FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-Q
May 08, 2009

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

Form 10-Q

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

For the quarterly period ended March 31, 2009

OR

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

For the transition period from to

Commission File No.: 0-50231

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

Fannie Mae

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

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

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

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

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 (Do not check if a smaller reporting company) Smaller reporting company o

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

As of March 31, 2009, there were 1,107,781,938 shares of common stock of the registrant outstanding.

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PART I FINANCIAL INFORMATION

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

We have been under conservatorship, with the Federal Housing Finance Agency (FHFA) acting as conservator, since September 6, 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of the company, and of any shareholder, officer or director of the company with respect to the company and its assets. The conservator has since delegated specified authorities to our Board of Directors and has delegated to management the authority to conduct our day-to-day operations. We describe the rights and powers of the conservator, the provisions of our agreements with the U.S. Department of Treasury (Treasury), and changes to our business, liquidity, corporate structure, business strategies and objectives since conservatorship in our Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K) in Part I Item 1 Business.

You also should read this Management s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, in conjunction with our unaudited condensed consolidated financial statements and related notes, and the more detailed information contained in our 2008 Form 10-K. This discussion contains forward-looking statements that are based upon management s current expectations and are subject to significant uncertainties and changes in circumstances. Our actual results may differ materially from those included in these forward-looking statements due to a variety of factors including, but not limited to, those described in this report in Part II Item 1A Risk Factors and in our 2008 Form 10-K in Part I Item 1A Risk Factors. Please also refer to our 2008 Form 10-K in Part I Item 7 MD&A Glossary of Terms Used in This Report for an explanation of terms we use in this report.

INTRODUCTION

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 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. In addition, we 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. 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.

EXECUTIVE SUMMARY

Housing and Economic Conditions

Mortgage and Housing Market and Economic Conditions

The U.S. residential mortgage market continued to experience significant deterioration in the first quarter of 2009, which adversely affected our financial condition and results.

Virtually all fundamental measures of the housing market s health worsened in the first quarter of 2009 compared with the fourth quarter of 2008. The market experienced declines in new and existing home sales, housing starts and home prices, as well as increases in mortgage delinquencies.

The recession that began in December 2007 continued to deepen in the first quarter. The U.S. gross domestic product, or GDP, for the fourth quarter of 2008 was revised downward to (6.3)% on an annualized basis, and declined further, although at a slower pace, by (6.1)% in the first quarter of 2009. The U.S. has lost a net total of over 5.1 million jobs since the start of the recession, and in the first quarter of 2009, the total number of Americans receiving unemployment benefits increased to the highest levels on record dating back to 1967. The U.S. Bureau of Labor Statistics reported successive increases in the unemployment rate in each month of the first quarter, reaching 8.5% in March. Unemployment rates in Florida, California, Arizona and Nevada rose to 9.7%, 11.2%, 7.8% and 10.4%, respectively, in March 2009.

High levels of unemployment, coupled with severe declines in home equity and household wealth, have contributed to a continued increase in residential mortgage delinquencies.

The actual number of unsold homes in inventory has begun to decline in recent months, but the supply of homes as measured by the inventory/sales ratio remains high since the pace of sales has slowed in recent months in response to rising unemployment. Although affordability measures have risen dramatically since home prices peaked and subsequently began falling, the limited availability of credit for many potential homebuyers and low consumer confidence have dampened purchase activity even at the decreasing price levels. Surveys of bank loan officers by the Federal Reserve showed lenders were still tightening credit standards in the first quarter.

While first quarter housing market indicators were worse than the fourth quarter, there were some tentative signs of improvement. On a seasonally adjusted basis, single-family housing starts, new home sales, and existing home sales were all higher in March than in January, though down from February.

Long-term mortgage rates declined to near-record lows in March, resulting in a wave of mortgage refinancing that drove an increase in mortgage originations overall from approximately $363 billion in the fourth quarter of 2008 to approximately $511 billion in the first quarter of 2009. Approximately 73% of first quarter 2009 mortgage originations were refinancings, compared with 63% in the first quarter of 2008.

Multifamily housing fundamentals are under increasing stress that reflects broader unfavorable economic conditions, including higher unemployment and severely restricted capital. These conditions are negatively affecting multifamily property level cash flows, vacancy rates and rent levels. Property values are declining due to both the downward pressure on cash flows and the higher premium required by investors.

As of December 31, 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 $11.9 trillion, including $11.0 trillion of single-family mortgages. Total U.S. residential mortgage debt outstanding decreased by 0.3% in 2008, compared with an increase of 7.0% in 2007 and 10.9% in 2006. 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 December 31, 2008, or approximately 26% of total U.S. residential mortgage debt outstanding. See Part I Item 1A Risk Factors of our 2008 Form 10-K for a description of the risks associated with the housing market downturn and continued home price declines.

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U.S. Government Actions to Stabilize the Markets and Support Economic Recovery

The U.S. government has taken a number of actions intended to strengthen market stability, improve the strength of financial institutions, enhance market liquidity, and provide support to homeowners, including the following actions, which were taken in 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 help reestablish confidence in the housing markets and to support a broader economic recovery. 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 mortgage loan modification program 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. On March 4, 2009, the Obama Administration announced new Treasury guidelines to enable servicers to begin modifications of eligible mortgages under the HASP. The refinancing and modification components of this program, the Making Home Affordable Program, are described in more detail below.

On March 18, 2009, the Federal Reserve announced it would expand a program it first announced in November 2008 to purchase direct obligations of Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks (FHLBs), and to purchase mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac and the Government National Mortgage Association (Ginnie Mae). The expansion increased the amounts to be purchased in 2009 from up to $100 billion to up to $200 billion in direct obligations, and from up to $500 billion to up to $1.25 trillion in mortgage-backed securities. The Federal Reserve also announced that, to help improve conditions in private credit markets, it would purchase up to $300 billion of longer-term Treasury securities over the next six months. The Federal Reserve began purchasing our debt and MBS under this program in January 2009.

