for 2008, 2007, 2006, 2005, and 2004, respectively.

(3) Includes charges of $333 million in 2008 related to unsecured HomeSaver Advance loans.

(4) Includes decrease in reserve for guaranty losses and increase in allowance for loan losses due to the purchase of delinquent loans from MBS trusts. Effective with our adoption of SOP 03-3 on January 1, 2005, we record seriously delinquent loans purchased from Fannie Mae MBS trusts at the lower of acquisition cost or fair value at the date of purchase. We no longer record an increase in the allowance for loan losses and reduction in the reserve for guaranty losses when we purchase these loans.

(5) Includes $150 million, $39 million, $28 million and $22 million as of December 31, 2008, 2007, 2006 and 2005, respectively, for acquired loans subject to the application of SOP 03-3.

(6) Includes charges recorded at the date of acquisition of $2.1 billion, $1.4 billion, $204 million and $251 million in 2008, 2007, 2006 and 2005, respectively, for acquired loans subject to the application of SOP 03-3 where the acquisition cost exceeded the fair value of the acquired loan. Excludes delinquent loans totaling $56 million that are subject to SOP 03-3 but are held in MBS trusts consolidated on our balance sheets.

(7) Represents loss reserves amount attributable to each loan type as a percentage of the guaranty book of business for each loan type.

(8) Loans are classified as nonperforming when we believe collectability of interest or principal on the loan is not reasonably assured. Additionally, troubled debt restructurings and HomeSaver Advance first-lien loans are classified as nonperforming loans. See Table 48: Nonperforming Single-Family and Multifamily Loans for detail on nonperforming loans.

We continued to build our combined loss reserves in 2008 and 2007 through provisions that have been well in excess of our charge-offs. The provision for credit losses attributable to our guaranty book of business of $25.5 billion for 2008 exceeded net charge-offs of $4.2 billion, reflecting an incremental build of $21.3 billion in our combined loss reserves for 2008. In comparison, we recorded a provision for credit losses attributable to our guaranty book of business of $3.2 billion and $385 million for 2007 and 2006, respectively.

As a result of our higher loss provisioning levels, we have substantially increased our combined loss reserves both in absolute terms and as a percentage of our guaranty book of business, to $24.8 billion, or 0.83% of our guaranty book of business, as of December 31, 2008, from $3.4 billion, or 0.12% of our guaranty book of business, as of December 31, 2007. This increase reflected the impact of the continued and dramatic national decline in home prices and the deepening economic downturn, which have resulted in higher delinquencies and defaults and an increase in the average loss severity, or initial charge-off per default. Our conventional single-family serious delinquency rate increased to 2.42% as of December 31, 2008, from 0.98% as of December 31, 2007. The average default rate and loss severity, excluding fair value losses related to SOP 03-3 and HomeSaver Advance loans, was 0.59% and 26%, respectively, for 2008, compared with 0.32% and 11% for 2007, and 0.26% and 4% for 2006.

These worsening mortgage performance trends have been most notable in certain states, certain higher risk loan categories and our 2006 and 2007 loan vintages. The Midwest, which has experienced prolonged economic weakness, and California, Florida, Arizona and Nevada, which previously experienced rapid home price increases and are now experiencing steep home price declines, have accounted for a disproportionately large share of our seriously delinquent loans and charge-offs. Our Alt-A book, particularly the 2006 and 2007 loan vintages, has exhibited early stage payment defaults and represented a disproportionate share of our seriously delinquent loans and charge-offs for 2008. In addition, the deepening economic downturn and increase in unemployment rates have adversely affected the performance of our more traditional loans, which recently have exhibited higher delinquency rates.

The rapidly changing and deteriorating housing and credit market conditions had a more prounounced impact on our loss reserves during the third and fourth quarters of 2008, as we made changes to our loss reserve models and adjustments to reflect: (1) higher severities and higher unpaid principal balance loan balance exposure at default relating to loans originated in 2006 and 2007, and Alt-A loans originated in 2005; (2) the sharp rise in unemployment rates in the second half of 2008 that is not yet fully reflected in our internal models; and (3) the significant adverse impact of geographically concentrated stress, particularly in California, Florida, Nevada, Arizona and the Midwest.

Although the suspension of foreclosure sales on occupied single-family properties scheduled to occur between the periods November 26, 2008 through January 31, 2009 and February 17, 2009 through March 6, 2009 affects the timing of when we incur a credit loss, it does not necessarily affect the credit-related expenses recognized in our consolidated statements of operations because we estimate probable losses inherent in our guaranty book of business as of each balance date in determining our loss reserves. See Critical Accounting Policies and Estimates Allowance for Loan Losses and Reserve for Guaranty Losses for additional information on the process for estimating our loss reserves.

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Provision Attributable to SOP 03-3 and HomeSaver Advance Fair Value Losses

SOP 03-3 refers to the accounting guidance issued by the American Institute of Certified Public Accountants Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer.* When we purchase delinquent loans from MBS trusts that are within the scope of SOP 03-3, we record our net investment in these loans at the lower of the acquisition cost of the loan or the estimated fair value at the date of purchase. To the extent the acquisition cost exceeds the estimated fair value, we record a SOP 03-3 fair value loss charge-off against the Reserve for guaranty losses at the time we acquire the loan. See Part I Item 1 Business Business Segments Single-Family Credit Guaranty Business MBS Trusts for information on the provisions in our MBS trusts agreements that govern the purchase of delinquent loans and the factors that we consider in determining whether to purchase these loans.

We introduced HomeSaver Advance in the first quarter of 2008. HomeSaver Advance serves as a foreclosure prevention tool early in the delinquency cycle and does not conflict with our MBS trust requirements because it allows borrowers to cure their payment defaults without modifying their mortgage loan. HomeSaver Advance allows servicers to provide qualified borrowers with a 15-year unsecured personal loan in an amount equal to all past due payments relating to their mortgage loan, generally up to the lesser of $15,000 or 15% of the unpaid principal balance of the delinquent first lien loan. We record HomeSaver Advance loans at their estimated fair value at the date of purchase of these loans from servicers, and, to the extent the acquisition cost exceeds the estimated fair value, we record a HomeSaver fair value loss charge-off against the Reserve for guaranty losses at the time we acquire the loan.

As indicated in Table 10 above, SOP 03-3 and HomeSaver Advance fair value losses increased to $2.4 billion in 2008, from $1.4 billion and $204 million in 2007 and 2006, respectively. As a result of our loss mitigation strategies, including the implementation of HomeSaver Advance, we reduced the number of delinquent loans purchased from MBS trusts to approximately 25,000 loans in 2008, from approximately 42,300 loans in 2007. Despite the significant reduction in the number of delinquent loans purchased from MBS trusts, we experienced an increase in SOP 03-3 fair value losses due to the significant decline in the price of mortgage assets during 2008 as a result of the ongoing deterioration in the housing and credit markets and widespread illiquidity in the financial markets. We describe how we account for SOP 03-3 fair value losses and the process we use to value loans subject to SOP 03-3 in Critical Accounting Policies and Estimates Fair Value of Financial Instruments Fair Value of Loans Purchased with Evidence of Credit Deterioration.

Table 12 provides a quarterly comparison of the average market price, as a percentage of the unpaid principal balance and accrued interest, of delinquent loans subject to SOP 03-3 purchased from MBS trusts and additional information related to these loans. The decline in national home prices and significant reduction in liquidity in the mortgage markets, along with the increase in mortgage credit risk, that was observed in the second half of 2007 has persisted and become more severe, resulting in continued downward pressure on the value of the collateral underlying these loans.

Table 12: Statistics on Delinquent Loans Purchased from MBS Trusts Subject to SOP 03-3[1]

	2008				2007			
	Q4	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Average market price[2]	44%	49%	53%	60%	70%	72%	93%	94%
	$ 1,286	$ 744	$ 807	$ 1,704	$ 1,832	$ 2,349	$ 881	$ 1,057

Unpaid principal balance and accrued interest of loans purchased (dollars in millions)								
Number of delinquent loans purchased	6,124	3,678	4,618	10,586	11,997	15,924	6,396	8,009

(1) Excludes delinquent loans held in MBS trusts that have been consolidated on our balance sheet and first lien loans associated with HomeSaver Advance loans.

(2) The value of primary mortgage insurance is included as a component of the average market price.

Table 13 presents activity related to delinquent loans subject to SOP 03-3 purchased from MBS trusts under our guaranty arrangements for 2008 and 2007.

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Table 13: Activity of Delinquent Loans Acquired from MBS Trusts Subject to SOP 03-3

	Contractual Amount[1]	Market Discount	Allowance for Loan Losses	Net Investment
	(Dollars in millions)			
Balance as of December 31, 2006	$ 5,949	$ (237)	$ (28)	$ 5,684
Purchases of delinquent loans	6,119	(1,364)		4,755
Provision for credit losses			(76)	(76)
Principal repayments	(1,041)	71	16	(954)
Modifications and troubled debt restructurings	(1,386)	316	10	(1,060)
Foreclosures, transferred to REO	(1,545)	223	39	(1,283)
Balance as of December 31, 2007	$ 8,096	$ (991)	$ (39)	$ 7,066
Purchases of delinquent loans	4,542	(2,096)		2,446
Provision for credit losses			(184)	(184)
Principal repayments	(648)	114	5	(529)
Modifications and troubled debt restructurings	(3,255)	1,247	37	(1,971)
Foreclosures, transferred to REO	(1,710)	460	32	(1,218)
Balance as of December 31, 2008	$ 7,025	$ (1,266)	$ (149)	$ 5,610

(1) Reflects contractually required principal and accrued interest payments that we believe are probable of collection.

