

Prospectus

Federal National Mortgage Association



Guaranteed Mortgage Pass-Through Certificates

(Residential Mortgage Loans)

Principal and Interest payable on the 25th day of each month

THE OBLIGATIONS OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION UNDER ITS GUARANTY ARE OBLIGATIONS SOLELY OF THE CORPORATION AND ARE NOT BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES. THE CERTIFICATES ARE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OF 1933 AND ARE "EXEMPTED SECURITIES" WITHIN THE MEANING OF THE SECURITIES EXCHANGE ACT OF 1934.

The Guaranteed Mortgage Pass-Through Certificates ("Certificates") are issued and guaranteed by the Federal National Mortgage Association (the "Corporation"), a corporation organized and existing under the laws of the United States, under the authority contained in Section 304(d) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 *et seq.*).

Each Certificate offered hereby and by the Supplement related hereto will represent an undivided interest in a pool of mortgage loans (a "Pool") to be formed by the Corporation. Each Pool will consist of residential mortgage loans ("Mortgage Loans") either previously owned by the Corporation or purchased by it in connection with the formation of the Pool. Each Pool will consist entirely of one of the following: (i) fixed-rate level installment Mortgage Loans, (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal, (iii) fixed-rate graduated payment Mortgage Loans having deferred interest features, (iv) adjustable-rate Mortgage Loans, and (v) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which multifamily Mortgage Loans may have balloon payments or other irregular features or characteristics.

Interests in each Pool will be evidenced by a separate issue of Certificates. Information regarding the aggregate principal amount and characteristics of the related Pool (including the type of Mortgage Loans in the Pool) will be furnished in a Supplement to this Prospectus at the time of the identification of the Pool.

The Corporation will have certain contractual servicing responsibilities with respect to each Pool. In addition, the Corporation will be obligated to distribute scheduled monthly installments of principal and interest (adjusted to reflect the Corporation's servicing and guaranty fee) to Certificateholders, whether or not received. The Corporation also will be obligated to distribute to Certificateholders the full principal balance of any foreclosed Mortgage Loan, whether or not such principal balance is actually recovered.

The date of this Prospectus is March 11, 1985

Retain this Prospectus for future reference. This Prospectus may not be used to consummate sales of Certificates unless accompanied by a Prospectus Supplement

No salesman, dealer, bank or other person has been authorized to give any information or to make any representation other than those contained in this Prospectus and, if given or made, such information or representation must not be relied upon as having been authorized by the Corporation. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the Certificates offered hereby and by the related Supplement nor an offer of the Certificates to any person in any state or other jurisdiction in which such offer would be unlawful.

TABLE OF CONTENTS

<u>Caption</u>	<u>Page</u>
Summary of Prospectus	A-3
The Mortgage Pools	A-5
Yield Considerations	A-6
Maturity and Prepayment Assumptions	A-8
Purchase Program	A-10
Description of Certificates	A-12
Federal Tax Aspects	A-19
Legal Opinion	A-22
ERISA Considerations	A-22
Capitalization	A-23
Federal National Mortgage Association	B-1
Selected Financial Data	B-2
Management's Discussion and Analysis of Financial Results	B-3
Mortgage Portfolio Spread	B-8
History	B-9
Government Regulation and Charter Act	B-9
Mortgage Portfolio	B-10
Mortgage-Backed Security Program	B-16
Corporate Indebtedness	B-18
Recent Legislative Developments	B-20
Management	B-20
Board of Directors	B-21
Report of Independent Certified Public Accountants	C-1
Financial Statements	C-2

SUMMARY OF PROSPECTUS

The following summary of certain pertinent information is qualified in its entirety by reference to the detailed information appearing elsewhere in this Prospectus and by reference to the information with respect to each pool of residential mortgage loans ("Mortgage Loans") contained in the supplement to this Prospectus (a "Prospectus Supplement") to be prepared in connection with the issue of Guaranteed Mortgage Pass-Through Certificates (the "Certificates") evidencing undivided interests in such pool of Mortgage Loans ("Pool").

Title of Security	Guaranteed Mortgage Pass-Through Certificates.
Issuer and Guarantor	Federal National Mortgage Association (the "Corporation"), a corporation organized and existing under the laws of the United States. See "Federal National Mortgage Association" and the remainder of the Prospectus following that section. The obligations of the Corporation under its guaranty are obligations solely of the Corporation and are not backed by, nor entitled to, the full faith and credit of the United States.
Description of Security	Each Certificate will represent a fractional undivided interest in a Pool of Mortgage Loans to be formed by the Corporation. A Certificate will initially represent at least \$25,000 unpaid principal amount of Mortgage Loans. The Certificates will be in fully registered form.
Interest	Interest on each Mortgage Loan will be passed through monthly to Certificateholders, commencing on the 25th day of the month following the month of initial issuance of the related Certificates. For all Pools containing fixed-rate Mortgage Loans ("Fixed-Rate Pools"), interest will be passed through at a uniform Pass-Through Rate (or Accrual Rate in the case of Fixed-Rate Pools containing graduated payment mortgage loans), which will be specified in the Prospectus Supplement and will not be greater than the lowest annual interest rate borne by any Mortgage Loan in the related Pool, less a specified minimum annual percentage representing compensation for servicing and the Corporation's guaranty and less, in the case of Fixed-Rate Pools containing graduated payment Mortgage Loans, deferred interest, which is added to the principal balances of the underlying Mortgage Loans. For Pools containing adjustable-rate Mortgage Loans ("ARM Pools"), interest will be passed through on each Mortgage Loan at the interest rate at the time applicable thereto less (i) the Corporation's fixed servicing and guaranty fee and (ii) any deferred interest which is added to the principal balance of such Mortgage Loan pursuant to its terms. See "Yield Considerations."
Principal (including prepayments)	Passed through monthly, commencing on the 25th day of the month following the month of initial issuance of the related Certificates. See "Maturity and Prepayment Assumptions" and "Description of Certificates."
Guaranty	The Corporation is obligated to distribute scheduled monthly installments of principal and interest (adjusted to reflect the Corporation's servicing and guaranty fee) on the Mortgage Loans in a Pool, whether or not received. The Corporation is

also obligated to distribute to Certificateholders the full principal balance of any foreclosed Mortgage Loan, whether or not such principal balance is actually recovered. If the Corporation were unable to perform these guaranty obligations, distributions to Certificateholders would consist solely of payments and other recoveries on Mortgage Loans and, accordingly, delinquencies and defaults would affect monthly distributions to Certificateholders. See "Description of Certificates—The Corporation's Guaranty."

Servicing

The Corporation will be responsible for servicing the Mortgage Loans and will, in most cases, contract with mortgage lenders to perform certain servicing functions on its behalf. See "Description of Certificates—Servicing Through Lenders."

The Mortgage Pools

Each Pool will consist entirely of Mortgage Loans of only one of the following types: (i) fixed-rate level installment Mortgage Loans, (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal, (iii) fixed-rate graduated payment Mortgage Loans with deferred interest features, (iv) adjustable-rate Mortgage Loans, and (v) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units, some of which multifamily Mortgage Loans may have balloon payments or other irregular features or characteristics. The Mortgage Loans in each Pool will have unpaid principal balances aggregating not less than \$1,000,000. Each Mortgage Loan will be secured by a first lien on a residential property and each Mortgage Loan will meet the applicable standards set forth under "Purchase Program." Pool information as to the type of Mortgage Loans (including whether such Mortgage Loans are conventional Mortgage Loans or are insured by the Federal Housing Administration or guaranteed by the Veterans Administration), the aggregate principal balance of the Mortgage Loans as of the Issue Date, the Pass-Through Rate for Certificates evidencing interests in level installment Fixed-Rate Pools, the Accrual Rate for Certificates evidencing interests in graduated payment Fixed-Rate Pools, and the latest maturity date of any Mortgage Loan will be contained in the related Prospectus Supplement. For an ARM Pool, the related Prospectus Supplement will also contain information respecting the index upon which adjustments are based, the frequency of interest rate and payment adjustments and any maximum or minimum limitations thereon, the Corporation's fixed guaranty and servicing fee and whether the underlying Mortgage Loans contain provisions for the deferral of interest.

Financial Results

The Corporation incurred a loss in 1984, after operating profitably in 1983 and incurring a loss in 1982. The primary reason for the losses in 1984 and 1982 was the excess in the cost of the Corporation's outstanding debt over the yield on its mortgage portfolio (or "negative spread"). During 1983, the Corporation's negative spread was substantially less than in 1984 and 1982, and its impact was more than offset by income from other sources. See "Selected Financial Data," "Management's Discussion and Analysis of Financial Results," and "Mortgage Portfolio Spread."

THE MORTGAGE POOLS

The Federal National Mortgage Association (the "Corporation") has implemented a program for (a) the setting aside of residential mortgage loans (the "Mortgage Loans") into separate pools (the "Pools") bearing distinctive identification and (b) the issuance and sale of trust certificates of beneficial interest evidencing pro rata undivided ownership interests in the Mortgage Loans comprising each separate Pool (the "Guaranteed Pass-Through Certificates" or "Certificates"). The Mortgage Loans may be purchased by the Corporation expressly for the Pools or may be Mortgage Loans that have been held by the Corporation in its own portfolio. Each Pool will consist of Mortgage Loans evidenced by promissory notes (the "Mortgage Notes") secured by first mortgages or deeds of trust (the "Mortgages") on either one- to four-family residential properties or multifamily projects consisting of five or more dwelling units, (the "Mortgaged Properties"). A Pool will contain Mortgage Loans of only one of the following types: (i) fixed-rate level payment Mortgage Loans ("Level Payment Mortgage Loans"), (ii) fixed-rate growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal ("GEMs"), (iii) fixed-rate graduated payment Mortgage Loans with deferred interest features ("GPMs"), (iv) adjustable-rate Mortgage Loans ("ARMs"), and (v) fixed-rate Mortgage Loans secured by multifamily projects consisting of five or more dwelling units ("Multifamily Mortgage Loans"), some of which Multifamily Mortgage Loans may have balloon payments or other irregular features or characteristics. The Mortgage Loans may be either conventional Mortgage Loans (i.e., not insured or guaranteed by any United States government agency) or Mortgage Loans that are either insured by the Federal Housing Administration or guaranteed by the Veterans Administration ("Conventional Mortgage Loans" and "FHA/VA Mortgage Loans," respectively). The Mortgage Loans purchased expressly for the Pools will be sold to the Corporation by eligible institutions that meet certain requirements set forth under "Purchase Program" and are referred to herein as "Lenders." No Pool will consist of Mortgage Loans having an aggregate unpaid principal balance of less than \$1,000,000 on the first day of the month of issuance of the related Certificates. See "Purchase Program—Mortgage Loan Eligibility" for a description of certain criteria applicable to the eligibility of Mortgage Loans for inclusion in Pools.

Interests in each Pool will be evidenced by a separate series of Certificates (an "Issue"). The Corporation will acquire the Mortgage Loans that it has purchased expressly for Pools under purchase contracts. By entering into such contracts, the Corporation will obligate itself to issue Certificates to, or to the order of, the Lenders named in the contracts, upon delivery to the Corporation of the required Mortgage Loans conforming to the Corporation's standards. The Corporation will not insure or guarantee the performance by any Lender of its obligation to deliver Mortgage Loans and, correspondingly, does not insure or guarantee the performance by any person of any obligation to deliver Certificates.

The Mortgage Loans in each Pool of fixed-rate Mortgage Loans other than GPMs will be held for the benefit of the holders of Certificates ("Certificateholders" or "Holders") pursuant to the combined terms of a trust indenture, as amended, executed by the Corporation in its corporate capacity and in its capacity as Trustee (the Trust Indenture dated as of November 1, 1981, as modified and amended by a First Supplemental Indenture dated as of February 15, 1982, a Second Supplemental Indenture dated as of October 1, 1982, a Third Supplemental Indenture dated as of August 1, 1983, a Fourth Supplemental Indenture dated as of May 1, 1984, and a Fifth Supplemental Indenture dated as of July 1, 1984, being herein called the "Fixed-Rate Trust Indenture"), and a supplement thereto for the related Issue (the "Issue Supplement"). The Mortgage Loans in each Pool of GPMs and ARMs will be held for the benefit of the Certificateholders pursuant to the terms of a Trust Indenture dated as of July 1, 1984 (the "GPM Trust Indenture") and a Trust Indenture dated as of July 1, 1984 (the "ARM Trust Indenture"), respectively, each executed by the Corporation in its corporate capacity and in its capacity as Trustee. The Fixed-Rate Trust Indenture, the GPM Trust Indenture, and the ARM Trust Indenture are herein, collectively, referred to as the "Trust Indenture" or "TI" where common

terms and provisions are being referred to or described. Certain capitalized words or series of words in this Prospectus refer to and are further defined in the Trust Indenture. The Corporation will be responsible for the administration and servicing of the Mortgage Loans in the Pool, including the supervision of the servicing activities of Lenders, if appropriate, the collection and receipt of payments from Lenders, and the remittance of distributions and certain reports to Certificateholders. The Corporation will be entitled to receive a fee for its guaranty obligations and its services pursuant to the Trust Indenture. The fee to the Corporation for any Mortgage Loan (out of which it will compensate Lenders for servicing the Mortgage Loans) will, as to any Pool containing fixed-rate Mortgage Loans (a "Fixed-Rate Pool"), be equal to the difference between the annual interest rate borne by the Mortgage Loan and the annual rate of interest paid to Certificateholders at the Pass-Through Rate for the related Fixed-Rate Pool or the Accrual Rate for Fixed-Rate Pools containing GPMs (a "GPM Pool"). For any Pool containing ARMs (an "ARM Pool"), the Corporation will similarly compensate itself from interest payments on the underlying ARMs in an amount, as to each ARM Pool, determinable from information in the related Prospectus Supplement. The Corporation will reserve the right to remove the servicing responsibility from a Lender at any time if it considers such removal to be in the best interest of Certificateholders. In such event, the Corporation will meet its obligation to provide servicing either by directly servicing the Mortgage Loans itself or by finding a replacement Lender that meets the eligibility standards.

The Corporation's obligations with respect to the Mortgage Loans will be limited to the servicing responsibilities under the Trust Indenture, and, in the event of any delinquency in payment or loss on any Mortgage Loan, its obligation to make supplemental payments in amounts described herein under "Description of Certificates—The Corporation's Guaranty."

Because the principal amount of the Mortgage Loans in a Pool will decline (with the exception of Fixed-Rate Pools containing GPMs and certain ARM Pools which contain ARMs providing for deferred interest) monthly as principal payments, including prepayments, are received, each Certificate Principal Balance (defined to be the principal amount appearing on the face of the related Certificate or, subsequent to the first Distribution Date, the last amount reported to the Holder of such Certificate by the Corporation as the principal balance thereof) will also decline over time. See "Maturity and Prepayment Assumptions."

YIELD CONSIDERATIONS

Fixed-Rate Pools Not Containing GPMs

Each Fixed-Rate Pool not containing GPMs will consist of Mortgage Loans that bear simple interest at fixed annual rates ("Mortgage Interest Rates"). Such a Fixed-Rate Pool may include Mortgage Loans that bear different Mortgage Interest Rates. The Pass-Through Rate of interest payable to Certificateholders of each such Issue, as set forth on the face of the Certificates, will be equal to the lowest Mortgage Interest Rate borne by any Mortgage Loan in the related Pool, less a specified minimum annual percentage representing compensation for servicing and the Corporation's guaranty. Because the Pass-Through Rate for an Issue will not be greater than the lowest Mortgage Interest Rate for the related Pool, any disproportionate principal prepayments among Mortgage Loans bearing different Mortgage Interest Rates will not affect the return to Certificateholders.

The effective yield to Certificateholders will be reduced slightly below the yield otherwise produced by the applicable Pass-Through Rate because the distribution of interest that accrues from the first day of each month will not be made until the 25th day of the month following the month of accrual.

When a Mortgage Loan is prepaid or otherwise liquidated, the proceeds of such prepayment or liquidation will, unless the Corporation elects in its discretion to make any distribution thereof

in the following month, be passed through to Certificateholders in the second month following the month of such prepayment or other liquidation. Because the Corporation will agree in each Certificate to distribute on each Distribution Date to the Holder thereof an amount as to interest representing one month's interest at the Pass-Through Rate on the Certificate Principal Balance, any prepayment or other liquidation of a Mortgage Loan and the timing of the distribution of the proceeds thereof will have no effect on the interest return to Certificateholders.

Assuming performance by the Corporation of its obligations under its guaranty, the net effect of each distribution respecting interest will be the pass-through to each Certificateholder of an amount that is equal to one month's interest at the Pass-Through Rate on the Certificate Principal Balance of such Holder's Certificate. See "Description of Certificates—Payments on Mortgage Loans; Distributions on Certificates."

GPM Pools

A GPM Pool will consist of fixed-rate fully amortizing Mortgage Loans providing for monthly payments that increase annually for a period of years (generally between three to seven) and are level thereafter. During all or part of the period in which monthly payments are increasing, those payments will not be sufficient to cover the full amount of interest on the GPM at the Mortgage Interest Rate borne thereby. The amount of each such interest insufficiency will be added to the principal balance of the GPM, which will accrue interest thereafter on this new increased amount.

GPM Pools will have characteristics similar to Fixed-Rate Pools described above commencing with the time at which payments are sufficient to cover interest on the principal balances of the underlying GPMs. Prior to that time, the Certificates evidencing interests in GPM Pools will provide for the monthly distribution of the scheduled interest payment on each Mortgage Loan in the Pool less the Corporation's servicing and guaranty fee attributable thereto, the amount of any such fee being equal to the difference between the fixed Mortgage Interest Rate at which interest accrues on the GPM and the Accrual Rate borne by the related Certificates.

The Prospectus Supplement relating to a GPM Pool will set forth the period over which payments on the GPMs increase.

The Corporation's guaranty of Certificates evidencing interests in GPM Pools will cover the principal amount of each underlying GPM, including any portion thereof representing deferred interest. The Corporation will, following the period (the "Deferred Interest Period") during which such payments are insufficient to cover interest at the Mortgage Interest Rate on their then-outstanding principal balances, including deferred interest that has been added thereto, also be obligated to distribute on each Distribution Date one month's interest at the Accrual Rate on the then-outstanding principal balances of the underlying GPMs. During the Deferred Interest Period, the Corporation's guaranty will cover, as to each underlying GPM, the amount of each scheduled payment less the Corporation's servicing and guaranty fee applicable thereto.

ARM Pools

An ARM Pool will contain Mortgage Loans that bear interest at rates that will vary in response to a single specified index (such as then prevailing yields on five-year Treasury obligations) and will adjust periodically at uniform specified intervals. The actual Mortgage Interest Rate at any time borne by an ARM will be equal to a specified percentage, or Margin, over the index rate then applicable thereto. ARMs may or may not contain provisions limiting the amount by which rates may be adjusted upward or downward and may or may not limit the amount by which monthly payments may be increased or decreased to accommodate upward or downward adjustments in interest. Certain ARMs may provide for periodic adjustments of scheduled payments in order to fully amortize the Mortgage Loan by its stated maturity while other ARMs may permit that maturity to be extended or shortened in accordance with the portion of each payment that is applied to interest in accordance with the periodic interest rate adjustments.

Where an ARM provides for limitations on the amount by which monthly payments may be increased or changes to the Mortgage Interest Rate of the ARM are made more frequently than payment changes, it is possible that an increase in the rate of interest cannot be covered by the amount of the scheduled payment. In that case, the uncollected portion of interest will be deferred and added to the principal balance of the Mortgage Loan.

Since the interest rates borne by Mortgage Loans in an ARM Pool will vary and since a portion of the interest accrued thereon may be deferred and payable at a future time, Certificates evidencing interests in such Pools will not provide for the distribution of interest at a fixed Pass-Through Rate. Rather, each Certificate issued with respect to an ARM Pool will provide for the monthly pass-through of all interest payable on each Mortgage Loan in the Pool less the Corporation's servicing and guaranty fee. In some ARM Pools, the Corporation's servicing and guaranty fee may not be the same amount as to each ARM in the ARM Pool, but will rather be a percentage amount as to each such ARM that, when subtracted from the related Margin, will cause each ARM in the ARM Pool to float above the applicable index at a single uniform "security spread" (the "Security Spread"). As a result, for such an ARM Pool, the rate at which interest accrues to Certificateholders (the "Accrual Rate") at any time (other than the period immediately following origination during which an initial rate having no relationship to the index may apply or during a period when a Mortgage Interest Rate minimum or maximum is applicable) on each Mortgage Loan included therein will be equal to the then-applicable index plus the Security Spread.

The Prospectus Supplement relating to an ARM Pool will contain information respecting the index upon which adjustments are based, the Security Spread, if any, the frequency of interest rate and payment adjustments and any maximum and minimum limitations thereon. The Prospectus Supplement will also describe any provisions for deferred interest and will, to the extent applicable, set forth the original rates of interest borne by the underlying Mortgage Loans.

The Corporation's guaranty of Certificates evidencing interests in ARM Pools will cover the principal of each underlying Mortgage Loan, including any portion thereof representing deferred interest. Its guaranty of interest will cover all interest due and payable by the Mortgagor (net of the Corporation's servicing and guaranty fee). The Corporation will also agree to add to the amount of interest accompanying the prepayment of an underlying Mortgage Loan any amount by which such interest is less than one month's interest at the Accrual Rate on the prepaid principal balance thereof. As a consequence, the timing of the prepayment of a Mortgage Loan will have no effect on the interest return to Certificateholders.