Our Business Objectives and Strategy

Our Board of Directors and management consult with FHFA, as our conservator, in establishing our strategic direction, and FHFA has approved our 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 the mortgage market and to the struggling housing market;

limiting the amount of the investment Treasury must make under our senior preferred stock purchase agreement with Treasury 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 some or all of these objectives. For example, limiting the amount of funds Treasury must invest in us under 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 targeted at providing liquidity, stability and affordability to the mortgage market. Conversely, to the extent we expand our efforts to assist the mortgage market, our financial results are likely to suffer, at least in the short term, which will increase the amount of funds that Treasury is required to provide to us and further limit our ability to return to long-term profitability. We regularly consult with and receive direction from our conservator on how to balance our objectives.

Accordingly, we currently are primarily focusing on the first two objectives listed above:

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

We are concentrating our efforts on keeping people in their homes and preventing foreclosures. We also are continuing to be active in the secondary mortgage market through our guaranty business. The essence of this strategy is to support liquidity and affordability in the mortgage market, while 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 the government s Making Home Affordable Program, which we describe in more detail below. Focusing on these objectives, rather than on returning to long-term profitability, is likely to contribute to further deterioration in both our results of operations and our net worth. Continuing deterioration in the housing and mortgage markets, along with the continuing deterioration in our guaranty book of business and the costs associated with the objectives on which we are focused, will increase the amount of funds that Treasury is required to provide to us. In turn, these factors put additional pressure on our ability to return to long-term profitability. If, however, the Making Home Affordable Program is successful in reducing foreclosures and keeping borrowers in their homes, it may benefit the overall housing market and help in reducing our long-term credit losses. We therefore consult regularly with our conservator on how to balance these two objectives against the competing objectives we face.

Summary of Our Financial Results for the First Quarter of 2009

Our financial results for the first quarter of 2009 were adversely affected by ongoing deterioration in the housing, mortgage, financial and credit markets.

We recorded a net loss of $23.2 billion and a diluted loss per share of $4.09 for the first quarter of 2009. In comparison, we recorded a net loss of $25.2 billion and a diluted loss per share of $4.47 for the fourth quarter of 2008, and a net loss of $2.2 billion and a diluted loss per share of $2.57 for the first quarter of 2008. Our results for the first quarter of 2009 were driven primarily by credit-related expenses of $20.9 billion, other-than-temporary impairment related to available-for-sale securities of $5.7 billion and fair value losses of $1.5 billion.

The $2.1 billion decrease in our net loss for the first quarter of 2009 from the fourth quarter of 2008 was driven principally by a $10.9 billion reduction in net fair value losses, which was partially offset by an $8.9 billion increase in credit-related expenses. The $21.0 billion increase in our net loss for the first quarter of 2009 compared to the loss we incurred in the first quarter of 2008 was driven principally by the significant increase in credit-related expenses.

Our credit-related expenses included a provision for credit losses of $20.3 billion, compared with a provision for credit losses of $11.0 billion in the fourth quarter of 2008. Our combined loss reserves, which reflect our best estimate of credit losses incurred in our guaranty book of business as of each balance sheet date, increased to $41.7 billion as of March 31, 2009, or 28.78% of our nonperforming loans, from $24.8 billion as of December 31, 2008, or 20.76% of our nonperforming loans. The substantial increase in our loss reserves primarily reflected further deterioration in the credit quality of both our single-family and multifamily guaranty book of business, evidenced by a significant increase in our nonperforming loans (loans for which we believe collectability of interest or principal is not reasonably assured) and seriously delinquent loans (single-family loans three months or more past due or in the foreclosure process or multifamily loans 60 days or more past due), as market conditions such as the severe economic downturn and rising unemployment continued to adversely affect the performance of our guaranty book of business. In addition, our average loss severities increased as a result of the continued decline in home prices during the first quarter of 2009. Because of the existing stress in the housing and credit markets, and the speed and extent to which these markets have deteriorated, our process for determining the adequacy of our loss reserves has become more complex and involves a greater degree of management judgment. The current state of the housing and mortgage markets is unprecedented in many respects, greatly reducing the usefulness of relying on our historical loan performance data in estimating our loss reserves. To address the limitations in these historical data, we made refinements to

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our loss estimation process during the first quarter of 2009. We provide additional information on our loss reserves, including refinements we made to our loss reserve process in response to the rapidly changing and unprecedented conditions in the housing and mortgage markets, in Critical Accounting Policies and Estimates Allowance for Loan Losses and Reserve for Guaranty Losses and in Consolidated Results of Operations Credit Related Expenses.

The other-than-temporary impairment on available-for-sale securities of $5.7 billion that we recognized in the first quarter of 2009 related to additional impairment losses on some of our Alt-A and subprime private-label securities that we had previously impaired, as well as impairment losses on other Alt-A and subprime securities, attributable to a continued deterioration in the credit quality of the loans underlying these securities and further declines in the expected cash flows.

Our mortgage credit book of business remained relatively unchanged at $3.1 trillion as of March 31, 2009, roughly the same level as at December 31, 2008, as high levels of refinancing activity led to high volumes of acquisitions and liquidations. Our estimated market share of new single-family mortgage-related securities issuances was 44.2% for the first quarter of 2009, compared with 41.7% for the fourth quarter of 2008.

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

Homeowner Assistance and Foreclosure Prevention Initiatives

On March 4, 2009, the Obama Administration announced the details of its Making Home Affordable Program. The program includes a Home Affordable Refinance Program, which provides for the refinance of mortgage loans owned or guaranteed by us or Freddie Mac, and the Home Affordable Modification Program, which provides for the modification of mortgage loans owned or guaranteed by us or Freddie Mac, as well as other mortgage loans. On April 28, 2009, the Obama Administration announced the Second Lien Program, which provides participating servicers with alternatives for addressing second-lien loans when the servicers are modifying the associated first-lien mortgage loan under the Home Affordable Modification Program.

On March 4, 2009, we announced our participation in the Home Affordable Refinance and Home Affordable Modification Programs and released guidelines for Fannie Mae sellers and servicers in offering these two programs for Fannie Mae borrowers. These two programs are designed to significantly expand the number of borrowers who can refinance or modify their mortgages to achieve a monthly payment that is more affordable now and into the future. We also are serving as program administrator under the Home Affordable Modification Program and the Second Lien Program for loans we do not own or guarantee.

Key aspects of the Making Home Affordable Program are as follows.