The proportion of delinquent loans purchased from MBS trusts for the purpose of modification varies from period to period, driven primarily by factors such as changes in our loss mitigation efforts, as well as changes in interest rates and other market factors. Beginning in November 2007, we decreased the number of optional delinquent loan purchases from our single-family MBS trusts in order to preserve capital in compliance with our regulatory capital requirements. We also reduced our optional delinquent loan purchases and the number of delinquent loans we purchased from MBS trusts as a result of the implementation of HomeSaver Advance in the first quarter of 2008. During the fourth quarter of 2008, we began increasing the number of delinquent loans we purchased from MBS trusts in response to our efforts to take a more proactive approach to prevent foreclosures by addressing potential problem loans earlier and offering additional, more flexible workout alternatives. We provide additional information on these workout alternatives, including workout activity during 2008 and re-performance data on problem loan workouts, in Risk Management Credit Risk Management Mortgage Credit Risk Management Problem Loan Management and Foreclosure Prevention.

Credit Loss Performance Metrics

Management views our credit loss performance metrics, which include our historical credit losses and our credit loss ratio, as significant indicators of the effectiveness of our credit risk management strategies. Management uses these metrics together with other credit risk measures to assess the credit quality of our existing guaranty book of business, make determinations about our loss mitigation strategies, evaluate our historical credit loss performance and determine the level of our loss reserves. These 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 exclude SOP 03-3 and HomeSaver Advance fair value losses from our credit loss performance metrics. However, we include in our credit loss performance metrics the impact of any credit losses we experience on loans subject to SOP 03-3 or first lien loans associated with HomeSaver Advance loans that ultimately result in foreclosure.

We believe that our credit loss performance metrics are useful to investors because they reflect how management evaluates our credit performance and the effectiveness of our credit risk management strategies and loss mitigation efforts. 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 SOP 03-3 and HomeSaver Advance fair value losses, investors are able to evaluate our credit performance on a more consistent basis among periods.

Table 14 below details the components of our credit loss performance metrics, which exclude the effect of SOP 03-3 and HomeSaver Advance fair value losses, for 2008, 2007 and 2006.

Table 14: Credit Loss Performance Metrics

	For the Year Ended December 31,					
	2008		2007		2006	
	Amount	Ratio[1]	Amount	Ratio[1]	Amount	Ratio[1]
	(Dollars in millions)					
Charge-offs, net of recoveries	$ 6,589	22.9bp	$ 2,032	8.0bp	$ 454	2.0bp
Foreclosed property expense	1,858	6.5	448	1.8	194	0.8
Less: SOP 03-3 and HomeSaver Advance fair value losses[2]	(2,429)	(8.4)	(1,364)	(5.4)	(204)	(0.9)
Plus: Impact of SOP 03-3 on charge-offs and foreclosed property expense[3]	501	1.7	223	0.9	73	0.3
Credit losses[4]	$ 6,519	22.7bp	$ 1,339	5.3bp	$ 517	2.2bp

(1) Based on the annualized amount for each line item presented divided by the average guaranty book of business during the period. We previously calculated our credit loss ratio based on annualized credit losses as a percentage of our mortgage credit book of business, which includes non-Fannie Mae mortgage-related securities held in our mortgage investment portfolio that we do not guarantee. In 2007, we revised the calculation of our credit loss ratio to reflect credit losses as a percentage of our guaranty book of business. We made this revision because losses related to non-Fannie Mae mortgage-related securities are not reflected in our credit losses. We revised the presentation of our credit loss ratio for 2006 to conform to our current presentation.

(2) Represents the amount recorded as a loss when the acquisition cost of a delinquent loan purchased from an MBS trust that is subject to SOP 03-3 exceeds the fair value of the loan at acquisition. Also includes the difference between the unpaid principal balance of unsecured HomeSaver Advance loans at origination and the estimated fair value of these loans that we record in our consolidated balance sheets.

(3) For seriously delinquent loans purchased from MBS trusts that are recorded at a fair value amount at acquisition that is lower than the acquisition cost, any loss recorded at foreclosure would be less than it would have been if we had recorded the loan at its acquisition cost instead of at fair value. Accordingly, we have added back to our credit losses the amount of charge-offs and foreclosed property expense that we would have recorded if we had calculated these amounts based on the purchase price.

(4) Interest forgone on nonperforming loans in our mortgage portfolio, which is presented in Table 48, reduces our net interest income but is not reflected in our credit losses total. In addition, other-than-temporary impairment losses resulting from deterioration in the credit quality of our mortgage-related securities and accretion of interest income on loans subject to SOP 03-3 are excluded from credit losses.

Our credit loss ratio increased to 22.7 basis points in 2008, from 5.3 basis points in 2007 and 2.2 basis points in 2006. Our credit loss ratio including the effect of SOP 03-3 and HomeSaver Advance fair value losses would have been

29.4 basis points, 9.8 basis points and 2.8 basis points for 2008, 2007 and 2006, respectively. The substantial increase in our credit losses in 2008 and 2007 also reflected the impact of the continued and dramatic national decline in home prices, as well as the deepening economic downturn. These conditions have resulted in higher default rates and loss severities, particularly for certain higher risk loan categories, loan vintages and loans within certain states that have had the greatest home price depreciation from their recent peaks. The suspension of foreclosure sales on occupied single-family properties scheduled to occur between November 26, 2008 through January 31, 2009 reduced our foreclosure activity in the fourth quarter of 2008, which resulted in a reduction in our credit losses during the quarter. If we are unable to modify a loan during the foreclosure suspension period and the property goes to foreclosure, we will record a charge-off upon foreclosure.

Specific credit loss statistics related to certain higher risk loan categories and loan vintages; loans within certain states that have had the greatest home price depreciation from their recent peaks; and loans within states in the Midwest, which has experienced prolonged economic weakness, include the following:

Certain higher risk loan types, including Alt-A loans, interest-only loans, loans to borrowers with low credit scores and loans with high loan-to-value ratios, many of which were originated in 2006 and 2007, represented approximately 28% and 29% of our single-family conventional mortgage credit book of business as of December 31, 2008 and 2007, respectively, but accounted for approximately 71% and 56% of our single-family credit losses for 2008 and 2007, respectively, compared with 46% for 2006.

California, Florida, Arizona and Nevada, which represented approximately 28% and 27% of our single-family conventional mortgage credit book of business as of December 31, 2008 and 2007, respectively, accounted for 49% and 15% of our single-family credit losses for 2008 and 2007, respectively, compared with 0% for 2006.

Michigan and Ohio, two key states driving credit losses in the Midwest, represented approximately 6% of our single-family conventional mortgage credit book of business as of December 31, 2008 and 2007, but accounted for 16% and 39% of our single-family credit losses for 2008 and 2007, respectively, compared with 50% for 2006.

We provide more detailed credit performance information, including serious delinquency rates by geographic region, statistics on nonperforming loans and foreclosed property activity, in Risk Management Credit Risk Management Mortgage Credit Risk Management.

Regulatory Hypothetical Stress Test Scenario

Pursuant to a September 2005 agreement with OFHEO, we 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. 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 15 shows the credit loss sensitivities before and after consideration of projected credit risk sharing proceeds, such as private mortgage insurance claims and other credit enhancement, as of December 31, 2008 and 2007 for first lien single-family whole loans we own or that back Fannie Mae MBS.

Table 15: Single-Family Credit Loss Sensitivity[(1)]

	As of December 31,	
	2008	2007
	(Dollars in millions)	
Gross single-family credit loss sensitivity	$ 13,232	$ 9,644
Less: Projected credit risk sharing proceeds	(3,478)	(5,102)
Net single-family credit loss sensitivity	$ 9,754	$ 4,542
Outstanding single-family whole loans and Fannie Mae MBS	$ 2,724,253	$ 2,523,440
Single-family net credit loss sensitivity as a percentage of outstanding single-family whole loans and Fannie Mae MBS	0.36%	0.18%

(1) Represents total economic credit losses, which consist of credit losses and forgone interest. Calculations are based on approximately 97% of our total single-family guaranty book of business as of both December 31, 2008 and 2007. The mortgage loans and mortgage-related securities that are included in these estimates consist of:

(i) 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; (ii) single-family mortgage loans, excluding mortgages secured only by second liens, subprime mortgages, manufactured housing chattel loans and reverse mortgages; and (iii) 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.

The increase in the projected credit loss sensitivities during 2008 reflected the significant decline in home prices during the year and the current negative near-term outlook for the housing and credit markets. These higher sensitivities also reflect the impact of updates to our underlying credit loss estimation models to capture the credit risk associated with the rapidly deteriorating conditions in the housing and credit markets. An environment of continuing lower home prices affects the frequency and timing of defaults and increases the level of credit losses, resulting in greater loss sensitivities.

We generated these sensitivities using the same models that we use to estimate fair value and impairment. 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.