MATURITY AND PREPAYMENT ASSUMPTIONS

The original maturities of substantially all of the Conventional Level Payment Mortgage Loans are expected to be between either eight to 15 years or 20 to 30 years. The maturities of substantially all of the FHA/VA Level Payment Mortgage Loans at origination are expected to be 30 years. Each Level Payment Mortgage Loan with an original maturity of 30 years will provide for amortization of principal according to a schedule that, in the absence of prepayments, would result in repayment of one-half of the original principal amount of such Mortgage Loan by approximately the 23rd to 27th year, with higher Mortgage Interest Rates resulting in slower amortization of principal. A 15-year fully amortizing Level Payment Mortgage Loan would, in the absence of prepayments, result in repayment of one-half of the original principal amount by approximately the 10th to 12th year, with higher Mortgage Interest Rates resulting in slower amortization of principal.

A significant number of the Conventional Mortgage Loans may provide by their terms that in the event of the sale of all or some of the underlying property the full unpaid principal balance of the Mortgage Loan is due and payable at the option of the holder. FHA/VA Mortgage Loans

contain no such "due-on-sale" provisions. As set forth under "Description of Certificates—Collection and Other Servicing Procedures," the Trust Indenture requires the Corporation to exercise its right to accelerate the maturity of a Conventional Mortgage Loan in such an event so long as acceleration is permitted under applicable law unless it elects to repurchase such Mortgage Loan.

The ability of mortgage lenders and their assignees and transferees to enforce "due-on-sale" clauses was addressed by the "Garn-St Germain Depository Institutions Act of 1982," which was passed by Congress and signed into law on October 15, 1982. This legislation, subject to certain exceptions, pre-empts state statutory and case law that prohibits the enforcement of "due-on-sale" clauses. Exempted from this pre-emption are mortgage loans (originated other than by federally chartered lenders) that were made or assumed during the period beginning on the date a state, by statute or statewide court decision, prohibited the exercise of "due-on-sale" clauses and ending on October 15, 1982. Mortgage lenders, however, may require any successor or transferee of the borrower to meet customary credit standards. The exemption for such loans ends on October 15, 1985 unless the state acts to otherwise regulate these loans by that date. The legislation also enumerates nine circumstances under which a lender may not enforce "due-on-sale" clauses, *e.g.*, the creation of a subordinate encumbrance that does not relate to a transfer of rights of occupancy in the property, a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety and the granting of a leasehold interest of three years or less not containing an option to purchase.

Conventional Mortgage Loans purchased by the Corporation from November 10, 1980, to October 15, 1982, in jurisdictions where, on the date of origination, the law substantially restricted lenders from enforcing "due-on-sale" provisions may provide that they are due and payable at the holder's option at the end of seven years. As described in "Description of Certificates—Collection and Other Servicing Procedures," the Trust Indenture provides that the Corporation will exercise or refrain from exercising any such "call option rider" in a manner that is consistent with then-current policies or practices employed by the Corporation respecting comparable mortgage loans held in its own portfolio.

Past experience of the Federal Housing Administration ("FHA") relating to government-insured single-family mortgage loans at various interest rates with original maturities of 26 to 30 years indicates that, while some of such mortgage loans remain outstanding until the scheduled maturity, a pool of 30-year FHA-insured single-family mortgage loans will produce an average loan life of 12 years. A 12-year prepayment assumption is the mortgage industry norm for quoting yields and is used in most generally accepted yield tables. Based upon published information and the Corporation's own experience, the rate of prepayments on 30-year single-family loans has fluctuated significantly in recent years, including a substantial reduction in the prepayment rate during 1980, 1981, and 1982, and a significant increase in the rate in 1983 and 1984. The Corporation believes such fluctuation is due to a number of factors, including general economic conditions, mortgage market interest rates, and homeowner mobility, and that such factors will affect the prepayment experience for the Mortgage Loans in Pools. Accordingly, the Corporation cannot estimate what such prepayment experience will be or how it might compare to the FHA 12-year prepayment assumption respecting insured mortgage loans. See "Description of Certificates—Termination" for a description of the Corporation's option to repurchase the Mortgage Loans in any Pool when the aggregate principal balance thereof becomes less than 10 percent of the aggregate principal balance of the Mortgage Loans in the Pool on the Issue Date.

A GEM provides for scheduled annual increases in the mortgagor's monthly payments. Since the additional scheduled portion of the monthly payments is applied to reduce the unpaid principal balance of a GEM, the scheduled maturity of a GEM will be significantly shorter than the 25- or 30-year term used as the basis for calculating the initial level installment of principal and interest applicable until the first adjustment. No GEM that matures by its terms more than 15 years subsequent to the Issue Date of the related Certificates will be eligible for inclusion in a

Pool. Since GEMs have not, until recently, been originated in any appreciable volume, there are no reliable data available regarding their prepayment experience.

As set forth above under "Yield Considerations," GPMs provide for payments that increase annually for a period of years (generally between three and seven) and then amortize on a level payment basis to their stated maturity. Since the principal amount of a GPM will increase during its Deferred Interest Period, the time at which one-half of the principal amount of a GPM will be paid in accordance with its amortization schedule will be longer than for a Level Payment Mortgage Loan bearing a similar Mortgage Interest Rate. ARMs vary substantially as to their terms and it is impossible to generalize other than that, because of their adjustable feature, ARMs may be less subject to prepayment than fixed-rate Mortgage Loans should interest rates decline below levels prevailing at origination. Since both GPMs and ARMs have not been originated in quantity until recent periods, there are, like GEMs, no reliable data available regarding their prepayment experience.

PURCHASE PROGRAM

Set forth below is a description of certain aspects of the Corporation's purchase program for mortgage loans eligible for inclusion in a Pool (the "Program"). The Prospectus Supplement to be prepared with respect to each Issue will contain information on the Mortgage Loans in the Pool, including information as to the type of Mortgage Loans, the aggregate principal balance of the Mortgage Loans as of the Issue Date, for Fixed-Rate Pools the Pass-Through Rate or Accrual Rate, whichever is applicable, and the latest maturity date of any Mortgage Loan.

Lender Eligibility

The Corporation will purchase Mortgage Loans from eligible federally and state-chartered savings and loan associations, mutual savings banks, commercial banks, credit unions, and similar financial institutions, the deposits or accounts of which are insured by the Federal Savings and Loan Insurance Corporation ("FSLIC"), the Federal Deposit Insurance Corporation ("FDIC"), or the National Credit Union Administration ("NCUA"), from certain other state-insured financial institutions and from certain institutions, principally mortgage bankers, that are mortgage sellers approved by the Corporation. The Corporation, on an individual institution basis, will determine whether such institutions will be approved as eligible Lenders for the Program by applying certain criteria, which may include depth of mortgage origination experience, servicing experience, and financial capacity. Approved Lenders will be party with the Corporation to a Mortgage Selling and Servicing Contract. Also, each Mortgage Loan purchased for inclusion in a Pool will be subject to and must comply with the terms of a Selling and Servicing Guide applicable to the Program. The Selling and Servicing Guide may be amended from time to time.

Mortgage Loan Eligibility

General

The Mortgage Loans to be included in each Pool will be Mortgage Loans on residential properties. These Mortgage Loans are permanent loans (as opposed to construction and land development loans) secured by Mortgages on properties comprised of (i) one- to four-family dwelling units, including units in condominium projects, planned unit developments, and *de minimis* planned unit developments or (ii) multifamily projects consisting of five or more dwelling units. The Prospectus Supplement to be prepared with respect to each Issue backed by Multifamily Mortgage Loans will describe the eligibility criteria for such loans, which will differ in certain respects from the criteria described below. Each Mortgage Loan will be documented by the appropriate FNMA/FHLMC Uniform Instrument in effect at the time of origination, FHA or VA mortgage instrument or other instrument acceptable to the Corporation, and will comply with all applicable federal and local laws, including laws relating to usury, equal credit opportunity, and disclosure

There is no requirement that Mortgage Loans be payable on the first day of the month in order to be eligible for inclusion in a Pool. The Mortgage Loans must have had maturities of not more than 30 years from their date of origination.

Conventional Mortgage Loans

Pursuant to the requirements of the Selling and Servicing Guide, Conventional Mortgage Loans must be real estate loans secured by first Mortgages on residential properties, with original principal balances that (when combined with the original principal balance of any second mortgage in which the Corporation has an interest) did not exceed certain federally imposed maximum principal balance limitations applicable to the Corporation. In 1985, the maximum dollar purchase limitations for Conventional Mortgage Loans are as follows: \$115,300 for mortgages secured by single-family residences (\$172,950 in Alaska and Hawaii); \$147,500 for mortgages secured by two-family residences (\$221,250 in Alaska and Hawaii), \$178,200 for mortgages secured by three-family residences (\$267,300 in Alaska and Hawaii); and \$221,500 for mortgages secured by four-family residences (\$332,250 in Alaska and Hawaii).

No Conventional Mortgage Loan with a loan-to-value ratio in excess of 95 percent will be included in any Pool. Conventional Mortgage Loans with loan-to-value ratios exceeding 80 percent must have the principal amount of the indebtedness in excess of 75 percent of the appraised value of the Mortgaged Property insured by a policy of primary mortgage guaranty insurance. Each mortgage insurer must be licensed to transact a mortgage guaranty insurance business in the state where the Mortgaged Property is located and be acceptable to the Corporation as a mortgage insurer. As an alternative to the requirement to obtain mortgage insurance for Conventional Mortgage Loans with loan-to-value ratios in excess of 80 percent, Lenders may contract with the Corporation to repurchase such Conventional Mortgage Loans at a price equal to the unpaid principal balance thereof in the event of default before the loan-to-value ratio has been reduced to 80 percent of the original value.

The maximum loan-to-value ratio at the time of purchase for a Conventional Mortgage Loan secured by a first Mortgage on an owner-occupied property including the unpaid principal balances of all subordinate financing is 95 percent. In the case of a Conventional Mortgage Loan secured by a first Mortgage on a non-owner occupied property, the maximum loan-to-value ratio including the unpaid principal balances of all subordinate financing is 90 percent. The maximum loan-to-value ratio for Mortgage Loans secured by non-owner occupied properties is generally 80 percent but may vary based on the Corporation's evaluation of the age of a Mortgage Loan and its experience with the Lender from whom it purchases such Mortgage Loan.

Pursuant to the requirements of the Selling and Servicing Guide, each eligible Lender that sells a Conventional Mortgage Loan to the Corporation for the purposes of the Program must assume responsibility for underwriting such Conventional Mortgage Loan using the Corporation's published criteria for mortgage loan underwriting, as from time to time in effect, as guidelines. After delivery of the Conventional Mortgage Loans, the Corporation will conduct reviews of the quality of credit and property underwriting used in the origination of certain randomly selected Conventional Mortgage Loans.

FHA/VA Mortgage Loans

Pursuant to the requirements of the Selling and Servicing Guide, FHA/VA Mortgage Loans must be real estate loans with stated constant annual rates of interest, secured by first Mortgages on residential properties. The principal balance and loan-to-value ratio of each FHA Mortgage Loan must comply with the standards established by the FHA. In the case of VA Mortgage Loans, the Corporation has imposed a maximum principal balance limitation of \$135,000. In addition, the unguaranteed portion of the VA Mortgage Loan amount cannot be greater than 75 percent of the lesser of (i) the purchase price of the property or (ii) the VA's estimate of reasonable value. For two- to four-family properties, such unguaranteed portion cannot be

greater than 75 percent of the least of (i) above, (ii) above, or the appraiser's estimate of market value. Each FHA/VA Mortgage Loan must be insured or guaranteed by a valid and subsisting policy or guaranty in full force and effect. In addition, each FHA/VA Mortgage Loan must have been originated prior to the 12-month period preceding the Corporation's purchase of the Mortgage Loan for inclusion in a Pool.

DESCRIPTION OF CERTIFICATES

Each Issue of Certificates will be issued pursuant to the applicable Trust Indenture described above. The applicable Trust Indenture will, as to each Issue, be supplemented by an Issue Supplement, which will be prepared at the time of the creation of such Issue. The Issue Supplement will set forth the specific terms of the Issue, such as the Pass-Through Rate applicable thereto in the case of Fixed-Rate Pools (other than those containing GPMs) and the Issue Date. The Issue Supplement will also contain any variation from the basic Trust Indenture applicable to a particular Issue, any such variation also being described in the Prospectus Supplement relating to such Issue. As set forth under "Legal Opinion," the validity of each Issue of Certificates, the Trust Indenture, and the applicable Issue Supplement will be passed upon by the General Counsel of the Corporation upon the request of any Holder of Certificates of such Issue.

Mortgage Loans not previously held in the Corporation's portfolio will be purchased pursuant to a Pool Purchase Contract for cash or in exchange for Certificates in the related Pool. Such Mortgage Loans will be serviced by one of the Corporation-approved Lenders, normally the same entity as the loan originator, pursuant to the terms of the Pool Purchase Contract, as supplemented by the Selling and Servicing Guide, which is incorporated therein by reference. Copies of the Trust Indenture and the Pool Purchase Contract, together with the Selling and Servicing Guide, may be obtained from the Corporation's Washington, D.C. office, from any of the Corporation's regional offices in Philadelphia, Atlanta, Chicago, Dallas, and Los Angeles, or from the Corporation's fiscal office in New York.

The following summaries describe certain provisions of the Trust Indenture. These summaries do not purport to be complete and are subject to, and qualified in their entirety by reference to, the more complete provisions of the Trust Indenture.

General

The Certificates will represent Fractional Undivided Interests in the Trust Fund created pursuant to the Trust Indenture and Issue Supplement for each Issue. The Fractional Undivided Interest represented by a particular Certificate will be equal to the initial principal denomination of such Certificate set forth on the face thereof divided by the aggregate Stated Principal Balance ⁽¹⁾ of the Mortgage Loans in the Pool (the "Pool Principal Balance") as of the Issue Date, which also will be set forth on the face of the Certificate. The Trust Fund for an Issue consists of (i) such Mortgage Loans as from time to time are subject to the Trust Indenture and Issue Supplement, (ii) such payments or other recoveries on Mortgage Loans as from time to time may be considered to be held by the Corporation for Certificateholders, (iii) property acquired by foreclosure of Mortgage Loans or by deed in lieu of foreclosure, and (iv) the interest of Certificateholders in the obligation of the Corporation to supplement payments and other recoveries on Mortgage Loans to the extent necessary to make required distributions to Certificateholders.

(1) All references herein to the Stated Principal Balance of a Mortgage Loan or to the aggregate Stated Principal Balance of all Mortgage Loans in a Pool are to the principal balance or aggregate principal balance, as the case may be, utilized by the Corporation in calculating the then outstanding principal balances of Certificates. Such Stated Principal Balances may differ from actual principal balances for a number of reasons, including supplemental payments by the Corporation on delinquent Mortgage Loans pursuant to its guaranty obligations and delays in the distribution of certain Mortgage Loan receipts.

The Certificates will be issued in fully registered form only unless the Corporation elects to establish a book-entry method for the registration of ownership of Certificates. Certificates will not be issued in initial principal denominations of less than \$25,000. (TI Section 7.01). In addition, Certificates may only be issued in integral multiples of \$5,000 in excess of \$25,000, with the exception of one odd denomination that may be issued for each Pool. The Certificates will be freely transferable and exchangeable at the corporate trust office of Chemical Bank, New York, New York. A service charge may be imposed for any exchange or registration of transfer of Certificates, and the Corporation may require payment of a sum sufficient to cover any tax or other governmental charge. (TI Section 7.02)

In the event that a book-entry system is established, Certificates that are presented for registration of transfer or exchange may be cancelled, and, in lieu of the physical delivery of a new Certificate or Certificates, the ownership of such new Certificates will be entered in such book-entry system. The provisions of the Trust Indenture are qualified to the extent required to permit the Corporation to establish such a book-entry system. (TI Section 7.02)

Distributions of principal and interest on each Issue of Certificates will be made by the Corporation on the 25th day of each month (the "Distribution Date") to the persons in whose names the Certificates are registered as of the close of business on the last day of the preceding month (the "Record Date"). The first distribution for each Issue of Certificates will be in the month following the month in which the Issue Date occurs. Distributions for each Issue will be made by check mailed to the address of the person entitled thereto as it appears on the Certificate Register not later than the 25th day of each month; provided, however, that the final distribution in retirement of Certificates of any Issue will be made only upon presentation and surrender of the Certificates at the office or agency of the Corporation specified in the notice to Certificateholders of such final distribution.

As described under "Rights Upon Event of Default," Holders of Certificates will have the right under certain circumstances to appoint a successor Trustee.

Transfer of Mortgage Loans to Pools

Each Mortgage Loan transferred to a Pool will be identified in a Mortgage Loan Schedule appearing as an exhibit to the Issue Supplement for the related Issue of Certificates. In addition, the Corporation, as Trustee of the Mortgage Loans, will retain on behalf of Certificateholders the original Mortgage Note, endorsed in blank, and a completed and executed assignment to the Corporation of the mortgage instrument in suitable form for recording but not recorded. At its option, the Corporation may choose to maintain such documents either with a custodian institution (the Lender or another institution) whose deposits or accounts are insured by the FDIC, FSLIC or a state agency, or with a subsidiary of the Lender. The Corporation will review the Mortgage Loan Schedule prior to the issuance of the Certificates and will conduct random spot checks to confirm the sufficiency of the documents after issuance of the Certificates.

Although the above procedures are intended to protect the interests of the Holders of Certificates in the Mortgage Loans in the related Pool, the law applicable to a liquidation, reorganization, or similar proceeding involving the assets of a Lender or of the Corporation is unclear and as a result no opinion can be rendered as to the status of Certificateholders' interests in the event of any such proceeding. The Corporation's guaranty would, however, by its terms be available in the event of any such proceeding involving the assets of a Lender.

Servicing Through Lenders

Pursuant to the Trust Indenture, the Corporation is responsible for servicing and administering the Mortgage Loans but, in its discretion, is permitted to contract with the originator of each Mortgage Loan, or another eligible servicing institution, to perform such functions under the supervision of the Corporation as more fully described herein. Any servicing contract or arrangement by the Corporation with a Lender for the direct servicing of Mortgage Loans is a contract solely between the Corporation and that Lender, and the Certificateholders are not deemed to be parties thereto and have no claims, rights, obligations, duties, or liabilities with respect to such Lender. (TI Section 5.01)

Lenders will be obligated pursuant to the Selling and Servicing Guide to perform diligently all services and duties customary to the servicing of mortgages, as well as those specifically prescribed by the Selling and Servicing Guide. The Corporation will monitor the Lender's performance and has the right to remove any Lender for cause at any time it considers such removal to be in the best interest of Certificateholders. The duties performed by Lenders include general loan servicing responsibilities, collection and remittance of principal and interest payments, administration of mortgage escrow accounts, collection of insurance claims, and, if necessary, foreclosure.

The Corporation retains as to each Fixed-Rate Mortgage Loan the difference in interest between the annual Mortgage Interest Rate borne by the Mortgage Loan and the Pass-Through Rate or Accrual Rate on the Certificates. For example, if a Mortgage Loan with a 12.25 percent Mortgage Interest Rate is included in a Pool against which a Certificate with an 11.25 percent Pass-Through Rate is issued, the Corporation would be entitled to receive total compensation of one percent per annum on the Mortgage Loan. For ARMs, the Corporation will retain an amount equal to the percentage Spread applicable thereto applied to the outstanding principal balance as increased by any deferred interest that has been included therein. See "Yield Considerations." The Corporation is also entitled to retain prepayment fees, late charges, assumption fees, and similar charges to the extent they are collected from borrowers. The Corporation will compensate Lenders in an amount up to, but never exceeding, the amount of interest retention described above, less a prescribed minimum amount to be retained by the Corporation for itself in consideration of its guaranty obligations and servicing responsibilities.

Payments on Mortgage Loans; Distributions on Certificates

On the twenty-fifth day of each month (beginning with the month following the month of the Issue Date), the Corporation will, respecting each Issue, distribute to Certificateholders an amount equal to the total of (i) the principal due on the Mortgage Loans in the related Pool during the period beginning on the second day of the month prior to the month of such distribution and ending on the first day of such month of distribution (the "Due Period"), (ii) the Stated Principal Balance of any such Mortgage Loan that was prepaid in full during the second month next preceding the month of such distribution (including as prepaid for this purpose any Mortgage Loan repurchased by the Corporation as described herein because of the Corporation's election to repurchase the Mortgage Loan after it is delinquent, in whole or in part, with respect to four consecutive installments of principal and interest, or because of the Corporation's election to repurchase such Mortgage Loan under the circumstances described in the last paragraph under "Collection and Other Servicing Procedures" below), (iii) the amount of any partial prepayment of a Mortgage Loan received in the second month next preceding the month of distribution, and (iv) in respect of all Fixed-Rate Mortgage Loans other than GPMs during their Deferred Interest Period, one month's interest at the Pass-Through Rate (or Accrual Rate in the case of GPMs) on the Pool Principal Balance as reported to Certificateholders in connection with the previous distribution (or, respecting the first distribution, the Pool Principal Balance on the Issue Date). For purposes of distributions, a Mortgage Loan will be considered to have been prepaid in full if, in the Corporation's reasonable judgment, the full amount finally recoverable on account of such Mortgage Loan has been received, whether or not such full amount is equal to the Stated Principal Balance of the Mortgage Loan. The Corporation may, in its discretion, include with any distribution principal prepayments, both full and partial, received during the month prior to the month of distribution but is under no obligation to do so.