Home Affordable Refinance Program

The Home Affordable Refinance Program is targeted at borrowers who have demonstrated an acceptable payment history on their mortgage loans but have been unable to refinance due to a decline in home prices or the unavailability of mortgage insurance. Loans under this program are available only if the new mortgage loan either reduces the monthly principal and interest payment for the borrower or provides a more stable loan product (such as movement from an adjustable-rate mortgage to a fixed-rate mortgage loan). Other eligibility requirements that must be met under this program include the following.

We must own or guarantee the mortgage loan being refinanced.

The unpaid principal balance on the mortgage loan may not exceed 105% of the current value of the property covered by the mortgage. In other words, the maximum loan-to-value, or LTV, ratio is 105%.

Mortgage insurance for the new mortgage loan is only required if the existing loan has an original LTV ratio greater than 80% and mortgage insurance is currently in force on the existing loan. In that case, mortgage insurance is required only up to the coverage level on the existing loan, which may be less than our standard coverage requirements. FHFA has provided guidance that permits us to implement this feature of the program in compliance with our charter requirements through June 2010.

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Reverse mortgage loans, second lien mortgage loans and government mortgage loans (such as loans guaranteed or insured by the Federal Housing Administration, or FHA, the Department of Veterans Affairs or the Rural Development Housing and Community Facilities Program of the Department of Agriculture) do not qualify for refinancing under this program.

The new mortgage loan cannot:

- be an adjustable rate mortgage loan, or ARM, if the initial period for which the interest rate is fixed is less than five years;
- have an interest-only feature that permits the payment of interest without a payment of principal;
- be a balloon mortgage loan; or
- have the potential for negative amortization.

We made the program available for newly refinanced mortgage loans delivered to us on or after April 1, 2009. The program replaced the streamlined refinance options we previously offered. If interest rates remain near record lows, we expect that the Home Affordable Refinance Program will bolster refinance volumes over time as major lenders adopt necessary system changes and consumer awareness continues to build.

Home Affordable Modification Program

The Home Affordable Modification Program is aimed at helping borrowers whose loan either is currently delinquent or is at imminent risk of default by modifying their mortgage loan to make their monthly payments more affordable. The program is designed to provide a uniform, consistent regime for servicers to use in modifying mortgage loans to prevent foreclosures, including loans owned or guaranteed by Fannie Mae and other qualifying mortgage loans. We expect borrowers at risk of foreclosure who are not eligible for a loan refinance under the Home Affordable Refinance Program to be evaluated for eligibility under the Home Affordable Modification Program before any other workout alternative is considered. Borrowers ineligible for the Home Affordable Modification Program may be considered under other workout alternatives we provide, such as HomeSaver Advance[tm] and our recently introduced HomeSaver Forbearance initiative. For modifications under the Home Affordable Modification Program of qualifying mortgage loans that are not owned or guaranteed by Fannie Mae, we serve as the program administrator for Treasury, as described further below.

The key elements of the Home Affordable Modification Program include the following.

Status of Mortgage Loan. The mortgage loan must be delinquent (and may be in foreclosure) or default must be imminent. All borrowers must attest to a financial hardship. Examples include: a reduction or loss of income; a change in household circumstances; an increase in the existing mortgage payment or other expenses; a lack of sufficient cash reserves; or excessive monthly debt obligations, with an overextension of obligations to creditors.

Reduction of Mortgage Payments. Under the Home Affordable Modification Program, the goal is to modify a borrower s mortgage loan to target the borrower s monthly mortgage payment, after adding accrued interest and third-party escrow and other advances to the principal balance, at 31% of the borrower s gross monthly income.

Modifications Permitted. Servicers must apply the permitted modification terms available in the order listed below until the borrower s new monthly mortgage payment achieves the target payment ratio of 31%:

- º *Reduction of Interest Rate.* Reduce the interest rate to as low as 2% for the first five years following modification, increasing by 1% per year thereafter generally until it reaches the market rate at the time of modification.

- º *Extension of Loan Term.* Extend the loan term to up to 40 years.

- *Deferral of Principal.* Defer payment of a portion of the principal of the loan until (1) the borrower sells the property, (2) the end of the loan term, or (3) the borrower pays off the loan, whichever occurs first.

Limits on Risk Features in Modified Mortgage Loans.

- *ARMs and Interest-Only Loans.* If a borrower has an adjustable-rate or interest-only loan, the loan will convert to a fixed interest rate, fully amortizing loan.

- *Prohibition on Negative Amortization.* Negative amortization is prohibited following the effective date of the modification.

Trial Period Required before Modification. Borrowers must satisfy the terms of a trial modification plan for a trial payment period of three months (for a delinquent loan) or four months (for a loan for which default is imminent). The modification will become effective upon satisfactory completion of the trial period.

Counseling. Borrowers with a total monthly debt-to-income ratio equal to or greater than 55% following modification must agree to work with a HUD-approved housing counselor on a plan to reduce the ratio below 55%.

Pre-Foreclosure Eligibility Evaluation. Servicers have been directed not to refer a loan for foreclosure or proceed with a foreclosure sale until the borrower has been evaluated for a modification under the program and, if eligible, has been extended an offer to participate in the program.

Incentive Payments to Servicers. For each of our loans for which a modification is completed under the Home Affordable Modification Program, we will pay the servicer:

- a $1,000 incentive payment for each completed modification;

- an additional $500 incentive payment for any modified loan that was current when it entered the trial period (*i.e.,* a loan for which default was imminent); and

- an annual pay for success fee of up to $1,000 for any modification that reduces a borrower s monthly payment by 6% or more, payable for each of the first three years after the modification as long as the borrower is continuing to make the payments due under the modified loan.

Incentives to Borrowers. For a completed modification under the Home Affordable Modification Program that reduces the borrower s monthly payment by 6% or more, we will provide the borrower an annual reduction in the outstanding principal balance of the modified loan of up to $1,000 for each of the first five years after the modification as long as the borrower is continuing to make the payments due under the modified loan.

Costs of Modifications. We bear all of the costs of modifying our loans under the Home Affordable Modification Program, including any additional amounts we are required to provide under our guarantees for loans owned by one of our MBS trusts during a trial payment period or any other mortgage-backed securities for which we have provided a guaranty.

The Home Affordable Modification Program expires on December 31, 2012.

