

Prospectus



Guaranteed Mortgage Pass-Through Certificates

(Fixed Rate Residential Mortgage Loans)

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

THE OBLIGATIONS OF FNMA UNDER ITS GUARANTY ARE OBLIGATIONS SOLELY OF FNMA 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 Certificates are issued and guaranteed by the Federal National Mortgage Association ("FNMA"), 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 FNMA. Each Pool will consist of fixed rate residential mortgage loans ("Mortgage Loans") either previously owned by FNMA 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 conventional Mortgage Loans, (ii) fixed rate level installment Mortgage Loans that are insured by the Federal Housing Administration or guaranteed by the Veterans Administration, or (iii) fixed rate conventional growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal.

Interests in each Pool will be evidenced by a separate issue of Certificates. Information regarding the Pass-Through Rate with respect to an issue and the aggregate principal amount and characteristics of the related Pool (including, without limitation, 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.

FNMA will have certain contractual servicing responsibilities with respect to each Pool. In addition, FNMA will be obligated to distribute scheduled monthly installments of principal and interest (adjusted to the applicable Pass-Through Rate) to Certificateholders, whether or not received. FNMA 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 October 18, 1982

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

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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 Mortgage Loans (a "Pool") 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

Title of Security	Guaranteed Mortgage Pass-Through Certificates.
Issuer and Guarantor	Federal National Mortgage Association ("FNMA"), a corporation organized and existing under the laws of the United States. See "Federal National Mortgage Association." The obligations of FNMA under its guaranty are obligations solely of FNMA 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 FNMA. A Certificate will initially represent at least \$25,000 unpaid principal amount of Mortgage Loans. The Certificates will be in fully registered form only.
Interest	Interest at the Pass-Through Rate 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. The Pass-Through Rate for a particular issue of Certificates 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 FNMA's guaranty. See "Yield Considerations."
Principal (including pre-payments)	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."
FNMA Guaranty	FNMA is obligated to distribute scheduled monthly installments of principal and interest (adjusted to the Pass-Through Rate) on Mortgage Loans in a Pool, whether or not received. FNMA 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 FNMA 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 impact monthly distributions to Certificateholders.
Servicing	FNMA will be responsible for the servicing of the Mortgage Loans and will 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 conventional Mortgage Loans, (ii) fixed rate level installment Mortgage Loans that are insured by the Federal Housing Administration or guaranteed by the Veterans Administration, or (iii) fixed rate conventional growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal. 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 one-family or two- to four-family residential property and each Mortgage Loan will meet the applicable standards set forth under "FNMA Purchase Program." No conventional Mortgage Loan with a loan-to-value ratio in excess of 95% will be included in any Pool. Mortgage Loans comprising a Pool either will be provided by FNMA from its own portfolio or will be purchased pursuant to criteria set forth under "FNMA Purchase Program." Pool information as to the type of Mortgage Loans, the aggregate principal balance of the Mortgage Loans as of the Issue Date, the average outstanding balance of the Mortgage Loans, the Pass-Through Rate and weighted average Mortgage Interest Rate, the weighted average remaining term to maturity of the Mortgage Loans and the latest maturity date of any Mortgage Loan will be contained in the related Prospectus Supplement. In addition, if Mortgage Loans having principal balances aggregating in excess of 25% of the aggregate principal balance of all Mortgage Loans are secured by Mortgaged Properties located in a single state, information as to such state or states and the related aggregate principal balance also will be supplied.
FNMA Financial Results	FNMA incurred substantial losses during 1981 and the first nine months of 1982 as its cost of borrowed funds was significantly greater than the yield on its mortgage portfolio. See "Selected Financial Data," "Management's Discussion and Analysis of Financial Results—Annual Period and —Interim Period" and "FNMA's Spread on Its Mortgage Portfolio" herein.

THE MORTGAGE POOLS

FNMA has implemented a program for: (a) the setting aside of fixed rate 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 FNMA expressly for the Pools or may be Mortgage Loans that have been held by FNMA 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 one-family or two- to four-family residential properties (the "Mortgaged Properties"). A Pool will contain Mortgage Loans of only one of the following types: (i) fixed rate level installment conventional (i.e., not insured or guaranteed by any U.S. government agency) Mortgage Loans ("Conventional Mortgage Loans"), (ii) fixed rate level installment Mortgage Loans that are insured by the Federal Housing Administration or guaranteed by the Veterans Administration ("FHA/VA Mortgage Loans"), or (iii) fixed rate conventional growing equity Mortgage Loans that provide for scheduled annual increased payments, with the full amount of the increase applied to principal ("GEMs"). The Mortgage Loans purchased expressly for the Pools will be sold to FNMA by eligible institutions that meet certain requirements set forth under "FNMA 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 "FNMA 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"). FNMA will acquire the Mortgage Loans that it has purchased expressly for Pools under purchase contracts with Lenders either for immediate delivery or, alternatively, for delayed delivery on a date not more than six months after the date of execution of such contracts (plus an additional six months if extended with FNMA's consent during the initial six month period). By entering into such contracts, FNMA will obligate itself to issue Certificates to, or to the order of, the Lenders named in the contracts, upon delivery to FNMA of the required Mortgage Loans conforming to FNMA's standards. **FNMA 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.**

FNMA will cause the Mortgage Loans in each Pool to be held for the benefit of the holders of Certificates ("Certificateholders" or "Holders") pursuant to the combined terms of a trust indenture executed by FNMA 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, and by a Second Supplemental Indenture dated as of October 1, 1982, being herein called the "Trust Indenture"), and a supplement thereto for the related Issue (the "Issue Supplement"). Certain capitalized words or series of words in this Prospectus refer to and are further defined in the Trust Indenture. FNMA 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. FNMA will be entitled to receive a fee for its guaranty obligations and its services pursuant to the Trust Indenture. The fee to FNMA for any Mortgage Loan (out of which it will compensate Lenders for servicing the Mortgage Loans) will 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 Pool. FNMA 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, FNMA 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.

FNMA's obligations with respect to the Mortgage Loans will be limited to the servicing responsibilities under the Trust Indenture, its representations and warranties made therein (see "Description of Certificates—Representations and Warranties of FNMA") 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—FNMA Guaranty"

Because the principal amount of the Mortgage Loans in a Pool will decline 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 FNMA as the principal balance thereof) will also decline over time. See "Maturity and Prepayment Assumptions"

YIELD CONSIDERATIONS

Each Pool will consist of Mortgage Loans that bear simple interest at fixed annual rates ("Mortgage Interest Rates") A Pool may include Mortgage Loans that bear different Mortgage Interest Rates The Pass-Through Rate of interest payable to Certificateholders of each 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 FNMA's guaranty Since 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 which 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 FNMA 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 Since FNMA 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 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 FNMA 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 which 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"

MATURITY AND PREPAYMENT ASSUMPTIONS

The maturities of substantially all of the Conventional Mortgage Loans at origination are expected to be between either 10 to 15 years or 20 to 30 years Conventional Mortgage Loans with original maturities of between 10 to 15 years and Conventional Mortgage Loans with original maturities of between 20 to 30 years will not be included in the same Pool The maturities of substantially all of the FHA/VA Mortgage Loans at origination are expected to be 30 years Each Mortgage Loan with an original maturity of 30 years will provide for amortization of principal according to a schedule which, 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 Conventional 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 and GEMs 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 FNMA to exercise its right to accelerate the maturity of the Conventional Mortgage Loan or GEM in such an event so long as acceleration is permitted under applicable law unless it elects to repurchase such Mortgage Loan.

Conventional Mortgage Loans originated 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 FNMA 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 FNMA respecting comparable mortgage loans held in its own portfolio.

Past experience of the Federal Housing Administration 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 FNMA'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 the first nine months of 1982. FNMA 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, FNMA 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 FNMA's option to repurchase the Mortgage Loans in any Pool when the aggregate principal balance thereof becomes less than 10% of the aggregate principal balance of the Mortgage Loans in the Pool on the Issue Date.

As set forth under "FNMA Purchase Program—Mortgage Loan Eligibility—GEMs" below, 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 which matures by its terms more than 15 years subsequent to the date of its origination 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.

FNMA PURCHASE PROGRAM

Set forth below is a description of certain aspects of FNMA'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, the average outstanding balance of the Mortgage Loans, the Pass-Through Rate and weighted average Mortgage Interest Rate, the weighted average remaining term to maturity of the Mortgage Loans and the latest maturity date of any Mortgage Loan. In addition, if Mortgage Loans having principal balances aggregating in excess of 25% of the aggregate principal balance of all Mortgage Loans are secured by Mortgaged Properties located in a single state, information as to such state or states and the related aggregate principal balance also will be supplied.

Lender Eligibility

FNMA will purchase Mortgage Loans from eligible state- and federally-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 FNMA-approved mortgage sellers. FNMA, 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. With respect to financial capacity, FNMA requires eligible Lenders who service Mortgage Loans under the Program to maintain net worth in an amount not less than \$250,000 plus .2% of the aggregate principal balance of all Mortgage Loans serviced under the Program by such Lenders. Approved Lenders will be party with FNMA to a Selling 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 one- to four-family 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 one- to four-family dwelling units, including units in condominium projects, planned unit developments, and *de minimis* planned unit developments. 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 as approved by FNMA, and will comply with all applicable federal and local laws, including laws relating to usury, equal credit opportunity and disclosure.

All principal and interest payments on the Mortgage Loans included in a Pool due prior to the second day of the month prior to the month of the Issue Date for such Pool must have been made. 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 with stated constant annual rates of interest, secured by first Mortgages on residential properties, with principal balances which, at the time of purchase by FNMA, did not exceed certain federally-imposed maximum principal balance limitations applicable to FNMA. In 1982, the maximum dollar purchase limitations for Conventional Mortgage Loans are as follows: \$107,000 for mortgages secured by single-family residences (\$160,500 in Alaska and Hawaii), \$136,800 for mortgages secured by two-family residences (\$205,200 in Alaska and Hawaii), \$165,100 for mortgages secured by three-family residences (\$247,650 in Alaska and Hawaii), and \$205,300 for mortgages secured by four-family residences (\$307,950 in Alaska and Hawaii).

No Conventional Mortgage Loan with a loan-to-value ratio in excess of 95% will be included in any Pool. Conventional Mortgage Loans with loan-to-value ratios exceeding 80% must have the principal amount of the indebtedness in excess of 75% 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 FNMA 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% (but not in excess of

90%), Lenders may contract with FNMA 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% of the original value.

The maximum loan-to-value ratio for a Conventional Mortgage Loan secured by a first Mortgage subject, at the time of origination of the Conventional Mortgage Loan, to subordinate financing is 80%, regardless of the unpaid principal balance. In addition, the sum of the combined unpaid balances of the Conventional Mortgage Loan secured by such first Mortgage and the subordinate financing may not exceed 90% of original value. The maximum loan-to-value ratio at the time of origination for Mortgage Loans secured by non-owner occupied properties is generally 80 percent, but may vary based on FNMA's evaluation of the age of a Mortgage Loan and its experience with the Lender from whom it purchases such Mortgage Loan.

Each Conventional Mortgage Loan must be repayable in equal monthly installments that reduce the principal balance of the loan to zero at the end of the term.

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

GEMs

The foregoing description of Conventional Mortgage Loans that are eligible for purchase under the Program applies equally to GEMs except for the requirement that amortization be on a level installment basis over the life of the Mortgage Loan. Each GEM must provide for scheduled annual increases of either 3%, 4% or 5% of the Mortgagor's monthly payments, which increases must be applied to reduce the unpaid principal balance of the GEM. All GEMs in a single Pool must have (1) scheduled payment increases of the same percentage amount and (2) scheduled annual increases in monthly payments that occur within a four-month period. The original monthly payment on a GEM must be based on either a 25- or 30-year level installment amortization schedule.

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. Each FHA/VA Mortgage Loan must be repayable in equal monthly installments that reduce the principal balance of the loan to zero at the end of the term. 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, FNMA 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% of the lesser of (1) the purchase price of the property or (2) the VA's estimate of reasonable value. For two- to four-family properties, such unguaranteed portion cannot be greater than the least of (1) above, (2) 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 FNMA's purchase of the Mortgage Loan for inclusion in a Pool.