Other Non-Interest Expenses

Other non-interest expenses consists of credit enhancement expenses, which represent the amortization of the credit enhancement asset we record at the inception of guaranty contracts, costs associated with the purchase of additional mortgage insurance to protect against credit losses, net gains and losses on the extinguishment of debt, the amortization of master servicing assets and other miscellaneous expenses. Other non-interest expenses totaled $1.3 billion, $686 million and $210 million in 2008, 2007 and 2006, respectively. The increase in expenses for 2008 was attributable to interest expense associated with the increase in our unrecognized tax benefit, an increase in amortization expense related to our master servicing assets and an increase in the net losses recorded on the extinguishment of debt. The increase in expenses for 2007 was attributable to higher credit enhancement expenses and a reduction in the amount of net gains recognized on the extinguishment of debt.

Federal Income Taxes

Although we incurred pre-tax losses for 2008, we did not record a tax benefit for the majority of the losses we incurred in 2008. Instead, we recorded a provision for federal income taxes of $13.7 billion, which reflects our conclusion as of September 30, 2008 that it was more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize all of our deferred tax assets. Based on this determination, we recorded a non-cash charge of $21.4 billion in the third quarter of 2008 to establish a partial deferred tax asset valuation allowance against our net deferred tax assets. In the fourth quarter of 2008, we recorded an additional deferred tax asset valuation allowance of $9.4 billion, which represented the reserve for the tax benefit associated with the pre-tax loss we incurred in the fourth quarter of 2008. Our deferred tax asset valuation allowance totaled $30.8 billion as of December 31, 2008, resulting in a reduction in our net deferred tax assets to $3.9 billion as of December 31, 2008, compared with $13.0 billion as of December 31, 2007.

We discuss the factors that led us to record a partial valuation allowance against our net deferred tax assets in Critical Accounting Policies and Estimates Deferred Tax Assets and Notes to Consolidated Financial Statements Note 12, Income Taxes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods. We will continue to monitor all available evidence related to our ability to utilize our remaining deferred tax assets. If we determine that recovery is not likely, we will record an additional valuation allowance against the deferred tax assets that we estimate may not be recoverable. Our income tax expense in future periods will be reduced or increased to the extent of offsetting decreases or increases to our valuation allowance.

We recorded a tax benefit of $3.1 billion for 2007, which resulted in an effective income tax rate of 60%. The tax benefit amount reflected the combined effect of a pre-tax loss in 2007 and tax credits generated from our LIHTC partnership investments. We recorded a tax provision of $166 million in 2006, which resulted in an effective income tax rate of 4%. The variance in our effective income tax rate between periods and the difference between our statutory income tax rate of 35% and our effective tax rate is primarily due to the effect of fluctuations in our pre-tax earnings, which affects the relative tax benefit of tax-exempt income and tax credits. As disclosed in Notes to Consolidated Financial Statements Note 12, Income Taxes, our effective tax rate would have been 40% and 29% for 2007 and 2006, respectively, if we had not received the tax benefits from our investments in LIHTC partnerships.

BUSINESS SEGMENT RESULTS

We provide a more complete description of our business segments in Part I Item 1 Business Business Segments. Results of our three business segments are intended to reflect each segment as if it were a stand-alone business. We describe the management reporting and allocation process used to generate our segment

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results in Notes to Consolidated Financial Statements Note 16, Segment Reporting. We summarize our segment results for 2008, 2007 and 2006 in the tables below and provide a discussion of these results.

Single-Family Business

Our Single-Family business recorded a net loss of $27.1 billion in 2008, compared with a net loss of $858 million in 2007, and net income of $2.0 billion in 2006. The primary source of revenue for our Single-Family business is guaranty fee income. Other sources of revenue trust management income and other fee income, primarily related to transaction and technology fees. Expenses primarily include credit-related expenses and administrative expenses. Table 16 summarizes the financial results for our Single-Family business for the periods indicated.

Table 16: Single-Family Business Results

	For the Year Ended December 31,			Variance			
				2008 vs. 2007		2007 vs. 2006	
	2008	2007	2006	$	%	$	%
	(Dollars in millions)						
Statement of operations data:[1]							
Guaranty fee income	$ 8,390	$ 5,816	$ 4,785	$ 2,574	44%	$ 1,031	22%
Trust management income[2]	256	553	109	(297)	(54)	444	407
Other income[3]	716	629	1,282	87	14	(653)	(51)
Losses on certain guaranty contracts		(1,387)	(431)	1,387	100	(956)	(222)
Credit-related expenses[4]	(29,725)	(5,003)	(778)	(24,722)	(494)	(4,225)	(543)
Other expenses[5]	(1,950)	(1,928)	(1,834)	(22)	(1)	(94)	(5)
Income (loss) before federal income taxes	(22,313)	(1,320)	3,133	(20,993)	(1,590)	(4,453)	(142)
(Provision) benefit provision for federal income taxes	(4,788)	462	(1,089)	(5,250)	(1,136)	1,551	142
Net (loss) income	$ (27,101)	$ (858)	$ 2,044	$ (26,243)	(3,059)%	$ (2,902)	(142)%
Other key performance data:							
Average single-family guaranty book of business[6]	$ 2,715,606	$ 2,406,422	$ 2,178,478	$ 309,184	13%	$ 227,944	10%

(1) Certain prior period amounts have been reclassified to conform with the current period presentation in our consolidated statements of operations.

(2)

We began separately reporting the revenues from trust management fees in our consolidated statements of operations effective November 2006. We previously included these revenues as a component of interest income. We have not reclassified prior period amounts to conform to the current period presentation.

(3) Consists of net interest income, investment gains and losses, and fee and other income.

(4) Consists of the provision for credit losses and foreclosed property expense.

(5) Consists of administrative expenses and other expenses.

(6) The single-family guaranty book of business consists of single-family mortgage loans held in our mortgage portfolio, single-family Fannie Mae MBS held in our mortgage portfolio, single-family Fannie Mae MBS held by third parties, 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 guarantee.

Key factors affecting the results of our Single-Family business for 2008 compared with 2007 included the following.

Increased guaranty fee income, primarily attributable to an increase in the average effective single-family guaranty fee rate, coupled with growth in the average single-family guaranty book of business.

The average effective single-family guaranty fee rate increased by 28% to 30.9 basis points in 2008, from 24.2 basis points in 2007. The growth in our average effective single-family guaranty fee rate during 2008 was primarily driven by the accelerated recognition of deferred amounts into income, as interest rates fell significantly during 2008, resulting in higher expected prepayment rates. Our average effective guaranty fee rate for 2008 also reflected the impact of guaranty fee pricing changes we implemented to address the current risks in the housing market and a shift in the composition of our new business to a greater proportion of higher-quality, lower risk and lower guaranty fee mortgages. The combined effect of these changes resulted in a reduction in the average charged guaranty fee on new single-family business to 28.0 basis points in 2008, from 28.6 basis points for 2007.

Our average single-family guaranty book of business increased by 13% to $2.7 trillion in 2008, from $2.4 trillion in 2007, reflecting the significant increase in our market share since the end of the second quarter of 2007. Our estimated market share of new single-family mortgage-related securities issuances, which is based on publicly available data and excludes previously securitized mortgages, increased to approximately 45.4% for 2008, from approximately 33.9% for 2007. However, we began to experience a decrease in market share during the second half of 2008.

A substantial increase in credit-related expenses, reflecting a significantly higher incremental provision for credit losses as well as higher charge-offs due to worsening credit performance trends, including significant increases in delinquencies, defaults and loss severities, particularly in certain higher risk loan categories and vintages and certain states. We also experienced an increase in SOP 03-3 fair value losses in 2008.

A non-cash charge during the third quarter of 2008 to establish a partial deferred tax asset valuation allowance against our net deferred tax assets. As a result of the partial deferred tax valuation allowance, we did not record tax benefits for the majority of the losses we incurred during 2008. The allocation of this charge, which totaled $21.4 billion, to our Single-Family business resulted in a provision for federal income taxes of $4.8 billion for 2008, compared with a tax benefit of $462 million for 2007.

Key factors affecting the results of our Single-Family business for 2007 compared with 2006 included the following.

Increased guaranty fee income in 2007, attributable to growth in the average single-family guaranty book of business, coupled with an increase in the average effective single-family guaranty fee rate.

Our average single-family guaranty book of business increased by 10% to $2.4 trillion in 2007, from $2.2 trillion in 2006, due to strong growth in single-family Fannie Mae MBS issuances. This growth reflected the shift in the product mix of mortgage originations in the primary mortgage market back to more traditional conforming products, such as 30-year fixed-rate loans, and a significant reduction in competition from private-label issuers of mortgage-related securities.

The growth in our average effective single-family guaranty fee rate resulted from targeted pricing increases on new business due to the increase in the market pricing of mortgage credit risk and an increase in the accretion of our guaranty obligation and deferred profit into income in 2007 as compared with 2006, due in part to accretion related to losses on certain guaranty contracts.

Significantly higher losses on certain guaranty contracts in 2007, primarily due to the deterioration in home prices and overall housing market conditions, which led to an increase in mortgage credit risk pricing that resulted in an increase in the estimated fair value of our guaranty obligations. As a result, we recorded increased losses on certain guaranty contracts associated with our MBS issuances during 2007.

A substantial increase in credit-related expenses in 2007, reflecting an increase in both the provision for credit losses and foreclosed property expenses resulting principally from the continued impact of weak economic conditions in the Midwest and the effect of the national decline in home prices. We also experienced a significant increase in market-based valuation adjustments on delinquent loans purchased from MBS trusts, which are presented as part of our provision for credit losses.

A relatively stable effective tax rate of 35.0% for 2007, compared with 34.8% for 2006.