For each GPM during its Deferred Interest Period and each ARM, the Corporation will, on each monthly Distribution Date, distribute an amount as to interest equal to the amount of interest payable on such Mortgage Loan during the applicable Due Period (which will, in the case of GPMs during their Deferred Interest Period, and may, in the case of ARMs having deferred interest features, be less than one month's interest at the Mortgage Interest Rate) less the amount retained by the Corporation as described under "Servicing Through Lenders" above.

Distributions on any Distribution Date will be made to Certificateholders of record on the prior Record Date (the close of business on the last day of the immediately preceding month). Each Certificateholder will be entitled to receive an amount equal to the total amount distributed multiplied by the Fractional Undivided Interest evidenced by such Holder's Certificate.

The Corporation's Guaranty

The Corporation's obligation described above to distribute amounts representing scheduled principal and interest, whether or not received, and its obligation to distribute the full principal amount of any foreclosed or otherwise finally liquidated Mortgage Loan, whether or not such principal amount is actually recovered, constitute the Corporation's guaranty obligations in respect of the Certificates. If the Corporation were unable to perform such obligations, distributions to Certificateholders would consist solely of payments and other recoveries on Mortgage Loans and, accordingly, delinquencies and defaults would affect monthly distributions to Certificateholders.

Reports to Certificateholders

With respect to each distribution, the Corporation will cause to be forwarded to each Certificateholder with respect to all Certificates held by such Certificateholder in each Pool, a statement setting forth, to the extent applicable, the following information:

- (i) the amount, if any, due on such Certificates on the related Distribution Date on account of total scheduled and unscheduled principal (including any Deferred Interest);
- (ii) the amount due on such Certificates on the related Distribution Date on account of interest;
- (iii) the total of the cash distribution on such Certificates on the related Distribution Date;
- (iv) the Certificate Principal Balances of such Certificates on the related Distribution Date after giving effect to any distribution of principal made on such date and to any Deferred Interest added to the principal balances of the underlying Mortgage Loans during the preceding Due Period;
- (v) the total amount of any Deferred Interest that was added to the principal balances of the underlying Mortgage Loans during the preceding Due Period;
- (vi) the amount, if any, of (i) above that is allocable to Deferred Interest;
- (vii) the amount, if any, of (iv) above that is allocable to Deferred Interest; and
- (viii) for ARM Pools, the Accrual Rate applicable to such Distribution Date (or, in the event the underlying Mortgage Loans have different Accrual Rates, the approximate weighted average Accrual Rate).

Within a reasonable period of time after the end of each calendar year, the Corporation will furnish to each Person who at any time during the calendar year was a Certificateholder a statement containing the information set forth in items (i), (ii), (v), and (vi) above, in summary form for such calendar year, or for any portion thereof during which such Person was a Certificateholder.

Servicing Compensation and Payment of Certain Expenses by the Corporation

As compensation for its activities and obligations under the Trust Indenture, the Corporation will be entitled to retain the amounts applicable to interest that are not required to be distributed to Certificateholders as described above. In addition, the Corporation is entitled to retain any amounts by which the proceeds of the liquidation of a Mortgage Loan exceed (i) the Stated

Principal Balance of that Mortgage Loan and (ii) interest thereon at the Pass-Through Rate in the case of a Fixed-Rate Mortgage Loan (other than a GPM) or interest thereon at the Accrual rate in the case of a GPM or an ARM. The Corporation will pay all expenses incurred by it in connection with its servicing activities, including, without limitation, the fees to Lenders, and is not entitled to reimbursement therefor out of the Trust Fund.

Additional servicing compensation in the form of prepayment charges, assumption fees, late payment charges, or otherwise will be retained by the Corporation.

Collection and Other Servicing Procedures

The Corporation is responsible for servicing the Mortgage Loans in each Pool and may, as set forth above, conduct such servicing through Lenders or through other Corporation-approved mortgage servicers. In connection with its servicing activities, the Corporation has full power and authority to do or cause to be done any and all things as it may deem necessary or appropriate in its sole discretion, including the foreclosure or comparable conversion of a defaulted Mortgage Loan. In lieu of undertaking any such foreclosure, the Corporation may, in its discretion and without obligation, repurchase from the Trust Fund any Mortgage Loan that is delinquent, in whole or in part, as to four consecutive installments of principal and interest. The purchase price will be equal to the Stated Principal Balance of the delinquent Mortgage Loan together with accrued interest at the Pass-Through Rate (or the Accrual Rate in the case of a GPM or an ARM) and will be distributed to Certificateholders in the same manner as full prepayments of Mortgage Loans. See "Description of Certificates—Payments on Mortgage Loans; Distributions on Certificates." (TI Sections 5.01 and 5.03)

With respect to each Mortgage Loan in a Pool, the Lender makes certain warranties to the Corporation concerning such matters as the recordation of the original Mortgage, the validity of the Mortgage Loan as a first lien on the Mortgaged Property, and compliance by such Mortgage Loan with applicable state and federal laws. In the event of a material breach of any such warranty or a material defect in the Mortgage Loan documentation, the Corporation may withdraw such Mortgage Loan from the Trust Fund at a price equal to its Stated Principal Balance together with interest thereon at the Pass-Through rate (or the Accrual Rate in the case of a GPM or an ARM). Alternatively, the Corporation may, at its option, for all Pools other than Pools containing Multifamily Mortgage Loans, substitute a new Mortgage Loan for a defective Mortgage Loan; provided, however, that no such substitution may take place more than two years subsequent to the date of the original issue of the related Certificates, and any such substitute Mortgage Loan must satisfy certain eligibility criteria designed to assure that the nature of the Pool will not be altered by any such substitution. Any amount by which the Stated Principal Balance of the defective Mortgage Loan exceeds the principal balance of the substitute Mortgage Loan (the substitute Mortgage Loan may not be larger than the Mortgage Loan it is replacing) will be passed through to Certificateholders.

Subject to the following paragraph and to the extent consistent with then-current policies of the Corporation respecting mortgage loans held in its own portfolio, the Corporation in its discretion may enforce or waive enforcement of any of the terms of any Mortgage Loan or enter into an agreement for the modification of any of the terms of any Mortgage Loan, or take any action or refrain from taking any action in servicing any Mortgage Loan. In such connection, the Corporation may waive any prepayment charge, assumption fee, or late payment charge or may exercise or refrain from exercising any "call option rider"; provided, however, that any decision to exercise or refrain from exercising any "call option rider" must be consistent with then-current policies or practices employed by the Corporation respecting comparable mortgage loans held in its own portfolio and must be without consideration of the ownership status of the related Mortgage Loan.

In connection with the transfer or prospective transfer of title to a Mortgaged Property, the Corporation is obligated to accelerate the maturity of the related Mortgage Loan where that Mortgage Loan contains a "due-on-sale" clause permitting acceleration under those conditions

unless the Corporation is restricted by law from enforcing the "due-on-sale" clause or the Corporation elects to withdraw such Mortgage Loan from the Pool. See "Maturity and Prepayment Assumptions."

In the event that, for any reason, the Corporation is not obligated to accelerate the maturity of a Conventional Mortgage Loan upon the transfer, or prospective transfer, of title to the underlying Mortgaged Property, the Corporation may enter into a transaction by which the obligor is released from liability on the related Mortgage Loan and the transferee assumes such liability; provided, however, that no such transaction shall (i) be entered into which would not have been entered into had the Mortgage Loan been held in the Corporation's own portfolio or (ii) provide for reduction of the Mortgage Interest Rate or, in the case of any ARM, provide for any change in any interest rate adjustment provision or provision governing the calculation of scheduled payments if any such change would be adverse to the interests of Certificateholders.

The Trust Indenture provides that the Corporation may repurchase from the related Pool, at a price equal to the Stated Principal Balance thereof plus accrued interest thereon at the applicable Pass-Through Rate (or the applicable Accrual Rate in the case of a GPM or an ARM), any Mortgage Loan respecting which the underlying Mortgaged Property is transferred, or proposed to be transferred, under circumstances permitting the Corporation to accelerate the maturity of such Mortgage Loan pursuant to the terms of any "due-on-sale" clause contained therein.

Certain Matters Regarding the Corporation

The Trust Indenture provides that the Corporation may not resign from its obligations and duties thereunder, except upon determination that those duties are no longer permissible under applicable law. No such resignation will become effective until a successor has assumed the Corporation's obligations and duties under the Trust Indenture; provided, however, that no successor will succeed to the Corporation's guaranty obligations described above, the Corporation continuing to be responsible thereunder notwithstanding any termination of its other duties and responsibilities under the Trust Indenture. In the event that the Corporation is unable to fulfill its continuing guaranty obligations, the Trust Indenture may be modified to provide for monthly distributions to be made from then-available Mortgage Loan payments and other recoveries in a manner similar to practices and procedures followed in the servicing of whole loans for institutional investors. (TI Section 9.01)

The Trust Indenture also provides that neither the Corporation nor any director, officer, employee, or agent of the Corporation will be under any liability to the Trust Fund or to Certificateholders for any action taken or for refraining from the taking of any action in good faith pursuant to such Trust Indenture, or for errors in judgment; provided, however, that neither the Corporation nor any such person will be protected against any liability that would otherwise be imposed by reason of willful misfeasance, bad faith or gross negligence or by reason of willful disregard of obligations and duties.

In addition, the Trust Indenture provides that the Corporation is not under any obligation to appear in, prosecute, or defend any legal action that is not incidental to its responsibilities under the Trust Indenture and that in its opinion may involve it in any expense or liability. The Corporation may, however, in its discretion undertake any such legal action which it may deem necessary or desirable in the interests of the Certificateholders. In such event, the legal expenses and costs of such action and any liability resulting therefrom will be expenses, costs, and liabilities of the Corporation that will not be reimbursable to the Corporation out of the Trust Fund. (TI Section 8.02)

Any corporation into which the Corporation may be merged or consolidated, or any corporation resulting from any merger, conversion, or consolidation to which the Corporation is a party, or any corporation succeeding to the business of the Corporation, will be the successor of the Corporation under the terms of the Trust Indenture (TI Section 9.02)

Events of Default

Events of Default under the Trust Indenture will consist of (i) any failure by the Corporation to distribute to Certificateholders any required payment that continues unremedied for 15 days after the giving of written notice of such failure to the Corporation by the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than five percent of the related Trust Fund; (ii) any failure by the Corporation duly to observe or perform in any material respect any other of its covenants or agreements in the Trust Indenture which failure continues unremedied for 60 days after the giving of written notice of such failure to the Corporation by the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 25 percent of the related Trust Fund; and (iii) certain events of insolvency, readjustment of debt, marshalling of assets and liabilities, or similar proceedings and certain actions by or against the Corporation indicating its insolvency, reorganization, or inability to pay its obligations. (TI Section 9.03)

Rights Upon Event of Default

As long as an Event of Default under the Trust Indenture for any Issue remains unremedied, the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 25 percent of the related Trust Fund may, in writing, terminate all of the obligations and duties of the Corporation as Trustee and in its corporate capacity under the Trust Indenture in respect of such Issue (other than its guaranty obligations described above which continue notwithstanding any such termination) and name and appoint, in writing, a successor to succeed to all such responsibilities, duties, and obligations of the Corporation thereunder (other than the Corporation's guaranty obligations) and to the legal title to the Mortgage Loans held in such Trust Fund. (TI Section 9.03)

Amendment

The Trust Indenture as it relates to any Issue may be amended by the Corporation without the consent of or notice to any of the Certificateholders, for one or more of the following purposes: (i) to add to the covenants of the Corporation; (ii) to evidence the succession of another party or parties to the Corporation and the assumption by such successor or successors of the obligations of the Corporation thereunder in its corporate capacity or in its capacity as Trustee or in both such capacities; (iii) to eliminate any right reserved to or conferred upon the Corporation in its corporate capacity; (iv) to make provisions for the purpose of curing any ambiguity or correcting or supplementing any provision in the Trust Indenture or any Issue Supplement, provided such provisions do not adversely affect the interests of any Certificateholder; or (v) to modify the Trust Indenture under the circumstances and for the purposes set forth in the final sentence of the first paragraph under "Certain Matters Regarding the Corporation" above. (TI Section 11.01)

The Trust Indenture as it relates to any Issue may also be amended by the Corporation with the consent of the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 66 percent of the related Trust Fund so as to waive compliance by the Corporation with any terms of the Trust Indenture or related Issue Supplement, or to allow the Corporation to eliminate, change, add to, or modify the terms of the Trust Indenture or Issue Supplement. However, no such waiver or amendment may, without the consent of all Certificateholders, terminate or modify the guaranty obligations of the Corporation or reduce the percentages of Certificates the Holders of which are required to consent to any waiver or amendments. In addition, no waiver or amendment shall, without the consent of each Certificateholder affected thereby, reduce in any manner the amount of, or delay the timing of, payments received on Mortgage Loans that are required to be distributed on any Certificate. (TI Section 11.02)

List of Certificateholders

With respect to each Pool, in the event that Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than five percent of the related Trust Fund notify the

Corporation in writing that they desire to communicate with other Certificateholders of that Trust Fund, accompanied by a copy of the proposed communication, then, within five business days after receipt of such notification, the Corporation will afford access to such Certificateholders during normal business hours to the most recent list of Certificateholders in such Pool. (TI Section 12.02)

Termination

The Trust Indenture as it relates to each Issue terminates upon the final payment or liquidation of the last Mortgage Loan remaining in the related Pool and distribution of all proceeds thereof. The Trust Indenture as it relates to each Issue will terminate also upon repurchase by the Corporation, at its option, of all remaining Mortgage Loans in the related Pool at a price equal to 100 percent of the Stated Principal Balance of each such Mortgage Loan together with one month's interest thereon at the Pass-Through Rate (or, in the case of a GPM Pool or an ARM Pool, one month's interest on the Stated Principal Balance of each GPM or ARM, as the case may be, at the applicable Accrual Rate). (TI Section 10.01) The exercise of such option will effect early retirement of the Certificates of that Issue, but the Corporation's right to repurchase is conditioned upon the Pool Principal Balance at the time of repurchase being less than ten percent of the Pool Principal Balance on the Issue Date. In addition, the Corporation has stated that it will be its policy not to exercise any such option in respect of any Pool if (i) it has knowledge that any related Certificate has been pledged to secure an issue of cash flow obligations and (ii) the exercise of such option would take place prior to the earliest date upon which the issuer of such cash flow obligations can exercise an option to redeem such obligations without premium. In no event, however, will the trust relating to each Pool as created by the Trust Indenture continue beyond the expiration of 21 years from the death of the last survivor of the persons named in the Trust Indenture. For each Issue, the Corporation will give written notice of termination of the Trust Indenture as it relates to such Issue to each affected Certificateholder, and the final distribution will be made only upon surrender and cancellation of the Certificates at an office of the Corporation specified in the notice of termination. (TI Section 10.01)

FEDERAL TAX ASPECTS

Set forth is a discussion of certain federal income tax consequences to persons purchasing Certificates. The discussion does not purport to deal with all aspects of federal taxation that may be relevant to particular investors. Prospective investors are advised to consult their own tax advisors regarding the federal income tax consequences of holding and disposing of Certificates as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

Revenue Ruling 84-10, 1984-1 C.B. 155, sets forth certain federal income tax consequences relating to investments in the Certificates issued with respect to a Pool. Pursuant to Revenue Ruling 84-10, a Pool will not be classified as an association taxable as a corporation, but will be classified as a trust of which the Certificateholders of the respective Pool are the owners under Subpart E of Part I of Subchapter J of the Internal Revenue Code of 1954, as amended (the "Code"). Each Certificateholder will be treated as the owner of a pro rata undivided interest in the ordinary income and corpus of the trust attributable to that particular Pool and will be considered to be the equitable owner of a pro rata undivided interest in each of the Mortgage Loans included therein.

Accordingly, Certificateholders of a particular series will be required to report on their federal income tax returns, consistent with their methods of accounting, their pro rata share of the entire income from the Mortgage Loans in that particular Pool, including interest, prepayment penalties, assumption fees and late payment charges received by the Pool, plus any

amount paid to the Pool by the Corporation as interest under its guaranty. Certificateholders will be entitled to deduct their pro rata share of the servicing fee paid to the Corporation, as provided in section 162 or section 212 of the Code, consistent with their methods of accounting.

Certificateholders must also report their pro rata share of any original issue discount not covered by the special rules of section 1272 of the Code on each of the Mortgage Loans as ordinary income, consistent with their methods of accounting. The special rules of section 1272 of the Code will be applicable to the Certificateholders' pro rata shares of such original issue discount on any Mortgage Loans in the Pool to the extent that the conditions for the application of that section are met. These special rules will not apply with respect to Mortgage Loans originated before March 2, 1984 if the Mortgagors of such Mortgage Loans were natural persons, but may apply with respect to such Mortgage Loans if they are originated on or after March 2, 1984. To the extent these special rules apply, Certificateholders may be required to include amounts in income before the receipt of cash attributable to that income. With respect to any undivided interest in a Mortgage Loan purchased at a premium, the Certificateholder will not be entitled to a deduction for amortization under the special rules of section 171 of the Code unless the conditions for the application of that section are met. However, such a premium may result in the inclusion by a Certificateholder of a lesser amount of original issue discount under the special rules of section 1272 of the Code. Certificateholders are advised to consult with their tax advisors as to whether premium or discount results from the acquisition of Certificates and the effect, if any, of such premium or discount upon any secondary market for Certificates. Such premium might be deductible only upon sale or final distribution in respect of the Certificates, and then only as a short- or long-term capital loss, depending upon how long the Certificates have been held. The long-term holding period is six months with respect to a Certificate acquired by a Certificateholder on or before December 31, 1987 and will be one year with respect to Certificates acquired thereafter.

The Internal Revenue Service also ruled in Revenue Ruling 84-10 as follows:

1. A Certificate owned by a domestic building and loan association is considered as representing "loans secured by an interest in real property" within the meaning of section 7701(a)(19)(C)(v) of the Code, provided the real property underlying the Mortgages is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code.

2. A Certificate owned by a real estate investment trust is considered as representing "real estate assets" within the meaning of section 856(c)(5)(A) of the Code, and the interest income is considered "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B) of the Code.

3. A Certificate is considered as representing "qualifying real property loans" within the meaning of section 593(d) of the Code, provided the real property underlying the Mortgages is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code. Thus, a Certificate owned by a domestic building and loan association or any other thrift institution described in section 593(a) of the Code will represent "qualifying real property loans" within the meaning of section 593(d) of the Code, provided the real property underlying the Mortgages is (or, from the proceeds of the Mortgage Loans, will become) the type of real property described in that section of the Code.

If a Certificateholder is considered as acquiring an undivided interest in a Mortgage Loan that constitutes a "market discount bond" and incurs or continues indebtedness to purchase or carry such undivided interest, the interest on such indebtedness for any taxable year that exceeds the interest (including original issue discount) on such undivided interest includable in the Holder's income for that year would be allowed as a deduction in that year only to the extent that such excess is greater than the portion of any accrued market discount. A deduction would, at the election of the Holder, be allowed in a subsequent taxable year for any previously disallowed

deduction to the extent that, for such subsequent taxable year, the interest (including original issue discount) includable in the Holder's gross income with respect to such undivided interest exceeds the interest paid or accrued with respect to the indebtedness. To the extent not previously deducted, the amount of any disallowed interest deduction will be allowed in the year of the disposition of such undivided interest. A market discount bond includes any undivided interest in a Mortgage Loan with respect to which the face amount exceeds the Certificateholder's basis in such undivided interest. In the case of an undivided interest in a Mortgage Loan issued at a discount, the face amount will be deemed to be the issue price (the original amount loaned by the lender of the Mortgage Loan) increased by the amount of original issue discount includable in the gross income of all Holders who owned such undivided interest for periods prior to its acquisition by the Certificateholder (without adjustment for any prior purchase premium). In addition, on the disposition of an undivided interest in a Mortgage Loan originated after July 18, 1984 that is a market discount bond, a Certificateholder will be required to include as interest income any gain realized on such disposition to the extent of any accrued market discount. If a Mortgage Loan was originated on or before July 18, 1984, any gain recognized by a Certificateholder on a disposition of an undivided interest in such Mortgage Loan shall be treated as ordinary income to the extent the amount of such gain does not exceed the amount of the previously disallowed interest deduction that is allowable in the year of such disposition. An exception to the rules in this paragraph will apply if the Certificateholder elects to include in income in each taxable year the portion of the market discount attributable to such year (computed either on a straight line or a constant interest rate basis) with respect to all market discount bonds acquired by the Certificateholder on or after the first day of the first taxable year to which such election applies.

The Corporation will furnish to each Certificateholder with each distribution a statement setting forth the amount of such distribution allocable to principal and to interest. In addition, the Corporation will furnish or make available, within a reasonable time after the end of each calendar year, to each Certificateholder who at any time during such year held a Certificate, a statement setting forth such Certificateholder's pro rata share of interest income and administrative expense for such calendar year to assist the Certificateholder in the preparation of its tax return. The Corporation shall also furnish to the required persons such other forms as may be required to be filed under the Code and regulations thereunder with respect to Pools. Certain reporting responsibilities are imposed on owners of mortgage loans relating to the receipt of interest income with respect to such mortgage loans and foreclosures and abandonments of the underlying mortgaged property. These reporting requirements are expected to apply to the Pools. However, the reporting of interest is the responsibility of the Trustee. Temporary Treasury regulations also impose the reporting of foreclosures and abandonments on the Trustee.