DESCRIPTION OF CERTIFICATES

Each Issue of Certificates will be issued pursuant to the Trust Indenture, which has been executed by FNMA in its corporate capacity and as Trustee for Certificateholders. The 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 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 FNMA upon the request of any Holder of Certificates of such Issue

Mortgage Loans not previously held in FNMA's portfolio will be purchased pursuant to a Pool Purchase Contract from FNMA-approved Lenders for cash or in exchange for Certificates in the related Pool Such Mortgage Loans will be serviced for FNMA by FNMA-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 form of the Pool Purchase Contract, together with the Selling and Servicing Guide, may be obtained from FNMA's Washington, D C office, from any of FNMA's regional offices in Philadelphia, Atlanta, Chicago, Dallas, and Los Angeles, or from FNMA'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 (cited herein as "TI")

General

The Certificates will be issued in fully registered form only and 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 Balance¹ 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 FNMA 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 FNMA to supplement payments and other recoveries on Mortgage Loans to the extent necessary to make required distributions to Certificateholders

Certificates will not be issued in initial principal denominations of less than \$25,000. (TI Section 7.01)

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 FNMA may require payment of a sum sufficient to cover any tax or other governmental charge (TI Section 7.02)

Distributions of principal and interest on each Issue of Certificates will be made by FNMA 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

¹All 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 FNMA 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 FNMA on delinquent Mortgage Loans pursuant to its guaranty obligations and delays in the distribution of certain Mortgage Loan receipts

thereto as it appears on the Certificate Register; 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 FNMA specified in the notice to Certificateholders of such final distribution

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. Such Mortgage Loan Schedule will include the following information as to each Mortgage Loan: the address of the Mortgaged Property, the first payment date and original term, the original principal amount, the Issue Date Principal Balance, the Mortgage Interest Rate, whether such Mortgage Loan is insured by the FHA or guaranteed by the VA, and whether such Mortgage Loan is a GEM and, if so, the dates when adjustments are effective and the percentage amount thereof. In addition, FNMA, 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 FNMA of the mortgage instrument in suitable form for recording but not recorded. At its option, FNMA may choose to maintain such documents with a custodian institution whose deposits or accounts are insured by the FDIC or the FSLIC. FNMA 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 FNMA 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. FNMA's guaranty would, however, by its terms be available in the event of any such proceeding involving the assets of a Lender.

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

Representations and Warranties of FNMA

With respect to each Mortgage Loan in a Pool, FNMA will represent and warrant that as of the Issue Date of the related Certificates: (i) each Mortgage Loan is documented by appropriate FNMA/FHLMC mortgage instruments in effect at the time of origination, FHA or VA mortgage instruments or other instruments approved by FNMA; (ii) the Mortgaged Property securing each Mortgage Loan is improved with a one- to four-family dwelling unit, including units in a condominium project, a planned unit development or a *de minimis* planned unit development; (iii) each Mortgage Loan at the time it was made complied in all material respects with applicable state and federal laws, including usury, equal opportunity and disclosure laws; (iv) each Mortgage Loan conforms to the applicable eligibility requirements set forth in this Prospectus; (v) each Mortgage Loan at the time it was made had an original term not exceeding 30 years and each Mortgage Loan bears interest at a constant annual rate and, except for any GEM, provides for payment of equal monthly installments; (vi) the information set forth in the Mortgage Loan Schedule is true and correct in all material respects; (vii) immediately prior to the transfer thereof, FNMA had good and indefeasible title to such Mortgage Loan, and immediately upon the assignment thereof, the Trustee will have good and indefeasible title to such Mortgage Loan; (viii) each original Mortgage was recorded and, in the case of any Mortgage Note delivered to a custodian, an assignment in recordable form of the related Mortgage to FNMA was delivered to the custodian; (ix) each Mortgage and Mortgage Note is the legal, valid and binding obligation of the maker thereof and is enforceable in accordance with its terms, except only as such enforcement may be limited by laws affecting the enforcement of creditors' rights generally; (x) each Mortgage Loan is secured by a first and paramount lien on the Mortgaged Property, subject only to (1) the liens of current real property taxes and assessments and (2) covenants, conditions

and restrictions, rights of way, easements and other matters of public record which are customarily acceptable to mortgage lending institutions generally or to which like properties are commonly subject and which do not materially affect the value or marketability of the Mortgaged Property, (x1) no Mortgage Loan is delinquent on the Issue Date to the extent of more than the monthly installment of principal and interest due after the first day of the month prior to the month of the Issue Date; and (x11) each Mortgage Loan identified in the Mortgage Loan Schedule as being insured by the FHA or guaranteed by the VA is so insured or guaranteed on the Issue Date by a valid and subsisting policy or guaranty in full force and effect on such date

Upon the discovery by FNMA of a breach of any representation and warranty which materially and adversely affects the interests of Certificateholders in and to the related Mortgage Loan (or which, in the case of the Prospectus and Prospectus Supplement description of the related Pool, causes that description to be materially incorrect), FNMA is obligated, within 60 days of such discovery, either to cure such breach in all material respects or to repurchase 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. In lieu of any such repurchase, FNMA may, at its option, substitute a new Mortgage Loan for a defective Mortgage Loan, provided, however, that no such substitution may take place more than 120 days 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.

Servicing Through Lenders

Pursuant to the Trust Indenture, FNMA 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 FNMA as more fully described herein. Any servicing contract or arrangement by FNMA with a Lender for the direct servicing of Mortgage Loans is a contract solely between FNMA 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. FNMA 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.

For each Mortgage Loan, FNMA retains the difference in interest between the annual Mortgage Interest Rate borne by the Mortgage Loan and the Pass-Through Rate on the Certificates. See "Yield Considerations." For example, if a Mortgage Loan with a 12.25% Mortgage Interest Rate is included in a Pool against which a Certificate with a 11.25% Pass-Through Rate is issued, FNMA would be entitled to receive total compensation of one percent per annum on the Mortgage Loan. FNMA is also entitled to retain prepayment fees, late charges, assumption fees, interest float on advance payments, and similar charges to the extent they are collected from borrowers. FNMA 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 FNMA 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), FNMA will, respecting each Issue, distribute to Certificateholders an amount equal to the total of (1) 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, (ii) the Stated Principal Balance of any such Mortgage Loan which 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 FNMA as described herein because of the breach of a representation and warranty, or because of FNMA'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 FNMA'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) one month's interest at the Pass-Through Rate 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 FNMA'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 FNMA 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

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.

FNMA Guaranty

FNMA'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 FNMA's guaranty obligations in respect of the Certificates. If FNMA 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 impact monthly distributions to Certificateholders

Reports to Certificateholders

With respect to each distribution, FNMA will cause to be forwarded to each Certificateholder a statement setting forth the following information

- (i) the amount due on the Certificate on account of scheduled principal;
- (ii) the amount due on the Certificate on account of interest,
- (iii) the amount, if any, due on the Certificate on account of unscheduled principal,
- (iv) the total of the cash distribution on the Certificate; and
- (v) the Certificate Principal Balance of the Certificate after giving effect to such distribution

Within a reasonable period of time after the end of each calendar year, FNMA 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)—(iii) 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 FNMA

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

thereon at the Pass-Through Rate FNMA 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 FNMA

Collection and Other Servicing Procedures

FNMA is responsible for servicing the Mortgage Loans in each Pool and may, as set forth above, conduct such servicing through Lenders or through other FNMA-approved mortgage servicers In connection with its servicing activities, FNMA 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, FNMA may, in its discretion and without obligation, repurchase from the Trust Fund any Mortgage Loan which 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 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)

Subject to the following paragraph and to the extent consistent with then-current policies of FNMA respecting mortgage loans held in its own portfolio, FNMA 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, FNMA 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 FNMA 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, FNMA 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 FNMA is restricted by law from enforcing the "due-on-sale" clause or FNMA elects to withdraw such Mortgage Loan from the Pool

In the event that, for any reason, FNMA is not obligated to accelerate the maturity of a Conventional Mortgage Loan or GEM upon the transfer, or prospective transfer, of title to the underlying Mortgaged Property, FNMA 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 FNMA's own portfolio or (ii) provide for reduction of the Mortgage Interest Rate

The Trust Indenture provides that FNMA 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, any Mortgage Loan respecting which the underlying Mortgaged Property is transferred, or proposed to be transferred, under circumstances permitting FNMA to accelerate the maturity of such Mortgage Loan pursuant to the terms of any "due-on-sale" clause contained therein

Certain Matters Regarding FNMA

The Trust Indenture provides that FNMA 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 FNMA's obligations and duties under the

Trust Indenture; provided, however, that no successor will succeed to FNMA's guaranty obligations described above, FNMA continuing to be responsible thereunder notwithstanding any termination of its other duties and responsibilities under the Trust Indenture. In the event that FNMA 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 FNMA nor any director, officer, employee or agent of FNMA 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 FNMA nor any such person will be protected against any liability which 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 FNMA is not under any obligation to appear in, prosecute or defend any legal action which is not incidental to its responsibilities under the Trust Indenture and which in its opinion may involve it in any expense or liability. FNMA 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 FNMA which will not be reimbursable to FNMA out of the Trust Fund (TI Section 8.02)

Any corporation into which FNMA may be merged or consolidated, or any corporation resulting from any merger, conversion or consolidation to which FNMA is a party, or any corporation succeeding to the business of FNMA, will be the successor of FNMA 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 FNMA to distribute to Certificateholders any required payment which continues unremedied for 15 days after the giving of written notice of such failure to FNMA by the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 5% of the related Trust Fund; (ii) any failure by FNMA 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 FNMA by the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 25% 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 FNMA 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% of the related Trust Fund may, in writing, terminate all of the obligations and duties of FNMA 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 FNMA thereunder (other than FNMA'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 FNMA, 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 FNMA, (ii) to evidence the succession of another party or parties to FNMA and the assumption by such successor or successors of the obligations of FNMA 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 FNMA 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 FNMA" above (TI Section 11 01)

The Trust Indenture as it relates to any Issue may also be amended by FNMA with the consent of the Holders of Certificates evidencing Fractional Undivided Interests aggregating not less than 66% of the related Trust Fund so as to waive compliance by FNMA with any terms of the Trust Indenture or related Issue Supplement, or to allow FNMA 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 FNMA 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 which 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 5% of the related Trust Fund notify FNMA 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, FNMA 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 FNMA, at its option, of all remaining Mortgage Loans in the related Pool at a price equal to 100% of the Stated Principal Balance thereof together with one month's interest thereon at the Pass-Through Rate (TI Section 10 01). The exercise of such option will effect early retirement of the Certificates of that Issue, but FNMA's right to repurchase is subject to the aggregate principal balances of the Mortgage Loans at the time of repurchase being less than ten percent (10%) of the Pool Principal Balance on the Issue Date. 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 five persons named in the Trust Indenture. For each Issue, FNMA 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 FNMA specified in the notice of termination (TI Section 10 01)

FEDERAL TAX ASPECTS

Taxation of Certificateholders

Rulings effective for Certificates issued on or before June 1, 1983 with respect to Pools consisting exclusively of Conventional Mortgage Loans have been received from the Internal Revenue Service as to certain Federal income tax consequences of investments in the Certificates. FNMA is currently seeking to have these rulings amended by removal of the limitation of the effective period. The firm of Silverstein and Mullens, tax counsel to FNMA, has issued its opinion respecting the Federal income tax consequences of investments in Certificates issued for Pools consisting exclusively of either GEMs or FHA/VA Mortgage Loans.

Pursuant to the Internal Revenue Service rulings and the opinion of Silverstein and Mullens, 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 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 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 amounts paid to the Pool by FNMA as interest under its guaranty. Under section 162 or section 212 of the Code, Certificateholders will be entitled to deduct the servicing fee paid to FNMA. Certificateholders using the cash method of accounting must take into account their pro rata share of income and deductions as and when collected or paid. Certificateholders using the accrual method of accounting must take into account their pro rata share of income and deductions as they become due.