HCD Business

Our HCD business recorded a net loss of $2.2 billion in 2008, compared with net income of $157 million and $338 million in 2007 and 2006, respectively. Table 17 summarizes the financial results for our HCD business for the periods indicated. The primary sources of revenue for our HCD business are guaranty fee income and other income, consisting of transaction fees associated with our multifamily business and bond credit enhancement fees. Expenses primarily include administrative expenses, credit-related expenses and net operating losses associated with our partnership investments, which generate tax benefits that may reduce our federal income tax liability. However, we determined in the third quarter of 2008 that we may be unable to realize the future tax benefits generated by these investments.

Table 17: HCD Business Results

	For the Year Ended December 31, 2008	2007	2006	Variance 2008 vs. 2007 $	%	Variance 2007 vs. 2006 $	%
	(Dollars in millions)						
Statement of operations data:							
Guaranty fee income	$ 633	$ 470	$ 562	$ 163	35%	$ (92)	(16)%
Other income[1][2]	186	359	279	(173)	(48)	80	29
Losses on partnership investments	(1,554)	(1,005)	(865)	(549)	(55)	(140)	(16)
Credit-related expenses[3]	(84)	(9)	(5)	(75)	(833)	(4)	(80)
Other expenses[1][4]	(859)	(1,167)	(1,076)	308	26	(91)	(8)
Income (loss) before federal income taxes	(1,678)	(1,352)	(1,105)	(326)	(24)	(247)	(22)
(Provision) benefit for federal income taxes	(511)	1,509	1,443	(2,020)	(134)	66	5
Net (loss) income	$ (2,189)	$ 157	$ 338	$ (2,346)	(1,494)%	$ (181)	(54)%
Other key performance data:							
Average multifamily guaranty book of business[5]	$ 161,722	$ 131,375	$ 118,537	$ 30,347	23%	$ 12,838	11%

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

(2) Consists of trust management income and fee and other income.

(3) Consists of the provision for credit losses and foreclosed property (expense) income.

(4) Consists of net interest expense, losses on certain guaranty contracts, administrative expenses, minority interest in earnings of consolidated subsidiaries and other expenses.

(5) The multifamily guaranty book of business consists of multifamily mortgage loans held in our mortgage portfolio, multifamily Fannie Mae MBS held in our mortgage portfolio, multifamily Fannie Mae MBS held by third parties 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 guarantee.

Key factors affecting the results of our HCD business for 2008 compared with 2007 included the following.

- Increased guaranty fee income, attributable to growth in the average multifamily guaranty book of business, an increase in the average effective multifamily guaranty fee rate and the accelerated amortization of our deferred guaranty obligation due to the decline in interest rates. The increases in our book of business and guaranty fee rate reflected the increased investment and liquidity that we provided to the multifamily mortgage market in 2008.

- A decrease in other income, primarily attributable to lower multifamily fees due to a reduction in multifamily loan prepayments during 2008.

- An increase in losses on partnership investments, primarily due to other-than-temporary impairment of $531 million recorded on our LIHTC partnership investments in 2008 because we may be unable to realize the future tax benefits generated by these investments. In addition, we experienced an increase in net operating losses and recorded other-than-temporary impairment on our investments in rental and for-sale affordable housing, attributable to the deepening economic downturn.

- A non-cash charge during the third quarter of 2008 to establish a partial deferred tax asset valuation allowance against our net deferred tax assets. As a result of the partial deferred tax valuation allowance, we did not record tax benefits for the majority of the losses we incurred during 2008. The allocation of this charge to our HCD business largely resulted in a provision for federal income taxes of $511 million for 2008. In comparison, we recorded a tax benefit of $1.5 billion for 2007, driven by tax credits of $1.0 billion.

Key factors affecting the results of our HCD business for 2007 compared with 2006 included the following.

Decreased guaranty fee income resulting from a decline in the average effective multifamily guaranty fee rate, which was partially offset by growth in the average multifamily guaranty book of business. The decline in our average effective multifamily guaranty fee rate was due in part to the recognition of deferred profits in 2006 related to a large multifamily transaction that was terminated in December 2006. Our HCD business continued to experience competitive fee pressure from private-label issuers of commercial mortgage-backed securities during the first six months of 2007. In the third quarter of 2007, this trend began to reverse as a result of the growing need for credit and liquidity in the multifamily mortgage market. These market factors contributed to a higher guaranty fee rate on new multifamily business and to faster growth in our multifamily guaranty book of business during the second half of 2007. The growth in the multifamily guaranty book of business was largely attributable to an increase in multifamily loan acquisitions by our Capital Markets group.

An increase in losses on partnership investments related to our for-sale housing partnership investments due to the deterioration in the housing market. In addition, we increased our investment in affordable rental housing partnership investments, which resulted in an increase in the net operating losses related to these investments. These losses more than offset gains on the sales of investments in LIHTC partnerships in 2007.

An increase in other income due to an increase in loan prepayment and yield maintenance fees resulting from higher multifamily loan prepayments during 2007.

An increase in other expenses primarily resulting from higher net interest expense associated with an increase in segment assets.

A tax benefit of $1.5 billion in 2007 driven primarily by tax credits of $1.0 billion, compared with a tax benefit of $1.4 billion in 2006 driven by tax credits of $1.1 billion.

Capital Markets Group

Our Capital Markets group recorded a net loss of $29.4 billion in 2008, compared with a net loss of $1.3 billion in 2007, and net income of $1.7 billion in 2006. Table 18 summarizes the financial results for our Capital Markets group for the periods indicated. The primary source of revenue for our Capital Markets group is net interest income. Expenses primarily consist of administrative expenses. Fair value gains and losses, investment gains and losses, and debt extinguishment gains and losses also have a significant impact on the financial performance of our Capital Markets group.

Table 18: Capital Markets Group Business Results

	For the Year Ended December 31,			Variance			
				2008 vs. 2007		2007 vs. 2006	
	2008	2007	2006	$	%	$	%
	(Dollars in millions)						
Statement of operations data:							
Net interest income	$ 8,664	$ 4,620	$ 6,157	$ 4,044	88%	$ (1,537)	(25)%

Investment losses, net[1]	(7,148)	(803)	(788)	(6,345)	(790)	(15)	(2)
Fair value gains (losses), net[1]	(20,129)	(4,668)	(1,744)	(15,461)	(331)	(2,924)	(168)
Fee and other income[1]	264	313	372	(49)	(16)	(59)	(16)
Other expenses[1][2]	(2,209)	(1,916)	(1,812)	(293)	(15)	(104)	(6)
Income (loss) before federal income taxes	(20,558)	(2,454)	2,185	(18,104)	(738)	(4,639)	(212)
(Provision) benefit for federal income taxes	(8,450)	1,120	(520)	(9,570)	(854)	1,640	315
Extraordinary gains (losses), net of tax effect	(409)	(15)	12	(394)	(2,627)	(27)	(225)
Net (loss) income	$ (29,417)	$ (1,349)	$ 1,677	$ (28,068)	(2,081)%	$ (3,026)	(180)%

(1) Certain prior period amounts have been reclassified to conform with the current period presentation in our consolidated statements of operations.

(2) Consists of debt extinguishment losses, allocated guaranty fee expense, administrative expenses and other expenses.

Key factors affecting the results of our Capital Markets group for 2008 compared with 2007 included the following.

An increase in net interest income, primarily attributable to an expansion of our net interest yield driven by a reduction in the average cost of our debt that more than offset a decline in the average yield on our interest-earning assets. The decrease in the average cost of our debt was due to the decline in short-term interest rates during 2008 and a shift in our funding mix to more short-term debt. The reversal of accrued interest expense on step-rate debt that we paid off during the first quarter of 2008 also reduced the average cost of our debt. The increase in our net interest income does not reflect the impact of a significant increase in the net contractual interest expense on our interest rate swaps.

A substantial increase in fair value losses, primarily attributable to significantly higher fair value losses on our derivatives as a result of the considerable decline in swap interest rates during 2008. We also experienced significant losses on our trading securities, primarily due to the continued widening of spreads during the year, particularly on private-label mortgage-related securities backed by Alt-A and subprime loans and CMBS. In addition, we recorded losses on some of the investments in corporate debt securities in our cash and other investments portfolio due to the default or distressed financial condition of the issuers of these securities.

A significant increase in investment losses, attributable to other-than-temporary impairment on available-for-sale securities totaling $7.0 billion in 2008, compared with $814 million in 2007. The impairment losses were primarily associated with our investments in Alt-A and subprime private-label securities, which have experienced extreme price declines and a significant reduction in the expected cash flows due to markedly higher expected defaults and loss severities on the underlying mortgages.

A non-cash charge during the third quarter of 2008 to establish a partial deferred tax asset valuation allowance against our net deferred tax assets. As a result of the partial deferred tax valuation allowance, we did not record tax benefits for the majority of the losses we incurred during 2008. The allocation of this charge, which totaled $21.4 billion, to our Capital Markets group resulted in a provision for federal income taxes of $8.5 billion for 2008, compared with a tax benefit of $1.1 billion for 2007.

Key factors affecting the results of our Capital Markets group for 2007 compared with 2006 included the following.

A significant reduction in net interest income during 2007, due to continued compression in our net interest yield, largely attributable to the increase in our short-term and long-term debt costs as we continued to replace, at higher interest rates, maturing debt that we had issued at lower interest rates during the past few years.