Payments of interest and principal, as well as payments of proceeds from the sale of Certificates, to Certificateholders who are not exempt recipients may be subject to the "backup withholding" tax under section 3406 of the Code at a rate of 20 percent if such Certificateholders fail to furnish certain information, including their taxpayer identification numbers, to the Corporation or its agent, or otherwise fail to establish an exemption from such tax. Any amounts deducted and withheld from a distribution to a Certificateholder would be allowed as a credit against such Certificateholder's federal income tax. Furthermore, certain penalties may be imposed by the Internal Revenue Service on a Certificateholder who is required to supply information but who does not do so in the proper manner.

Foreign taxpayers should consult their own tax advisors concerning certain additional tax consequences that may apply to their holding and disposing of Certificates, including the possible application to interest payments on the Certificates of the 30 percent (or lower treaty rate) withholding tax and certain information reporting requirements.

The Department of the Treasury has proposed a fundamental tax reform plan that, if enacted, could adversely affect certain Certificateholders' holding of the Certificates, particularly those Certificateholders that are financial institutions.

LEGAL OPINION

Any purchaser of Certificates will be furnished upon request an opinion by Caryl S. Bernstein, Esq., Executive Vice President, General Counsel, and Secretary of the Corporation, as to the validity of the Certificates, the applicable Trust Indenture, and the relevant Issue Supplement.

ERISA CONSIDERATIONS

On May 13, 1982, the Department of Labor issued a final regulation (29 C.F.R. § 2550.401b-1), effective June 17, 1982, which provides that in the case where an employee benefit plan ("plan") subject to the Employee Retirement Income Security Act of 1974 ("ERISA") acquires a "guaranteed governmental mortgage pool certificate" then, for purposes of the fiduciary responsibility provisions of ERISA and the prohibited transaction provisions of the Code, the plan's assets include the certificate and all of its rights with respect to such certificate under applicable law, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying such certificate. Under the regulation, the term "guaranteed governmental mortgage pool certificate" is specifically defined to include a mortgage pool certificate with respect to which interest and principal payable pursuant to the certificate are guaranteed by the Corporation. The effect of such regulation is to make clear that the sponsor (that is, the entity that organizes and services the pool, in this case the Corporation), the trustee, and other persons, in providing services with respect to the mortgages in the pool, would not be subject to the fiduciary responsibility provisions of Title I of ERISA, nor be subject to the prohibited transaction provisions of Section 4975 of the Code, merely by reason of the plan's investment in a certificate. The Corporation has been advised by its counsel, Brown, Wood, Ivey, Mitchell & Petty, that, on the basis of the final regulation and class exemptions previously issued by the Department of Labor, the acquisition from the Corporation and holding of the Certificates by plans are not prohibited either by ERISA or related provisions of the Code.

CAPITALIZATION

The following table sets forth the capitalization of the Corporation as of December 31, 1984.

	<u>Average Maturity</u>	<u>Average Annual Cost</u>	<u>Outstanding</u> <small>(Dollars in thousands)</small>
Bonds, notes, and debentures (1)			
Due within one year			
Short-term notes, net of unamortized discount	4 mos.	11.51%	\$10,164,948
Master notes	5 mos.	8.33	1,220,385
Investment notes (2)		9.65	1,275,273
Mortgage-backed bonds	8 mos.	6.70	33,589
Debentures	6 mos.	12.00	18,067,185
Capital debentures	1 mo.	11.77	500,000
Total due within one year			31,261,380
Due after one year			
Mortgage-backed bonds	5 yrs 2 mos.	8.42	368,270
Debentures	3yrs. 4 mos.	11.53	49,733,435
Exchangeable debentures	6 yrs. 2 mos.	12.66	450,000
Zero coupon debentures, net of unamortized discount	29 yrs. 6 mos.	11.50	221,344
Zero coupon capital debentures, net of unamortized discount	34 yrs. 9 mos.	10.22	211,155
Capital debentures, net of unamortized discount	7 yrs. 9 mos.	10.34	1,446,451
Convertible capital debentures	11 yrs. 8 mos.	4.43	27,465
Total due after one year			52,458,120
Total bonds, notes, and debentures			\$83,719,500
Stockholders' equity			\$ 1,208,139

(1) All of the outstanding bonds, notes, and debentures were issued under Section 304(b) of the Charter Act except the capital debentures and convertible capital debentures which were issued under Section 304(e) and the mortgage-backed bonds which were issued under Section 304(d). See "Corporate Indebtedness" for a description of certain limitations imposed by the Charter Act applicable to debt issued by the Corporation.

(2) Investment notes are individually negotiated agreements providing for the investment of a variable principal amount at a fixed or floating rate of interest. The average term as of December 31, 1984, of the outstanding agreements is two years, three months.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

The Corporation is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 *et seq*) (the "Charter Act"). It is the largest investor in home mortgage loans in the United States, with a net portfolio of \$84.4 billion of mortgage loans as of December 31, 1984. The Corporation was originally established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market and was transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

The Corporation provides funds to the mortgage market primarily by purchasing mortgage loans from local lenders, thereby replenishing their funds for additional lending. The Corporation acquires funds to purchase loans from many capital market investors that may not ordinarily invest in mortgage loans, thereby expanding the total amount of funds available for housing. Operating nationwide, the Corporation helps to redistribute mortgage funds from capital-surplus to capital-short areas.

The Corporation incurred a loss in 1984, after operating profitably in 1983 and incurring a loss in 1982. The primary reason for the losses in 1984 and 1982 was the excess in the cost of the Corporation's outstanding debt over the yield on its mortgage portfolio (or "negative spread"). During 1983, the Corporation's negative spread was substantially less than in 1984 and 1982, and its impact was more than offset by income from other sources. See "Selected Financial Data," "Management's Discussion and Analysis of Financial Results," and "Mortgage Portfolio Spread."

Although the Secretary of the Treasury of the United States has discretionary authority to lend the Corporation up to \$2.25 billion outstanding at any time, neither the United States nor any agency thereof is obligated to finance the Corporation's operations or to assist the Corporation in any other manner.

The principal office of the Corporation is located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016, and there are five regional offices located in Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; Los Angeles, California; and Philadelphia, Pennsylvania. The Corporation also has a fiscal office at 100 Wall Street, New York, New York 10005.

Copies of the Corporation's most recent annual and quarterly reports and proxy statement are available without charge from John Meehan, Senior Vice President—Finance and Treasurer, Federal National Mortgage Association, 100 Wall Street, New York, New York 10005 (telephone: 212-425-9002) or Paul Paquin, Director of Investor Relations, Federal National Mortgage Association, 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: 202-537-7115).

SELECTED FINANCIAL DATA

The following selected financial data for the years 1980 through 1984 (which data are not covered by the report of independent certified public accountants) have been summarized or derived from the audited financial statements. These data should be read in conjunction with the audited financial statements and notes to financial statements which are presented elsewhere herein.

Condensed Statements of Operations (Dollars in millions, except per share amounts)

	Year Ended December 31,				
	1980	1981(1)	1982	1983	1984(2)
Interest margin	\$ 21	\$ (468)	\$ (506)	\$ (62)	\$(152)
Commitment, guaranty, and other fees	68	125	301	288	228
Gain (loss) on sales of mortgages	—	—	44	91	12
Other expenses	(68)	(22)	(96)	(129)	(198)
Income (loss) before federal income taxes and extraordinary item	26	(360)	(257)	138	(110)
Provision for federal income taxes	12	(170)	(128)	68	(58)
Income (loss) before extraordinary item	14	(190)	(134)	75	(57)
Extraordinary item: gain on early retirement of debt(3)	—	—	29	—	—
Net income (loss)	<u>\$ 14</u>	<u>\$ (190)</u>	<u>\$ (105)</u>	<u>\$ 75</u>	<u>\$ (57)</u>
Earnings (loss) per share:					
Before extraordinary item:					
Primary	\$.24	\$(3.22)	\$(2.20)	\$ 1.15	\$(.87)
Fully diluted .....	.28	(3.22)	(2.20)	1.13	(.87)
Net:					
Primary .....	.24	(3.22)	(1.72)	1.15	(.87)
Fully diluted .....	.28	(3.22)	(1.72)	1.13	(.87)
Cash dividends per share	1.12	.40	.16	.16	.16

Condensed Balance Sheets (Dollars in millions)

	December 31,				
	1980	1981	1982	1983	1984
Assets					
Mortgage portfolio, net	\$55,742	\$59,846	\$69,714	\$75,665	\$84,430
Other assets	2,426	2,052	3,753	3,253	3,929
Total assets	<u>\$58,168</u>	<u>\$61,898</u>	<u>\$73,467</u>	<u>\$78,918</u>	<u>\$88,359</u>
Liabilities					
Bonds, notes, and debentures:					
Due within one year	\$15,542	\$17,365	\$25,781	\$26,860	\$31,261
Due after one year	39,338	41,186	43,833	47,734	52,458
Other liabilities	1,831	2,104	2,650	3,048	3,432
Total liabilities	56,711	60,655	72,264	77,642	87,151
Stockholders' equity	1,457	1,243	1,203	1,276	1,208
Total liabilities and stockholders' equity	<u>\$58,168</u>	<u>\$61,898</u>	<u>\$73,467</u>	<u>\$78,918</u>	<u>\$88,359</u>

(1) Results for the year ended December 31, 1981, include a \$42.0 million reduction in the allowance for loan losses effected in the second quarter.

(2) Effective October 1, 1984, the Corporation stopped accruing interest on all conventional loans that were 90 or more days delinquent, reducing interest income by \$11.6 million. At the same time, the Corporation raised the rates at which it records a provision for loss when conventional mortgage loans are purchased, increasing the provision for loan losses by an additional \$9.9 million. Also, in September 1984, the Corporation recorded a \$35.0 million supplemental provision to the allowances for loan losses. The combined effect of all of these actions was to increase the Corporation's after-tax loss by \$29.3 million (\$0.44 per share).

(3) In September 1982, the Corporation entered into a nontaxable transaction which resulted in the issuance of 6.3 million shares of its common stock in exchange for \$101 million of its long-term debentures, which were retired.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS

General

During the 1970s, the Corporation served the housing industry by raising funds in the private capital markets and purchasing fixed-rate loans for its portfolio, primarily 30-year FHA/VA and conventional single-family mortgages. Although the average maturity of the debt portfolio was significantly shorter than the average life of the mortgage portfolio, the existence of a relatively stable interest rate environment, combined with the Corporation's ability to borrow funds at favorable rates, allowed the Corporation to establish a record of profitability throughout the 1970s.

In the 1980s, the environment in which the Corporation operates changed dramatically. In 1980, and again in 1981, interest rates rose sharply to unprecedented levels. In this environment, the mismatch in the maturity structures of the Corporation's asset and debt portfolios became the Corporation's major financial problem. Significant amounts of maturing debt had to be refinanced at much higher costs, while repayment of assets was much slower. The increase in yield on the mortgage portfolio did not keep pace with the sharp increase in the average cost of outstanding debt. The result was greatly reduced profits in 1980 and substantial losses in 1981 and 1982.

In 1981, a new management team began implementing a wide range of strategic, operating, and financing changes designed to alleviate the maturity mismatch problem. These management initiatives included emphasizing the purchase of adjustable-rate and second mortgages (so that the repricing term of assets better matched that of borrowings), extending the average maturity of outstanding debt, and emphasizing fee income. At the same time, the Corporation has continued to serve the housing industry, by making a secondary market in the many new types of mortgage instruments that have been developed in the marketplace.

These changes, aided by a moderation in interest rates, produced a profit in 1983. In 1984, however, interest rates moved upward once again. Although the new policies mitigated the effect that the increase in the level of interest rates would otherwise have had on the Corporation, the result was a net loss from operations in 1984.

The Corporation's continuing sensitivity to increases in interest rates exists largely because a significant portion of its assets was acquired before the dramatic change in the financial markets took place. At December 31, 1980, the Corporation had a gross mortgage portfolio of \$57.3 billion, which was yielding 9.24 percent. This portfolio consisted entirely of fixed-rate mortgages, virtually all of which had original maturities of 30 years or more. At December 31, 1984, approximately \$46 billion of these assets were still in the Corporation's portfolio.

The business policy changes that began in 1981 should, in the long run, make the Corporation much less sensitive to interest rate fluctuations. This discussion and analysis reports on the Corporation's operating activities and financial results in the three years ended December 31, 1984. The discussion also highlights the new operating policies that have helped to mitigate the effect of increased borrowing costs.

Results of Operations

The Corporation's operations produced a net loss of \$57.4 million in 1984, compared with net income of \$75.5 million in 1983. In 1982, the Corporation incurred a net loss of \$104.9 million (\$133.8 million excluding an extraordinary gain on the early retirement of debt). The per share net loss in 1984 was \$0.87, compared with the 1983 per share net income of \$1.13 (fully diluted) and the 1982 per share loss of \$1.72 (\$2.20 before the extraordinary gain). Cash dividends were \$0.16 per share in each of the years 1984, 1983, and 1982.

Overall portfolio performance is measured by the "spread" between the average net yield on the mortgage portfolio and the average cost of outstanding debt. In 1984, the average portfolio yield was 10.81 percent and the average cost of outstanding debt was 11.39 percent, producing an average negative spread of 58 basis points. In 1983, the average portfolio yield was 10.67 percent and the average cost of outstanding debt was 11.12 percent, resulting in an average negative spread of 45 basis points. In 1982, the average portfolio yield was 10.29 percent and the average cost of outstanding debt was 11.59 percent, producing an average negative spread of 130 basis points. The Corporation's negative interest margin was \$151.7 million in 1984, compared with \$61.5 million and \$506.5 million in 1983 and 1982, respectively.

Interest earned on marketable securities was \$196.9 million in 1984, compared with \$221.7 million in 1983 and \$232.1 million in 1982. This reflects the Corporation's decision to maintain a smaller average liquidity position in 1984 than in the prior two years.

Other major sources of revenue are commitment fees, mortgage-backed security guaranty fees and gains on sales of mortgages. Commitment fees were \$114.3 million in 1984, compared with \$151.2 million in 1983 and \$263.9 million in 1982. Although there is a declining trend within the three years under review, all of these amounts are high relative to historical standards. The decline in 1983 from 1982's record level reflects the increased competition in the mortgage market, which resulted largely from the lower interest rate environment. The decline from 1983 to 1984 reflects the Corporation's increased effort to acquire shorter-term mortgages for its portfolio, for which the fee-earning opportunities were less. Standard, posted program commitments for the purchase of 30-year, single-family, fixed-rate first mortgages comprised only 11 percent of total commitments in 1984, compared with 29 percent in 1983. In 1984, 55 percent of all commitments issued for the purchase of single-family, fixed-rate first mortgages were negotiated commitments for the purchase of seasoned loans with remaining maturities of less than 30 years.

Guaranty fees from mortgage-backed securities increased to \$78.1 million in 1984 from \$54.3 million in 1983 and \$16.1 million in 1982 (the first full year of the program). Such guaranty fees grow in direct relation to the volume of securities outstanding. Mortgage-backed securities outstanding totaled \$36.2 billion at December 31, 1984, compared with \$25.1 billion and \$14.5 billion at December 31, 1983 and 1982, respectively. Gains on sales of mortgages were \$11.7 million in 1984, compared with \$90.7 million in 1983 and \$44.4 million in 1982, reflecting decreased sales activity in 1984.

In addition to interest expense, the other operating expenses of the Corporation are the provision for losses and administrative expenses. The provision for losses increased to \$85.8 million in 1984 from \$47.9 million in 1983 and \$35.7 million in 1982. Beginning in late 1983, the Corporation started experiencing an increase in foreclosure losses on conventional loans charged to the allowance for losses. Such charges totaled \$87.3 million in 1984, compared with \$38.4 million and \$1.6 million in 1983 and 1982, respectively. In response to this increase in loss experience, in September of 1984 the Corporation recorded a \$35 million supplemental addition to the allowance for losses on conventional mortgages. Also, effective October 1, 1984, the Corporation increased the rates at which it adds to the allowance when conventional loans are purchased. These actions caused the sharp increase in the provision for losses from 1983 to 1984.

Administrative expenses increased to \$112.1 million in 1984 from \$80.8 million in 1983 and \$60.1 million in 1982. The increases relate largely to employee compensation and professional services. As discussed above, the Corporation has restructured the way in which it does business, in response to a dramatically changed environment. The Corporation has greatly expanded the types of mortgage instruments purchased, has begun to market its products aggressively, and has pursued many other initiatives. Given this increase in complexity, the Corporation has made the expenditures necessary to continue to maintain control of the business.

The Mortgage Portfolio

Prior to 1982, virtually all of the Corporation's mortgage purchases were made pursuant to optional delivery commitments where the yield was fixed at the time of the commitment. Such commitments resulted in mortgage deliveries primarily when interest rates increased, so that assets were generally purchased at yields below current market levels. When rates declined, lenders were free to sell to other investors at a better price. Beginning in 1981, the Corporation started phasing out such optional delivery commitments. In 1984, virtually all of the commitments issued by the Corporation were either mandatory delivery commitments or market rate standby commitments.

Mandatory delivery commitments require the lender to deliver mortgages at the commitment yield, whether this is above or below the current market rate. Such commitments eliminate the risk of adverse selection discussed above, and also allow the Corporation to plan its borrowings and risk management strategies more effectively. Under market rate standby commitments, lenders obtain an "earmarking of funds" for loans currently in their production pipelines. The Corporation commits only to purchase a designated amount of mortgages; no yield is established upon issuance of the commitment. To deliver mortgages, the lender must convert the standby commitment to a mandatory delivery commitment, at which time the yield is established at a current market rate.

In 1984, the Corporation also introduced guaranteed rate convertible commitments. Although these commitments effectively gave lenders an option to deliver mortgages at a yield fixed at the time of the commitment, the commitments were structured such that the Corporation was able to hedge the delivery risk at no additional net cost to the Corporation.

The Corporation issued \$21.0 billion in mortgage purchase commitments in 1984, compared with \$18.6 billion and \$22.1 billion in 1983 and 1982, respectively. In 1984, negotiated transactions comprised 83 percent of commitments issued, compared with 58 percent in 1983 and 62 percent in 1982. The high percentage of negotiated transactions in these three years reflected the extent to which the Corporation has increased its flexibility as to the types of mortgage instruments it will purchase, and its ability to aggressively market its products.

The Corporation's purchase volume in 1984 was \$16.7 billion at an average net yield of 12.79 percent, compared with \$17.6 billion at 12.65 percent in 1983 and \$15.1 billion at 15.00 percent in 1982. Adjustable-rate mortgages ("ARMs") and second mortgages comprised 33 percent and 6 percent, respectively, of 1984's purchase volume. In 1983, ARM and second mortgage purchases were 24 percent and 8 percent of total purchases, respectively. In 1982, ARMs comprised 21 percent of purchases and second mortgages were 10 percent of purchases.

The Corporation continued its leadership in the ARM market in 1984 by purchasing interest rate-capped ARMs on a negotiated basis, and then, in December, by introducing a standard program for the purchase of these mortgages. In 1984, the Corporation also began to purchase conventional multifamily loans.

The positive spread between the average net yield on purchases and the average cost of debt issued in 1984 was 132 basis points, compared with 258 basis points in 1983 and 218 basis points in 1982. The reduction in this spread in 1984 reflected the increased percentage of ARM purchases and a decline in the average spread between mortgage instruments and Treasury securities.

Mortgage repayments totaled \$5.4 billion in 1984, compared with \$6.2 billion in 1983 and \$2.1 billion in 1982. On December 31, 1984, the net mortgage portfolio was \$84.4 billion, compared with \$75.7 billion and \$69.7 billion on December 31, 1983 and 1982, respectively.

Financing Activities

In 1984, the Corporation issued a total of \$48.0 billion of debt at an average cost of 11.47 percent, compared with \$40.0 billion at 10.07 percent in 1983 and \$55.0 billion at 12.82 percent in 1982. The Corporation has sought to maintain a balance between minimizing the average cost of outstanding debt, by relying on lower cost shorter-term borrowings, and lengthening the average maturity of outstanding debt by issuing longer-term debt when rates are favorable.

With the increased level of interest rates in 1984, the Corporation did not seek to achieve a significant overall extension of the maturity of outstanding debt. The Corporation did, however, take advantage of market opportunities to issue longer-term instruments, by using a number of innovative financing techniques. These initiatives avoided the shortening of the average maturity of outstanding debt which otherwise would have occurred.

The major new financing techniques employed in 1984 were as follows:

- The Corporation issued \$450 million of seven-year exchangeable debentures at a cost of 12.66 percent. The Corporation has the option to call for the conversion of the exchangeable debentures, in which case the debenture holders may either accept the Corporation's adjustable-rate preferred stock or extend the maturity of the debt. This instrument provides a type of insurance policy against significantly higher interest rates in the future, by providing access to equity at a time when it may be very costly to raise equity in the market.
- The Corporation issued its first debentures targeted to foreign investors. The \$300 million Eurobond offering had a maturity of seven years and an effective cost of 11.57 percent.
- The Corporation issued a 30-year zero coupon debenture and a 35-year zero coupon subordinated capital debenture. The former offering produced net proceeds of \$209.6 million at a cost of 11.50 percent; the latter offering produced net proceeds of \$206.4 million at a cost of 10.22 percent.
- The Corporation entered into interest rate swap agreements with a "notional" amount totaling \$1.3 billion and an average term of 5.5 years. These agreements extend the effective maturity of shorter-term debt. Over the term of such agreements, the Corporation makes periodic payments based on fixed rates applied to a notional amount of principal, and in exchange receives periodic payments based on short-term variable rates.
- The Corporation established a new investment note program. These are individually negotiated agreements that provide for the investment of a variable principal amount at a fixed- or floating-rate of interest. At December 31, 1984, the outstanding principal balance under such agreements was \$1.3 billion at a cost of 9.65 percent.
- The Corporation issued \$250 million of 30-year debentures with a 10-year call provision at a cost of 12.68 percent.