Certificateholders must report their ratable share of the discount income realized on the purchase of each of the Mortgage Loans as ordinary income, consistent with their methods of accounting. The special rules of section 1232 of the Code will be applicable to the Certificateholders' proportionate share of the discounts on any Mortgage Loans in the Pool that are obligations of corporations, or of governments or their political subdivisions, if, and to the extent that, the other conditions for the application of that section are met. With respect to any undivided interest in a mortgage purchased at a premium, the Certificateholder will be entitled to a deduction for amortization under the special rules of section 171 of the Code. Certificateholders are advised to consult with their tax advisors as to whether premium or discount results either from the initial acquisition of Certificates or thereafter, including premium and discount resulting from purchase of the Mortgage Loans or from market purchases and sales of Certificates, and the effect, if any, of such premium or discount upon any secondary market for Certificates. Certificateholders may be required to report annually as ordinary income their pro rata share of any such discount but may not be permitted to deduct annually their pro rata share of any such premium. Such premium may 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.

With respect to Pools consisting exclusively of Conventional Mortgage Loans, the Internal Revenue Service has also ruled, effective for Certificates issued on or before June 1, 1983, as follows:

1. A Certificate owned by a "domestic building and loan association" within the meaning of section 7701(a)(19) of the Code 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 is (or, from the proceeds of the loan, will become) the type of real property described in that section of the Code.

2. A Certificate owned by a thrift institution described in section 593(a) of the Code is considered as representing "qualifying real property loans" within the meaning of section 593(d) of the Code.

3. A real estate investment trust that owns a Certificate is considered as owning a "real estate asset" within the meaning of section 856(c)(5)(A) of the Code, and interest income will be considered "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B) of the Code.

4. A Certificate owned by a "domestic building and loan association" within the meaning of section 7701(a)(19) of the Code 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 loan, will become) the type of real property described in that section of the Code.

Silverstein and Mullens have reached the identical conclusions with respect to Pools consisting exclusively of either GEMs or FHA/VA Mortgage Loans.

FNMA 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, FNMA will furnish, within a reasonable time after the end of each calendar year, to each Certificateholder at any time during such year information necessary to enable the Certificateholder to prepare its tax return. Certificateholders residing in states or localities which impose intangible property or income taxes are advised to consult their own tax advisors as to the status of the Certificates and the income thereon.

Withholding

Under section 301 of the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, Congress required certain statutorily designated payors of interest to withhold ten percent of the amount of such interest distributed to nonexempt recipients, commencing with distributions of interest made or credited on or after July 1, 1983 (regardless of when the investment was made). FNMA is currently seeking to obtain a determination from the Internal Revenue Service or the Department of Treasury as to whether the interest component of distributions by FNMA on the Certificates will be subject to the newly enacted withholding tax. In the absence of any such determination by July 1, 1983, FNMA may decide that it must deduct and withhold from each distribution made or credited to a nonexempt Certificateholder an amount equal to ten percent of the interest component of such distribution.

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 FNMA, as to the validity of the Certificates, the 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 Internal Revenue Code of 1954, as amended (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 FNMA. The effect of such regulation is to make clear that the sponsor (that is, the entity which organizes and services the pool, in this case FNMA), the trustee, and other persons 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 engaged in a prohibited transaction under Section 4975 of the Code, merely by reason of the plan's investment in a certificate. FNMA 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 and holdings of the Certificates by plans are not prohibited either by ERISA or the Code.

FNMA

FNMA is a federally-chartered and privately-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 nation's largest supplier of residential mortgage funds, with a portfolio of more than \$68.8 billion of mortgage loans as of September 30, 1982. FNMA 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.

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

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

The principal office of FNMA 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. FNMA also maintains a fiscal office at 100 Wall Street, New York, New York 10005.

Copies of FNMA's annual report and quarterly financial statements, as well as other financial information, are available from John Meehan, Senior Vice President—Finance and Treasurer, 100 Wall Street, New York, New York 10005 (Telephone: 212-425-9002) or Paul Paquin, Director of Investor Relations, FNMA, 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (Telephone: 202-537-7115).

CAPITALIZATION

The following table sets forth the capitalization of FNMA as of September 30, 1982

	<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	3 mos	12.27%	\$11,678,068
Debentures	6 mos	11.33%	13,913,590
Mortgage-backed bonds	6 mos.	8.47%	<u>12,522</u>
Total due within one year			<u>25,604,180</u>
Due after one year			
Debentures	3 yrs 1 mo	11.84%	40,224,435
Mortgage-backed bonds	7 yrs 4 mos	8.58%	464,857
Capital debentures, net of unamortized discount	8 yrs. 5 mos.	10.36%	1,509,066
Convertible capital debentures	14 yrs. —	4.43%	<u>36,059</u>
Total due after one year			<u>42,234,417</u>
Total Bonds, Notes and Debentures.			<u>\$67,838,597</u>
Total Stockholders' Equity			<u>\$ 1,210,787</u>

(1) All of the above outstanding short-term and long-term debt was issued under Section 304(b) of the Charter Act except the subordinated 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 applicable to indebtedness issued by FNMA.

SELECTED FINANCIAL DATA

The following selected financial data for the years 1977 through 1981 (which data are not covered by the report of independent certified public accountants) have been summarized or derived from the audited financial statements. The financial data for the nine months ended September 30, 1981 and 1982 are unaudited and include, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation.

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

	For The Year Ended December 31,					Nine Months Ended September 30,	
	1977	1978	1979	1980	1981(1)	1981(1)	1982
						(Unaudited)	
Mortgage portfolio income (loss), net of costs.....	\$ 251	\$ 294	\$ 241	\$ (42)	\$ (485)	\$ (291)	\$ (494)
Commitment fees	67	97	51	59	113	55	207
Gain (loss) on sales of mortgages.....	(6)	—	(2)	—	—	—	26
Other income	6	9	9	9	12	7	24
Income (loss) before Federal income taxes and extraordinary item	318	400	299	26	(360)	(229)	(237)
Provision for Federal income taxes	153	191	137	12	(170)	(109)	(109)
Income (loss) before extraordinary item.....	165	209	162	14	(190)	(120)	(128)
Extraordinary item: gain on early retirement of debt(2)	—	—	—	—	—	—	29
Net income (loss)	\$ 165	\$ 209	\$ 162	\$ 14	\$ (190)	\$ (120)	\$ (99)
Earnings (loss) per share:							
Before extraordinary item:							
Primary.....	\$ 3.15	\$ 3.81	\$ 2.81	\$.24	\$ (3.22)	\$ (2.02)	\$ (2.16)
Fully diluted.....	2.77	3.47	2.68	.23	(3.22)	(2.02)	(2.16)
Net:							
Primary.....	3.15	3.81	2.81	.24	(3.22)	(2.02)	(1.67)
Fully diluted.....	2.77	3.47	2.68	.23	(3.22)	(2.02)	(1.67)
Cash dividends per share.....	1.00	1.15	1.28	1.12	.40	.36	.12

Condensed Balance Sheets(3) (Dollars in millions)

	At December 31,					At September 30,	
	1977	1978	1979	1980	1981	1981	1982
						(Unaudited)	
Assets							
Mortgage portfolio, net	\$33,188	\$42,010	\$49,655	\$55,742	\$59,846	\$58,129	\$66,987
Other assets.....	759	1,355	1,424	2,426	2,052	1,486	4,491
Total assets.....	\$33,947	\$43,365	\$51,079	\$58,168	\$61,898	\$59,615	\$71,478
Liabilities							
Bonds, notes and debentures:							
Due within one year	\$ 5,526	\$ 9,018	\$13,087	\$15,542	\$17,365	\$17,854	\$25,604
Due after one year	26,331	31,826	35,116	39,338	41,186	38,511	42,234
Other liabilities	917	1,159	1,375	1,831	2,104	1,934	2,429
Total liabilities	32,774	42,003	49,578	56,711	60,655	58,299	70,267
Stockholders' equity	1,173	1,362	1,501	1,457	1,243	1,316	1,211
Total liabilities and stockholders' equity.....	\$33,947	\$43,365	\$51,079	\$58,168	\$61,898	\$59,615	\$71,478

Condensed Statements of Changes in Financial Position
(Dollars in millions)

	Nine Months Ended September 30,	
	1981(1)	1982
	(Unaudited)	
Funds Provided		
Operations	\$ (143)	\$ (270)
Extraordinary gain(2)	—	—
Proceeds from issuance of debentures and bonds	5,790	15,314
Increase in short-term notes	1,399	2,687
Mortgage repayments, less discount amortized	1,066	930
Sales of mortgages, excluding gains and losses.. . . .	1	542
Net increase in stockholders' equity resulting from debt ex- change and debenture conversions.. . . .	—	103
Other items	(69)	329
Total funds provided	8,044	19,635
Funds Applied		
Debentures and bonds retired...	5,715	8,727
Mortgage purchases including refinancings, less discount ..	3,714	9,064
Mortgage refinancings	(372)	(482)
Dividends paid	21	7
Total funds applied	9,078	17,316
Increase (decrease) in cash and short-term investments	(1,034)	2,319
Beginning balance, cash and short-term investments	1,651	1,066
Ending balance, cash and short-term investments....	\$ 617	\$ 3,385

(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. There was also a decrease in the rate of providing for losses on conventional loans which resulted in a reduction in the loss provision of \$8.3 million during the last three quarters of 1981. Exclusive of these reductions, the 1981 loss would have been \$217.0 million or \$3.67 per share. The loss for the nine months ended September 30, 1981 exclusive of these reductions would have been \$143.7 million or \$2.43 per share.

(2) In September 1982, FNMA 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. This transaction has no funds effect.

(3) Data for 1982 have been reclassified and data for years 1977 through 1981 have been conformed to achieve comparability.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS

ANNUAL PERIOD

General

FNMA provides funds to the mortgage market by channeling the capital it attracts from the credit markets to the primary lenders of residential mortgage credit—mortgage banking companies, thrift institutions and commercial banks. The operations and earnings of the corporation are heavily influenced by the level of interest rates and the availability of alternative sources of mortgage credit. In the past, when interest rates rose, demand for the corporation's funds also rose, because funds available to the traditional suppliers of mortgage credit were diverted to other more profitable investment opportunities. During such periods, demand for mortgage funds increased FNMA's commitment activity and fee income, but corresponding increases in borrowing costs lowered the net return from the corporation's mortgage portfolio. Conversely, when interest rates declined, the traditional suppliers of mortgage funds returned to the housing market, reducing the corporation's commitment activity and associated fee income. The reduction in fee income was usually offset, however, by improved portfolio return as maturing debt was refinanced at lower cost.

In the period under review, 1979 through 1981, high interest rates and rising home prices, combined with inflation and high unemployment, resulted in home ownership costs that fewer American families could afford. New housing starts decreased to 1.1 million in 1981, from 1.3 million in 1980 and 1.7 million in 1979. According to the Federal Home Loan Bank Board index for previously occupied homes, the average yield on newly originated conventional mortgages reached a record 15.80 percent in November 1981, compared with previous yearly highs of 13.74 percent in May 1980 and 11.59 percent in December 1979. Yields for FNMA's Free Market System ("FMS") auction for conventional mortgages peaked at 19.22 percent in September 1981, compared with yearly highs of 17.51 percent in April 1980 and 13.97 percent in November 1979. The average yield accepted for FMS conventional commitments was 16.59 percent in 1981, compared with 14.34 percent in 1980 and 11.94 percent in 1979. With most prospective home buyers out of the market during 1981 because of high interest rates, net new investment in residential mortgages continued to decline. The volume of net investment in residential mortgages by thrift institutions declined from \$43.0 billion in 1979 to \$26.5 billion in 1980 and to an estimated \$20.0 billion in 1981.

During most of the last three years, the capital markets have experienced an inverted yield curve; with the cost of short-term capital exceeding the cost of long-term capital. This is the longest such phenomenon on record, if the brief declines in May to July of 1980 and the last quarter of 1981 are excluded. This protracted condition, coupled with a general increase in interest rates at all maturity levels, undermined FNMA's traditional business practice of financing its mortgage portfolio with short-term borrowings during periods of increasing interest rates in anticipation of refinancing with longer-term debt as rates decline.