An increase in investment losses primarily due to increased losses on trading securities in 2007, reflecting the decrease in the fair value of these securities due to wider credit spreads that more than offset the favorable impact of a decrease in interest rates during the fourth quarter of 2007.

An increase in derivatives fair value losses due to the significant decline in swap interest rates during the second half of 2007. The 5-year swap interest rate fell by 131 basis points to 4.19% as of December 31, 2007 from 5.50% as of June 30, 2007.

An effective tax rate of 45.6% for 2007, compared with an effective tax rate of 23.8% for 2006. The variance in the effective tax rate and statutory rate was primarily due to fluctuations in our pre-tax income and the relative benefit of tax-exempt income generated from our investments in mortgage revenue bonds.

CONSOLIDATED BALANCE SHEET ANALYSIS

We seek to structure the composition of our balance sheet and manage its size to ensure compliance with our regulatory requirements, to provide adequate liquidity to meet our needs, to mitigate our interest rate and credit risk exposure, and to maintain a positive net worth. The major asset components of our balance sheet include our mortgage investments and our cash and other investments portfolio. We fund and manage the interest rate risk on these investments through the issuance of debt securities and the use of derivatives. Our debt securities and derivatives represent the major liability components of our consolidated balance sheet.

Total assets of $912.4 billion as of December 31, 2008 increased by $33.0 billion, or 3.8%, from December 31, 2007. Total liabilities of $927.6 billion increased by $92.3 billion, or 11.0%, from December 31, 2007. Stockholders equity decreased by $59.3 billion during 2008, to a deficit of $15.3 billion as of December 31, 2008, from a surplus of $44.0 billion as of December 31, 2007. The decrease in stockholders equity was attributable to the pre-tax loss in 2008, the non-cash charge of $21.4 billion that we recorded in the third quarter of 2008 to establish a partial deferred tax asset valuation allowance, and a significant increase in unrealized losses on available-for-sale securities. Following is a discussion of material changes in the major components of our assets and liabilities since December 31, 2007. See Liquidity and Capital Management Capital Management Capital Activity, for additional discussion of changes in our stockholders equity (deficit).

Mortgage Investments

Our mortgage investment activities may be constrained by our regulatory requirements, certain operational limitations, tax classifications and our intent to hold certain temporarily impaired securities until recovery in value, as well as risk parameters applied to the mortgage portfolio. Our mortgage portfolio activity for 2008 was affected by market conditions, as well as certain regulatory actions and requirements, including the following:

- For the first two months of 2008, we were subject to an OFHEO-directed limitation on the size of our mortgage portfolio, which is described in our 2007 Form 10-K. Effective March 1, 2008, OFHEO removed the limitation on the size of our mortgage portfolio.

- On March 19, 2008, OFHEO reduced the 30% capital surplus requirement, which was part of our May 2006 consent order with OFHEO, to 20%. In May 2008, OFHEO further reduced our capital surplus requirement to 15%. In October 2008, FHFA announced that our capital requirements would not be binding during the conservatorship.

- The senior preferred stock purchase agreement with Treasury permits us to increase our mortgage portfolio temporarily up to a cap of $850 billion through December 31, 2009. We then, however, are required to reduce our mortgage portfolio by 10% per year beginning in 2010. We also are required to limit the amount of indebtedness we can incur to 110% of our aggregate indebtedness as of June 30, 2008.

- FHFA has encouraged us to acquire and hold increased amounts of mortgage loans and mortgage-related securities in our mortgage portfolio to provide additional liquidity to the mortgage market.

Table 19 summarizes our mortgage portfolio activity for 2008, 2007 and 2006.

Table 19: Mortgage Portfolio Activity[1]

	Purchases[2]			Sales			Liquidations[3]		
	2008	2007	2006	2008	2007	2006	2008	2007	20
	(Dollars in millions)								
e loans:									
te:									
rm	$ 72,956	$ 62,738	$ 65,680	$	$	$	$ 22,913	$ 30,656	$ 3
liate-term[4]	30,004	32,080	16,044				10,797	18,937	2
ed-rate loans	102,960	94,818	81,724				33,710	49,593	6
le-rate loans	14,313	16,535	9,431				9,447	10,402	1
ortgage loans	117,273	111,353	91,155				43,157	59,995	7
e securities:									
te:									
rm	50,509	16,141	18,948	33,595	59,617	42,538	21,137	25,060	3
liate-term[5]	11,970	14,429	6,945	6,734	4,012	4,977	4,716	4,258	
ed-rate securities	62,479	30,570	25,893	40,329	63,629	47,515	25,853	29,318	4
le-rate securities	14,794	38,686	64,718	2,711	5,349	5,160	17,091	28,273	3
ortgage securities	77,273	69,256	90,611	43,040	68,978	52,675	42,944	57,591	8
ortgage portfolio	$ 194,546	$ 180,609	$ 181,766	$ 43,040	$ 68,978	$ 52,675	$ 86,101	$ 117,586	$ 15
iquidation rate							11.5%	16.2%	

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

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

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

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

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

Although the significant widening of mortgage-to-debt spreads during 2008 presented more opportunities for us to purchase mortgage assets at attractive prices and spreads, we limited our mortgage portfolio purchases in the earlier part of the year to preserve capital. We were able to expand our mortgage portfolio purchases during the second quarter of 2008 as a result of OFHEO s reduction in our capital surplus requirement and the additional capital raised from the issuance of equity securities in May and June 2008. However, the demand for our callable or longer-term debt was significantly reduced during the second half of 2008, which limited our ability to issue these debt securities at attractive rates. Because of these market conditions, as well as the limit on the amount of debt we are permitted to issue under the senior preferred stock purchase agreement, we increased our portfolio at a slower rate in the second half of 2008. The demand for our debt has improved since late November 2008, which allowed us to issue callable and longer-term debt in early 2009. However, there can be no assurance that this recent improvement will continue. For additional information on our funding activity, see Liquidity and Capital Management Liquidity Management Debt Funding. For a description of the Treasury agreements and terms, see Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements.

Our level of portfolio purchases decreased in 2007 from 2006, due in part to lower market volumes resulting from the reduction in mortgage origination activity and a more limited availability of mortgage assets that met our targeted return thresholds during the first half of 2007.

We experienced a decrease in the level of sales from our mortgage portfolio during 2008, due in part to the significant widening of spreads and less favorable market conditions for the sale of mortgage assets. Our mortgage portfolio sales increased in 2007 from 2006, primarily due to an increase in portfolio sales during the second half of 2007 to manage the size of our mortgage portfolio to comply with our regulatory mortgage portfolio cap and to enhance our capital position. The substantial decrease in the rate of mortgage liquidations during 2008 reflected the reduction in refinancing activity due to the continued deterioration in the housing market and tightening of credit standards in the primary mortgage market. Our mortgage liquidation rate also decreased in 2007 from 2006, largely due to a reduction in refinancings.

Table 20 shows the composition of our mortgage portfolio by product type and the carrying value, which reflects the net impact of our purchases, sales and liquidations, as of the end of each year of the five-year period ended December 31, 2008. Our net mortgage portfolio totaled $765.1 billion as of December 31, 2008, reflecting an increase of 6% from December 31, 2007.

Table 20: Mortgage Portfolio Composition[1]

	As of December 31,				
	2008	2007	2006	2005	2004
	(Dollars in millions)				
Mortgage loans:[2]					
Single-family:					
Government insured or guaranteed[3]	$ 43,799	$ 28,202	$ 20,106	$ 15,036	$ 10,112
Conventional:					
Long-term, fixed-rate	186,550	193,607	202,339	199,917	230,585
Intermediate-term, fixed-rate[4]	37,546	46,744	53,438	61,517	76,640
Adjustable-rate	44,157	43,278	46,820	38,331	38,350
Total conventional single-family	268,253	283,629	302,597	299,765	345,575
Total single-family	312,052	311,831	322,703	314,801	355,687
Multifamily:					
Government insured or guaranteed[3]	699	815	968	1,148	1,074
Conventional:					
Long-term, fixed-rate	5,636	5,615	5,098	3,619	3,133
Intermediate-term, fixed-rate[4]	90,837	73,609	50,847	45,961	39,009
Adjustable-rate	20,269	11,707	3,429	1,151	1,254
Total conventional multifamily	116,742	90,931	59,374	50,731	43,396
Total multifamily	117,441	91,746	60,342	51,879	44,470
Total mortgage loans	429,493	403,577	383,045	366,680	400,157
Unamortized premiums (discounts) and other cost basis adjustments, net	(894)	726	943	1,254	1,647
Lower of cost or fair value adjustments on loans held for sale	(264)	(81)	(93)	(89)	(83)
Allowance for loan losses for loans held for investment	(2,923)	(698)	(340)	(302)	(349)
Total mortgage loans, net	425,412	403,524	383,555	367,543	401,372

Mortgage-related securities:					
Fannie Mae single-class MBS	159,712	102,258	124,383	160,322	272,665
Fannie Mae structured MBS	69,238	77,905	75,261	74,129	71,739
Non-Fannie Mae single-class mortgage securities	26,976	28,129	27,980	27,162	35,656
Non-Fannie Mae structured mortgage securities[5]	88,467	96,373	97,399	86,129	109,455
Mortgage revenue bonds	15,447	16,315	16,924	18,802	22,076
Other mortgage-related securities	2,863	3,346	3,940	4,665	5,461
Total mortgage-related securities	362,703	324,326	345,887	371,209	517,052
Market value adjustments[6]	(15,996)	(3,249)	(1,261)	(789)	6,680
Other-than-temporary impairments	(7,349)	(603)	(1,004)	(553)	(432)
Unamortized premiums (discounts) and other cost basis adjustments, net[7]	296	(1,076)	(1,083)	(909)	173
Total mortgage-related securities, net	339,654	319,398	342,539	368,958	523,473
Mortgage portfolio, net[8]	$ 765,066	$ 722,922	$ 726,094	$ 736,501	$ 924,845

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(1) Mortgage loans and mortgage-related securities are reported at unpaid principal balance.