With several of these financing techniques, the Corporation was able to issue instruments with extended effective maturities at costs lower than comparable debentures. As a result of these initiatives, the Corporation was able to issue debt with an overall average maturity of two years, five months in 1984, despite the higher interest rate environment. In 1983, when interest rates were substantially lower, the average maturity of debt issued was also two years, five months. The average maturity of debt issued in 1982 was one year, four months. The average maturity of all outstanding debt was two years, seven months at December 31, 1984, compared with two years, five months at December 31, 1983 and two years, three months at December 31, 1982.

Mortgage-Backed Securities

The mortgage-backed securities ("MBS") program was introduced in 1981 as part of the effort to help insulate the Corporation's earnings from interest rate fluctuations. MBS guaranty fees are a stable source of revenue, which are not as interest rate sensitive as the Corporation's portfolio investing activities. The Corporation has marketed these securities very successfully, and, to date, has already earned substantial guaranty fee income.

The Corporation issued \$13.5 billion of MBS in 1984, compared with \$13.3 billion and \$14.0 billion in 1983 and 1982, respectively. The primary channel for the issuance of MBS is "swap" transactions where participating lenders exchange pools of mortgages directly for securities. The lenders can then either retain the securities for use as collateral, or sell them for cash to other investors. In 1984, the Corporation established an MBS "trading desk" to assist lenders who wish to sell their securities to investors. This service helps to create additional MBS originations, by allowing lenders to pool mortgages from their portfolios and sell them for immediate cash in a fast and efficient fashion. Another way in which the Corporation has successfully marketed its MBS product is by promoting the use of the MBS as collateral for collateralized mortgage obligations. Use of the MBS helps the issuer obtain a AAA rating.

In addition to issuing MBS through swap transactions, the Corporation also pools mortgages from its portfolio and issues securities for cash through public offerings and private placements. MBS issues from portfolio, which are treated as sales of assets, increase market liquidity and also have produced substantial gains. MBS sales from portfolio totaled \$1.0 billion in 1984, compared with \$4.4 billion in 1983 and \$3.0 billion in 1982.

In 1984, the Corporation began entering into commitments to enhance the credit of tax-exempt bond issues that finance multifamily housing projects. The resulting project mortgages will be swapped for special MBS. This activity will provide the Corporation with an additional source of guaranty fee income in the future.

In 1984, the Corporation passed the \$40 billion mark for total MBS issued since the inception of the program in 1981. The Corporation intends to remain very active in the MBS market, which should provide it with an increasing stream of fee income.

MORTGAGE PORTFOLIO SPREAD

The performance of the Corporation's portfolio is measured by the difference, or "spread," between the return it receives on its mortgage loan portfolio and the cost of money it borrows to finance that portfolio. The following table sets forth the spread on the portfolio during the periods indicated.

<u>For the Month</u>	<u>Net Portfolio at Month-End</u>	<u>Average Yield(1)</u>	<u>Average Cost of Outstanding Indebtedness(1)</u>			<u>Spread</u>
			<u>Short-term Notes</u>	<u>Bonds and Debentures</u>	<u>Aggregate</u>	
	(In millions)					
December 1980	\$55,742	9.20	13.93	9.29	9.87	(.67)
December 1981	59,846	9.82	16.10	10.63	11.42	(1.60)
December 1982	69,714	10.69	10.85	11.55	11.39	(.70)
December 1983	75,665	10.70	9.64	11.35	11.07	(.37)
1984						
January	76,438	10.71	9.67	11.36	11.08	(.37)
February	76,700	10.74	9.72	11.35	11.08	(.34)
March	78,224	10.75	9.86	11.36	11.11	(.36)
April	79,083	10.75	10.07	11.45	11.21	(.46)
May	79,736	10.76	10.36	11.46	11.27	(.51)
June	80,220	10.79	10.67	11.49	11.33	(.54)
July	80,726	10.83	11.03	11.58	11.46	(.63)
August	81,022	10.85	11.30	11.63	11.54	(.69)
September	81,594	10.89	11.56	11.72	11.64	(.75)
October	82,161	10.86	11.63	11.75	11.70	(.84)
November	83,000	10.89	11.52	11.69	11.65	(.76)
December	84,430	10.93	11.23	11.64	11.56	(.63)

(1) Average yield on portfolio is calculated for the month shown and converted to an annual interest rate using, as the numerator, the interest income plus the amortized discount less servicing fees and, as the denominator, the average outstanding unpaid principal balance of the mortgage loan portfolio less unamortized discount. Similarly, the average cost of bonds and debentures and aggregate indebtedness is calculated using actual expense and the average outstanding applicable indebtedness during the month. The average cost of short-term indebtedness is the average original issue cost computed on a 365-day basis.

Approximately \$17.1 billion principal amount at maturity of bonds and debentures (original term of one year or longer) matured or will mature during the twelve months following December 31, 1984, as shown below.

<u>Maturity Date</u>	<u>Principal Amount at Maturity</u>	<u>Weighted Average Cost</u>	<u>Maturity Date</u>	<u>Principal Amount at Maturity</u>	<u>Weighted Average Cost</u>
	(In millions)			(In millions)	
1985			1985		
January 10	\$1,050	9.95%	August 12	\$1,200	14.16%
February 11	1,250	14.85	September 10	1,300	13.31
March 11	1,050	11.17	October 10	1,400	9.26
April 10	500	13.81	November 12	750	13.06
May 10	1,600	12.87	December 10	2,000	12.45
June 10	1,400	9.62	Other Dates	2,039	11.39
July 10	1,600	12.56			

An improvement in the spread will depend upon the Corporation's ability to increase the yield on its mortgage loan portfolio and to refinance maturing borrowings at lower rates

HISTORY

The Corporation was incorporated in 1938 pursuant to Title III of the National Housing Act. The Corporation was then a wholly owned government corporation that borrowed operating funds almost entirely from the United States Treasury. Its business primarily consisted of the purchase and resale of mortgage loans insured by the Federal Housing Administration ("FHA") and, since 1948, mortgage loans guaranteed by the Veterans Administration ("VA"), for the purpose of establishing and maintaining a secondary market for such mortgage loans. Title III was revised in 1954 and called the Federal National Mortgage Association Charter Act. Under the new Charter Act, the Corporation became a mixed-ownership corporate instrumentality of the United States. In connection with its secondary market operations, the Corporation issued non-voting common stock to the institutions from which it purchased mortgages.

From 1950 to 1965, the Corporation was a constituent agency of the Housing and Home Finance Agency and from November 9, 1965 to September 1, 1968 the Corporation operated in the Department of Housing and Urban Development ("HUD"). The Charter Act, as in effect prior to September 1, 1968, empowered the Corporation to (1) conduct secondary market operations in FHA-insured and VA-guaranteed home mortgage loans consisting of purchases and sales of such loans ("Secondary Market Operations"), (2) perform special assistance functions in the purchase of mortgage loans as authorized by the President of the United States or by the Congress to assist in financing home loans in instances where established home financing facilities were inadequate ("Special Assistance Functions") and (3) manage and liquidate certain mortgage loans ("Management and Liquidating Functions").

Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the "1968 Act"), the Corporation in 1968 was partitioned into two separate and distinct corporations. One, the Government National Mortgage Association ("GNMA"), is a wholly owned corporate instrumentality of the United States within HUD. GNMA retained all of the assets and liabilities acquired and incurred under the Special Assistance Functions and Management and Liquidating Functions carried on by the predecessor corporation prior to the effective date of the 1968 Act.

The second, Federal National Mortgage Association, now constituted as a federally chartered corporation, retained the assets and liabilities related to the Secondary Market Operations prior to the effective date of the 1968 Act. The 1968 Act changed each share of outstanding non-voting common stock of the Corporation, par value \$100 per share, into one share of voting common stock without par value and authorized the Corporation to issue its common stock to the public. The 1968 Act also provided for a transitional period for the Corporation's stockholders to assume control of the Corporation, and all preferred stock theretofore held by the Secretary of the Treasury was retired in 1968. Accordingly, the entire equity interest in the Corporation became, and is now, stockholder-owned.

GOVERNMENT REGULATION AND CHARTER ACT

The Corporation is a federally chartered and stockholder-owned corporation organized and existing under the Charter Act. Although the 1968 Act eliminated all federal ownership interest in the Corporation, it did not terminate the significant government regulation of the Corporation. Under the Charter Act, approval of the Secretary of the Treasury and, prior to October 1, 1985, the Secretary of HUD, is required for the Corporation's issuance of its obligations; however, the Secretary of HUD has delegated the authority to approve the issuance of the Corporation's debt instruments to the Secretary of the Treasury.

Obligations of the Corporation issued under Section 304(b) of the Charter Act are subject to limitations imposed by the Charter Act and regulations adopted by HUD. See "Corporate Indebtedness."

In addition to specific enumerated powers, including those described above, the Secretary of HUD is granted general regulatory power over the Corporation under Section 309(h) of the Charter Act with authority to promulgate rules and regulations to carry out the purposes of the Charter Act. Also, the Secretary may require, pursuant to said Section 309(h), that a reasonable portion of the Corporation's mortgage loan purchases be related to the national goal of providing adequate housing for low- and moderate-income families, but with a reasonable economic return to the Corporation.

The Charter Act also gives the Secretary of HUD the authority to audit and examine the books and financial transactions of the Corporation, but this authority has never been exercised.

Although thirteen members of the Corporation's eighteen-member Board of Directors are elected by the holders of the Corporation's common stock, the remaining five members are required to be appointed by the President of the United States. One such appointed director is required to be from each of the home building, mortgage lending, and real estate industries. Any member of the Board of Directors, including a member elected by stockholders, may be removed by the President of the United States for good cause.

In addition to placing the Corporation under significant federal regulation, the Charter Act also grants to the Corporation certain privileges and immunities that it would not otherwise enjoy. For instance, securities issued by the Corporation are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Accordingly, registration statements with respect to the Corporation's securities are not filed with the Securities and Exchange Commission.

As described in "Corporate Indebtedness," the Corporation has the authority to borrow up to \$2.25 billion from the Secretary of the Treasury. Any such borrowing would be within the Secretary's discretion. The Corporation has not used this facility since its transition from government control.

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

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

MORTGAGE PORTFOLIO

General

The principal activity of the Corporation consists of the purchase of mortgage loans on residential properties meeting certain eligibility requirements established by statute and by the Corporation. Substantially all of such purchases are made by the Corporation pursuant to forward purchase commitments issued by the Corporation. Under such commitments, the Corporation agrees in advance to purchase a specified dollar amount of mortgage loans at an agreed price. See "Mortgage Purchase Activity" and "Commitments."

In addition, the Corporation issues guaranteed mortgage pass-through certificates evidencing beneficial interests in pools of mortgage loans. See "Mortgage-Backed Securities Program."

Prior to 1972, all mortgage loans purchased were insured or guaranteed by the federal government, but since February 1972, under authority granted by the Emergency Home Finance Act of 1970, the Corporation also has purchased mortgage loans that are not federally insured or guaranteed (so-called "conventional" mortgage loans).

Those who sell mortgage loans to the Corporation generally retain, subject to the Corporation's supervision, the responsibility for servicing the mortgage loans sold. Servicers are compensated through the retention of a specified portion of each interest payment on a serviced mortgage loan. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, collection of insurance claims and, if necessary, processing of foreclosures.

Mortgage Purchase Activity

The Corporation currently purchases conventional mortgage loans as well as mortgage loans that are insured by the FHA or guaranteed by the VA. Substantially all loans currently in the Corporation's portfolio are secured by first liens, but the Corporation purchases second lien loans also. The Corporation purchases both whole mortgage loans and participations in such mortgage loans. With the exception of \$5.8 billion of multifamily project loans held by the Corporation at December 31, 1984, all of the mortgage loans purchased by the Corporation and held in its portfolio are secured by residential one-to four-family properties. The Corporation has purchased adjustable-rate mortgage loans since 1981.

Because FHA-insured and VA-guaranteed mortgage loans, as a result of their government backing, involve minimal risk from a credit standpoint, the Corporation's basic eligibility criterion for their purchase is simply the FHA insurance or the VA guaranty.

Because conventional mortgage loans have no federal government backing, the Corporation has established certain underwriting guidelines for their purchase in an effort to reduce the risk of loss from mortgagor defaults. These guidelines are designed to assess the creditworthiness of the mortgagor as well as the value of the mortgaged home relative to the amount of the mortgage loan. These guidelines are changed from time to time by the Corporation, and the Corporation may deviate from them as to particular mortgage loans. For information on the Corporation's loss and delinquency experience on conventional mortgage loans, see "Conventional Mortgage Portfolio Loss Charge-off and Delinquency Experience."

Generally, the Corporation requires that the unpaid principal amount of each conventional first mortgage loan purchased by it (i) not be greater than 80 percent of the value of the mortgaged property or (ii) if it is greater than 80 percent, that the excess over 75 percent be insured by an acceptable mortgage insurance company for so long as the principal balance of the mortgage loan is greater than 80 percent of such original value (or of the value as determined by a subsequent appraisal). Mortgage insurance is not required on mortgage loans with loan-to-value ratios greater than 80 percent (but not greater than 90 percent) if the mortgage seller retains a participation in the loan of not less than 10 percent or, in certain instances, agrees to repurchase the loan in the event of default. Mortgage insurance is required for second mortgages if the combined loan-to-value ratios of the first and second mortgages on the property exceed 65 percent.

Conventional mortgage loans on single-family dwellings may not be purchased by the Corporation if their original principal balance exceeds \$115,300, except for loans secured by properties in Alaska and Hawaii. Higher maximum mortgage amounts also apply to loans secured by two or more family dwelling units. Maximum principal balances applicable to the Corporation's conventional mortgage loan purchases are increased annually if there have been increases in the average cost of certain homes. Loans eligible for insurance by the FHA are subject to statutory maximum amount limitations, and the Corporation imposes maximum amount limitations on loans guaranteed by the VA.

In addition to conventional fixed-rate loans, the Corporation purchases ARMs, which are mortgage loans with interest rates that are automatically adjusted, both up and down, in accordance with changes in a specified index. The Corporation specifies the types of ARMs that are eligible for purchase under its standard plans. In addition, the Corporation purchases in

negotiated transactions ARMs that do not conform to its standard plans. In 1984, the Corporation purchased \$5.5 billion of ARMs, which constituted 33 percent of the loans it purchased. As of December 31, 1984, the Corporation had \$11.7 billion of ARMs in its portfolio and had outstanding commitments totaling \$2.9 billion. The Corporation, in 1984, began purchasing ARMs only if the adjustments are limited by caps on the amounts by which monthly payments or the interest rate on the mortgage loans may increase or decrease.

In addition to mortgage loans secured by first liens, the Corporation also purchases conventional loans secured by second mortgages and participations in such loans. Second mortgages generally bear higher interest rates than contemporaneous first mortgages of comparable maturities, and have shorter maturities. In 1984, the Corporation purchased \$0.9 billion of second mortgages, which constituted 6 percent of the loans it purchased. At December 31, 1984, the Corporation owned \$2.8 billion of loans secured by second mortgages and had outstanding commitments to purchase \$0.3 billion of such loans.

The Corporation's purchases of ARMs and loans secured by second mortgages are designed to make the Corporation's mortgage loan portfolio more responsive to fluctuations in prevailing interest rates and to better match its borrowing costs. These purchases, as well as the growth of the Corporation's mortgage-backed securities program (see "Mortgage-Backed Securities Program"), are expected to assist in mitigating the risks associated with rising interest rates.

Since 1981, to upgrade the yield on its portfolio, the Corporation has offered financing to persons purchasing or refinancing homes that secure the Corporation's existing portfolio loans. These new mortgage loans are offered at interest rates that result from combining the existing balance at its original rate with an additional amount at a market rate. The resulting rate tends to be less than prevailing market rates but significantly greater than that applicable to the refinanced loan. Refinanced mortgage loans facilitate the complete financing of the sale and discourage the assumption of the existing mortgage loan as part of a financing package. As of December 31, 1984, \$2.5 billion resale/refinance mortgage loans had been made by the Corporation and, of that amount, \$1.1 billion, or 44 percent, represented newly loaned money.

The Corporation has begun purchasing conventional multifamily mortgage loans for its portfolio. These mortgage loans typically have a shorter term and shorter average life than mortgage loans secured by one- to four-family dwellings. This aids the Corporation's goal of reducing the difference between the average life of its debt and that of its assets. The multifamily mortgage loans that the Corporation purchases generally do not have a term exceeding 15 years. Also, conventional multifamily loans typically have higher interest rates, resulting in a higher yield to the Corporation. In 1984, the Corporation purchased a total of \$0.6 billion of conventional multifamily mortgage loans at a weighted average yield of 13.55 percent. Conventional multifamily loans purchased by the Corporation are subject to certain maximum principal amounts, as set forth in the Charter Act, based on the number of units in the property being financed and its location.

The Corporation purchases mortgages in two ways: through standard, posted program commitments and through negotiated bulk purchases. Negotiated purchases are used whenever the mortgages do not conform in some manner to one of the Corporation's standard, posted mortgage products or, in some cases, when the seller wants to service mortgages through a simplified mortgage accounting system ("summary format"), which is not generally available for mortgages purchased through the standard, posted program commitments.

Commitments

The Corporation's mortgage loan purchases are based on its issuance of commitments by which the Corporation agrees in advance to purchase a specified dollar amount of loans. Lenders often pay fees, typically from one-quarter of one percent to two percent of the amount of the commitment, for these commitments depending on market conditions, the type of mortgage loan,

and the length and characteristics of the commitment. A portion of the Corporation's commitments, however, are issued for no fee.

The Corporation purchases most of its mortgage loans pursuant to mandatory delivery commitments. Under such commitments, lenders are obligated to sell loans to the Corporation at the commitment yield.

The Corporation also issues standby commitments. Under these commitments, the Corporation commits to purchase a designated amount of mortgage loans. A yield on the mortgages is not established at the time the standby commitment is issued. To deliver the mortgage loans, the lender must convert the standby commitment to a mandatory delivery commitment. In such event, the lender generally pays an additional fee to the Corporation. The yield on the mortgage loans is established at the time of conversion.

In January 1985, the Corporation announced it will issue guaranteed-rate standby commitments, which will enable lenders to lock in an interest rate at the time they receive a standby commitment. The rate will remain in effect for the term of the commitment; however, the lender must convert its commitment to a mandatory delivery commitment before the Corporation will purchase the mortgage loans. The commitments are structured so that the Corporation can hedge its interest rate risk. The combined term of the standby and mandatory commitments can be up to five months. The Corporation also issued such commitments in 1984 as part of a pilot program.

The following table sets forth the Corporation's mortgage loan portfolio commitment activity.

Mortgage Loan Portfolio Commitments
(Dollars in millions)

Commitments Issued	Year Ended December 31,				
	1980	1981	1982	1983	1984
Home Government insured or guaranteed	\$5,570	\$2,971	\$ 923	\$ 141	\$ 68
Conventional: Fixed-rate	2,511	4,927	13,405	10,562	11,838
Adjustable-rate	—	1,360	6,024	6,573	7,072
Second mortgage	—	213	1,745	1,325	1,240
Total home mortgage loans	<u>8,081</u>	<u>9,471</u>	<u>22,097</u>	<u>18,601</u>	<u>20,218</u>
Project: Government insured	2	—	9	—	—
Conventional: Fixed-rate	—	—	—	6	703
Adjustable-rate	—	—	—	—	86
Total project mortgage loans	<u>2</u>	<u>—</u>	<u>9</u>	<u>6</u>	<u>789</u>
Total	<u>\$8,083</u>	<u>\$9,471</u>	<u>\$22,106</u>	<u>\$18,607</u>	<u>\$21,007</u>

Commitments Outstanding	December 31,				
	1980	1981	1982	1983	1984
Home: Government insured or guaranteed	\$2,246	\$ 920	\$ 44	\$ 8	\$ 12
Conventional: Fixed-rate	1,008	1,468	4,016	1,554	3,015
Adjustable-rate	—	1,279	3,331	3,828	2,913
Second mortgage	—	31	206	66	331
Total home mortgage loans	<u>3,254</u>	<u>3,698</u>	<u>7,597</u>	<u>5,456</u>	<u>6,271</u>
Project: Government insured	24	19	9	—	—
Conventional: Fixed-rate	—	—	—	4	113
Total project mortgage loans	<u>24</u>	<u>19</u>	<u>9</u>	<u>4</u>	<u>113</u>
Total	<u>\$3,278</u>	<u>\$3,717</u>	<u>\$7,606</u>	<u>\$5,460</u>	<u>\$6,384</u>

Mortgage Portfolio Statistics

At December 31, 1984, the majority of the Corporation's mortgage loan portfolio consisted of fixed-rate mortgage loans. Substantially all such loans provide for level monthly installments of principal and interest, such installments consisting primarily of interest during the early and middle years, with the major portion of the original principal balance being payable during the years immediately preceding maturity. The majority of such loans had original maturities of not less than 25 years (generally 30 years for single-family loans and 40 years for FHA-insured project loans). At December 31, 1984, the weighted average dollar life (based on the underlying amortization schedules and assuming no prepayments) of the mortgage loans in the Corporation's mortgage portfolio was approximately 25 years, and the weighted average yield (net of servicing) was 10.93 percent.

The following table sets forth the composition of the Corporation's mortgage loan portfolio, purchase activity, principal repayments, mortgage loan sales, the weighted average yield (net of servicing) on the mortgage loan portfolio, and the average net yield on mortgage loans purchased.