Results of Operations and Dividends

FNMA experienced a net loss of \$190.4 million (\$217.0 million excluding the effect of the reduction in FNMA's provision and allowance for conventional loan losses) for the year 1981. This compares with net income of \$14.2 million in 1980 and \$161.7 million in 1979. On a fully diluted per share basis, 1981 losses were \$3.22 (\$3.67 per share excluding the effect of the adjustment for conventional loan losses), contrasted with per share earnings of 23 cents in 1980 and \$2.68 in 1979.

Return on portfolio, a key measure of profitability, declined in each of the three years under review. Return on portfolio was down from \$241.3 million in 1979 to a negative \$41.7 million in 1980 and a negative \$484.8 million (\$535.1 million excluding the effect of the adjustment for conventional loan losses described above) in 1981. At the same time, the net yield on the corporation's mortgage portfolio improved from 8.39 percent at the beginning of 1979 to 8.75 percent on December 31, 1979, to 9.24 percent on December 31, 1980, to 9.85 percent on December 31, 1981. Yields were outpaced, however, by the rising cost of the debt portfolio, which increased from 8.05 percent at the beginning of 1979 to 8.81 percent, 10.11 percent and 11.42 percent, respectively, at the end of each of the three years.

The difference or "spread" between net mortgage yield and gross financing cost represents the most significant element of return on portfolio. Average spread for the month of December in each of the three years was lower than that for December of the previous year: 39 percent in 1978, 02 percent in 1979, negative 67 percent in 1980, and negative 160 percent in 1981. In 1981, the spread on the mortgage portfolio deteriorated during most of the year to an average negative 186 percent in October. It improved during November and was an average negative 160 percent for December, in large part because of an improved interest rate environment during the final quarter which did not continue into the early part of 1982.

Also contributing to the improvement experienced in November and December was FNMA's ability to draw upon new lower-cost funds made available to thrift institutions through the All Savers Certificate program by inaugurating its Residential Financing Security on October 1, 1981. This security, which like other FNMA debt instruments is regarded as a qualifying mortgage investment for thrift institutions and banks, provided FNMA \$646 million in one-year funds at a cost of 14.62 percent in the last quarter of the year.

Commitment fees earned by FNMA totaled \$112.6 million in 1981, compared with \$58.6 million in 1980 and \$50.9 million in 1979. The significant increase in fee income for 1981, which offset part of the loss on the portfolio, was generated by new programs and fee increases.

The Board of Directors halved the quarterly dividend rate from 32 cents to 16 cents per share in October 1980, and further reduced it to four cents in July 1981. Per share cash dividends paid in 1979, 1980 and 1981 were \$1.28, \$1.12 and \$0.40.

Mortgage Purchases

In an effort to reduce portfolio losses, FNMA's new management sought to purchase larger volumes of higher-yielding mortgages and to increase fees charged for mortgage commitments. For the long term, FNMA instituted new purchase policies which will expand its services to the home lending market and reduce the corporation's exposure to interest rate fluctuations. It was clear that the methods by which growth and improved profitability were achieved in the past had to be reassessed in view of the current economic environment and future outlook.

The corporation altered its commitment strategy by shifting emphasis from the Free Market System auction with its optional fixed rate commitments to a variety of new approaches, including mandatory delivery and market rate standby commitments, negotiated contracts, mortgage refinancing, and pass-through securities. (See "Mortgage Portfolio.") The auction process accounted for 77 percent of FNMA's mortgage commitment activity in 1980 and 64 percent in 1979, but only 37 percent during 1981. FNMA issued \$9.3 billion in mortgage commitments in 1981, compared with \$8.1 billion in 1980 and \$10.2 billion in 1979. In 1981, new purchase policies accounted for nearly all of the \$5.9 billion in commitments issued outside the FMS auction process and resulted in \$51.4 million in earned fees. An additional \$3.3 billion of commitments were issued for the new FNMA conventional mortgage-backed securities, which were introduced in October 1981 and provided \$19.9 million in commitment fees.

FNMA's mortgage portfolio yield reacts less quickly to changes in interest rates than does the cost of outstanding debt, which has a substantially shorter average maturity. The imbalance has been exacerbated during recent years by an appreciable decline in the rate of mortgage prepayments. This decline in prepayments has caused lower-yielding loans to remain in FNMA's portfolio for longer terms and therefore heavier reliance on high-cost borrowings to make up for reduced reflows of funds. As a result, in 1981 repayments provided only \$1.1 billion or eight percent of net money requirements, down from \$1.6 billion or 11 percent in 1980, and \$2.7 billion or 18 percent in 1979. One FNMA strategy to reduce this strain on profitability is the corporation's resale/refinance program. (See "Mortgage Portfolio—New Mortgage Purchase Policies.") Under this program in 1981, FNMA improved the average yield on \$630 million of its mortgage portfolio from 9.06 percent to 13.02 percent by lending an additional \$516 million on those loans at 17.86 percent.

Mortgages purchased during 1981, including the previously outstanding \$630 million portion of the resale/refinance program, totaled \$6.1 billion with a gross yield of 15.75 percent, compared with 1980 purchases of \$8.1 billion at 12.64 percent and 1979 purchases of \$10.8 billion at 10.48 percent. The growth rate of FNMA's portfolio was seven percent in 1981, compared with 12 percent in 1980 and 18 percent in 1979.

In May 1981, the corporation reduced the allowance for conventional loan losses by \$42.0 million, based upon its favorable experience with the conventional mortgage portfolio.

Debt

FNMA's financing strategy continues to emphasize shorter-term borrowings in periods of high interest rates and placement of longer-term securities when a more acceptable long-term rate can be obtained. The sustained high cost of credit throughout 1981 afforded FNMA little opportunity to improve its total cost of debt or lengthen its maturities. The corporation's average cost of new funds in 1981 was a record 16.22 percent. In 1981, \$30.2 billion of short-term notes with an average maturity of 98 days, plus \$9.6 billion in debentures with an average maturity of 3 years, 9 months, were issued to finance mortgage purchases and refinance maturing debt. These issues shortened the average remaining term of outstanding debt from 2 years, 11 months at the end of 1980 to 2 years, 7 months at the end of 1981. At the end of 1979, the average remaining term of all outstanding debt was 3 years, 3 months. Short-term notes comprised 16 percent of total debt outstanding at the end of both 1981 and 1980, up from 14 percent at the end of 1979. The corporation's average cost of 16.22 percent for new funds in 1981 compares with previous record costs of 13.37 percent in 1980 and 10.72 percent in 1979.

Despite its losses and currently unfavorable "spread," FNMA has continued to enjoy its necessary access to the credit markets at competitive rates. During July 1981, \$5.3 billion of short-term notes were issued at a cost of 18.36 percent, which was the highest cost incurred for this category of debt for any month during the year. The corporation experienced its lowest short-term borrowing cost of the year in December, when \$1.4 billion of notes were issued at a cost of 11.93 percent. The highest cost for long-term debt during any month of 1981 was incurred in September, when \$1.4 billion of debentures with an average maturity of one year, 7 months were issued at a cost of 17.95 percent. In December 1981, by contrast, \$1.6 billion of debentures with an average maturity of 4 years, 3 months were issued at a cost of 14.05 percent.

At year-end 1981, FNMA had outstanding \$9.2 billion of short-term notes with an average cost of 15.47 percent and an average term to maturity of 57 days, \$6 billion of Residential Financing Securities with an average cost of 14.62 percent and an average term to maturity of 10 months, and \$48.9 billion of debentures and mortgage-backed bonds with an average cost of 10.66 percent and an average term to maturity of 3 years. During 1982, \$7.7 billion of debentures (excluding Residential Financing Securities) and mortgage-backed bonds with an average cost of 10.03 percent will mature. FNMA's net mortgage portfolio at year-end 1981 totaled \$59.8 billion, with an average net yield of 9.85 percent. Stockholders' equity at year-end was \$1.24 billion in 1981, \$1.46 billion in 1980, and \$1.50 billion in 1979.

The new policies described in "Mortgage Portfolio—New Mortgage Purchase Policies" have significant long-term implications for the corporation but may not have an appreciable short-term effect on FNMA's results. They are designed primarily to minimize the impact on FNMA of credit cycle fluctuations.

INTERIM PERIOD

Nine Months Ended September 30, 1982

The net loss for the first nine months of 1982 was \$99.2 million or \$1.67 per share, which includes a \$28.9 million extraordinary gain, resulting from a September 1982 nontaxable exchange of 6.3 million shares of FNMA's common stock for \$100.6 million of its long-term debentures that were retired. Excluding the extraordinary item, operating results reflected a loss of \$128.1 million, or \$2.16 per share.

during the first nine months of 1982, compared with a loss of \$119.6 million or \$2.02 per share for the first nine months of 1981. (Excluding the reductions in the allowance and provision for conventional loan losses, the net loss for the first nine months of 1981 was \$143.7 million or \$2.43 per share.)

Debt issued during the first nine months of 1982 had an average cost of 13.64 percent, compared with an average cost of 16.83 percent during the first nine months of 1981. Debt issued during August and September 1982 had an average cost of 11.92 percent and 11.12 percent, respectively, reflecting further interest rate improvement that has continued into the early part of the fourth quarter. The lower levels of interest rates generally experienced on new borrowings during the first nine months of 1982 and the increased yield on the purchased mortgages were responsible for the improvement in spread from a negative 1.85 percent for September 1981 to a negative 1.60 percent for December 1981 to a negative 1.17 percent for September 1982. However, the average negative spread on the portfolio for the nine-month period ended September 30, 1982 was greater than for the comparable 1981 period. The significant improvement in spread occurred primarily during the last two months. The total cost of debt outstanding rose to 11.75 percent on September 30, 1982 from 11.42 percent on December 31, 1981 and 11.52 percent on September 30, 1981.

The net yield on mortgage purchases during the first nine months of 1982 was 15.75 percent, compared with 15.12 percent for mortgage purchases during the comparable 1981 period. The net yield on the portfolio increased to 10.62 percent on September 30, 1982 from 9.85 percent on December 31, 1981 and 9.62 percent on September 30, 1981. The loss from FNMA's portfolio increased to \$493.7 million in the first nine months of 1982, compared with \$290.8 million recorded during the first nine months of 1981 (\$337.0 million excluding the reductions in the allowance and provision for conventional loan losses).

Commitment fee income was \$206.8 million for the nine months ended September 30, 1982, compared with \$54.8 million for the first nine months of 1981. This substantial increase reflects the restructuring of FNMA's purchase policies and fee schedules discussed under "Mortgage Purchases" above. Negotiated commitments during the first nine months of 1982 provided \$136.3 million of the total fee income. The policy for negotiated transactions was implemented in the second half of 1981.

In the third quarter of 1982, FNMA recorded \$22.9 million of gains from the sales of mortgages through the issuance of \$541.6 million of conventional mortgage-backed securities. A total of \$26.1 million of gains are reflected in the first nine months of 1982. Other income amounted to \$23.6 million in the first nine months of 1982, compared with \$7.2 million in the comparable 1981 period. Included in other income for 1982 is \$8.5 million of guarantee fees resulting from the conventional mortgage-backed securities program, which was implemented in November 1981.

FNMA'S SPREAD ON ITS MORTGAGE PORTFOLIO

FNMA's profitability depends primarily on the difference, or "spread," between the return it receives on its mortgage 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.

For the Month	Portfolio at Month-End (In millions)	Average Effective Yield*	Average Cost of Outstanding Indebtedness*			Spread
			Short-term Notes	Bonds and Debentures	Aggregate	
December 1977	\$34,377	8.08%	6.33%	7.58%	7.51%	.57%
December 1978	43,315	8.38	9.10	7.86	7.99	.39
December 1979	51,097	8.74	11.90	8.29	8.72	.02
December 1980	57,327	9.20	13.93	9.29	9.87	(.67)
1981						
October	60,489	9.69	17.77	10.32	11.55	(1.86)
November	60,941	9.76	16.89	10.47	11.47	(1.71)
December	61,412	9.82	16.10	10.63	11.42	(1.60)
1982						
January	61,721	9.88	15.07	10.76	11.32	(1.44)
February	62,112	9.92	14.65	10.95	11.37	(1.45)
March	62,544	9.97	14.43	11.10	11.41	(1.44)
April	63,132	10.04	14.52	11.19	11.56	(1.52)
May	63,951	10.12	14.46	11.29	11.65	(1.53)
June	65,008	10.23	14.31	11.43	11.72	(1.49)
July	66,158	10.33	14.21	11.58	11.87	(1.54)
August	67,810	10.47	13.35	11.60	11.84	(1.37)
September	68,841	10.58	12.59	11.62	11.75	(1.17)

* Average effective 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 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 \$11.4 billion principal amount of bonds and debentures (original term of one year or longer) mature during the twelve months following September 30, 1982.