(2) Mortgage loans include unpaid principal balances totaling $65.8 billion, $81.8 billion, $105.5 billion, $113.3 billion and $152.7 billion as of December 31, 2008, 2007, 2006, 2005 and 2004 , respectively, related to mortgage-related securities that were consolidated under FASB Interpretation (FIN) No. 46R (revised December 2003), *Consolidation of Variable Interest Entities (an interpretation of ARB No. 51)* (FIN 46R), and mortgage-related securities created from securitization transactions that did not meet the sales criteria under SFAS No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125)* (SFAS 140), which effectively resulted in mortgage-related securities being accounted for as loans.

(3) Refers to mortgage loans that are guaranteed or insured by the U.S. government or its agencies, such as the Department of Veterans Affairs, Federal Housing Administration or the Rural Development Housing and Community Facilities Program of the Department of Agriculture.

(4) Intermediate-term, fixed-rate consists of mortgage loans with contractual maturities at purchase equal to or less than 15 years.

(5) Includes private-label mortgage-related securities backed by subprime or Alt-A mortgage loans totaling $52.4 billion as of December 31, 2008. Refer to Available-for-Sale and Trading Securities Investments in Alt-A and Subprime Mortgage-Related Securities for a description of our investments in subprime and Alt-A securities.

(6) Includes unrealized gains and losses on mortgage-related securities and securities commitments classified as trading and available for sale.

(7) Includes the impact of other-than-temporary impairments of cost basis adjustments.

(8) Includes consolidated mortgage-related assets acquired through the assumption of debt. Also includes $720 million and $538 million as of December 31, 2008 and 2007, respectively, of mortgage loans and mortgage-related securities that we have pledged as collateral and that counterparties have the right to sell or repledge.

Cash and Other Investments Portfolio

Our cash and other investments portfolio consists of cash and cash equivalents, federal funds sold and securities purchased under agreements to resell and non-mortgage investment securities. Our cash and other investments portfolio totaled $93.0 billion and $91.1 billion as of December 31, 2008 and December 31, 2007, respectively. Under our current liquidity policy, our initial source of liquidity in the event of a liquidity crisis that restricts our access to the unsecured debt market is the sale or maturation of assets in our cash and other investments portfolio. Because of the reduced liquidity of some of the assets in our cash and other investments portfolio, we significantly increased the cash and cash equivalents portion of this portfolio during the second half of 2008 to $17.9 billion as of December 31, 2008. In comparison, our cash and cash equivalents totaled $3.9 billion as of December 31, 2007. See Liquidity and Capital Management Liquidity Management Liquidity Contingency Plan Cash and Other Investments Portfolio for more information on our cash and other investments portfolio.

Trading and Available-for-Sale Investment Securities

Our mortgage investment securities are classified in our consolidated balance sheets as either trading or available for sale and reported at fair value. In conjunction with our January 1, 2008 adoption of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), we elected to reclassify all of our non-mortgage investment securities from available for sale to trading. Table 21 details the amortized cost, fair value, maturity and average yield of our investment securities classified as available for sale as of December 31, 2008.

Table 21: Amortized Cost, Fair Value, Maturity and Average Yield of Investments in Available-for-Sale Securities

	As of December 31, 2008									
			One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Yea	
	Total Amortized Cost[1]	Total Fair Value	Amortized Cost[1]	Fair Value	Amortized Cost[1]	Fair Value	Amortized Cost[1]	Fair Value	Amortized Cost[1]	F V
	(Dollars in millions)									
Mae ass MBS[2]	$ 112,943	$ 116,107	$ 3	$ 3	$ 705	$ 723	$ 19,783	$ 20,356	$ 92,452	$
Mae d MBS[2]	59,002	60,137			4	4	6,456	6,578	52,542	
nie Mae d e-related s[2]	63,008	49,406	202	134	395	332	16,591	12,243	45,820	
nie Mae ass e s[2]	25,798	26,436			121	123	945	976	24,732	
e revenue	14,636	12,488	20	20	314	312	825	809	13,477	
e-related s	2,319	1,914						26	2,319	
	$ 277,706	$ 266,488	$ 225	$ 157	$ 1,539	$ 1,494	$ 44,600	$ 40,988	$ 231,342	$ 2
	4.76%		3.38%		4.72%		3.47%		5.01%	

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

(2) Maturities are based on contractual maturities assuming no prepayments. The contractual maturity of mortgage-backed securities generally is not a reliable indicator of the expected life because borrowers typically have the right to repay these obligations at any time.

(3) Yields are determined by dividing interest income (including the amortization and accretion of premiums, discounts and other cost basis adjustments) by amortized cost balances as of year-end.

Table 22 shows the composition of our trading and available-for-sale securities at amortized cost and fair value as of December 31, 2008, which totaled $375.7 billion and $357.3 billion, respectively. We also disclose the gross unrealized gains and gross unrealized losses related to our available-for-sale securities as of December 31, 2008, and a stratification of these losses based on securities that have been in a continuous unrealized loss position for less than 12 months and for 12 months or longer.

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Table 22: Trading and Available-for-Sale Investment Securities

	As of December 31, 2008							
					Less Than 12 Consecutive Months		12 Consecutive Months or Longer	
	Amortized Cost[(1)]	Gross Unrealized Gains	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses	Total Fair Value
	(Dollars in millions)							
Trading:								
Fannie Mae single-class MBS	$ 46,309	$	$	$ 48,134	$	$	$	$
Fannie Mae structured MBS	10,011			9,872				
Non-Fannie Mae single-class mortgage-related securities	1,030			1,061				
Non-Fannie Mae structured mortgage-related securities	19,799			13,404				
Mortgage revenue bonds	796			695				
Asset-backed securities	11,959			10,598				
Corporate debt securities	7,092			6,037				
Other non-mortgage-related securities	1,005			1,005				
Total trading	$ 98,001	$	$	$ 90,806	$	$	$	$
Available for sale:								
Fannie Mae single-class MBS	$ 112,943	$ 3,231	$ (67)	$ 116,107	$ (64)	$ 4,842	$ (3)	$ 330
Fannie Mae structured MBS	59,002	1,333	(198)	60,137	(105)	2,471	(93)	2,514
Non-Fannie Mae single-class mortgage-related securities	25,798	665	(27)	26,436	(23)	1,775	(4)	643
Non-Fannie Mae structured mortgage-related	63,008	195	(13,797)	49,406	(3,792)	11,388	(10,005)	22,836

securities								
Mortgage revenue bonds	14,636	29	(2,177)	12,488	(854)	6,230	(1,323)	4,890
Other mortgage-related securities	2,319	29	(434)	1,914	(388)	1,313	(46)	77
Total available for sale	$ 277,706	$ 5,482	$ (16,700)	$ 266,488	$ (5,226)	$ 28,019	$ (11,474)	$ 31,290
Total investments in securities	$ 375,707	$ 5,482	$ (16,700)	$ 357,294	$ (5,226)	$ 28,019	$ (11,474)	$ 31,290

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

The estimated fair value of our available-for-sale securities decreased to $266.5 billion as of December 31, 2008 from $293.6 billion as of December 31, 2007. Gross unrealized losses related to these securities totaled $16.7 billion as of December 31, 2008, compared with $4.8 billion as of December 31, 2007. The increase in gross unrealized losses during 2008 was primarily due to significantly wider spreads during the period, which reduced the fair value of substantially all of our mortgage-related securities, particularly our private-label mortgage-related securities backed by Alt-A and subprime loans and CMBS. We discuss our process for assessing our available-for-sale investment securities for other-than-temporary impairment below.

Investments in Private-Label Mortgage-Related Securities

The non-Fannie Mae mortgage-related security categories presented in Table 22 above include agency mortgage-related securities issued or guaranteed by Freddie Mac or Ginnie Mae and private-label mortgage-related securities backed by Alt-A, subprime, multifamily, manufactured housing or other mortgage loans. We do not have any exposure to collateralized debt obligations, or CDOs. We classify private-label securities as Alt-A, subprime, multifamily or manufactured housing if the securities were labeled as such when issued. We also have invested in private-label Alt-A and subprime mortgage-related securities that we have resecuritized to include our guaranty (wraps), which we report in Table 22 above as a component of Fannie Mae structured MBS. We generally have focused our purchases of these securities on the highest-rated tranches available at the time of acquisition. Higher-rated tranches typically are supported by credit enhancements to

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reduce the exposure to losses. The credit enhancements on our private-label security investments generally are in the form of initial subordination provided by lower level tranches of these securities and prepayment proceeds within the trust. In addition, monoline financial guarantors have provided secondary guarantees that are based on specific performance triggers. The characteristics of the subprime securities that we hold are different than the securities underlying the ABX indices, which is a widely used performance-tracking index for the U.S. structured finance market. For example, the pass-through securities in our portfolio reflect the entirety of the underlying AAA cash flows, while only a portion of the underlying AAA cash flows backs the securities in the ABX indices.