Our Role as Program Administrator of the Home Affordable Modification Program and Second Lien Program

Treasury has engaged us to serve as program administrator for loans modified under the Home Affordable Modification Program that are not owned or guaranteed by us. In April 2009, we released guidance to servicers for adoption and implementation of the Home Affordable Modification Program for mortgage loans that are not owned or guaranteed by us or Freddie Mac. Freddie Mac maintains guidelines for modification under the program of loans it owns or guarantees. Freddie Mac bears the costs of loan modifications under the Home Affordable Modification Program for all loans owned or guaranteed by Freddie Mac, and Treasury bears the costs for loans other than Fannie Mae s or Freddie Mac s modified under the program. Treasury also generally will compensate investors (other than Fannie Mae or Freddie Mac) for 50% of the amount by which

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a payment is reduced due to the modification, subject to certain limits, and will pay an up-front incentive fee of $1,500 to such investors if the borrower was current on the loan before the trial period and the borrower s monthly mortgage payment was reduced by 6% or more.

Our principal activities as program administrator include the following:

Implementing the guidelines and policies within which the program will operate;

Preparing the requisite forms, tools and training to facilitate efficient loan modifications by servicers;

Creating and making available a process for servicers to report modification activity and program performance;

Acting as paying agent to calculate and remit subsidies and compensation consistent with program guidelines;

Acting as record-keeper for executed loan modifications and program administration;

Coordinating with Treasury and other parties toward achievement of the program s goals; and

Performing other tasks as directed by Treasury from time to time.

Treasury also has engaged us to serve as program administrator of the Second Lien Program for loans that are not owned or guaranteed by us. Our principal activities as program administrator for the Second Lien Program are similar to those described above for the Home Affordable Modification Program.

Expected Impact of the Making Home Affordable Program

The actions we are taking and the initiatives we have introduced to assist homeowners and limit foreclosures, including those described above, are significantly different from our historical approach to delinquencies, defaults and problem loans. 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. Some of the initiatives we undertook prior to the Making Home Affordable Program have not achieved the results we expected. We will continue to work with our conservator as we move forward under the Making Home Affordable Program to help us best fulfill our objective of helping homeowners and the mortgage market. As we gain more experience under these programs, we may supplement them with other initiatives to help us assist more homeowners. We have included data relating to our borrower loss mitigation activities for the first quarter and prior periods in Risk Management Credit Risk Management Mortgage Credit Risk Management. Given the timing of implementation of the Making Home Affordable Program, these data do not include activities under the program.

The nature of the Making Home Affordable Program is unprecedented. As a result, it is difficult for us to predict the full extent of our activities under the program and how those will affect us, the response rates we will experience, or the costs that we will incur. We do expect modifications of loans to increase in 2009 as a result of the Home Affordable Modification Program, however, we cannot predict the degree of increase in part due to the complexity involved in the process from the time we identify a potential loan for modification to actually modifying the loan. The steps in the process, which are generally performed by servicers, include:

Identifying loans within our portfolio and Fannie Mae MBS that are candidates for modification;

Making contact with the borrower;

Obtaining current financial information from the borrower;

Evaluating whether Home Affordable Modification Program is a viable workout option;

Structuring the terms of the modification;

Communicating the terms to the borrower together with the legal documentation; and

Receiving agreement of the borrower to the terms of the modification.

We are working with servicers to effectively implement the program and reach borrowers who are eligible for a modification under the program. However, the need to complete the steps detailed above, including having multiple servicer contacts with the borrower, creates significant uncertainty in our ability to estimate the number of modifications we will accomplish. It is also uncertain whether the borrower and servicer incentives under the Home Affordable Modification Program will provide sufficient motivation for modifications.

We expect modifications under the Home Affordable Modification Program of loans we own or guarantee in particular to adversely affect our financial results and condition for several reasons, including:

- Fair value loss charge-offs under Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer (* SOP 03-3), against the Reserve for guaranty losses at the time we acquire loans, which we must do prior to any modification of a loan held in a Fannie Mae MBS trust;

- Incentive and pay for success fees paid to our servicers for modification of loans we own or guarantee;

- Principal balance reductions on loans if certain borrowers perform on the loans following modification; and

- The effect of holding these modified loans in our mortgage portfolio, as the loans will provide a below market yield that may be lower than our cost of funds.

We also expect to incur additional operational expenses associated with the Making Home Affordable Program. Accordingly, the Making Home Affordable Program will likely have a material adverse effect on our business, results of operations and financial condition, including our net worth. If the program is successful in reducing foreclosures and keeping borrowers in their homes, however, it may benefit the overall housing market and help in reducing our long-term credit losses.

Providing Mortgage Market Liquidity and Other Market Support

Ongoing provision of liquidity to the mortgage markets. During the first quarter of 2009, we purchased or guaranteed an estimated $175.4 billion in new business, measured by unpaid principal balance. These purchases and guarantees consisted primarily of single-family mortgage loans, providing financing for approximately 730,000 conventional single-family loans. Our purchase or guarantee of approximately $3.8 billion of new and existing multifamily loans during the first quarter of 2009 helped to finance approximately 87,000 multifamily units. The $175.4 billion in new business for the quarter consisted of $125.4 billion in Fannie Mae MBS that were acquired by third parties, and $50.0 billion in mortgage loans and mortgage-related securities we purchased for our mortgage investment portfolio. Our estimated market share of new single-family mortgage-related securities issuances was 44.2% for the first quarter of 2009, compared with 41.7% for the fourth quarter of 2008, making us the largest single provider of mortgage-related securities in the secondary market.

Suspension of foreclosures. We maintained a suspension of foreclosures from November 26, 2008 through January 31, 2009, and from February 17, 2009 through March 6, 2009. We extended the suspension to allow us time to implement the Making Home Affordable Program.

Adoption of National Real Estate Owned Rental Policy. In January 2009, we adopted our National Real Estate Owned Rental Policy, which is designed to allow qualified renters in Fannie Mae-owned foreclosed properties to stay in their homes. Under the policy, eligible renters are offered a new month-to-month lease with Fannie Mae or financial assistance for their transition to new housing should they choose to vacate the property.