Maturity Date	Principal Amount	Weighted Average Cost
	(Dollars in millions)	
1982		
October 1	\$399	15.51%
October 11	800	8.90
December 10	300	7.39
Other	317	13.48
1983		
February 10	450	17.25
March 10	1,300	8.74
April 11	1,397	9.16
May 10	1,550	15.22
June 10	800	7.51
July 11	1,000	10.91
August 10	1,000	9.76
September 12	950	8.09
Other	1,163	13.74

Any near-term improvement in the spread on the mortgage portfolio must result from FNMA's ability to (1) refinance the short-term note portion of its borrowings at rates (either long-term or short-term depending upon FNMA's appraisal of market conditions and future interest rates) that more than compensate for the anticipated increased cost of debenture borrowings or (11) continue to increase the yield on its mortgage portfolio

Since FNMA's mortgage portfolio aggregated \$68.8 billion at September 30, 1982, and its stockholders' equity was approximately \$1.2 billion at that date, a significant improvement in FNMA's spread over the next several quarters is essential to the maintenance of a satisfactory equity base

RECENT DEVELOPMENTS

The "Garn-St Germain Depository Institutions Act of 1982" was passed by Congress and signed into law on October 15, 1982. This legislation authorizes FNMA to issue preferred stock and removes the statutory restriction that limited FNMA's outstanding subordinated debentures to twice the sum of (1) the capital of FNMA represented by the outstanding common stock and (11) its surplus and undistributed earnings. This legislation also pre-empts certain state statutory and case law prohibiting enforcement of "due-on-sale" clauses. See "New Mortgage Purchase Policies."

Legislation that alters FNMA's tax status to give it tax loss carryback and carryforward treatment for operating losses comparable to that of other financial institutions (10-year carryback and 5-year carryforward) was recently passed by Congress. This legislation gives FNMA access to refunds not otherwise available that are attributable to periods in which FNMA had taxable income of \$967 million and paid taxes of \$463 million.

The Department of Housing and Urban Development ("HUD") recently amended its regulations to permit it to increase the federally regulated ceiling on FNMA's debt to capital ratio without formal rulemaking proceedings. FNMA subsequently requested that the Secretary of HUD increase FNMA's maximum debt to capital ratio from 25:1 to 30:1.

HISTORY AND BUSINESS

FNMA was incorporated on February 10, 1938 pursuant to Title III of the National Housing Act. FNMA was then a wholly-owned government corporation that borrowed operating funds almost entirely from the United States Treasury. Its business consisted for the most part of the purchase and resale of mortgages insured by the FHA and, since 1948, mortgages guaranteed by the VA, for the purpose of establishing and maintaining a secondary market for such mortgages. Title III was revised on August 2, 1954 and called the Federal National Mortgage Association Charter Act. Under the new Charter Act, FNMA became a mixed-ownership corporate instrumentality of the United States. In connection with its secondary market operations, FNMA issued non-voting common stock to the institutions from which it purchased mortgages.

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

Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the "1968 Act"), FNMA was, as of September 1, 1968, partitioned into two separate and distinct corporations. One, Government National Mortgage Association ("GNMA"), is a wholly-owned corporate instrumentality of the United States within the Department of 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, FNMA, 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 FNMA, par value \$100 per share, into one share of voting common stock without par value and authorized FNMA to issue its common stock to the public. The 1968 Act also provided for a transitional period for FNMA's stockholders to assume control of the corporation, and all preferred stock theretofore held by the Secretary of the Treasury was retired as of September 30, 1968. Accordingly, the entire equity interest in FNMA became, and is now, publicly owned.

Government Supervision

Although the 1968 Act eliminated all federal ownership interest in FNMA, it did not terminate the significant government regulation of the corporation. Under the Charter Act, approval of the Secretaries of the Treasury and HUD is required for FNMA's issuance of its obligations, however, the Secretary of HUD has delegated the authority to approve the issuance of FNMA debt instruments to the Secretary of the Treasury. The Secretaries of both the Treasury and HUD have approved the issuance and guaranty by FNMA of the Certificates described herein and in the Prospectus.

With regard to FNMA's issuance of debt instruments, the Charter Act specifically provides that the aggregate amount of the corporation's general obligations (under Section 304(b)) shall not exceed, at any one time, fifteen times the sum of capital, capital surplus, general surplus, reserves and undistributed earnings of FNMA unless a greater ratio is fixed by the Secretary of HUD. The Secretary of HUD by regulation has increased this ratio to twenty-five to one and also has provided that, in the event of a reduction in the capital of FNMA, the ratio will automatically increase to such figure as is necessary to include all obligations outstanding pursuant to Section 304(b) of the Charter Act. The Certificates described herein and in the Prospectus are authorized by Section 304(d) of the Charter Act, and, as such, are not subject to any Charter Act limitations as to the maximum amount which may be issued or outstanding at any time.

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

The Charter Act also gives the Secretary of HUD the authority to audit the books and examine the records of FNMA, but this authority has not been exercised.

Although ten members of FNMA's fifteen member Board of Directors are elected by the holders of FNMA common stock, the remaining five members are 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 FNMA under significant federal supervision, the Charter Act also grants to FNMA certain privileges and immunities that it would not otherwise enjoy. For instance, securities issued by FNMA 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, no registration statement or other document with respect to the Certificates offered hereby and by the Prospectus has been 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 and FNMA has not used this facility since its transition from government control.

FNMA is exempt from all taxation by any state or by any county, municipality or local taxing authority except for real property taxes. FNMA is not exempt from payment of federal corporate income taxes. Also, FNMA 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 Commonwealth of Puerto Rico and the territories and possessions of the United States.

MORTGAGE PORTFOLIO

General

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

Prior to 1972, all mortgages purchased were insured or guaranteed by the federal government, but since February 1972, under authority granted by the Emergency Home Finance Act of 1970, FNMA has also purchased mortgages which are not federally insured or guaranteed (so-called "conventional mortgages"). See "Mortgage Portfolio—Mortgage Purchase Activity" below.

Commitments

FNMA's mortgage loan purchases are based on its issuance of commitments by which FNMA agrees in advance to purchase a specified dollar amount of loans. Lenders pay fees, generally one-half of one percent to five percent, for these commitments depending on market conditions, the type of mortgage loan, and the length and characteristics of the commitment.

FNMA offers both optional and mandatory delivery commitments. Under optional delivery commitments, the actual sale of mortgages to FNMA is at the discretion of the lender. If interest rates move upward, lenders holding this type of commitment generally deliver newly-closed loans to FNMA, when rates trend downward, lenders are free to sell to other investors at lower yields. Under mandatory delivery commitments, lenders are obligated to sell mortgages to the corporation. These commitments entail lower FNMA fees and are most often used for loans already closed.

The following table sets forth FNMA's mortgage commitment activity in connection with both FNMA's portfolio and conventional mortgage-backed securities

FNMA Mortgage Commitments

<u>Commitments Issued</u>	<u>For the Year Ended December 31,</u>					<u>Nine Months Ended September 30, 1982</u>
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	
	(Dollars in millions)					
Portfolio						
FNMA						
Home: Government insured or guaranteed	\$ 6,240	\$ 9,119	\$ 5,698	\$ 5,570	\$ 2,971	\$ 812
Conventional	4,605	9,829	4,441	2,511	6,500	14,010
Total home mortgage.....	10,845	18,948	10,139	8,081	9,471	14,822
Project	6	11	40	2	—	9
Total FNMA	10,851	18,959	10,179	8,083	9,471	14,831
FNMA/GNMA tandem plans	43	—	—	—	—	—
Total portfolio	<u>\$10,894</u>	<u>\$18,959</u>	<u>\$10,179</u>	<u>\$ 8,083</u>	<u>\$ 9,471</u>	<u>\$14,831</u>
Conventional mortgage-backed se- curities.. ..	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,259</u>	<u>\$10,081</u>

<u>Commitments Outstanding</u>	<u>At December 31,</u>					<u>At September 30, 1982</u>
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	
	(Dollars in millions)					
Portfolio						
FNMA						
Home: Government insured or guaranteed	\$ 2,615	\$ 3,902	\$ 3,243	\$ 2,246	\$ 920	\$ 137
Conventional	2,016	5,258	3,111	1,008	2,778	6,441
Total home mortgage...	4,631	9,160	6,354	3,254	3,698	6,578
Project	15	25	55	24	19	9
Total FNMA	4,646	9,185	6,409	3,278	3,717	6,587
FNMA/GNMA tandem plans	52	—	—	—	—	—
Total portfolio	<u>\$ 4,698</u>	<u>\$ 9,185</u>	<u>\$ 6,409</u>	<u>\$ 3,278</u>	<u>\$ 3,717</u>	<u>\$ 6,587</u>
Conventional mortgage-backed se- curities.. ..	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,555</u>	<u>\$ 3,871</u>

Mortgage Purchase Activity

As described above, FNMA currently purchases conventional mortgages as well as mortgages that are insured by the FHA or guaranteed by the VA. Substantially all loans currently in FNMA's portfolio are secured by first liens, but FNMA has also begun to purchase second lien whole loans and participations in such loans. With the exception of \$5.3 billion of FHA-insured project loans, all of the mortgage loans purchased by FNMA and held in its portfolio are secured by residential one- to four-family properties. Since FHA-insured and VA-guaranteed loans are, because of their government backing, essentially risk-free from a credit standpoint, FNMA's basic eligibility criterion for their purchase is simply the FHA insurance or the VA guaranty. Because conventional loans have no federal government backing, FNMA has established certain eligibility criteria for their purchase in an effort to minimize the risk of loss from mortgagor defaults. As shown by the table under "Conventional Mortgage (Whole Loan) Portfolio" below, FNMA has experienced an extremely low level of losses on its conventional mortgage portfolio. FNMA believes that its favorable experience to date results from a number of factors, including its purchase eligibility requirements and loan underwriting criteria as well as inflationary pressures which have tended to increase dramatically the market value of the homes securing its portfolio loans.

Generally, FNMA requires that the unpaid principal amount of each conventional mortgage purchased by it (i) not be greater than 80 percent of the appraised 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 loan is greater than 80 percent of such original appraised value (or of the appraised value as determined by a subsequent appraisal). Mortgage insurance is not required on mortgages with loan-to-value ratios greater than 80 percent if the mortgage seller either retains a participation in the mortgage of not less than 10 percent or agrees to repurchase the loan in the event of default.

Sellers of mortgages to FNMA generally retain, subject to FNMA supervision, the responsibility for servicing the loans sold to FNMA. 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, foreclosure. In the first nine months of 1982, mortgage banking companies accounted for 47 percent of FNMA's purchases, savings and loan associations for 42 percent, banks for 8 percent, and others for 3 percent.

Conventional mortgage loans may not be purchased by FNMA if their principal balance at the time of purchase exceeds \$107,000, except for loans secured by properties in Alaska and Hawaii or by two- to four-family dwelling units, where higher maximums apply. Loans eligible for insurance by the FHA are subject to statutory maximum amount limitations, while FNMA imposes maximum amount limitations on loans guaranteed by the VA. Maximum principal balances applicable to FNMA's conventional mortgage purchases can be increased annually to reflect the increasing cost of homes.

Generally, conventional mortgages purchased by FNMA must conform with credit appraisal and underwriting guidelines established by FNMA. These guidelines are designed to assess the credit-worthiness of the mortgagor as well as to assure that the value of the mortgaged home is sufficient to secure the mortgage loan. These guidelines are changed from time to time by FNMA, and FNMA may deviate from them respecting particular loans if other considerations warrant doing so.