Mortgage Loan Portfolio (Dollars in millions)

	Year Ended December 31,				
	1980	1981	1982	1983	1984
Unpaid Principal Balances at End of Period					
Home: Government insured or guaranteed	\$33,416.7	\$34,550.7	\$33,742.3	\$30,999.9	\$29,016.3
Conventional: Fixed-rate	18,358.0	21,153.2	27,789.6	32,583.3	38,710.9
Adjustable-rate	—	106.8	3,331.9	7,126.3	11,666.2
Second mortgage	—	175.3	1,635.5	2,385.4	2,780.8
Project: Government insured	5,551.9	5,425.9	5,283.3	5,148.3	5,060.0
Conventional: Fixed-rate	—	—	31.1	63.0	634.4
Adjustable-rate	—	—	—	—	71.2
Total unpaid balance	<u>\$57,326.6</u>	<u>\$61,411.9</u>	<u>\$71,813.7</u>	<u>\$78,256.2</u>	<u>\$87,939.8</u>
Average yield net of servicing	9.24%	9.85%	10.73%	10.70%	10.93%
Purchases During Period					
Home: Government insured or guaranteed	\$ 5,272.5	\$ 2,284.0	\$ 901.1	\$ 186.1	\$ 189.7
Conventional: Fixed-rate	2,801.8	3,544.3	9,442.9	11,702.4	9,544.0
Adjustable-rate	—	106.8	3,210.0	4,246.3	5,403.2
Second mortgage	—	175.9	1,552.3	1,407.9	936.7
Project: Government insured	26.8	1.9	9.5	12.0	—
Conventional: Fixed-rate	—	—	—	2.3	567.0
Adjustable-rate	—	—	—	—	80.2
Total mortgage loans purchased	<u>\$ 8,101.1</u>	<u>\$ 6,112.9(1)</u>	<u>\$15,115.8(1)</u>	<u>\$17,557.0(1)</u>	<u>\$16,720.8(1)</u>
Average net yield on mortgage loans purchased	12.27%	15.38%	15.00%	12.65%	12.79%
Repayments During Period					
Home: Government insured or guaranteed	\$ 1,343.3	\$ 1,252.1	\$ 1,263.6	\$ 2,045.5	\$ 1,650.6
Conventional: Fixed-rate	549.2	740.5	909.6	3,474.0	2,916.2
Adjustable-rate	—	—	28.9	451.9	997.2
Second mortgage	—	.6	92.1	658.0	541.3
Project: Government insured	84.0	127.1	121.0	110.5	81.4
Conventional: Fixed-rate	—	—	—	7.0	4.6
Adjustable-rate	—	—	—	—	9.0
Total mortgage loan repayments	<u>\$ 1,976.5</u>	<u>\$ 2,120.3(1)</u>	<u>\$ 2,415.2(1)</u>	<u>\$ 6,746.9(1)</u>	<u>\$ 6,200.3(1)</u>
Sales During Period					
Home: Government insured or guaranteed	\$ —	\$ —	\$ 518.2	\$ 907.2	\$ 528.8
Conventional: Fixed-rate .....	.6	8.6	1,896.9	3,560.3	450.2
Project: Government insured	—	.8	—	—	—
Total sales	<u>\$.6</u>	<u>\$ 9.4</u>	<u>\$ 2,415.1</u>	<u>\$ 4,467.5</u>	<u>\$ 979.0</u>

(1) Includes \$630 million, \$617 million, \$126 million, and \$54 million principal amount of mortgage loans that were refinanced under the Corporation's resale/refinance policy in 1981, 1982, 1983, and 1984, respectively.

Prepayments and Assumptions

As shown by the table under "Mortgage Portfolio Statistics," the level of principal repayments as a percentage of the Corporation's mortgage loan portfolio in 1983 and 1984 reflects a substantial increase from the unusually low levels of 1980-1982. Because all of the mortgage loans in the Corporation's portfolio are prepayable by the borrower (in some cases with a small penalty), the moderation in interest rates experienced since 1982 resulted in a significant increase in prepayments of the high interest rate mortgage loans in the Corporation's loan portfolio.

The low level of principal prepayments experienced in 1980-1982 contributed to the Corporation's losses in 1981 and 1982. As a result, the Corporation kept lower-yielding mortgage loans on its books, which reduced significantly the increase in yield on its mortgage loan portfolio that, under more normal conditions, the Corporation would have expected to realize. In addition, the Corporation was forced to rely more heavily on high cost borrowings to finance new mortgage purchases and to refund maturing indebtedness.

The Corporation believes that the significant reduction in principal paydowns during 1980-1982 was due primarily to the high interest rate environment. The high cost of new financing resulted in both a decline in the number of home sales and a major portion of home sales being financed through so-called "creative" financing wherein the existing mortgage was assumed by the purchaser of the home (and generally coupled with second mortgage or purchase money financing) or "wrapped" by another loan from another lender.

The Corporation currently enforces "due-on-sale" clauses in conventional fixed-rate mortgages purchased by the Corporation pursuant to commitments issued on and after November 10, 1980 and in conventional mortgages covering properties whose sale has been facilitated by "wraparound" or second mortgages made by institutional lenders. Because approximately 60 percent of the Corporation's portfolio loans (including all FHA and VA loans) do not contain any such clause, however, and a number of states substantially prohibit the enforcement of such clauses in loans originated or assumed during certain periods prior to October 15, 1982, the Corporation has been unable to prevent assumptions on a major portion of its portfolio.

Conventional Mortgage Portfolio Loss Charge-off and Delinquency Experience

The portfolio of conventional mortgages consists predominantly of loans made to owner-occupants and secured by first liens on residential real property. The losses charged off and the delinquencies experienced on this conventional loan portfolio are summarized in the following tables. These tables exclude loans purchased as participation interests and loans purchased in summary format by the Corporation.

Conventional Loan Loss Charge-off Experience

(Dollars in millions)

	Year Ended December 31,				
	1980	1981	1982	1983	1984
Net losses charged off during period (1)	\$ 9	\$ 8	\$ 16	\$ 38.4	\$ 79.2
Principal balance at end of period(2)	\$17,450.4	\$19,561.3	\$23,982.9	\$24,457.3	\$24,633.9
Net loss charge-off ratio(2)(3)	0.0052%	0.0041%	0.0067%	0.1570%	0.3215%
Number of foreclosures during period	368	606	1,270	2,963	4,664
Number of loans at end of period	435,355	472,414	539,465	538,470	540,188
Percent foreclosed(3)	0.0845%	0.1283%	0.2354%	0.5503%	0.8634%

(1) For 1980 through 1982, net losses charged off were determined upon disposition of foreclosed properties by subtracting from the proceeds realized the sum of the book value of the foreclosed asset and related foreclosure costs, expenses, interest accrued but uncollected to the

(footnote continues)

Loan losses charged off relating to the remainder of the Corporation's total conventional mortgage loan portfolio of \$28.5 billion totaled \$8.1 million for 1984.

As indicated in the preceding table, the amount of net losses charged off increased to \$79.2 million in 1984 from \$38.4 million in 1983 and \$1.6 million in 1982. The net loss charge-off ratio has increased to .322 percent in 1984 from .157 percent in 1983 and .007 percent in 1982. The increase in losses charged off on conventional mortgage loans resulted both from an increase in the percent of mortgage loans foreclosed and from a higher average loss per foreclosure. In response to the increase in charge-offs, the Corporation made a supplemental addition of \$35 million to its allowance for loan losses on conventional mortgages in September 1984. Also, effective October 1, 1984, the Corporation stopped accruing interest on all conventional loans that were 90 or more days delinquent (reducing interest income by \$11.6 million in 1984) and raised the rates at which it adds to the allowance when conventional mortgage loans are purchased (increasing the provision for loan losses by an additional \$9.9 million in 1984). The total allowance for losses on conventional mortgages (including the allowance for losses on loans in summary format) was \$92.3 million at December 31, 1984, compared with \$112.6 million at December 31, 1983.

Conventional Loan Delinquency Experience
(Percent of Portfolio By Number of Loans)

<u>Period of Delinquency</u>	<u>December 31,</u>				
	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
One month	2.7%	2.9%	3.3%	3.5%	3.7%
Two months	.5	.5	.7	.8	.9
Three or more months	.1	.2	.3	.5	.5
Total(1)	<u>3.3%</u>	<u>3.6%</u>	<u>4.3%</u>	<u>4.8%</u>	<u>5.1%</u>
Under special lender forbearance(2)	.3%	.2%	.4%	.5%	.6%
In foreclosure(2)	.5%	.6%	.6%	.9%	.8%

(1) Delinquency percentages exclude loans in foreclosure or under special lender forbearance.

(2) A substantial percentage of loans under special lender forbearance or in foreclosure are reinstated.

MORTGAGE-BACKED SECURITIES PROGRAM

In 1981, the Corporation began issuing mortgage-backed securities ("MBS"). These are guaranteed mortgage pass-through certificates evidencing beneficial interests in pools of mortgages. Initially, these securities were issued for only conventional fixed-rate mortgages secured by one-to-four family dwellings. However, in 1982, the Corporation expanded the program to include pools of FHA-insured, VA-guaranteed, and growing equity mortgages; and in 1984, the program was further expanded to include ARMs, graduated payment mortgage loans and conventional multifamily loans.

(footnote continued)

date of foreclosure, and other carrying costs. Beginning in September 1983, estimated losses on acquired properties are charged to the allowance for losses when properties are acquired rather than at disposition. Write-downs to market for properties on hand produced a charge to the allowance for losses of \$20.1 million in September 1983. Also charged to the allowance in September 1983 was \$6.2 million related to below market financing on sales of acquired properties in all prior periods. The items had no effect on reported net income in 1983 because losses had been provided for previously.

(2) The principal balance at the end of the period has been adjusted to exclude principal sold as participation interests. The information reported for the periods 1980 through 1983 has been restated for purposes of comparability.

(3) The ratios are based on principal balance or number of loans at the end of the period.

Most MBS are issued in "swap" transactions, in which lenders approved by the Corporation exchange pools of mortgage loans directly for MBS. Lenders then either hold the certificates or sell them to other investors. In 1984, the Corporation began a program to swap MBS representing beneficial interests in conventional multifamily mortgage loans financed by bond issues of state or local governments or authorities. In addition to "swap" transactions, the Corporation pools mortgage loans from its own portfolio or purchases mortgage loans from lenders in exchange for cash, assembles the mortgage loans in a pool, and sells the related certificates.

The MBS carry the Corporation's guaranty of timely payment of scheduled principal and interest on the underlying pooled mortgage loans, whether or not such payments are received from the mortgagor. Because of the Corporation's guaranty of timely payment on the MBS, these instruments attract investors that would not ordinarily invest in mortgage loans. The program enables the Corporation to further its statutory purpose of increasing the liquidity of residential mortgage loans without requiring that the Corporation take the financing or "spread" risk on the pooled mortgage loans. In addition, MBS create a stable source of fee income to the Corporation that is not as interest-rate-sensitive as the Corporation's portfolio investing activities.

The Corporation receives commitment and guaranty fees for its MBS. During 1984, fees from MBS included \$78.1 million of guaranty fees and \$3.5 million of commitment fees. Commitment fees are paid at the time a commitment is issued. Guaranty fees are generally paid monthly.

Because the Corporation guarantees timely payment of scheduled principal and interest on the MBS, it absorbs the ultimate credit risk of a borrower's default on all conventional mortgage loans in MBS pools. The Corporation protects against this risk in the same manner as for portfolio mortgage loans. The standards for mortgage loans purchased for MBS pools are the same as those for mortgage loans purchased for portfolio as described under "Mortgage Portfolio—Mortgage Purchase Activity." In addition, the Corporation's risk may be offset somewhat to the extent sellers of pools of mortgage loans elect to remain at risk on the mortgage loans sold to the Corporation. Lenders are provided an option to assume the credit risk in exchange for paying a lower guaranty fee. At December 31, 1984, \$26.7 billion of the conventional mortgage loans that are part of MBS pools were purchased with recourse to the sellers in the event of default by the borrowers on the underlying mortgage loans. If the loss rate on conventional mortgage loans in pools should appreciably increase, the Corporation's losses could, to the extent not offset by recourse to sellers, become significant.

The Corporation's activity in MBS is shown in the following chart.

MBS
(Dollars in Millions)

	Year Ended December 31,			
	1981	1982	1983	1984
Commitments:				
Issued during year	\$ 3,259	\$15,517	\$15,722	\$42,235 (1)
Outstanding at year end	2,555	2,331	1,627	4,505
MBS Certificates:				
Issued during year	\$ 717	\$13,970	\$13,340	\$13,546
Outstanding at year end	717	14,450	25,121	36,215

(1) The substantial increase in the commitment volume for mortgage-backed securities in 1984 resulted from a marketing effort that included the elimination of commitment fees for a limited period on optional delivery mortgage-backed securities commitments. Because these optional delivery commitments were issued without charging any commitment fee, the delivery rate on these commitments was lower than normal.

The majority of the Corporation's MBS outstanding represent beneficial interests in conventional fixed-rate mortgage loans on one-to four-family dwellings.

CORPORATE INDEBTEDNESS

Although the Corporation is stockholder-owned and its obligations (other than its outstanding mortgage-backed bonds guaranteed by GNMA) are not backed by the United States or any agency or instrumentality thereof other than the Corporation, the Corporation's debt has traditionally been treated as "U.S. Agency" debt in the U.S. marketplace. The Corporation, as a result, has historically enjoyed ready access to funds in the U.S. private credit markets at rates that are slightly higher than the yields on U.S. Treasury obligations of comparable maturities.

The following table sets forth at December 31, 1984, the maturity profile of the Corporation's debentures and bonds that were originally issued with a maturity of one year or longer.

<u>Maturing Within</u>	<u>Book Value</u>	<u>Weighted Average Cost</u>
	(In millions)	
One year	\$17,139	12.08%
One to two years	13,317	11.63
Two to three years	16,960	11.58
Three to four years	9,857	11.47
Four to five years	5,296	12.09
Over five years	7,028	10.49

At December 31, 1984, the Corporation had short-term and master notes outstanding aggregating \$11.8 billion at face amount. Such notes had a weighted average term to maturity of 129 days at such date and a weighted average cost of 11.16 percent. The Corporation also had \$1.3 billion under outstanding investment note agreements at December 31, 1984. Such agreements had a weighted average cost of 9.65 percent and were outstanding for various periods of time.

The outstanding indebtedness of the Corporation consists of general unsecured obligations issued under Section 304(b) of the Charter Act, subordinated capital debentures (including convertible capital debentures) issued under Section 304(e) of the Charter Act, and mortgage-backed bonds issued under Section 304(d) of the Charter Act.

Section 304(b) provides that the aggregate amount of obligations outstanding under such subsection shall not exceed, at any one time, fifteen times the sum of the capital (including, for this purpose, capital debentures), capital surplus, general surplus, reserves and undistributed earnings of the Corporation unless a greater ratio is fixed by the Secretary of HUD. In 1982, the Secretary of HUD increased this ratio to 30:1. Regulations adopted by HUD provide that this increased ratio is, in the event of a reduction in the Corporation's capital, automatically increased to such ratio as shall be necessary to include all obligations outstanding pursuant to Section 304(b). At December 31, 1984, this debt-to-capital ratio was 23.2:1, as compared with a ratio of 25.8:1 at December 31, 1983.

Issuances of indebtedness pursuant to Section 304(b) are also subject to the condition that, at the time of any such issuance, the aggregate amount of indebtedness outstanding under such Section 304(b), after giving effect to the indebtedness being issued, is not greater than the Corporation's ownership, free from any liens or encumbrances, of cash, mortgages or other security holdings and obligations, participations or other investments. Unlike the debt-to-capital ratio limitation described above, this Section 304(b) limitation is statutory and may not be waived or varied by the Secretary of HUD. For purposes of each of the foregoing calculations, the Corporation accounts for debt obligations issued at a discount at their book value (face amount less unamortized discount).

Section 304(d) of the Charter Act, pursuant to which mortgage-backed securities and mortgage-backed bonds are outstanding, imposes a requirement with respect to securities issued thereunder that the mortgages pledged or set aside must be sufficient at all times to make debt service payments on the securities. At December 31, 1984, the Corporation had \$401.9 million in

mortgage-backed bonds outstanding, of which \$392.7 million were guaranteed by GNMA pursuant to Section 306(g) of the National Housing Act and are thus backed by the full faith and credit of the United States.

Section 304(c) of the Charter Act authorizes the Secretary of the Treasury, as a public debt transaction, to purchase obligations of the Corporation up to a maximum of \$2.25 billion outstanding at any one time. The Corporation has not used such borrowing facility with the U.S. Treasury since its transition from government control. Although the Secretary of the Treasury is authorized to purchase the obligations of the Corporation, he is under no requirement to do so. Any such obligations purchased by the Secretary of the Treasury must be issued pursuant to Section 304(b) of the Charter Act and, accordingly, would be subject to the applicable limitations and restrictions described above.

The following table sets forth the Corporation's borrowing activity and outstanding borrowings, the respective costs of borrowings and average maturities. The amounts given are book value (face amount less unamortized discount) except for short-term notes, which, because they have a maturity less than one year, are reported at their face amount.

		Debt				
		(Dollars in millions)				
		Year Ended December 31.				
		<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Short-Term Notes, Master Notes and Investment Notes						
Issued during period.						
Amount		\$17,654	\$30,185	\$34,196	\$20,262	\$23,135
Cost		14.29%	16.56%	12.31%	9.47%	10.87%
Average Maturity—Days (1)		152	98	129	161	211
Outstanding at end of period.						
Amount		\$ 8,578	\$ 9,189	\$11,752	\$11,841	\$13,030
Cost		14.68%	15.47%	10.48%	9.67%	11.00%
Average Maturity—Days (1)		92	57	141	106	129
Bonds and Debentures						
Issued during period						
Amount		\$11,500	\$10,221	\$20,764	\$19,756	\$24,836
Cost		12.05%	15.26%	13.62%	10.66%	11.90%
Average Maturity—Months		48	43	36	53	46
Outstanding at end of period						
Amount		\$46,604	\$49,560	\$58,279	\$63,046	\$71,059
Cost		9.32%	10.71%	11.55%	11.38%	11.61%
Average Maturity—Months		41	36	32	34	35
Total Debt						
Issued during period:						
Amount		\$29,154	\$40,406	\$54,960	\$40,018	\$47,971
Cost		13.37%	16.22%	12.82%	10.07%	11.47%
Average Maturity—Months(1)		22	13	16	29	29
Outstanding at end of period						
Amount		\$55,182	\$58,749	\$70,031	\$74,887	\$84,089
Cost		10.11%	11.42%	11.38%	11.12%	11.56%
Average Maturity—Months(1)		35	31	27	29	31

(1) The average maturity is calculated exclusive of investment notes, because the balance associated with each investment note fluctuates over the life of the agreement.

RECENT LEGISLATIVE DEVELOPMENTS

The Administration's proposed 1986 fiscal year budget package includes a recommendation to require the Corporation and other government-sponsored enterprises to pay a fee to the United States Treasury when issuing debt or MBS. The proposal would impose a 5 basis point annual fee on new borrowings, including rollover of debt and issuances of MBS. Beginning in 1987, the fee would increase to 8.3 basis points for debt issuances but would remain at 5 basis points for MBS issues. Congressional hearings on this and other provisions of the Administration's budget package are anticipated. If adopted such legislation would have an adverse effect on the Corporation.

Housing legislation introduced in the House of Representatives (H.R. 1) would, among other things, prohibit the imposition of such fees upon the Corporation.

The 1986 budget report of the President of the United States includes the following statement: "The administration also remains committed to the total privatization of these two housing-related, Government-sponsored enterprises [the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation], which receive special advantages in the securities markets that completely private institutions do not receive." Similar statements were included in the 1983, 1984 and 1985 budget reports. Any alteration of the relationship of the Corporation to the federal government would require legislation to be introduced in and passed by both Houses of Congress and signed by the President. No such legislation has been introduced to date. Alteration or elimination of the Corporation's relationship with the federal government could require the Corporation to change the manner in which it currently conducts business and could have a material adverse effect on its results of operations.

MANAGEMENT

The executive officers of the Corporation, their ages as of February 1, 1985, and their business experience are as follows:

Mr. David O. Maxwell, 54, has been Chairman of the Board of Directors and Chief Executive Officer since 1981. He also served briefly as the Corporation's President and Chief Operating Officer in 1981 until his election to his present position. Prior to his employment with the Corporation, Mr. Maxwell was Chairman of the Board and Chief Executive Officer of Ticor Mortgage Insurance Company, a mortgage insurance company.

Dr. Mark J. Riedy, 42, has been President and Chief Operating Officer since January 1985. Prior to his employment with the Corporation, Dr. Riedy was Executive Vice President of the Mortgage Bankers Association of America, a trade association.

Mrs. Caryl S. Bernstein, 51, has been Executive Vice President since 1982; and General Counsel and Secretary since 1981. Mrs. Bernstein was Senior Vice President from 1981 until her election as Executive Vice President. Prior to her employment with the Corporation, Mrs. Bernstein held a number of positions with the Overseas Private Investment Corporation ("OPIC"), a U.S. government agency that encourages private investment in less developed countries and insures against certain risks involved in such overseas investments. Mrs. Bernstein's most recent title at OPIC was Vice President for Insurance.