Enhancing multifamily Fannie Mae MBS. Our HCD business is proactively working with our DUS lenders and other parties to expand our Fannie Mae multifamily MBS product suite to increase third-party investor interest and provide liquidity and stability in the multifamily market. Third-party multifamily Fannie Mae MBS execution was 32% of total multifamily commitment volume during the first quarter of 2009, compared with 2% of total multifamily commitment volume during the first quarter of 2008.

Increased flexibility to allow more loans to one borrower. In February 2009, we modified our policies to allow investor and second home borrowers to own up to ten financed properties if they meet certain eligibility, underwriting and delivery requirements. We previously limited the number of properties to five.

HomeSaver Forbearance. On March 4, 2009, we introduced HomeSaver Forbearance, which is a new loss mitigation option available for borrowers whose loan either is delinquent or is at imminent risk of default and who do not qualify for a modification under the Home Affordable Modification Program. We have directed servicers to offer forbearance if an eligible borrower has a willingness and ability to make reduced monthly payments of at least one-half of their contractual monthly payment amount. The forbearance period lasts for six months, during which time the servicer works with the borrower to identify a more permanent foreclosure prevention alternative. We have instructed servicers to identify such an alternative during the first three months of the forbearance period and implement the alternative by the end of the six-month period.

Increase in conforming loan limit for 2009. In March 2009, we announced our requirements for the acquisition of high-balance mortgage loans during 2009 under temporary authority granted under the 2009 Stimulus Act. This authority set the conforming loan limit for a one-family residence in high cost areas at a maximum of $729,750 for 2009.

New multifamily trust documents. In January 2009, we introduced new master trust agreements for multifamily Fannie Mae MBS. The new agreements, which include an amendment and restatement of a prior master trust agreement, are designed to increase flexibility in managing delinquent loans backing multifamily Fannie Mae MBS issued on or after February 1, 2009, without requiring a repurchase of the affected loans or a change to an investor s cash flows.

Credit Overview

We continued to experience a deterioration in the credit performance of mortgage loans in our guaranty book of business during the first quarter of 2009, reflecting the ongoing impact of the adverse conditions in the housing market, as well as the deepening economic recession and rising unemployment. We expect these conditions to continue to adversely affect our credit results in 2009. Table 1 below presents information about the credit performance of mortgage loans in our single-family guaranty book of business for the year ended December 31, 2008 and for each subsequent quarter, illustrating the worsening trend in performance throughout 2008 and continuing in the first quarter of 2009.

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

	2009	2008					2007
	Q1	Full Year	Q4	Q3	Q2	Q1	Full Year
	(Dollars in millions)						
As of the end of each period:							
Serious delinquency rate[2]	3.15%	2.42%	2.42%	1.72%	1.36%	1.15%	0.98%
On-balance sheet nonperforming	$ 23,145	$ 20,484	$ 20,484	$ 14,148	$ 11,275	$ 10,947	$ 10,067

loans[3]							
Off-balance sheet nonperforming loans[4]	$ 121,378	$ 98,428	$ 98,428	$ 49,318	$ 34,765	$ 23,983	$ 17,041
Combined loss reserves[5]	$ 41,082	$ 24,649	$ 24,649	$ 15,528	$ 8,866	$ 5,140	$ 3,318
Foreclosed property inventory (number of properties)[6]	62,371	63,538	63,538	67,519	54,173	43,167	33,729
During the period:							
Loan modifications (number of loans)[7]	12,418	33,249	6,276	5,262	10,190	11,521	26,421
HomeSaver Advance problem loan workouts (number of loans)[8]	20,424	70,943	25,783	27,267	16,742	1,151	
Foreclosed property acquisitions (number of properties)[9]	25,374	94,652	20,998	29,583	23,963	20,108	49,121
Single-family credit-related expenses[10]	$ 20,330	$ 29,725	$ 11,917	$ 9,215	$ 5,339	$ 3,254	$ 5,003
Single-family credit losses[11]	$ 2,465	$ 6,467	$ 2,197	$ 2,164	$ 1,249	$ 857	$ 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, 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 conventional single-family loans that are three or more consecutive months past due and loans that have been referred to foreclosure but not yet foreclosed upon divided by the number of loans in our conventional single-family guaranty book of business. We include all of the conventional single-family loans that we own and those that back Fannie Mae MBS in the calculation of the single-family serious delinquency rate.

(3) Represents the total amount of 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. Prior to the fourth quarter of 2008, we generally classified loans as nonperforming when the payment of principal or interest on the loan was three months or more past due. In the fourth quarter of 2008, we began classifying loans as nonperforming at an earlier stage in the delinquency cycle, generally when the payment of principal or interest on the loan is two months or more past due.

(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. Prior to the fourth quarter of 2008, we generally classified loans as nonperforming when the payment of principal or interest on the loan was three months or more past due. In the fourth quarter of 2008, we began classifying loans as nonperforming at an earlier stage in the delinquency cycle, generally when the payment of principal or interest on the loan is two months or more past due.

(5) Consists of the allowance for loan losses for loans held for investment in our mortgage portfolio and reserve for guaranty losses related to loans backing Fannie Mae MBS and loans that we have guaranteed under long-term standby commitments.

(6) Reflects the number of single-family foreclosed properties we held in inventory as of the end of each period. 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) Includes deeds in lieu of foreclosure.

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

(11) Consists of (a) charge-offs, net of recoveries and (b) foreclosed property expense; adjusted to exclude the impact of SOP 03-3 and HomeSaver Advance fair value losses 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 Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3), are excluded from credit losses. Please see Consolidated Results of Operations Credit-Related Expenses Provision Attributable to SOP 03-3 and HomeSaver Advance Fair Value Losses for a discussion of SOP 03-3.

Our entire guaranty book of business, including loans with lower risk characteristics, has begun to experience increases in delinquency and default rates as a result of the sharp rise in unemployment, the continued decline in home prices, the prolonged downturn in the economy, and the resulting increase in mark-to-market LTV ratios. In addition, certain loan types have continued to contribute disproportionately to the increases in serious delinquencies and credit losses we reported for the first quarter of 2009. These include loans on properties in California, Florida, Arizona and Nevada; loans originated in 2006 and 2007; and loans in higher-risk categories such as Alt-A loans and interest-only loans.