At September 30, 1982, virtually all of FNMA's mortgage portfolio consisted of fixed rate mortgage loans. Substantially all of 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 great majority of such loans had original maturities of not less than 25 years (generally 30 years for single-family loans and 40 years for loans secured by projects). At September 30, 1982, the weighted average dollar life (based on the underlying amortization schedules and assuming no prepayments) of the mortgage loans in FNMA's mortgage portfolio was approximately 25 years, and the weighted average yield (net of servicing) was 10.62 percent.

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

FNMA Mortgage Portfolio

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	Nine Months Ended September 30, <u>1982</u>
(Dollars in millions)						
Unpaid Principal Balances At End of Period						
Home: Government insured or guaranteed ...	\$21,907.2	\$26,054.6	\$29,381.7	\$33,416.7	\$34,550.7	\$34,525.4
Conventional	6,597.0	11,524.4	16,106.0	18,358.0	21,435.3	28,969.7
Project government insured	5,872.3	5,736.3	5,609.1	5,551.9	5,425.9	5,345.7
Total unpaid balance	\$34,376.5	\$43,315.3	\$51,096.8	\$57,326.6	\$61,411.9	\$68,840.8
Average yield net of servicing	8.09%	8.39%	8.75%	9.24%	9.85%	10.62%
Purchases During Period						
Home: Government insured or guaranteed ...	\$ 2,283.5	\$ 6,619.9	\$ 5,387.8	\$ 5,272.5	\$ 2,284.0	\$ 793.0
Conventional	2,366.4	5,681.7	5,410.2	2,801.8	3,827.0	8,689.1
Project government insured	133.7	2.9	9.2	26.8	1.9	8.3
Total mortgages purchased	\$ 4,783.6	\$12,304.5	\$10,807.2	\$ 8,101.1	\$ 6,112.9(1)	\$ 9,490.4(1)
Average gross yield on mortgages purchased.	8.80%	9.46%	10.48%	12.64%	15.75%	16.09%
Repayments During Period						
Home: Government insured or guaranteed ...	\$ 2,533.8	\$ 2,472.5	\$ 2,060.7	\$ 1,343.3	\$ 1,252.1	\$ 876.7
Conventional	542.8	754.3	827.9	549.2	741.1	633.1
Project government insured	185.9	129.9	115.3	84.0	127.1	88.5
Total mortgage repayments.....	\$ 3,262.5	\$ 3,356.7	\$ 3,003.9	\$ 1,976.5	\$ 2,120.3(1)	\$ 1,598.3(1)
Sales During Period						
Home: Government insured or guaranteed ...	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Conventional	3.1	—	.7	.6	8.6	541.6
Project government insured	78.6	9.0	21.1	—	.8	—
Total sales.....	\$ 81.7	\$ 9.0	\$ 21.8	\$.6	\$ 9.4	\$ 541.6

(1) Includes \$630 million and \$482 million principal amount of mortgage loans which were refinanced under FNMA's resale/refinance policy in 1981 and the first nine months of 1982, respectively.

As shown by the table, the level of principal payments on FNMA's mortgage portfolio has decreased markedly during recent periods. This decrease, which has resulted in FNMA's keeping lower yielding mortgages on its books, has reduced significantly the increase in yield on its mortgage portfolio which, under more normal conditions, FNMA would otherwise have expected to realize. In addition, FNMA has been forced to rely more heavily on high cost borrowings to finance new mortgage purchases and to refund maturing indebtedness.

FNMA believes that the significant reduction in principal paydowns is due primarily to the current high interest rate environment. Because of the substantially increased cost of new financing, a major portion of current home sales is being financed through so-called "creative" financing wherein the existing mortgage is 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. FNMA currently enforces due-on-sale clauses in conventional mortgages purchased by FNMA 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. FNMA, however, will not accelerate the loan if the prospective purchaser's creditworthiness is acceptable to FNMA and if such

purchaser agrees to pay a note rate adjusted to current market rates. However, since at least 60 percent of FNMA's portfolio loans (including all FHA and VA loans) do not contain any such clause and a number of states substantially prohibit the enforcement of such clauses, FNMA has been unable to prevent assumptions on a major portion of its portfolio. (See "Description of Certificates—Collection and Other Servicing Procedures" in the Prospectus for a description of FNMA's policy for Mortgage Loans in Pools.)

Since all of the loans in FNMA's portfolio are prepayable by the borrower (in some cases with a small penalty), a significant decline in interest rates may result in prepayment of a significant portion of the high rate loans recently added to FNMA's mortgage portfolio.

Conventional Mortgage (Whole Loan) Portfolio

The portfolio of conventional mortgages that FNMA purchased on a whole loan basis (as opposed to participation interests) consists predominantly of loans made to owner-occupants and secured by first liens on residential real property. Since 1972, FNMA has purchased \$28.4 billion of such loans and on September 30, 1982 this portfolio approximated \$24.1 billion. The loss and delinquency experience on this portfolio is summarized in the following tables:

Loss Experience

	Year Ended December 31,					Nine Months Ended September 30, 1982
	1977	1978	1979	1980	1981	
	(Dollars in millions)					
Principal Balance(1).....	\$6,597.0	\$11,383.9	\$15,864.5	\$18,060.3	\$20,268.9	\$24,085.7
Net Losses for the Period(2).....	\$.3	\$.4	\$.8	\$.9	\$.8	\$ 1.1
Net Loss Ratio(3).....	0.0045%	0.0035%	0.0050%	0.0050%	0.0039%	0.0061%
Total Number of Loans(1).....	203,271	308,627	395,903	435,355	472,414	535,630
Total Number of Foreclosures for the Period.....	275	323	219	368	606	786
Percent Foreclosed(3).....	0.1353%	0.1047%	0.0553%	0.0845%	0.1283%	0.1957%

(1) At end of period.

(2) Net losses are determined by subtracting from the proceeds realized on foreclosures the sum of the book value of the foreclosed asset and related foreclosure costs, expenses, interest accrued but uncollected to the date of foreclosure and imputed interest.

(3) Ratio is annualized and based on amounts at the end of the period.

Delinquency Experience

(% of Portfolio By Number of Loans)

Period of Delinquency	At December 31,					At September 30, 1982
	1977	1978	1979	1980	1981	
One month.....	3.3%	2.9%	2.9%	2.7%	2.9%	3.0%
Two months.....	.4	.4	.5	.5	.5	.7
Three or more months.....	.1	.2	.2	.1	.2	.3
Total.....	<u>3.8%</u>	<u>3.5%</u>	<u>3.6%</u>	<u>3.3%</u>	<u>3.6%</u>	<u>4.0%</u>

While these delinquency and loss rates represent past experience, there can be no assurance that the experience on the mortgage loans in a pool serving as the basis for certificates will be as favorable.

New Mortgage Purchase Policies

In order to make FNMA's mortgage portfolio more responsive to fluctuations in prevailing interest rates and to better match its borrowing costs, FNMA has instituted a number of new policies. These are of considerable importance to FNMA's future, but they cannot be expected to have a substantial short-term effect on FNMA's results of operations or financial condition. They include:

- *Call Option Rider.* From November 10, 1980 to October 15, 1982, FNMA required that "call option riders" be added to conventional mortgage loans purchased by it in states where, in FNMA's judgment, the law therein either substantially restricted the enforcement of "due-on-sale" clauses or was unclear in that regard (but not where the seller was not subject to state law governing "due-on-sale" enforcement). The terms of such rider authorize FNMA to accelerate the maturity of any such loan, whether or not the underlying property is sold, at the loan's seventh anniversary. As a result of the "Garn-St Germain Depository Institutions Act of 1982," which permits the enforcement of "due-on-sale" clauses in all mortgages originated on or after October 15, 1982, FNMA no longer requires the rider.

- *Purchase of Adjustable Rate Mortgage Loans ("ARMs").* FNMA has developed standard plans applicable to the purchase of conventional mortgage loans that contain provisions for the automatic adjustment, both up and down, of their interest rates in accordance with changes in a specified index. FNMA also has entered into special negotiated purchases of ARMs that do not conform to its standard plans. FNMA has so far purchased \$2.5 billion of ARMs, has outstanding commitments totalling \$3.8 billion as of September 30, 1982 and expects that future purchases will be substantial. FNMA believes that these ARM loans will enable it to better avoid in the future the risk that its interest costs on debt will exceed the income realized on its mortgage portfolio.

- *Resale/Refinance Loans.* Since March 1981, FNMA has, in order to upgrade the yield on its portfolio, been offering financing to persons purchasing or refinancing homes that secure existing FNMA portfolio loans. These new 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. In resale situations these refinanced loans facilitate the complete financing of the sale and discourage the assumption of the existing loan as part of a financing package. As of September 30, 1982, \$2.0 billion resale/refinance loans have been made by FNMA and, of that amount, \$859 million, or 44%, represents newly-loaned money.

- *Second Mortgages.* Substantially all of the loans currently in FNMA's portfolio are secured by first liens; however, FNMA has also begun to purchase conventional loans secured by second mortgages and participations in such loans. Second mortgages generally bear higher interest rates than contemporaneous first mortgages, have shorter maturities, and are usually prepaid prior to maturity. FNMA will not purchase a second mortgage where the combined unpaid principal balances of the first and the second mortgages exceed 80% of the appraised value of the mortgaged property. At September 30, 1982, FNMA had purchased \$1.2 billion of second mortgages and had commitments to purchase \$.2 billion.

- *Guaranteed Mortgage Pass-Through Certificates.* In November 1981, FNMA began issuing guaranteed mortgage pass-through certificates evidencing beneficial interests in pools of conventional loans that are generally sold to FNMA by lenders in exchange for certificates. As of September 30, 1982, \$8.2 billion of guaranteed mortgage pass-through certificates have been issued and \$8.1 billion are outstanding. FNMA will issue similar certificates representing beneficial interests in FHA/VA mortgages and will also issue similar certificates representing beneficial interests in growing equity mortgages during the fourth quarter. The FNMA lenders either hold the certificates or sell them to private investors. In addition, FNMA may pool mortgages from its own portfolio or may purchase mortgages from lenders in exchange for cash, assemble the mortgages in a pool, and sell the related certificates pursuant to public offerings. FNMA believes that these securities, which are modeled after the highly successful GNMA mortgage-backed security program (which applies only to U.S. government-backed mortgages), will play a significant role in its future operations. FNMA will receive fees for its origination, servicing and guaranty

of certificates, a portion of which will be paid by FNMA to institutions that directly service pooled loans on behalf of FNMA. FNMA expects that the guaranteed mortgage pass-through certificates will enable it to further its statutory purpose of increasing the liquidity of residential mortgages without requiring that FNMA take the financing or "spread" risk on the pooled loans.

However, since FNMA will guarantee timely payment of loans in certificate pools, it will absorb the ultimate credit risk on all loans in these pools. This risk may be offset somewhat to the extent that sellers of pools of loans elect, in order to obtain a higher servicing fee, to remain at risk on the loans sold. If losses on loans in pools mirror losses currently being experienced by FNMA respecting conventional loans held in its own portfolio, FNMA's exposure should be minimal. If, however, the loss rate on conventional loans should appreciably increase, FNMA's losses could, to the extent not offset by recourse to sellers, become significant since it is likely that the amount of loans in such pools would be substantial, even in relation to FNMA's existing \$68.8 billion mortgage portfolio.

CORPORATE INDEBTEDNESS

FNMA borrows more than any other privately-owned corporation in the United States. Although FNMA is privately owned and its obligations (other than its outstanding mortgage-backed bonds guaranteed by GNMA) are not backed by the United States or any agency thereof, FNMA's debt has traditionally been treated as "U.S. Agency" debt in the marketplace. FNMA, as a result, has historically enjoyed ready access to funds in the 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 September 30, 1982, FNMA's bonds and debentures that had an original maturity of one year or longer.

<u>Maturing Within</u>	<u>Principal Amount</u> (In millions)	<u>Weighted Average Cost</u>
One year	\$11,426	11.00%
One to two years	10,823	10.88
Two to three years	13,638	12.90
Three to four years	9,248	12.07
Four to five years	4,263	11.41
Over five years	4,283	9.87

At September 30, 1982, FNMA had short-term notes outstanding aggregating \$11.9 billion at face amount. Such notes had a weighted average term to maturity of 78 days at such date and a weighted average cost of 12.27%.