The unpaid principal balance of private-label mortgage-related securities backed by Alt-A, subprime, multifamily, manufactured housing and other mortgage loans and mortgage revenue bonds held in our mortgage portfolio was $98.9 billion as of December 31, 2008, down from $111.1 billion as of December 31, 2007, reflecting a reduction of $12.2 billion primarily due to principal payments, as well as the sale of some of these securities. Table 23 summarizes, by loan type, the composition of our investments in private-label securities and mortgage revenue bonds as of December 31, 2008 and the average credit enhancement. The average credit enhancement generally reflects the level of cumulative losses that must be incurred before we experience a loss of principal on the tranche of securities that we own. Table 23 also provides information on the credit ratings of our private-label securities as of February 20, 2009. The credit rating reflects the lowest rating as reported by Standard & Poor s (Standard & Poor s), Moody s Investors Service (Moody s), Fitch Ratings (Fitch) or Dominion Bond Rating Service Limited (DBRS, Limited), each of which is a nationally recognized statistical rating organization.

Table 23: Investments in Private-Label Mortgage-Related Securities and Mortgage Revenue Bonds

	As of December 31, 2008		As of February 20, 2009			
	Unpaid Principal Balance	Average Credit Enhancement(1)	% AAA(2)	% AA to BBB-(2)	% Below Investment Grade(2)	Current % Watchlist(3)
	(Dollars in millions)					
Private-label mortgage-related securities backed by:						
Alt-A mortgage loans:						
Option ARM Alt-A mortgage loans	$ 6,711	53%	5%	25%	70%	%
Other Alt-A mortgage loans	21,147	14	42	16	42	1
Total Alt-A mortgage loans	27,858	23	33	18	49	1
Subprime mortgage loans	24,551	36	26	23	51	3
Multifamily mortgage loans (CMBS)	25,825	30	100			
Manufactured housing loans	2,840	36	3	33	64	1
Other mortgage loans	2,332	6	93	4	3	
Total private-label mortgage-related securities	83,406					
Mortgage revenue bonds(4)	15,447	35	39	59	2	17

Total	$ 98,853

(1) 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 a securitization structure before any losses are allocated to securities that we own. Percentage calculated based on the quotient of the total unpaid principal balance of all credit enhancement 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.

(2) Reflects credit ratings as of February 20, 2009, calculated based on unpaid principal balance as of December 31, 2008. Investment securities that have a credit rating below BBB- or its equivalent or that have not been rated are classified as below investment grade.

(3) Reflects percentage of investment securities, calculated based on unpaid principal balance as of December 31, 2008, that have been placed under review by either Standard & Poor s, Moody s, Fitch or DBRS, Limited.

(4) Reflects that 35% of the outstanding unpaid principal balance of our mortgage revenue bonds are guaranteed by third parties.

Investments in Alt-A and Subprime Private-Label Mortgage-Related Securities

As indicated in Table 23, the unpaid principal balance of our investments in private-label mortgage-related securities backed by Alt-A and subprime loans totaled $52.4 billion as of December 31, 2008. We recognized net fair value losses of $2.7 billion in 2008 on our investments in private-label Alt-A securities and subprime securities, including wraps, that were classified as trading during 2008 and that we continued to hold in our mortgage portfolio as of December 31, 2008. These amounts are included in our consolidated results of operations as a component of Fair value losses, net. The gross unrealized losses on our Alt-A and subprime private-label securities, including wraps, classified as available for sale were $8.8 billion as of December 31, 2008, compared with $3.3 billion as of December 31, 2007.

A substantial portion of our Alt-A and subprime private-label mortgage-related securities were downgraded during 2008. Approximately 33% of our Alt-A private-label mortgage-related securities were rated AAA as of February 20, 2009, and 18% were rated AA to BBB-. Approximately $205 million, or 1%, of our Alt-A private-label mortgage-related securities had been placed under review for possible credit downgrade or on negative watch as of February 20, 2009. In comparison, all of our Alt-A private-label securities were rated AAA as of December 31, 2007.

The percentages of our subprime private-label mortgage-related securities rated AAA and rated AA to BBB- were 26% and 23%, respectively, as of February 20, 2009, compared with 97% and 3%, respectively, as of December 31, 2007. The percentage of our subprime private-label mortgage-related securities rated below investment grade was 51% as of February 20, 2009. Approximately $656 million, or 3%, of our subprime private-label mortgage-related securities had been placed under review for possible credit downgrade or on negative watch as of February 20, 2009. None of these securities were rated below investment grade as of December 31, 2007.

Although our portfolio of Alt-A and subprime private-label mortgage-related securities primarily consists of senior level tranches, we believe we are likely to incur losses on some securities that are currently rated AAA as a result of the significant and continued deterioration in home prices and increasing delinquency, foreclosure and REO levels, particularly with regard to 2006 to 2007 loan vintages, which were originated in an environment of significant increases in home prices and relaxed underwriting and eligibility standards. These conditions, which have had an adverse effect on the performance of the loans underlying our Alt-A and subprime private-label securities, have contributed to a sharp rise in expected defaults and loss severities and slower voluntary prepayment rates, particularly for the 2006 and 2007 loan vintages. Table 24 presents a comparison, based on data provided by Intex Solutions, Inc. (Intex), where available, of the 60 days or more delinquency rates as of December 31, 2008, September 30, 2008 and June 30, 2008 for Alt-A and subprime loans backing private-label securities that we own or guarantee.

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Table 24: Delinquency Status of Loans Underlying Alt-A and Subprime Private-Label Securities

	³ 60 Days Delinquent[1]		
Loan Categories:	**December 31, 2008**	**September 30, 2008**	**June 30, 2008**
Option ARM Alt-A loans:			
2004 and prior	22.97%	18.88%	15.95%
2005	26.48	21.65	17.35
2006	32.84	27.97	21.44
2007	24.16	17.17	10.79
Other Alt-A loans:			
2004 and prior	4.75	3.87	3.36
2005	12.18	10.27	8.78
2006	19.70	16.99	15.40
2007	26.05	21.55	17.55
Subprime loans:			
2004 and prior	21.09	20.71	21.51
2005	39.86	38.58	36.51
2006	44.60	40.19	36.13
2007	35.37	29.62	23.87

(1) Delinquency data provided by Intex for Alt-A and subprime loans backing private-label securities that we own or guarantee. However, we have adjusted the Intex delinquency data for consistency purposes, where appropriate, to include in the delinquency rates all bankruptcies, foreclosures and real estate owned.

Other-than-temporary Impairment Assessment on Alt-A and Subprime Private-Label Securities

Our other-than-temporary impairment assessment as of December 31, 2008, which included an evaluation of the individual performance of the securities and the potential for continued adverse developments, indicated a continued increase in the level of uncertainty as to whether we would collect all principal and interest amounts due in accordance with the contractual terms. As a result, we determined that we did not have sufficient persuasive evidence to conclude that the impairment of certain available-for-sale securities was temporary. For these securities, we recognized other-than-temporary impairment totaling $4.6 billion in the fourth quarter of 2008, of which $3.4 billion related to Alt-A securities with an unpaid principal balance of $10.1 billion as of December 31, 2008, and $967 million related to subprime securities with an unpaid principal balance of $4.0 billion as of December 31, 2008. Table 25 presents the other-than-temporary impairment losses recorded on our investments in Alt-A and subprime private-label securities in 2008, including the fourth quarter of 2008, 2007 and the cumulative other-than-temporary impairment losses that we have recognized on these investments as of December 31, 2008.

Table 25: Other-than-temporary Impairment Losses on Alt-A and Subprime Private-Label Securities

	As of December 31,

	Q4 2008	For the Year Ended December 31, 2008	2007	2008 Cumulative
		(Dollars in millions)		
Other-than-temporary impairment on private-label mortgage-related securities backed by:				
Alt-A mortgage loans	$ 3,406	$ 4,820	$	$ 4,820
Subprime mortgage loans	967	1,932	160	2,092
Total	$ 4,373	$ 6,752	$ 160	$ 6,912

The current market pricing of Alt-A and subprime securities, which reflects a significant discount to cost, has been adversely affected by a significant reduction in the liquidity of these securities and market perceptions that defaults on the mortgages underlying these securities will increase significantly. As a result, the current fair value of some of these securities is substantially less than what we believe is indicated by the performance of the collateral underlying the securities and our calculation of the expected cash flows of the securities. Although we have recognized other-than-temporary impairment equal to the difference between the cost basis and the fair value of the security, we anticipate at this time, based on the expected cash flows of the securities, that we will recover some of these impairment amounts. For the Alt-A securities classified as available for sale for which we recognized other-than-temporary impairment during 2008, the average credit enhancement was not sufficient to cover projected expected credit losses. The average credit enhancement as of December 31, 2008 was approximately 16% and the expected average collateral loss was approximately 27%, resulting in projected expected credit losses of $2.6 billion. For the available-for-sale subprime securities for which we recognized other-than-temporary impairment during 2008, the average credit enhancement was approximately 26% and the expected average collateral loss was approximately 40%, resulting in projected expected credit losses of $1.2 billion. However, the other-than- temporary impairment we recorded on our Alt-A and subprime securities totaled $4.8 billion and $1.9 billion, respectively, for 2008. We will accrete into interest income the portion of the amounts we expect to recover that exceeds the cost basis of these securities over the remaining life of the securities. The amount accreted into earnings on our Alt-A and subprime securities for which we have recognized other-than-temporary impairment totaled $233 million in 2008.