Alt-A loans generally refers to mortgage loans that can be underwritten with reduced or alternative documentation than that required for a full documentation mortgage loan but may also include other alternative product features. In reporting our credit exposure, we classify mortgage loans as Alt-A if the lenders that deliver the mortgage loans to us have classified the loans as Alt-A based on documentation or other product features. We have classified loans as nonperforming, and placed them on nonaccrual status, when we believe collectability of interest or principal on the loan is not reasonably assured.

Net Worth and Fair Value Deficit

Net Worth and Fair Value Deficit Amounts

Under the senior preferred stock purchase agreement that was entered into between us and Treasury in September 2008 and amended in May 2009, Treasury committed to provide us funds of up to $200 billion, on a quarterly basis, in the amount, if any, by which our total liabilities exceed our total assets at the end of the applicable fiscal quarter. This net worth deficit equals the total deficit that we report in our condensed consolidated balance sheets, and is calculated by subtracting our total liabilities from our total assets, each as shown on our condensed consolidated balance sheets prepared in accordance with generally accepted accounting principles (GAAP) for that fiscal quarter. We describe the amended terms of the agreement in more detail below in Amendment to Senior Preferred Stock Purchase Agreement and we describe the terms of the agreement prior to its May 2009 amendment, most of which continue to apply, in our 2008 Form 10-K in Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements.

Our net worth as of March 31, 2009 was negative and is presented in our condensed consolidated GAAP balance sheets as a total deficit of $18.9 billion as of March 31, 2009, which is an increase of $3.8 billion over our total deficit of $15.2 billion as of December 31, 2008. The increase in our net worth deficit was primarily attributable to the net loss we recorded during the first quarter of 2009, partially offset by the $15.2 billion we received from Treasury.

Our fair value deficit as of March 31, 2009, which is reflected in our supplemental non-GAAP fair value balance sheet, was $110.3 billion, an increase of $5.2 billion over our fair value deficit of $105.2 billion as of December 31, 2008. The amount that Treasury committed to provide us under the senior preferred stock purchase agreement is determined based on our GAAP balance sheet, not 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 Supplemental Non-GAAP Information Fair Value Balance Sheets.

Due to current trends in the housing and financial markets, we expect to 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 and Effect of Treasury Funding

Under the Federal Housing Finance Regulatory Reform Act (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 funds 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. On March 31, 2009, we received our first investment from Treasury under the senior preferred stock purchase agreement of $15.2 billion, which eliminated our net worth deficit as of December 31, 2008.

The Director of FHFA submitted a request to Treasury on May 6, 2009 for $19.0 billion on our behalf under the terms of the senior preferred stock purchase agreement to eliminate our net worth deficit as of March 31, 2009, and requested receipt of those funds on or prior to June 30, 2009.

When Treasury provides the additional funds that FHFA requested on our behalf, the aggregate liquidation preference of our senior preferred stock will total $35.2 billion and the annualized dividend on the senior preferred stock will be

$3.5 billion, based on the 10% dividend rate. This dividend amount exceeds 50% of our reported annual net income in six of the past seven years, in most cases by a significant margin. If we do not make cash payments on time, the dividend rate increases to 12% annually, and the unpaid dividend is added to the liquidation preference, further increasing the amount of the annual dividends.

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

Our net worth deficit, which equals our total deficit reported on our consolidated GAAP balance sheet, includes the combined loss reserves of $41.7 billion that we recorded in our consolidated balance sheet as of March 31, 2009. Our non-GAAP fair value balance sheet presents all of our assets and liabilities at estimated fair value as of the balance sheet date. 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, which is also referred to as the exit price. In determining fair value, we use a variety of valuation techniques and processes. 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. We describe our use of assumptions and management judgment and our valuation techniques and processes for determining fair value in more detail in Supplemental Non-GAAP information Fair Value Balance Sheets, Critical Accounting Policies and Estimates Fair Value of Financial Instruments and Notes to Condensed Consolidated Financial Statements Note 18, Fair Value of Financial Instruments.

Neither our GAAP combined loss reserves 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 March 31, 2009, 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.

Amendment to Senior Preferred Stock Purchase Agreement

Treasury and FHFA, acting on our behalf in its capacity as our conservator, entered into an amendment to the senior preferred stock purchase agreement between us and Treasury on May 6, 2009. Unless the context indicates otherwise, references in this report to the senior preferred stock purchase agreement refer to the agreement as amended on May 6, 2009. The May 6, 2009 amendment revised the terms of the senior preferred stock purchase agreement in the following ways:

Treasury s maximum funding commitment to us under the agreement was increased from $100 billion to $200 billion.

The covenant limiting the amount of mortgage assets we can own on December 31, 2009 was increased from $850 billion to $900 billion. We continue to be required to reduce our mortgage assets, beginning on December 31, 2010 and each year thereafter, to 90% of the amount of our mortgage assets as of December 31 of the immediately preceding calendar year, until the amount of our mortgage assets reaches $250 billion.

The covenant limiting the amount of our indebtedness was changed. Prior to the amendment, our debt cap was equal to 110% of our indebtedness as of June 30, 2008. As amended, our debt cap through December 30, 2010 equals $1,080 billion. Beginning December 31, 2010, and on December 31 of each year thereafter, our debt cap that will apply through December 31 of the following year will equal 120% of the amount of mortgage assets we are allowed to own on December 31 of the immediately preceding calendar year.

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We estimate that our indebtedness as of March 31, 2009 totaled $869.3 billion, which was approximately $22.7 billion below our estimated debt limit of $892.0 billion in effect at that time and approximately $210.7 billion below our revised debt limit.

º Our calculation of our indebtedness for purposes of complying with our debt cap, which has not been confirmed by Treasury, reflects the unpaid principal balance of our debt outstanding or, in the case of long-term zero coupon bonds, the unpaid principal balance at maturity. Our calculation excludes debt basis adjustments and debt recorded from consolidations.

The definition of indebtedness in the May 6, 2009 amendment was revised to clarify that it does not give effect to any change that may be made in respect of SFAS No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125)* (SFAS 140) or any similar accounting standard. The agreement continues to provide that, for purposes of evaluating our compliance with the limitation on the amount of mortgage assets we may own, the effect of changes in generally accepted accounting principles that occur subsequent to the date of the agreement and that require us to recognize additional mortgage assets on our balance sheet (for example, proposed amendments to SFAS 140), will not be considered.