All of the outstanding indebtedness of FNMA consists of general unsecured obligations issued and outstanding under Section 304(b) of the Charter Act except the subordinated capital debentures (including the convertible capital debentures), which were issued under Section 304(e), and the mortgage-backed bonds, which were issued under Section 304(d). Section 304(b) provides that the aggregate amount of obligations outstanding thereunder 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 FNMA unless a greater ratio is fixed by the Secretary of HUD. The Secretary of HUD has promulgated regulations that both increase the permitted ratio to 25:1 and provide that this increased ratio is, in the event of a reduction in FNMA's capital, further automatically increased to such ratio as shall be necessary to include all obligations outstanding pursuant to Section 304(b). At September 30, 1982, this debt to capital ratio was 23.9:1 compared with a ratio of 22.9:1 and 23.1:1 at June 30, 1982 and March 31, 1982, respectively. The increase in this ratio has been somewhat curtailed by the issuance of \$259 million of subordinated capital debentures since May 1982, and the September 1982 exchange of 6.3 million shares of FNMA's common stock for \$101 million of debt, which was retired. See "Recent Developments" for a discussion of a recently adopted rule that permits the Secretary of HUD to change FNMA's maximum debt to capital ratio.

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 FNMA'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.

Section 304(d) of the Charter Act, pursuant to which the mortgage-backed bonds and the Guaranteed Mortgage Pass-Through Certificates are outstanding, contains no limitation on the amount of obligations that may be outstanding thereunder. Section 304(d) of the Charter Act provides, however, that the mortgages pledged or set aside must be sufficient at all times to make debt service payments on the securities. Mortgage-backed bonds outstanding in the amount of \$428,379,000 at September 30, 1982 are 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 FNMA up to a maximum of \$2.25 billion outstanding at any one time. FNMA 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 FNMA, he is under no requirement to do so. Any borrowings from the Secretary of the Treasury would be made 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 FNMA's borrowing activity and outstanding borrowings at face amounts, the respective costs of borrowings and average maturities.

FNMA Debt Portfolio

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>Nine Months Ended September 30, 1982</u>
(Dollars in millions)						
Short-Term Notes						
Issued during period						
—Amount	\$ 3,090	\$ 9,621	\$10,567	\$17,654	\$30,185	\$26,372
—Cost	6.06%	8.28%	11.75%	14.29%	16.56%	13.09%
—Average Maturity—Days.....	170	185	198	152	98	102
Outstanding at end of period						
—Amount	\$ 1,857	\$ 4,357	\$ 6,593	\$ 8,578	\$ 9,189	\$11,949
—Cost	6.36%	9.25%	12.09%	14.68%	15.47%	12.27%
—Average Maturity—Days.....	99	129	108	92	57	78
Bonds and Debentures						
Issued during period						
—Amount	\$ 5,750	\$10,400	\$10,056	\$11,500	\$10,221	\$15,349
—Cost	7.32%	8.69%	9.71%	12.05%	15.26%	14.51%
—Average Maturity—Months...	82	53	57	48	43	31
Outstanding at end of period						
—Amount	\$30,033	\$36,628	\$41,831	\$46,604	\$49,560	\$56,181
—Cost	7.59%	7.90%	8.33%	9.32%	10.71%	11.64%
—Average Maturity—Months...	56	50	45	41	36	31
Total Debt						
Issued during period						
—Amount	\$ 8,840	\$20,021	\$20,623	\$29,154	\$40,406	\$41,721
—Cost	6.89%	8.49%	10.72%	13.37%	16.22%	13.64%
—Average Maturity—Months...	55	30	31	22	13	13
Outstanding at end of period						
—Amount	\$31,890	\$40,985	\$48,424	\$55,182	\$58,749	\$68,130
—Cost	7.52%	8.05%	8.81%	10.11%	11.42%	11.75%
—Average Maturity—Months...	53	45	39	35	31	26

MANAGEMENT

The senior officers of FNMA, their ages as of September 30, 1982 and business experience are as follows:

David O Maxwell, 52, has been Chairman of the Board of Directors and Chief Executive Officer since May 1981. He served briefly as the corporation's President and Chief Operating Officer from February 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.

James E Murray, 50, has been President since May 1981. Mr Murray was the corporation's Senior Vice President and General Counsel from 1972 until his election to his present position.

Caryl S Bernstein, 48, has been Executive Vice President since February 1982; Secretary since July 1981; and General Counsel since May 1981. Mrs Bernstein was Senior Vice President from May 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.

David M. deWilde, 42, has been Executive Vice President for Policy and Planning since March 1981. Prior to his employment with the corporation, Mr. deWilde was a Managing Director for Lepercq, deNeufize & Company, an investment banking firm, where he specialized in mortgage-related securities. Mr deWilde also served as President of the Government National Mortgage Association, a federal agency, from 1976 until 1977.

Stuart A McFarland, 35, has been Executive Vice President-Operations since May 1981. Prior to his employment with the corporation, Mr McFarland held a number of positions with Ticor Mortgage Insurance Company, most recently that of President.

Arthur P Solomon, 42, has been Executive Vice President and Chief Financial Officer since February 1982. Prior to his employment with the corporation, Mr. Solomon was Senior Vice President of Seraco Enterprises, a subsidiary of Sears, Roebuck & Co., engaged in real estate and financial services. Mr. Solomon also was a Professor in the Department of Urban Studies and Planning at the Massachusetts Institute of Technology and Executive Director of the MIT/Harvard Joint Center for Urban Studies from 1971 until 1980.

Richard R. Betchley, 33, has been Senior Vice President-Marketing and Regional Activities since February 1982. Prior to his employment with the corporation, Mr Betchley was the Manager, Southern California Bond & Money Market Headquarters for Crocker National Bank. Mr Betchley held a number of general management positions with Crocker National Bank, where he was employed from December 1975 until January 1982.

F G Gosling, 56, has been Senior Vice President-Administration since February 1982. From 1973 until assuming his present position, Mr Gosling was the corporation's Vice President for Administration.

J Donald Klink, 46, has been Senior Vice President for Mortgage Securities and Negotiated Transactions since June 1982. Mr Klink was the corporation's Vice President for Mortgage Marketing from August 1981 until February 1982, when he was elected Vice President for Mortgage Securities and Negotiated Transactions. Prior to his employment with the corporation, Mr Klink was employed by Coast Federal Savings and Loan Association for seven years, where he held the position of Senior Vice President in charge of mortgage banking.

Robert J Mahn, 54, has been Senior Vice President-Mortgage Operations since February 1982. Mr Mahn was the corporation's Vice President and Controller from April 1969 until June 1981, when he was elected Vice President-Mortgage Operations.

John J Meehan, 37, has been Senior Vice President-Finance and Treasurer since February 1982. Mr Meehan was the corporation's Vice President-Finance and Treasurer from May 1981 until his election to his present position. Prior to that, Mr Meehan was Vice President and Fiscal Agent. Mr Meehan has been with the corporation since 1975.

BOARD OF DIRECTORS

The members of the Board of Directors of FNMA, their ages as of September 30, 1982 and their backgrounds are as follows

<u>Member and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Merrill Butler(2)—57	President, Butler Housing Corp , a home building company, 1956 to present, past president, National Association of Home-builders, 1980	1981	
James B Coles(2)—41 . . .	Chairman, James B. Coles, Inc , a framing contractor, 1972 to present, Chairman, The Coles Development Company, Inc , a home building company, 1979 to present	1981	
Bert A Getz(2)—45	President and Director Globe Corporation, a banking, real estate and investment company, 1975 to present	1981	The Arizona Bank, The First National Bank of Winnetka
Joseph P Hayden—52	Chairman of the Board and Chief Executive Officer, The Midland Company, financing and insuring of manufactured housing, December 1980 to present, President and Chief Executive Officer, 1961 to December 1980	1969	The Midland Company and its subsidiaries, The First National Bank of Cincinnati, First National Cincinnati Corporation
Carla A Hills—48	Partner, Latham, Watkins & Hills, a law firm practicing in Washington, D.C., Illinois and California, 1978 to present, Secretary, Department of Housing & Urban Development, 1975 to 1977	1982	American Airlines, Inc , Corning Glass Works, International Business Machines Corporation, The Signal Companies, Inc , Standard Oil Company of California
A Oakley Hunter—66	Private Consultant; Chairman of the Board of Directors and Chief Executive Officer, FNMA, January 1971 to May 1981	1970	Thrift Institution Short-Term Liquidity Fund, Inc , Stewart Information Services Corporation
Dianne E Ingels(2)—41 .	Principal, Dianne Ingels and Associates, an independent real estate broker, investor and consultant, 1977 to present, President, Ingels Company, 1976 to 1977, Chairman, Colorado Springs Urban Renewal Commission, 1974 to 1976	1981	Columbia Savings and Loan Association (1977-1980)
John E Krout—62	Chairman of the Board, Germantown Savings Bank, a mutual savings bank, 1977 to present, President, Germantown Savings Bank, 1971 to 1978	1970	Chicago Title & Trust Co , Trustee PNB Mortgage & Realty Investors

<u>Member and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
James E. Lyon(2)—55	Chairman of the Board and Chief Executive Officer, River Oaks Bank and Trust Company, a commercial bank and trust company, River Oaks Financial Corporation, and Ruska Instrument Corporation	1981	
David O. Maxwell—52	Chairman of the Board of Directors and Chief Executive Officer, FNMA, May 1981 to present, President and Chief Operating Officer, FNMA, February to May 1981, Chairman of the Board and Chief Executive Officer, Tigor Mortgage Insurance Company, private mortgage insurance, 1973 to February 1981	1981	
James J. O'Leary—68	Economic Consultant to United States Trust Company, a commercial bank and trust company, May 1979 to present, Vice Chairman, United States Trust Company, until May 1979	1971	Excelsior Income Shares, Inc., GAF Corp., Kennecott Corp.
John M. O'Mara—55	Senior Vice President, Wertheim and Co., a securities business, July 1981 to present; Vice President, Merrill Lynch, Pierce, Fenner & Smith Incorporated, a securities business, 1978 to July 1981; First Vice President, White Weld & Co., Inc., 1974-1978	1970	AZL Resources, Inc.; Baldwin and Lyons, Inc.
Samuel J. Simmons—55	Housing and Real Estate Consultant, June 1981 to present, President, National Center for Housing Management, a non-profit research and training organization, 1972 to June 1981	1978	
Richard C. Van Dusen—57	Executive Partner, Dickinson, Wright, Moon, Van Dusen & Freeman, a Detroit law firm	1981	Pennwalt Corporation, TICOR and its subsidiary, Tigor Mortgage Insurance Company
Mallory Walker—43	President, Walker & Dunlop, a mortgage banking and real estate company, 1976 to present	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 14(d) of that Act or any company registered as an investment company under the Investment Company Act of 1940

(2) appointed by the President of the United States

ACCOUNTANTS

The financial statements of Federal National Mortgage Association included herein have been examined by Peat, Marwick, Mitchell & Co , independent certified public accountants, to the extent and for the periods indicated in their report thereon. Such financial statements have been included in reliance upon the report of Peat, Marwick, Mitchell & Co and given upon the authority of that firm as experts in accounting and auditing.