Mr. Stuart A. McFarland, 37, has been Executive Vice President and Chief Financial Officer since 1983. From 1982 until 1983, Mr. McFarland was Executive Vice President and Chief Planning Officer. From 1981 until 1982, Mr. McFarland was the Corporation's Executive Vice President—Operations. Prior to his employment with the Corporation, Mr. McFarland held a number of positions with Ticor Mortgage Insurance Company, most recently that of President.

Mr. Michael A. Smilow, 47, has been Executive Vice President—Operations since July 1984. From 1980 until his employment with the Corporation, Mr. Smilow was with Mortgage Guaranty Insurance Corporation, a mortgage insurance company, where he held the position of Executive Vice President. He was also an officer and director of MGIC Investment Corporation related companies. Prior to 1980, Mr. Smilow was Deputy Director, Office of State Agency and Bond Financed Programs, Department of Housing and Urban Development.

On February 25, 1985, Mr. William A. Dawson, 55, became the Corporation's Executive Vice President—Technology. Prior to his employment with the Corporation, Mr. Dawson was Executive Vice President in charge of bank operations and information systems for Girard Bank, a commercial bank.

BOARD OF DIRECTORS

The age and background, as of February 1, 1985, of each of the members of the Board of Directors of the Corporation are as follows:

<u>Name and Age</u>	<u>Principal Occupation, Business Experience and Residence</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Mr Eli Broad 51	Chairman of the Board and Chief Executive Officer, Kaufman and Broad, Inc., a housing and financial services corporation, 1976 to present; President and Chief Executive Officer, Sun Life Insurance Company of America, 1983 to present; Chairman of the Board, Sun Life Group of America, Inc., a life insurance-holding company, 1978 to present; Los Angeles, California	1984	
Mr. Felix M Beck 59	Chairman of the Board and Chief Executive Officer, Margaretten and Co, Inc., a mortgage banking company, 1969 to present; Livingston, New Jersey	1985	
Mr. Merrill Butler(2) 59	President, Chief Executive Officer and Chairman of the Board, The Butler Group, Inc., a real estate development company, January 1984 to present, President, 1971-1983, and Chairman of the Board, 1971 to present, M. B. Development Company, a real estate development company; Chairman of the Board, Bullard Homes Corporation, a home building company, 1976 to present; President and Chairman of the Board, BHC Housing, Inc, a home building company, 1972 to present, President, National Association of Homebuilders, a trade association, 1980; Newport Beach, California	1981	Commodore Corporation
Mr. James B. Coles(2) 43	Chairman of the Board, SunWest Builders, a home building company, 1983 to present; Partner, SunWest Properties Limited Partnership, a home building company, 1982 to present; Chairman of the Board, C&C SunWest Contractors, Inc, 1982 to present; Chairman of the Board, Pacific SunWest Marketing, Inc., an in-house marketing company for SunWest Builders, Inc., 1983 to present; President and Chairman of the Board, James B. Coles, Inc., a framing contractor, 1972 to 1983; President and Chairman of the Board, The Coles Development Company, a home building company, 1979 to 1983, San Diego, California	1981	

<u>Name and Age</u>	<u>Principal Occupation, Business Experience and Residence</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Mr. Bert A. Getz(2) 47	President and Director, Globe Corporation, a banking, real estate and investment company, 1975 to present; Scottsdale, Arizona	1981	Arizona Bancwest Corporation
Mr. Joseph P Hayden 55	Chairman of the Board and Chief Executive Officer, 1980 to present, and President and Chief Executive Officer, 1960 to 1980, The Midland Company and its subsidiaries, financing and insuring of manufactured housing, 1980 to present; Cincinnati, Ohio	1969	First National Cincinnati Corporation, First National Bank of Cincinnati
Mrs Carla A. Hills 51	Partner, Latham, Watkins & Hills, a law firm practicing in Washington, D.C, Illinois and California, 1978 to present; Washington, D.C.	1982	AMR Corporation; Corning Glass Works; International Business Machines Corporation; The Signal Companies, Inc.; Chevron Corporation
Ms Dianne E. Ingels(2) 43	Partner, The York Companies, a real estate development, acquisition and marketing firm, January 1984 to present; Principal, Dianne Ingels and Associates, an independent real estate broker, investor and consultant, 1977 to present; Colorado Springs, Colorado	1981	
Mr. John E. Krout 65	Member, Board of Managers, Germantown Savings Bank, a mutual savings bank 1977 to present; Chairman of the Board, Germantown Savings Bank, a mutual savings bank, 1977 to January 1985; Rosemont, Pennsylvania	1970	Chicago Title & Trust Co; Trustee, PNB Mortgage & Realty Investors
Mr. James E. Lyon(2) 56	Chairman of the Board, River Oaks Bancshares, Inc., a bank holding company, April 1984 to present; Chairman of the Board, River Oaks Financial Corporation, a real estate development company, 1962 to present; Chairman of the Board, Ruska Instrument Corporation, a manufacturing company, 1961 to present; Houston, Texas	1981	
Mr David O. Maxwell 54	Chairman of the Board of Directors and Chief Executive Officer of the Corporation, 1981 to present; President and Chief Operating Officer of the Corporation, 1981; Chairman of the Board and Chief Executive Officer, Ticor Mortgage Insurance Company, private mortgage insurance, 1973 to 1981; Washington, D.C	1981	Kaufman and Broad, Inc

<u>Name and Age</u>	<u>Principal Occupation, Business Experience and Residence</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Mr Robert J. Mylod 45	Chairman of the Board and Chief Executive Officer, Michigan National Corporation, a bank holding company, January 1985 to present; President and Chief Operating Officer of the Corporation, 1983 to 1985, President, Advance Mortgage Corporation, 1975 to 1982, Bloomfield Hills, Michigan	1983	
Mr. John M O'Mara 57	Senior Vice President, Wertheim & Co., a securities business, 1981 to present; Vice President, Merrill Lynch White Weld Capital Markets Group, a securities business, 1978 to 1981; Greenwich, Connecticut	1970	Baldwin & Lyons, Inc.
Dr. Mark J Riedy 42	President and Chief Operating Officer of the Corporation, January 1985 to present; Executive Vice President and Chief Operating Officer, Mortgage Bankers Association of America, a trade association, 1977 to December, 1984; Great Falls, Virginia	1985	
Mr. Samuel J Simmons 57	President, National Caucus and Center on Black Aged, Inc, a non-profit organization, 1982 to present; Housing and real estate consultant, 1981 to present, President, National Center for Housing Management, a non-profit research and training organization, 1972 to 1981; Washington, D.C.	1978	
Mr. Christopher J Sumner 39	President, Chief Executive Officer and Director, Western Savings and Loan Company, a financial institution, 1980 to present; Salt Lake City, Utah	1985	Ticor Mortgage Insurance Company; Ticor Life Insurance Company; Financial American Network
Mr Richard C. Van Dusen 58	Executive Partner, Dickinson, Wright, Moon, Van Dusen & Freeman, a Detroit law firm, 1977 to present, Birmingham, Michigan	1981	Pennwalt Corporation; Ticor Mortgage Insurance Company; Primark Corporation
Mr. Mallory Walker 45	President, Walker & Dunlop, Inc., a mortgage banking and real estate company, 1976 to present, Washington, D C.	1981	

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

(2) Appointed by the President of the United States

[THIS PAGE INTENTIONALLY LEFT BLANK]

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Federal National Mortgage Association:

We have examined the balance sheets of Federal National Mortgage Association as of December 31, 1984 and 1983, and the related statements of operations and changes in financial position for each of the years in the three-year period ended December 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of Federal National Mortgage Association at December 31, 1984 and 1983 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & Co.

Washington, D.C.
January 24, 1985

FEDERAL NATIONAL MORTGAGE ASSOCIATION

BALANCE SHEETS

Assets

	<u>December 31,</u>	
	<u>1984</u>	<u>1983</u>
	(Dollars in thousands)	
Mortgage portfolio, net	\$84,429,522	\$75,664,817
Cash	49,323	30,115
U.S. Government and Federal Agency securities at cost (market value of \$264.7 million in 1984 and \$227.7 million in 1983)	264,691	227,163
Federal funds	1,574,700	1,462,259
Accrued interest receivable	871,605	770,328
Federal income tax refundable	264,814	152,601
Accounts receivable and other assets	259,079	202,660
Acquired property and foreclosure claims, less allowance for losses of \$13.6 million in 1984 and \$10.0 million in 1983	568,818	347,035
Unamortized debenture issue costs	76,262	60,559
Total Assets	<u><u>\$88,358,814</u></u>	<u><u>\$78,917,537</u></u>

Liabilities and Stockholders' Equity

Liabilities:

Bonds, notes, and debentures, net:

Due within one year

\$31,261,380

\$26,859,533

Due after one year

52,458,120

47,734,289

83,719,500

74,593,822

Accrued interest payable

2,152,467

1,904,645

Mortgagors' escrow deposits, exclusive of approximately
\$574.8 million held by servicers in 1984 (\$609.6 million
in 1983)

308,593

271,440

Deferred federal income taxes

627,305

568,200

Other liabilities

342,810

303,519

Total liabilities

87,150,675

77,641,626

Stockholders' Equity:

Preferred stock, adjustable-rate, series A, \$100 stated
value, 4,500,000 shares authorized, no shares issued

—

—

Common stock, \$6.25 stated value, no maximum author-
ization—66,045,677 shares issued (66,038,701 shares in
1983)

412,785

412,742

Additional paid-in capital

311,006

310,913

Retained earnings

486,243

554,151

1,210,034

1,277,806

Less treasury stock, at cost—208,926 shares

1,895

1,895

Total stockholders' equity

1,208,139

1,275,911

Total Liabilities and Stockholders' Equity

\$88,358,814

\$78,917,537

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1984	1983	1982
	(Dollars in thousands, except per share amounts)		
Interest income:			
Mortgage portfolio	\$8,857,619	\$7,921,758	\$6,806,975
Less servicing fees	210,251	216,262	217,984
	8,647,368	7,705,496	6,588,991
Marketable securities	196,860	221,666	232,123
Total interest income	8,844,228	7,927,162	6,821,114
Interest on borrowings and related costs	8,995,947	7,988,663	7,327,570
Interest margin	(151,719)	(61,501)	(506,456)
Other income:			
Commitment fees	114,306	151,225	263,913
Gain on sales of mortgages	11,723	90,688	44,405
Guaranty fees	78,080	54,318	16,124
Other	35,424	32,622	20,617
Total other income	239,533	328,853	345,059
Other expenses:			
Administrative	112,088	80,760	60,067
Provision for losses	85,800	47,900	35,700
Total other expenses	197,888	128,660	95,767
Income (loss) before federal income taxes and extraordinary item	(110,074)	138,692	(257,164)
Provision for federal income taxes:			
Currently refundable	(111,805)	(15,200)	(200,900)
Deferred	59,105	78,400	77,500
	(52,700)	63,200	(123,400)
Income (loss) before extraordinary item	(57,374)	75,492	(133,764)
Extraordinary item: gain on early retirement of debt	—	—	28,899
Net income (loss)	\$ (57,374)	\$ 75,492	\$ (104,865)
Per share:			
Earnings (loss) before extraordinary item:			
Primary	\$ (.87)	\$ 1.15	\$ (2.20)
Fully diluted	(.87)	1.13	(2.20)
Net earnings (loss):			
Primary	(.87)	1.15	(1.72)
Fully diluted	(.87)	1.13	(1.72)
Cash dividends	.16	.16	.16
Average number of shares outstanding, in thousands	65,837	65,646	60,927

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31,		
	1984	1983	1982
	(Dollars in thousands)		
Funds Provided:			
Income (loss) before extraordinary item	\$ (57,374)	\$ 75,492	\$ (133,764)
Items not (providing) using funds:			
Interest capitalized on graduated-payment mortgages, net	(135,091)	(99,841)	(116,342)
Provision for deferred federal income taxes, net	59,105	78,400	77,500
Provision for losses	85,800	47,900	35,700
Funds provided by (applied to) operations before extraordinary item	(47,560)	101,951	(136,906)
Extraordinary gain—no funds effect	—	—	—
Proceeds from issuance of debentures and bonds	24,822,445	19,733,939	20,743,135
Increase in short-term notes	1,112,780	213,817	2,342,988
Mortgage repayments, less discount amortized	4,960,745	5,735,250	1,224,576
Foreclosure claims collected	596,749	425,440	289,063
Sale of mortgages, excluding gains and losses	941,847	4,370,300	2,071,297
Net increase in stockholders' equity resulting from debt exchange and debenture conversions	136	7,592	103,552
Increase in accrued interest payable/receivable, net	24,570	21,852	138,727
Other items, net	(62,403)	195,802	94,412
Total funds provided	32,349,309	30,805,943	26,870,844
Funds Applied:			
Debentures and bonds retired	16,840,365	14,991,082	12,044,363
Mortgage purchases including refinancing, less discount	15,383,051	16,663,040	14,047,268
Mortgage refinancings	(53,818)	(125,627)	(617,033)
Dividends paid	10,534	10,502	9,709
Total funds applied	32,180,132	31,538,997	25,484,307
Increase (decrease) in cash and marketable securities	169,177	(733,054)	1,386,537
Cash and marketable securities, beginning of year	1,719,537	2,452,591	1,066,054
Cash and marketable securities, end of year	\$ 1,888,714	\$ 1,719,537	\$ 2,452,591

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation operates in the residential mortgage finance industry. Its accounting policies conform to generally accepted accounting principles. The following is a description of significant accounting policies and practices:

Mortgage Portfolio and Purchase Discount

Mortgages acquired for investment are carried at their unpaid principal balances less unamortized discount. Discount is recognized as income using an amortization method, which in the aggregate approximates a level yield over the estimated life of the related mortgages.

Allowance for Losses on Portfolio

In order to recognize losses which may be sustained due to defaults on conventional mortgages acquired for portfolio, the Corporation maintains an allowance for losses, which is established by charges to income when conventional mortgages are purchased.

Due to the nature of U.S. government insured or guaranteed loans, the Corporation does not establish an allowance for loss on these loans until such time as specific loans are determined to be in default.

Risk Management

From time to time, the Corporation takes positions in financial markets to hedge against fluctuations in interest rates that affect the cost of certain planned borrowings or the yield on certain mortgage purchases. Results of hedging activity are deferred and amortized over the lives of the related borrowings or assets.

Commitment Fees

Commitment fees are generally recognized as income upon the execution of the commitment contract. However, commitment fees that are considered to be an adjustment to the yield on the related mortgages purchased are deferred and recognized as income using an amortization method that in the aggregate approximates a level yield over the estimated life of the related mortgages.

Income Taxes

Certain income and expense items are recognized in different periods for financial and income tax reporting purposes. Provisions for deferred income taxes are made for such timing differences. Investment tax credits are recognized as deductions from income tax expense in the year the related assets are purchased (flow-through method).

Earnings Per Share

Earnings per share are computed on the weighted average number of shares outstanding. Fully diluted earnings per share are computed on the assumption that all outstanding convertible capital debentures were converted at the beginning of the year, after increasing earnings for the related interest expense, net of federal income taxes.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

MORTGAGE PORTFOLIO, NET

The mortgage portfolio balances consist of the following investments at December 31:

	<u>1984</u>	<u>1983</u>
(Dollars in millions)		
Home mortgages:		
First mortgages:		
Government insured or guaranteed:		
Whole loans	\$28,857	\$30,970
Participations	159	30
	<u>29,016</u>	<u>31,000</u>
Conventional fixed-rate:		
Whole loans	33,451	28,108
Participations	5,260	4,425
	<u>38,711</u>	<u>32,533</u>
Conventional adjustable-rate:		
Whole loans	10,020	6,120
Participations	1,646	1,006
	<u>11,666</u>	<u>7,126</u>
Second mortgages:		
Whole loans	1,028	989
Participations	1,753	1,397
	<u>2,781</u>	<u>2,386</u>
Project mortgages:		
Government insured	5,060	5,148
Conventional fixed-rate	635	63
Conventional adjustable-rate	71	—
	<u>5,766</u>	<u>5,211</u>
Total unpaid principal balance	87,940	78,256
Less:		
Unamortized discount	3,414	2,474
Allowance for losses	96	117
	<u>\$84,430</u>	<u>\$75,665</u>

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

Changes in the allowance for loan losses for the years 1982-1984 are summarized below:

	Government Insured or Guaranteed	Conventional	Total
	(Dollars in millions)		
Balance, January 1, 1982	\$ 6.2	\$ 99.4	\$105.6
Additions (a)	4.9	29.6	34.5
Net foreclosure losses charged off	(4.2)	(1.6)	(5.8)
Transferred to estimated liability for foreclosure losses on mortgage-backed securities	—	(2.3)	(2.3)
Balance, December 31, 1982	6.9	125.1	132.0
Additions (a)	11.2	34.4	45.6
Net foreclosure losses charged off	(4.4)	(38.4)	(42.8)
Transferred to estimated liability for foreclosure losses on mortgage-backed securities	—	(8.5)	(8.5)
Balance, December 31, 1983	13.7	112.6	126.3
Additions (a) (b)	13.2	68.1	81.3
Net foreclosure losses charged off	(9.0)	(87.3)	(96.3)
Transferred to estimated liability for foreclosure losses on mortgage-backed securities	—	(1.1)	(1.1)
Balance, December 31, 1984	<u>\$17.9</u>	<u>\$ 92.3</u>	<u>\$110.2</u>

(a) The provision for losses in the Statement of Operations also includes a charge related to certain mortgage-backed securities where the Corporation assumes the risk of foreclosure losses on the underlying mortgages. These charges were \$4.5 million in 1984, \$2.3 million in 1983, and \$1.2 million in 1982.

(b) During 1984, the Corporation experienced an increase in foreclosure losses on conventional loans due to both an increase in the percent of mortgage loans foreclosed and a higher average loss per foreclosure. Effective October 1, 1984 the Corporation raised the rates at which it adds to the allowance when conventional loans are purchased. Application of the higher rates to purchases in the fourth quarter increased additions to the 1984 allowance by \$9.9 million. The 1984 additions also include a \$35.0 million supplemental charge to operations. Both of these amounts are included in the \$68.1 million of additions to the allowance for losses on conventional loans reported for 1984.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

BONDS, NOTES, AND DEBENTURES, NET

Bonds, notes, and debentures consist of the following at December 31:

	<u>1984</u>	<u>1983</u>
	(Dollars in millions)	
Due within one year:		
Short-term notes—net of \$369 million discount in 1984 (\$293 million in 1983)	\$10,165	\$10,833
Master notes	1,220	715
Investment notes	1,275	—
Mortgage-backed bonds	34	23
Debentures	18,067	15,289
Capital debentures	500	—
Total due within one year	<u>31,261</u>	<u>26,860</u>
Due after one year:		
Mortgage-backed bonds	368	402
Debentures	49,734	45,794
Exchangeable debentures	450	—
Zero coupon debentures—net of \$5,779 million discount in 1984	221	—
Zero coupon capital debentures—net of \$6,539 million discount in 1984	211	—
Capital debentures—net of \$19 million discount in 1984 (\$20 million in 1983)	1,446	1,510
Convertible capital debentures	28	28
Total due after one year	<u>52,458</u>	<u>47,734</u>
	<u>\$83,719</u>	<u>\$74,594</u>

Short-term notes are general obligations of the Corporation. These notes were issued in both discount and interest-bearing form through October 1984, after which only the discount form has been issued. Maturities range up to 360 days, and the minimum original amount of purchase is \$10,000; additional amounts can be purchased in increments of \$5,000. Master notes are individually negotiated, variable principal amount short-term notes. These notes have varying maturities and carry a floating interest rate which is adjusted weekly and is tied to 91-day U.S. Treasury bill rates. Investors have the option of increasing or decreasing the principal amount outstanding on these notes on a daily basis, usually within a range of 80 to 120 percent of the original principal balance.

The Corporation had short-term and master notes outstanding of \$11.8 billion (face amount) at December 31, 1984 and December 31, 1983. The largest aggregate amount of short-term and master notes outstanding at any month-end was \$13.4 billion in 1984 and \$11.8 billion in 1983. The average cost to the Corporation of notes outstanding at December 31, 1984 and 1983 was 11.16 percent and 9.67 percent, respectively. These rates represent the effective average cost computed on a 365 day basis. The average remaining terms were approximately 129 and 106 days at December 31, 1984 and 1983, respectively. The average aggregate amount of notes outstanding during 1984 was \$12.2 billion at an average cost of 10.70 percent; during 1983, it was \$10.1 billion at an average cost of 9.67 percent.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The Corporation began issuing investment notes in 1984. These are individually negotiated agreements providing for the investment of a variable principal amount at a fixed- or floating-rate of interest. The agreements remain in effect for various periods of time. The average total outstanding during 1984 was \$110.0 million, and the average cost to the Corporation of those outstanding at December 31, 1984 was 9.65 percent.

In 1984, the Corporation began entering into interest rate swap agreements with various parties to extend the effective maturity of its debt obligations at a cost that was less than could otherwise be obtained on comparable long-term debt. Under these agreements, the Corporation makes periodic payments based on fixed rates applied to a notional principal amount and in exchange receives periodic payments based on short-term variable rates. At December 31, 1984, the Corporation had interest rate swap agreements outstanding with an average remaining term of 5 years, 4 months on notional amounts totalling \$1.3 billion.

The Corporation has a \$322 million line of credit with a group of commercial banks. The credit agreement can be terminated by either party on the anniversary date with 45 days prior written notice. The Corporation did not utilize the commercial line of credit in 1984 or 1983.