The limitation on entering into or changing compensation arrangements with our named executive officers (as defined by SEC rules) was broadened to apply to all of our executive officers (as defined by SEC rules). The agreement provides that we may not enter into any new compensation arrangements or increase amounts or benefits payable under existing compensation arrangements for these officers without the consent of the Director of FHFA, in consultation with the Secretary of the Treasury. As amended this requirement now applies to twelve of our current officers, instead of the five to whom it applied prior to the amendment. The executives who served as our executive officers as of February 26, 2009 are identified in Part III Item 10 Directors, Executive Officers and Corporate Governance in our 2008 Form 10-K.

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 funds: the Treasury credit facility and the senior preferred stock purchase agreement.

The dynamics of our funding program have improved significantly since late November 2008, including demand for our long-term and callable debt. As a result of our improved access to the long-term debt markets, we have decreased the portion of our total outstanding debt represented by short-term debt to 32% as of March 31, 2009 from 38% as of December 31, 2008, and the aggregate weighted-average maturity of our debt increased to 45 months as of March 31, 2009 from 42 months as of December 31, 2008.

We believe the improvement in our debt funding is due to actions taken by the federal government to support us and our debt securities, including the senior preferred stock purchase agreement entered into in September 2008, Treasury s program announced in September 2008 to purchase MBS of the GSEs, the Treasury credit facility made available to us in September 2008 and the Federal Reserve s program announced in November 2008 to purchase up to $100 billion in debt securities of Fannie Mae, Freddie Mac and the FHLBs and up to $500 billion in mortgage-backed securities of Fannie Mae, Freddie Mac and Ginnie Mae. On February 18, 2009, Treasury announced that it will continue to purchase Fannie Mae and Freddie Mac mortgage-backed securities to promote stability and liquidity in the marketplace. On March 18, 2009, the Federal Reserve announced that it intended to increase purchases of debt securities of Fannie Mae, Freddie Mac and the FHLBs and of Fannie Mae, Freddie Mac and Ginnie Mae mortgage-backed securities under its program to a total of up to $200 billion and $1.25 trillion, respectively.

There can be no assurance that the improvements in our access to the unsecured debt markets and in our ability to issue long-term and callable debt will continue. We believe the improvements stem from federal government support, such as the support described above, and, as a result, changes or perceived changes in the government s support of us may have a material adverse affect on our ability to fund our operations. In particular, to the extent the market for our debt securities has improved due to the availability to us of the Treasury credit facility, we believe that the actual and perceived risk that we will be unable to refinance our debt as it becomes due is likely to increase substantially as we progress toward December 31, 2009, which is the date on which the Treasury credit facility terminates. Accordingly, we continue to have significant roll-over risk notwithstanding improved access to long-term funding, and this risk is likely to increase as we approach expiration of the Treasury credit facility. See Liquidity and Capital Management Liquidity

Management Debt Funding for more information on our debt funding activities and Part II Item 1A Risk Factors of this report and Part I Item 1A Risk Factors of our 2008 Form 10-K for a discussion of the risks to our business posed by our reliance on the issuance of debt to fund our operations.

Outlook

We anticipate that adverse market dynamics and certain of our activities undertaken to stabilize and support the housing and mortgage markets will negatively affect our financial condition and performance through the remainder of 2009.

Overall Market Conditions. We expect the current financial market crisis to continue through 2009. We expect further home price declines and rising default and severity rates, all of which may worsen if unemployment rates continue to increase and if the U.S. continues to experience a broad-based recession. We continue to expect the level of foreclosures and single-family delinquency rates to increase further in 2009, as well as the level of multifamily defaults and loss severities. We expect growth in residential mortgage debt outstanding to be flat in 2009.

Home Price Declines: Following a decline of approximately 10% in 2008, we expect that home prices will decline another 7% to 12% on a national basis in 2009. We also continue to expect that we will experience a peak-to-trough home price decline of 20% to 30%. These estimates are based on our home price index, which is calculated differently from the S&P/Case-Schiller index and therefore results in lower percentages for comparable declines. These estimates also 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 has taken and 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.

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, causing declines in home prices on higher priced homes to 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 foreclosed home prices less representative of market values, whereas the S&P/Case-Schiller index includes sales of foreclosed homes. 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 geographic areas of the country. 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 Credit-Related Expenses. We continue to expect our credit losses and our credit loss ratio (each of which excludes fair value losses under SOP 03-3 and our HomeSaver Advance product) in 2009 will exceed our credit losses and 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, if our book of business continues to be adversely affected by market and economic conditions or other factors, we expect our credit-related expenses to be higher in 2009 than they were in 2008, although we believe that our credit-related expenses for the first quarter of 2009 are not necessarily indicative of the expenses we will incur in subsequent quarters during 2009. Because of the current state of the market and a focus on keeping people in their homes and supporting liquidity and stability in the mortgage market, we are no longer providing guidance on expected changes in our combined loss reserves during 2009.

Expected Lack of Profitability for Foreseeable Future. We expect to continue to have losses as our guaranty book of business continues to deteriorate and as we continue to incur ongoing costs in our efforts to keep people in homes and provide liquidity to the mortgage market. We expect that we will not operate profitably for the foreseeable future.

Uncertainty Regarding our Future Status and Long-Term Financial Sustainability: 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 the Making Home Affordable Program, 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. Although Treasury s additional funds under the senior preferred stock purchase agreement permit us to remain solvent and avoid receivership, the resulting dividend payments are substantial and will increase as we request additional funds from Treasury under the senior preferred stock purchase agreement. As a result of these factors, along with current and expected market and economic conditions and the deterioration in our single-family and multifamily books of business, there is significant uncertainty as to our long-term financial sustainability. We expect that for the foreseeable future the earnings of the company, if any, will not be sufficient to pay the dividends on the senior preferred stock. As a result, future dividend payments will be paid from equity drawn from the Treasury. Further, the conservatorship that we are under has no specified termination date, and the future structure of our business during and following termination of the conservatorship is uncertain.