We will continue to monitor and analyze the performance of these securities to assess the collectability of principal and interest as of each balance sheet date. If there is further deterioration in the housing and mortgage markets and the decline in home prices exceeds our current expectations, we may recognize significant other-than-temporary impairment amounts in the future. See Part I Item 1A Risk Factors for a discussion of the risks related to potential future write-downs of our investment securities.

Hypothetical Performance Scenarios

Tables 26, 27 and 28 present additional information as of December 31, 2008 for our investments in Alt-A and subprime private-label mortgage-related securities, reported based on half-year vintages for securities we hold that were issued during the years 2005 to 2008. The securities within each reported half-year vintage are stratified by credit enhancement quartile. The 2006 and 2007 vintages of loans underlying these securities have experienced significantly higher delinquency rates than other vintages. Accordingly, the year of issuance or origination of the collateral underlying these securities is a significant factor in projecting expected cash flow performance and evaluating the ongoing credit performance. The credit enhancement quartiles presented range from the lowest level of credit enhancement to the highest. A higher level of credit enhancement generally reduces the exposure to loss.

We have disclosed for information purposes the net present value of projected losses (NPV) of our securities under four hypothetical scenarios, which assume specific cumulative constant default and loss severity rates against the loans underlying our Alt-A and subprime private-label securities. The projected loss results under these scenarios are calculated based on the projected cash flows from each security and include the following additional key assumptions: (i) discount rate, (ii) expected constant prepayment rates (CPR) and (iii) average life of the securities. These scenarios assume a discount rate based on LIBOR and constant default and loss severity rates experienced over a six-year period. We assume CPRs of 15% for our Alt-A securities and 10% to 15% for our subprime securities, which vary in each scenario based on the loan age. A CPR of 15% indicates that for each period, 15% of the remaining unpaid principal balance of the loans underlying the security will be paid off.

Table 26: Investments in Alt-A Private-Label Mortgage-Related Securities, Excluding Wraps*

					As of December 31, 2008						
					Credit Enhancement Statistics						
	Unpaid Principal Balance										
Quartile(1)	**Trading Securities(2)**	**Available-for-Sale Securities(3)**	**Average Price**	**Fair Value**	**Average Current(4)**	**Original(4)**	**Minimum Current(4)**	**Monoline Financial Guaranteed Amount(5)**	**40d/60s NPV**	**Hypothetical Scenar 50d/50s NPV**	**70d/6 NPV**
					(Dollars in millions)						
lt-A											
-A securities:											
	$	$ 650	$ 46.56	$ 302	23%	10%	15%	$	$ 21	$ 27	$ 1
		101	45.59	46	20	7	20		2	3	
		155	43.19	67	23	12	23		3	5	
		131	42.50	56	27	16	24		2	4	
		151	43.29	65	43	33	34				
		538	43.50	234	29	18	20		7	12	1
		233	45.26	106	34	28	33		2	4	
		233	42.96	100	37	32	37		4	6	
		352	47.14	166	48	42	44			1	
		321	42.40	136	100	100	100	321			
		1,139	44.56	508	57	53	33	321	6	11	1
		131	20.62	27	21	19	10		26	30	
		402	44.91	181	40	38	39			4	
		363	41.28	150	44	43	44				
		411	28.04	115	88	88	48	317			
		1,307	36.16	473	54	53	10	317	26	34	1
		208	44.26	92	37	35	37				
		95	42.07	40	41	40	41				
		219	35.79	78	68	68	47	89			
		522	40.31	210	51	50	37	89			
	200		43.29	86	25	24	24		2	8	
	362		44.12	160	46	45	45				

	258		40.34	104	48	47	48				
	516		19.88	103	100	100	100	516			
	1,336		33.91	453	64	64	24	516	2	8	1
	290		42.54	123	33	32	25		4	9	
	213		45.33	97	47	47	47				
	303		48.47	147	48	47	48				
	413		20.72	86	100	100	100	413			
	1,219		37.10	453	62	62	25	413	4	9	1
M Alt-A	$ 2,555	$ 4,156	$ 39.23	$ 2,633	53%	50%	10%	$ 1.656	$ 66	$ 101	$ 9
s with 7 losses:(9)											
									$ 308	$ 308	$ 7
									740	740	1,6
									$ (432)	$ (432)	$ (9
e securities NPV											
									$ 831	$ 901	$ 1,4
									1,913	2,062	3,4
									$ (1,082)	$ (1,161)	$ (1,9

	Unpaid Principal Balance				As of December 31, 2008 Credit Enhancement Statistics						
								Monoline Financial		Hypothetical Scenarios[6]	
e[1]	Trading Securities[2]	Available-for-Sale Securities[3]	Average Price	Fair Value	Average Current[4]	Original[4]	Minimum Current[4]	Guaranteed Amount[5]	40d/40s NPV	50d/50s NPV	50d/60s NPV
					(Dollars in millions)						
in ties:[7]											
or	$	$ 8,633	$ 73.73	$ 6,366	12%	6%	5%	$ 25	$ 501	$ 1,261	$ 1,702
		362	67.28	244	9	5	6		24	58	77
		441	69.40	306	13	7	12		15	62	88
		372	72.83	271	15	11	14		14	47	66
		435	66.13	287	18	12	15		11	46	67
tal		1,610	68.83	1,108	14	9	6		64	213	298
		955	72.26	690	6	5	4		96	183	231
		999	67.91	678	10	8	8		69	162	214
		1,002	58.78	589	16	14	14		27	106	156
		1,005	64.36	647	20	17	18		16	74	118
tal		3,961	65.75	2,604	13	11	4		208	525	719
	33	1,069	67.78	747	5	4	5		117	216	271
		1,062	61.41	652	9	8	9		61	161	218
		1,312	65.27	856	14	12	11		57	228	322
	48	1,170	51.19	624	19	17	17		8	52	102
tal	81	4,613	61.33	2,879	12	11	5		243	657	913
		487	47.11	229	10	10	7		10	54	77
		269	51.23	138	16	16	16			20	33
		323	48.68	158	16	16	16			14	26
tal		1,079	48.61	525	13	13	7		10	88	136
	129		48.39	62	6	6	6			14	21
	106		46.79	50	7	7	7			12	18
	75		54.93	41	7	7	7		7	14	18
	274		49.28	135	16	16	15			15	28

otal	584		49.36	288	11	11	6		7	55	85
	420		55.47	233	100	100	100	420			
otal	420		55.47	233	100	100	100	420			
		166	70.27	116	21	20	21				
otal[9]		166	70.27	116	21	20	21				
Alt-A	$ 1,085	$ 20,062	$ 66.77	$ 14,119	14%	11%	4%	$ 445	$ 1,033	$ 2,799	$ 3,853
rities etical [10]											
									$ 151	$ 338	$ 338
									280	665	665
									$ (129)	$ (327)	$ (327)
r-sale th NPV											
									$ 11,173	$ 13,116	$ 13,247
									16,088	19,401	19,593
									$ (4,915)	$ (6,285)	$ (6,346)

(1) The footnotes to this table are presented following Table 27.

Table 27: Investments in Subprime Private-Label Mortgage-Related Securities, Excluding Wraps

	As of December 31, 2008											
	Unpaid Principal Balance				Credit Enhancement Statistics				Hypothetical Scenarios(6)			
tage and Quartile[1]	Trading Securities[2]	Available-for-Sale Securities[3]	Average Price	Fair Value	Average Current[4]	Original[4]	Minimum Current[4]	Monoline Financial Guaranteed Amount[5]	60d/70s NPV	70d/60s NPV	70d/70s NPV	80d/7 NP
	(Dollars in millions)											
stments in rime rities:(8)												
4 and prior	$	$ 2,938	$ 79,63	$ 2,340	72%	53%	13%	$ 1,295	$ 49	$ 60	$ 116	$ 2
5-1[1]												
5-1[2]		21	88.39	19	73	36	73					
5-1[3]												
5-1[4]		31	81.09	25	83	29	83					
5-1 subtotal		52	84.11	44	79	32	73					
5-2[1]		77	85.01	65	41	23	38					
5-2[2]		32	85.58	28	56	38	56					
5-2[3]		98	85.39	84	61	30	61					
5-2[4]		118	83.25	98	88	75	70	69				
5-2 subtotal		325	84.54	275	65	45	38	69				
6-1[1]		1,195	61.59	736	23	19	20		94	133	240	3
6-1[2]		1,617	67.38	1,089	29	22	26		30	75	225	4
6-1[3]		1,519	69.18	1,051	35	24	32		3	9	64	2
6-1[4]		1,473	73.43	1,082	49	31	40	52			11	1
6-1 subtotal		5,804	68.19	3,958	34	24	20	52	127	217	540	1,2
6-2[1]		2,560	61.98	1,586	21	19	14		236	337	591	9
6-2[2]		2,512	66.56	1,672	25	21	24		123	210	452	8
6-2[3]		2,748	69.47	1,909	28	21	27		67	137	400	8
6-2[4]		2,887	66.92	1,932	36	28	31		3	23	207	6
6-2 subtotal		10,707	66.31	7,099	28	22	14		429	707	1,650	3,1
7-1[1]	586		31.70	186								