Section 304(c) of the Federal National Mortgage Association Charter Act authorizes the Secretary of the Treasury to purchase obligations of the Corporation, as a public debt transaction, up to a maximum of \$2.25 billion outstanding at any one time. The interest rate on such obligations is based upon the average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the date of making such purchases. The Corporation did not utilize the Treasury borrowing authority in 1984 or 1983.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

A summary of bonds and debentures due after one year follows:

(Dollars in millions)	December 31,			
	1984		1983	
Maturity	Weighted Average Interest Rates	Amount Outstanding	Weighted Average Interest Rates	Amount Outstanding
Mortgage-backed bonds:				
1985	—%	\$ —	6.70%	\$ 34
1986	6.39	76	6.39	76
1987	9.01	12	9.01	12
1988	9.01	12	9.01	12
1989	9.01	11	9.01	11
1990-1994	8.69	236	8.69	236
1995-1999	10.01	13	10.01	13
2000-2002	11.97	8	11.97	8
	8.36	368	8.22	402
Debentures:				
1985	—	—	12.37	12,600
1986	11.71	12,941	11.46	10,850
1987	11.53	16,948	11.16	10,650
1988	11.40	9,845	11.00	6,345
1989	11.86	4,650	10.67	1,200
1990-1994	10.45	4,696	10.13	3,745
1995-1999	7.10	154	7.10	154
2000-2014	12.50	500	12.35	250
	11.48	49,734	11.44	45,794
Exchangeable debentures, due 1991	12.50	450	—	—
Zero coupon debentures, net of discount, due 2014	11.50	221	—	—
Zero coupon subordinated capital debentures, net of discount, due 2019	10.22	211	—	—
Capital debentures, net of discount:				
1985	—	—	11.70	500
1986	8.15	300	8.15	300
1989	12.92	635	15.25	200
1997	7.40	250	7.40	250
2002 (8.20% coupon rate)	9.18	261	9.18	260
	10.30	1,446	10.32	1,510
Convertible capital debentures:				
1996	4.38	28	4.38	28
Total	11.43%	\$52,458	11.37%	\$47,734

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

Pursuant to the Corporation's Charter Act and related regulations, no debt instrument may be issued without the approval of the Secretary of the Treasury. Under current regulatory authority, the maximum amount of the Corporation's general obligations (those neither subordinated nor secured) outstanding at any time generally may not exceed 30 times the sum of its stockholders' equity and outstanding subordinated obligations. Subordinated obligations include capital debentures and convertible capital debentures.

In addition to debt restrictions under the Charter Act, the Corporation is also subject to a restriction set forth in certain capital debenture agreements, which limits the amount of capital debentures outstanding to not more than two times the Corporation's common stock, additional paid-in capital, and retained earnings. At December 31, 1984, the Corporation could have issued an additional \$231 million in capital debentures and still have been in compliance with this restriction.

The mortgage-backed bonds, of which \$402 million were outstanding at December 31, 1984 and \$425 million at December 31, 1983, were issued pursuant to authority contained in the Charter Act to issue and sell securities based upon mortgages set aside from the Corporation's portfolio. There is no limitation on the amount of such obligations that may be outstanding. Most of the mortgage-backed bonds are guaranteed as to principal and interest by the Government National Mortgage Association (GNMA) under the provisions of a Trust Indenture dated May 15, 1970, as amended. GNMA guaranteed \$393 million of the mortgage-backed bonds outstanding at December 31, 1984 and \$416 million of the mortgage-backed bonds outstanding at December 31, 1983. Trust assets of approximately \$538 million at December 31, 1984 and \$898 million at December 31, 1983, consisting of the aggregate unpaid principal balances of specified mortgage loans and Federal Agency securities, are restricted for the payment of principal and interest on mortgage-backed bonds and are included in the accompanying balance sheets. Interest earned on trust assets exceeds bond interest requirements.

The following debentures are redeemable at par, in whole or in part, at the option of the Corporation: 7.10 percent debentures due 1997 (\$154 million, beginning in 1982); 12.35 percent debentures due 2013 (\$250 million, beginning in 1993), and 12.65 percent debentures due 2014 (\$250 million, beginning in 1994).

The 7.40 percent and 8.20 percent capital debentures, due in 1997 and 2002, are redeemable at par, in whole or in part, at the option of the Corporation, on any interest payment date commencing October 1, 1982 and July 10, 1988, respectively.

The Corporation may call for the conversion of the Exchangeable Debentures at any time on or prior to March 15, 1991, in which case the debenture holders have two options. They may accept the conversion and receive 10 shares of Adjustable-Rate Preferred Stock, Series A for each \$1,000 principal amount of Exchangeable Debentures. Alternatively, they may reject the call for conversion by extending the maturity date of those debentures to March 15, 1994. The Corporation may call for the conversion only once and only on the entire issue.

The Zero Coupon Debentures and the Zero Coupon Subordinated Capital Debentures do not pay interest periodically. The only scheduled payment to the holders of these debentures is the principal amount due at maturity. The Zero Coupon Debentures will mature in the principal amount of \$6 billion on July 5, 2014. The Zero Coupon Subordinated Capital Debentures will mature in the principal amount of \$6.75 billion on October 9, 2019. Neither of these debentures is redeemable prior to maturity. Interest expense is recognized throughout the life of each zero coupon instrument, by amortizing the difference between the maturity amount and the net proceeds, on a level yield basis.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The Convertible Capital Debentures are convertible into 1.4 million shares of common stock at a price of \$19.63 per share, subject to adjustment in certain events. These debentures are redeemable, at the option of the Corporation, at par.

The average cost of all debt outstanding at December 31, 1984 and 1983, including issuance costs and the effect of hedging and interest rate swaps, was 11.56 percent and 11.12 percent, respectively. Annual maturities of all debt for the years 1986-1990 are \$13.3, \$17.0, \$9.9, \$5.3, and \$1.4 billion, respectively.

STOCKHOLDERS' EQUITY

Transactions in common stock, additional paid-in capital, retained earnings, and treasury stock for the years 1982, 1983, and 1984 are summarized as follows:

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	<u>Total Stockholders' Equity</u>
	(Dollars in Thousands)				
Balance, January 1, 1982	\$370,737	\$270,673	\$603,735	\$(1,895)	\$1,243,250
Conversion of convertible debentures	259	565	—	—	824
Shares issued in exchange for outstanding debentures	39,317	34,512	—	—	73,829
Net loss	—	—	(104,865)	—	(104,865)
Dividends	—	—	(9,709)	—	(9,709)
Balance, December 31, 1982	<u>410,313</u>	<u>305,750</u>	<u>489,161</u>	<u>(1,895)</u>	<u>1,203,329</u>
Conversion of convertible debentures	2,429	5,163	—	—	7,592
Net income	—	—	75,492	—	75,492
Dividends	—	—	(10,502)	—	(10,502)
Balance, December 31, 1983	<u>412,742</u>	<u>310,913</u>	<u>554,151</u>	<u>(1,895)</u>	<u>1,275,911</u>
Conversion of convertible debentures	43	93	—	—	136
Net loss	—	—	(57,374)	—	(57,374)
Dividends	—	—	(10,534)	—	(10,534)
Balance, December 31, 1984	<u>\$412,785</u>	<u>\$311,006</u>	<u>\$486,243</u>	<u>\$(1,895)</u>	<u>\$1,208,139</u>

Pursuant to the Corporation's Charter Act and related regulations, approval of the Secretary of Housing and Urban Development is required prior to a change in the stockholding requirements for lenders or the issuance of any stock of the Corporation. The Corporation is authorized by the Charter Act to have preferred stock on such terms and conditions as the Board of Directors of the Corporation may prescribe. To date, the Board of Directors has authorized a maximum of 4,500,000 shares of Adjustable-Rate Preferred Stock, Series A, \$100 stated value. These shares may be issued only upon exchange for the 12.50% Exchangeable Debentures Due 1991 (described under "Bonds, Notes, and Debentures, Net"). No shares have been issued.

In 1982, the Corporation adopted a performance share plan that makes awards to officers for three four-year periods starting in 1982, 1983, and 1984, provided certain financial goals are attained. Performance shares will be issued, if earned, generally half in cash and half in stock. However, no more than 200,000 shares of common stock can be distributed under the plan. As of December 31, 1984, 142,200 performance shares are outstanding for the 1982-85 period, 58,700 for the 1983-86 period, and 120,500 for the 1984-87 period.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

During 1984, the Corporation adopted a stock option plan for key employees. Under the plan, the Corporation may grant options to purchase up to one million shares of common stock. The number of shares that may be granted under the plan may be increased by up to 200,000 shares, but only to the extent that shares are not issued under the performance share plan described above. The options do not become exercisable until at least one year after the date granted, and they generally expire ten years from the date of grant. The purchase price of the common stock covered by each option is equal to the fair market value of the stock on the date that the options are granted.

Option activity in 1984 was as follows:

	<u>Number of Shares</u>	<u>Price</u>
Granted:		
January 17	205,500	\$23.75
November 20	<u>117,600</u>	\$16.12
	323,100	
Terminated	<u>18,500</u>	\$23.75
Balance at December 31	<u>304,600</u>	\$16.12-\$23.75

No options were exercisable at December 31, 1984.

In 1984, the Board of Directors adopted the 1985 Employee Stock Purchase Plan, subject to the approval of the Corporation's stockholders and receipt of a favorable tax ruling from the Internal Revenue Service. Under the plan, the Corporation can issue up to 500,000 shares of common stock to qualified employees at a price equal to 85 percent of the fair market value of the stock on the first day of the time period in which employees can elect to purchase stock. The Corporation can grant each employee the right to purchase up to 200 shares of stock during a purchase period.

In September 1982, the Corporation entered into a nontaxable transaction which resulted in the issuance of 6.3 million shares of its common stock in exchange for \$101 million of its long-term debentures, which were retired. Had this transaction and all conversions of convertible debentures during the year taken place on January 1, 1982, the net loss per share for 1982 would have been \$1.56 (\$2.00 before extraordinary item), compared with a loss of \$1.72 per share (\$2.20 before extraordinary item) as reported in the Statements of Operations.

INCOME TAXES

Deferred federal income tax expense relating to timing differences consists of the following:

	<u>1984</u>	<u>1983</u>	<u>1982</u>
	(Dollars in millions)		
Amortization of purchase discount	\$31.7	\$52.9	\$71.3
Losses on dispositions of mortgages	(2.7)	44.5	(3.9)
Risk management activities	26.6	(9.4)	6.3
Systems development costs	5.9	1.5	—
Other items, net	<u>(2.4)</u>	<u>(11.1)</u>	<u>3.8</u>
Total deferred federal income tax expense	<u>\$59.1</u>	<u>\$78.4</u>	<u>\$77.5</u>

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The Internal Revenue Service has completed its examinations of the Corporation's federal income tax returns for the years 1979-1982, and has proposed certain adjustments. The Corporation has filed a protest contesting these adjustments and has filed a claim for refund for \$124.9 million relating to losses on sales of participation interests in mortgages. In addition, the Corporation filed amended returns for 1981 and 1982 to claim losses sustained on mortgages exchanged pursuant to the Corporation's resale/refinance program. Such mortgage disposition losses can be carried back only three years (as opposed to ten years for other losses) and have resulted in a claim for refund of an additional \$15.2 million. Mortgage disposition losses claimed in excess of the amount carried back were more than sufficient to offset 1983 taxable income. Remaining mortgage disposition losses of \$119.6 million which expire in 1997 and 1998 are available to reduce future taxable income.

All disputed amounts relate to items for which deferred taxes have been provided. It is management's opinion that any unfavorable determinations would have no material adverse impact on the results of operations.

At December 31, 1984, the Corporation had investment tax credit carryforwards of \$1.7 million (expiring at various dates from 1996 to 1999) which are available to reduce future federal tax provisions and federal tax liabilities.

The 1984 tax loss from operations will be carried back to recover certain taxes paid during the previous 10 years.

The Corporation is exempt from state and local taxes, with the exception of real estate taxes.

RETIREMENT PLANS

All permanent, full-time employees of the Corporation are covered by the non-contributory Federal National Mortgage Association Retirement Plan or by the contributory Civil Service Retirement Law. Pension expenses for these plans were \$0.7 million and \$0.2 million, respectively, for the year ended December 31, 1984 (\$0.6 million and \$0.2 million in 1983, and \$0.8 million and \$0.2 million in 1982). For the Corporation's defined benefit pension plan, pension expense includes unfunded past service costs which are being amortized over 10 years. Prior to 1984, the Corporation made annual contributions to the plans equal to the amounts accrued for pension expense. During 1984, however, the Corporation contributed \$0.2 million to the Corporation's pension plan and has recorded a \$0.5 million liability to the plan at December 31, 1984. Accumulated plan benefits, total actuarial liabilities and plan assets for the Corporation's defined benefit pension plan at January 1 are presented below:

	<u>1984</u>	<u>1983</u>
	(Dollars in millions)	
Actuarial present value of accumulated plan benefits:		
Vested	\$ 7.8	\$ 5.8
Nonvested	<u>1.5</u>	<u>1.7</u>
Total accumulated benefits	<u>\$ 9.3</u>	<u>\$ 7.5</u>
Total actuarial liability	<u>\$21.8</u>	<u>\$18.4</u>
Net assets available for benefits	<u>\$34.4</u>	<u>\$28.4</u>

The rate of return for determining the present value of accumulated plan benefits is 7.5 percent. The rate was changed to 7.5 percent in 1982 from 6.0 percent in 1981. This change had the effect of reducing the annual pension expense for 1982 by \$1.6 million.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

In addition to providing pension benefits, the Corporation provides certain health care and life insurance benefits for retired employees. All employees who retire from the Corporation are eligible for these benefits. The cost of retiree health care and life insurance benefits is recognized as an expense as premiums are paid. For 1984, these costs totaled \$0.6 million.

COMMITMENTS AND CONTINGENCIES

Portfolio

The Corporation had mandatory delivery commitments outstanding to purchase \$3.5 billion of mortgages at an average net yield of 12.32 percent at December 31, 1984, compared with \$1.7 billion at 12.36 percent at December 31, 1983.

The Corporation also issues standby commitments, which must be converted to mandatory delivery commitments in order for the seller to deliver mortgages. The yield is set on the date of conversion. The Corporation had \$2.8 billion of such commitments outstanding at December 31, 1984, compared with \$3.7 billion at December 31, 1983.

Further, the Corporation issues certain commitments under which delivery is at the option of the seller, and the yield is set on the date that the commitment is issued. The Corporation had \$0.1 billion of such commitments outstanding at December 31, 1984 and December 31, 1983, at an average net yield of 12.02 percent and 12.29 percent, respectively.

Mortgage-Backed Securities

The Corporation packages pools of mortgages in mortgage-backed securities (Fannie Mae Guaranteed Mortgage Pass-Through Certificates) and guarantees the payment of principal and interest. The outstanding principal balance of the pools was \$36.2 billion at December 31, 1984, compared with \$25.1 billion at December 31, 1983. These securities represent interests in mortgages held in trust by the Corporation.

The pools of mortgages are not assets of the Corporation, nor are the outstanding securities liabilities of the Corporation. As issuer and guarantor of the mortgage-backed securities, the Corporation is obligated to disburse scheduled monthly installments of principal and interest, whether or not such amounts have actually been received, unscheduled principal payments when received, and the full principal balance upon liquidation of any foreclosed mortgage whether or not such principal balance is recovered. Either the Corporation or the participating lender from whom the mortgages were acquired can assume the foreclosure loss risk on the mortgages in a pool. The Corporation establishes, by charges to operations, a liability for estimated foreclosure losses on those securities where the Corporation has assumed the risk of loss on the underlying mortgages. The outstanding principal balance of mortgage-backed securities on which the Corporation has the foreclosure loss risk was \$9.5 billion at December 31, 1984 compared with \$7.2 billion at December 31, 1983. The amount of the related liability for estimated foreclosure losses was \$19.6 million at December 31, 1984 and \$15.6 million at December 31, 1983.

At December 31, 1984, the Corporation had commitments outstanding to issue and guarantee \$2.9 billion of mortgage-backed securities when the related mortgages are delivered by participating lenders, generally at their option, compared with \$1.6 billion at December 31, 1983. At December 31, 1984 the Corporation also had \$1.6 billion in outstanding mandatory delivery commitments to issue guaranteed mortgage-backed securities. There were no such commitments outstanding at December 31, 1983.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

UNAUDITED INTERIM PERIOD RESULTS OF OPERATIONS

The following unaudited results of operations include, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair statement of the results of operations for such periods:

	1984 Quarter Ended			
	December	September	June	March
	(Dollars in thousands, except per share amounts)			
Interest margin(a)	\$(78,531)	\$(56,027)	\$(21,640)	\$ 4,479
Commitment fees	44,981	17,289	28,405	23,631
Gain on sales of mortgages	—	—	3,005	8,718
Guaranty fees	22,578	20,303	18,484	16,715
Other income	10,165	8,608	8,379	8,272
Other expenses(b)(c)	(58,971)	(71,821)	(32,127)	(34,969)
Income (loss) before federal income taxes	(59,778)	(81,648)	4,506	26,846
Federal income taxes	(28,600)	(38,500)	2,100	12,300
Net income (loss)	<u>\$(31,178)</u>	<u>\$(43,148)</u>	<u>\$ 2,406</u>	<u>\$ 14,546</u>
Per share:				
Net earnings (loss):				
Primary	\$ (.47)	\$ (.66)	\$.04	\$.22
Fully diluted	(.47)	(.66)	.04	.22
Cash dividends	.04	.04	.04	.04

	1983 Quarter Ended			
	December	September	June	March
	(Dollars in thousands, except per share amounts)			
Interest margin	\$ (1,386)	\$(18,730)	\$(11,974)	\$(29,411)
Commitment fees	23,890	44,680	42,862	39,793
Gain on sales of mortgages	13,476	28,454	18,445	30,313
Guaranty fees	16,125	14,585	13,003	10,605
Other income	8,000	9,656	8,657	6,309
Other expenses	(35,994)	(32,792)	(30,197)	(29,677)
Income before federal income taxes	24,111	45,853	40,796	27,932
Federal income taxes	10,500	21,000	18,800	12,900
Net income	<u>\$ 13,611</u>	<u>\$ 24,853</u>	<u>\$ 21,996</u>	<u>\$ 15,032</u>
Per share:				
Net earnings(d):				
Primary	\$.21	\$.38	\$.34	\$.23
Fully diluted	.20	.37	.34	.22
Cash dividends	.04	.04	.04	.04

(a) Effective October 1, 1984, the Corporation stopped accruing interest on all conventional loans that were 90 days or more delinquent. The effect of this change was to reduce interest income by approximately \$11.6 million in the fourth quarter, increasing the Corporation's after-tax loss by approximately \$6.0 million (\$.09 per share).

(b) In September 1984, the Corporation recorded a supplemental provision of \$35.0 million for conventional loan losses, which increased the Corporation's after-tax loss by \$18.2 million (\$.27 per share).

(c) Effective October 1, 1984, the Corporation increased the rates at which it records a provision for loss when conventional loans are purchased. The effect of this change was to increase the provision for loan losses by \$9.9 million in the fourth quarter, increasing the Corporation's after-tax loss by \$5.1 million (\$.08 per share).

(d) The total of the four quarters does not necessarily equal the amount for the year, since the amount for each period is calculated independently based on the weighted average number of shares outstanding during that period.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Concluded

UNAUDITED FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES

The Corporation is subject to a requirement, promulgated by the Financial Accounting Standards Board (FASB), that it provide supplementary financial information which is intended to disclose the impact of changing prices (inflation) on its financial condition and the results of operations. As a financial institution, the Corporation does not maintain inventories or significant amounts of plant and equipment. Accordingly, the adjustments to income required by the statement are not material and need not be reported.

The FASB statement also provides that the impact of inflation on the Corporation's financial condition be shown by reporting the loss from decline in purchasing power of its net monetary assets. For the Corporation, the definition of net monetary assets includes virtually all assets and liabilities. Net monetary assets are, therefore, approximately equivalent to stockholders' equity. The loss from decline in purchasing power is required to be measured by restating net monetary assets in constant dollars using the Consumer Price Index for All Urban Consumers.

In accordance with the FASB statement, an unaudited five-year comparison of the impact of changes in purchasing power on certain financial data is shown below.

FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES

	<u>1984</u>	<u>1983</u>	<u>1982</u>	<u>1981</u>	<u>1980</u>
	(Dollars in millions, except per share amounts)				
Interest margin:					
As reported	\$ (152)	\$ (62)	\$ (506)	\$ (463)	\$ 21
In constant dollars(a)	(152)	(64)	(545)	(529)	27
Net income (loss):					
As reported	(57)	75	(105)	(190)	14
In constant dollars(a)	(57)	79	(113)	(217)	18
Net monetary assets at end of year					
As reported	1,159	1,233	1,164	1,204	1,419
In constant dollars(a)	1,139	1,261	1,234	1,325	1,704
Loss in purchasing power of average net monetary assets for the year	48	44	48	135	212
Per share:					
Fully diluted earnings (loss):					
As reported	(.87)	1.13	(1.72)	(3.22)	.23
In constant dollars(a)	(.87)	1.18	(1.85)	(3.68)	.29
Cash dividends:					
As reported	.16	.16	.16	.40	1.12
In constant dollars(a)	.16	.17	.17	.46	1.41
Year-end market price:					
As reported	15.38	23.00	24.50	8.50	11.88
In constant dollars(a)	15.12	23.54	25.98	9.35	14.28
Average consumer price index	311.0	298.4	289.1	272.4	246.8

(a) Constant dollars are computed by reference to the Consumer Price Index for All Urban Consumers and are expressed in average 1984 dollars.