HOUSING GOALS

Proposed 2009 Housing Goals

As described in our 2008 Form 10-K, the Regulatory Reform Act provides that the housing goals previously established by the Department of Housing and Urban Development for 2008 remain in effect for 2009; however, the Regulatory Reform Act also includes a requirement that the Director of FHFA review these goals to determine their feasibility for 2009 in light of current market conditions and, after seeking public comment, make appropriate adjustments to the goals consistent with these market conditions.

In April 2009, FHFA issued a proposed rule lowering our 2009 housing goals from the 2008 levels. FHFA determined that, in light of current market conditions, the previously established 2009 housing goals were not feasible unless adjusted. FHFA s proposed adjustments would reduce our 2009 housing goals approximately to the levels that prevailed in 2004 through 2006. FHFA s proposed rule would also permit loan modifications that we make in accordance with HASP to be treated as mortgage purchases and count towards the housing goals. In addition, the proposed rule would exclude from counting towards the 2009 housing goals any purchases of loans on one-to four-unit properties with a maximum original principal balance higher than the nationwide conforming loan limit (currently set at $417,000). The adverse market conditions that FHFA took into consideration in its determination that the existing 2009 goals were not feasible included tighter underwriting practices, the sharply increased standards of private mortgage insurers, the increased role of the FHA in the marketplace, the collapse of the private-label mortgage-related securities market, increasing unemployment, multifamily market volatility and the prospect of a refinancing surge in 2009. These conditions contribute to fewer goals-qualifying mortgages available for purchase by us. FHFA s proposed rule notes that, even with these reductions, the proposed 2009 goals are generally at the upper end of FHFA s market estimates for 2009.

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The following table sets forth FHFA s proposed 2009 housing goals and subgoals, and for comparative purposes our 2008 housing goals and subgoals, and our performance against those goals and subgoals. The 2008 performance results have not yet been validated by FHFA.

Table 2: Housing Goals and Subgoals

	2009 Proposed Goal	2008 Result[1]	2008 Goal
Housing goals:[2]			
Low- and moderate-income housing	51.0%	53.6%	56.0%
Underserved areas	37.0	39.4	39.0
Special affordable housing	23.0	26.0	27.0
Housing subgoals:			
Home purchase subgoals:[3]			
Low- and moderate-income housing	40.0%	38.9%	47.0%
Underserved areas	30.0	30.4	34.0
Special affordable housing	14.0	13.6	18.0
Multifamily special affordable housing subgoal ($ in billions)[4]	$ 5.49	$ 13.42	$ 5.49

(1) Results presented for 2008 were reported to FHFA in Fannie Mae s Annual Housing Activities Report. They have not yet been validated by FHFA.

(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.

Determination by FHFA Regarding 2008 Housing Goals Compliance

As described above and in our 2008 Form 10-K, we believe that we did not meet our two income-based housing goals (the low- and moderate-income housing goal and the special affordable housing goal) or any of our three home purchase subgoals for 2008. In March 2009, FHFA notified us of its determination that achievement of these housing goals and subgoals was not feasible due to housing and economic conditions and our financial condition in 2008. As a result, we will not be required to submit a housing plan for failure to meet these goals and subgoals pursuant to the Federal Housing Enterprises Safety and Soundness Act of 1992.

For additional background information on our housing goals and subgoals, refer to Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Regulation and Oversight of Our Activities Housing Goals and Subgoals of our 2008 Form 10-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the condensed consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We describe our most significant accounting policies in Notes to Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies of our 2008 Form 10-K and in Notes to Condensed Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies of this report.

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

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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. We describe below significant changes in the judgments and assumptions we made during the first quarter of 2009 in applying our critical accounting policies and estimates. Management has discussed any changes in judgments and assumptions in applying our critical accounting policies with the Audit Committee of the Board of Directors. See Part II Item 7 MD&A Critical Accounting Policies and Estimates of our 2008 Form 10-K for additional information about our critical accounting policies and estimates.

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. SFAS No. 157, *Fair Value Measurements* (SFAS 157), defines fair value as 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). 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. 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 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.

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 Condensed Consolidated Financial Statements Note 18, Fair Value of Financial Instruments. 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.

In April 2009, the Financial Accounting Standards Board (FASB) issued two FASB Staff Positions (FSPs) to clarify the guidance on fair value measurement and to amend the recognition, measurement and presentation requirements of other-than-temporary impairments for debt securities. These FSPs consist of:

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(1) FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* and (2) FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. These FSPs are effective for interim and annual periods ending after June 15, 2009 with early adoption permitted. See Notes to Condensed Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies for additional information, including the expected impact of these recently issued pronouncements on our condensed consolidated financial statements.

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. 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.

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. 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 and liabilities 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.

Guaranty Obligations. The fair value of all guaranty obligations, measured subsequent to their initial recognition, reflects our estimate of a hypothetical transaction price that 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 estimate the fair value of the guaranty obligations using internal valuation models that calculate the present value of expected cash flows based on management s best estimate of certain key assumptions, such as default rates, severity rates and a required rate of return. During 2008, we further adjusted the model-generated values based on our current market pricing to arrive at our estimate of a hypothetical transaction price for our existing guaranty obligations. Beginning in the first quarter of 2009, we concluded that the credit characteristics of the pools of loans upon which we were issuing new guarantees increasingly did not reflect the credit characteristics of our existing guaranteed pools; thus, current market prices for our new guarantees were not a relevant input to our estimate of the hypothetical transaction price for our existing guaranty obligations. Therefore, at March 31, 2009, we based our estimate of the fair value of our existing guaranty obligations solely upon our model without further adjustment.

Fair value measurements related to financial instruments that are reported at fair value in our condensed 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 as non-recurring fair value measurements.

Table 3 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 March 31, 2009 and December 31, 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 3: Level 3 Recurring Financial Assets at Fair Value

Balance Sheet Category	**As of March 31, 2009**	**As of December 31, 2008**
	(Dollars in millions)	
Trading securities	$ 10,308	$ 12,765
Available-for-sale securities	40,412	47,837
Derivatives assets	331	362
Guaranty assets and buy-ups	1,179	1,083
Level 3 recurring assets	$ 52,230	$ 62,047
Total assets	$ 919,638	$ 912,404
Total recurring assets measured at fair value	$ 349,759	