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, 1981 and 1980, and the related statements of operations and retained earnings, and of changes in financial position for each of the years in the three-year period ended December 31, 1981. 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, 1981 and 1980 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, 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO

Washington, D.C
January 22, 1982

**FEDERAL NATIONAL MORTGAGE ASSOCIATION
BALANCE SHEETS**

Assets

	December 31,	
	1981	1980
	(Dollars in thousands)	
Mortgages at unpaid principal balances		
Home: Government insured or guaranteed	\$34,550,686	\$33,416,650
Conventional.....	21,435,303	18,358,037
Project government insured	5,425,894	5,551,922
Total unpaid principal balance	61,411,883	57,326,609
Less Unamortized discount.....	1,463,475	1,449,248
Allowance for losses	102,582	135,855
Net mortgage portfolio	59,845,826	55,741,506
Cash, including time deposits of \$13.9 million in 1980	18,880	94,622
U.S. Government and Federal Agency securities at cost (market value \$409.2 million in 1981 and \$396.5 million in 1980)	415,024	403,209
Federal funds.....	632,150	1,153,000
Accrued interest receivable	510,002	454,279
Federal income taxes refundable.....	271,585	145,213
Accounts receivable and other assets	90,379	72,846
Acquired property and foreclosure claims less allowance for losses of \$3.0 million in 1981 (\$3.2 million in 1980)	76,288	49,191
Unamortized discount on short-term notes	198,334	301,804
Unamortized debenture expense	37,435	54,333
Total Assets	\$62,095,903	\$58,470,003

See Notes to Financial Statements

Liabilities and Stockholders' Equity

	December 31,	
	1981	1980
	(Dollars in thousands)	
Liabilities		
Bonds, notes and debentures		
Due within one year:		
Short-term notes	\$ 9,189,355	\$ 8,578,250
Debentures	8,254,235	7,199,955
Mortgage-backed bonds	119,589	65,856
Total due within one year	17,563,179	15,844,061
Due after one year		
Debentures	39,472,000	37,505,050
Mortgage-backed bonds	427,654	547,243
Capital debentures	1,250,000	1,250,000
Convertible capital debentures	36,059	36,064
Total due after one year	41,185,713	39,338,357
Total bonds, notes and debentures	58,748,892	55,182,418
Accrued interest payable	1,369,323	1,238,240
Mortgagors' escrow deposits, exclusive of approximately \$562.8 million held by servicers in 1981 and \$472.0 million in 1980	257,377	255,875
Deferred Federal income taxes	410,694	308,894
Other liabilities	66,367	27,318
Total Liabilities	60,852,653	57,012,745
Stockholders' Equity		
Common stock, \$6.25 stated value, no maximum authorization—59,317,854 shares issued (59,317,600 shares in 1980)	370,737	370,735
Additional paid-in capital	270,673	270,670
Retained earnings	603,735	817,748
	1,245,145	1,459,153
Less treasury stock, at cost—208,926 shares	1,895	1,895
Total Stockholders' Equity	1,243,250	1,457,258
Total Liabilities and Stockholders' Equity	\$62,095,903	\$58,470,003

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

	Year Ended December 31,		
	1981	1980	1979
	(Dollars in thousands, except per share amounts)		
Interest and discount on mortgages:			
Home	\$5,159,325	\$4,567,343	\$3,700,375
Project	437,466	446,016	453,182
Total interest and discount income	5,596,791	5,013,359	4,153,557
Portfolio costs:			
Interest on borrowings and related costs	5,997,097	4,923,619	3,745,675
Less income from short-term investments	139,998	121,486	78,600
Net interest and related costs	5,857,099	4,802,133	3,667,075
Administrative	49,462	44,139	46,300
Mortgage servicing fees	202,622	190,186	164,210
Provision for losses	(27,600)	18,600	34,700
Net portfolio costs	6,081,583	5,055,058	3,912,285
Return (loss) from portfolio	(484,792)	(41,699)	241,272
Commitment fees:			
Home and project	92,656	58,631	50,904
Conventional mortgage-backed securities	19,905	—	—
Total commitment fees	112,561	58,631	50,904
Gain (loss) on sales of mortgages	152	42	(1,687)
Other income	12,209	9,434	9,060
Income (loss) before Federal income taxes	(359,870)	26,408	299,549
Provision for Federal income taxes:			
Currently payable (refundable)	(271,300)	(138,300)	108,500
Deferred	101,800	150,500	29,300
Total provision for Federal income taxes	(169,500)	12,200	137,800
Net income (loss)	(190,370)	14,208	161,749
Retained earnings at beginning of year	817,748	869,499	781,728
Less cash dividends declared	627,378	883,707	943,477
Retained earnings at end of year	23,643	65,959	73,978
Retained earnings at end of year	\$ 603,735	\$ 817,748	\$ 869,499
Average number of shares outstanding, in thousands	59,109	58,887	57,566
Per share:			
Earnings (loss):			
Primary	\$ (3.22)	\$.24	\$ 2.81
Fully diluted	(3.22)	.23	2.68
Cash dividends .....	.40	1.12	1.28

See Notes to Financial Statements

**FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION**

	Year Ended December 31,		
	1981	1980	1979
	(Dollars in thousands)		
Funds Provided			
Net income (loss)	\$ (190,370)	\$ 14,208	\$ 161,749
Interest capitalized on graduated payment mortgages, net ...	(102,111)	(105,811)	(66,338)
Provision for deferred Federal income taxes	101,800	150,500	29,300
Provision for losses	(27,600)	18,600	34,700
Funds provided by (applied to) operations	(218,281)	77,497	159,411
Proceeds from issuance of debentures	10,236,006	11,480,157	10,038,761
Increase in short-term notes	714,575	1,904,824	2,156,456
Mortgage repayments, less discount amortized	1,052,168	1,630,143	2,724,259
Foreclosure claims collected	230,684	176,077	203,182
Sales of mortgages, excluding gains and losses	9,340	571	21,773
Increase in common stock, net, including debenture conversions	5	8,646	50,560
Increase in accrued interest payable/receivable, net.	39,815	259,283	131,716
Total funds provided..	12,064,312	15,537,198	15,486,118
Funds Applied:			
Debentures and bonds retired	7,265,815	6,727,052	4,853,674
Mortgage purchases including refinancings, less discount	5,903,936	7,786,417	10,530,805
Mortgage refinancings	(630,490)	—	—
Dividends paid	23,643	65,959	73,978
Other items, net	86,185	163,410	24,624
Total funds applied	12,649,089	14,742,838	15,483,081
Increase (decrease) in cash and short-term investments	(584,777)	794,360	3,037
Cash and short-term investments, beginning of year.... ..	1,650,831	856,471	853,434
Cash and short-term investments, end of year	\$ 1,066,054	\$ 1,650,831	\$ 856,471

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:

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 produces a level yield over the estimated life of the related mortgages. In 1981 and 1980 the corporation purchased and sold participations in pools of mortgages which did not require the recognition of gains or losses for financial statement purposes.

Allowance for Losses

In order to recognize losses which may be sustained due to defaults on mortgages, the corporation maintains an allowance for losses which has been established by charges to income. During 1981, the corporation reduced the allowance for losses by \$42.0 million and also reduced the rate at which provisions are made for estimated losses on conventional loans.

Commitment Fees

Commitment fees are generally recognized as income upon the execution of the commitment contract, unless they are considered to be an adjustment to the yield on the related mortgages purchased. In such cases, the fees are deferred and recognized as income using an amortization method which produces 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 which pertain principally to purchase discount, the loss on sales of pools of mortgages, and the provision for losses on conventional mortgages.

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.

INCOME TAXES

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

<u>Dollars in millions</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>
Losses on sales of participations in pools of mortgages	\$ 35.9	\$ 97.9	\$ —
Amortization of purchase discount	48.9	51.1	30.3
Provision for losses—conventional mortgages	19.7	(4.0)	(3.1)
Other items	<u>(2.7)</u>	<u>5.5</u>	<u>2.1</u>
Total deferred Federal income tax expense	<u>\$101.8</u>	<u>\$150.5</u>	<u>\$29.3</u>

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The Internal Revenue Service has assessed the corporation \$8.2 million resulting from audits of Federal income tax returns for the years 1976-1978. The total amount of the proposed deficiency will not have an impact on results of operations since the deficiency relates to timing differences for which deferred taxes were previously provided.

With the exception of real estate taxes, the corporation is exempt from state and local taxes.

RETIREMENT PLANS

All permanent, full-time employees of the corporation are covered by the non-contributory Federal National Mortgage Association Retirement Plan or the contributory Civil Service Retirement Law. Pension expenses for these plans were \$2.5 million and \$3 million, respectively, for the year ended December 31, 1981 (\$2.6 million and \$3 million in 1980, and \$2.4 million and \$3 million in 1979). The corporation makes annual contributions to the plans equal to the amounts accrued for pension expense, which includes, as to the corporation's defined benefit pension plan, amortization over 10 years of unfunded past service costs. Accumulated plan benefits and plan assets for the corporation's defined benefit pension plan at January 1 are presented below in millions of dollars.

	<u>1981</u>	<u>1980</u>
Actuarial present value of accumulated plan benefits:		
Vested	\$ 3.7	\$ 2.1
Nonvested	<u>2.6</u>	<u>2.7</u>
Total accumulated benefits	<u>\$ 6.3</u>	<u>\$ 4.8</u>
Net assets available for benefits	<u><u>\$18.0</u></u>	<u><u>\$13.5</u></u>

The annual rate of return assumed for determining the actuarial present value of accumulated plan benefits is six percent.

DEBT SECURITIES

Short-term notes are general obligations of the corporation. These notes are issued in both discounted and interest-bearing form. Maturities range up to 360 days, and denominations range from \$5,000 to \$1,000,000 with a minimum original purchase of \$50,000. The corporation had short-term notes outstanding of \$9.2 billion at December 31, 1981 and \$8.6 billion at December 31, 1980. The largest amount of short-term notes outstanding at any month-end in 1981 was \$10.4 billion, in 1980, \$9.3 billion. The average cost to the corporation of notes outstanding at December 31, 1981 and 1980 was 15.5 percent and 14.7 percent, respectively, which represents the effective average cost including commission computed on a 365-day basis. The average remaining term was approximately 57 and 92 days at December 31, 1981 and 1980, respectively. The average aggregate amount of notes outstanding during 1981 was \$8.8 billion at an average cost of 16.6 percent; during 1980, it was \$7.1 billion at an average cost of 13.8 percent.

Residential Financing Securities are offered for issue primarily to financial institutions participating in the All Savers Certificate program under the Economic Recovery Tax Act of 1981. These securities are general obligations of FNMA and are issued to mature in one year. At December 31, 1981 the corporation had \$0.6 billion of Residential Financing Securities outstanding with an average cost of 14.6 percent and an average remaining term of ten months.

The corporation has a \$300 million line of credit with a group of commercial banks. The total amount is available to FNMA on the same day. Interest on any borrowings is calculated at the prime rate used by Continental Illinois National Bank and Trust Company of Chicago. The credit agreement is terminable by either party on the anniversary date with 45 days prior written notice.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

Section 304(c) of the FNMA 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 interest rate on such obligations is to be 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 commercial line of credit or the Treasury borrowing authority in 1981 or 1980.

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

Dollars in millions	December 31,			
	1981		1980	
	Weighted Average Interest Rates	Amount Outstanding	Weighted Average Interest Rates	Amount Outstanding
<u>Maturity</u>				
Debentures				
1982	— %	\$ —	10.02%	\$ 7,608
1983	10.34	10,047	9.02	8,547
1984	11.21	10,425	10.27	8,850
1985	11.59	8,950	9.39	5,350
1986	10.82	4,800	8.35	2,500
1987-1991	9.96	4,650	9.16	4,050
1992-1996	7.03	400	7.03	400
1997-2001	7.10	200	7.10	200
	10.82	<u>39,472</u>	9.51	<u>37,505</u>
Mortgage-backed Bonds:				
1982	—	—	6.16	119
1983	8.47	12	8.47	12
1984	7.16	23	7.16	23
1985	6.61	34	6.61	34
1986	6.28	76	6.28	76
1987-1991	8.70	252	8.70	252
1992-1996	9.00	24	9.00	24
1997-2001	9.00	7	9.00	7
	8.04	<u>428</u>	7.63	<u>547</u>
Capital Debentures:				
1985	11.70	500	11.70	500
1986	8.15	300	8.15	300
1997	7.40	250	7.40	250
2002	8.20	200	8.20	200
	9.43	<u>1,250</u>	9.43	<u>1,250</u>
Convertible Capital Debentures				
1996	4.38	36	4.38	36
Total	10.74%	<u>\$41,186</u>	9.48%	<u>\$39,338</u>

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The convertible capital debentures are convertible into 1.8 million shares of common stock at a price of \$19.63 per share, subject to adjustment in certain events. Such debentures are redeemable, at the option of the corporation, at par.

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.

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 servicers or the issuance of any common stock of the corporation. In addition, no debt instrument may be issued without the approval of the Secretary of the Treasury. The maximum amount of the corporation's general obligations (those neither subordinated nor secured) outstanding at any one time may not exceed 25 times the sum of its stockholders' equity and outstanding subordinated obligations, such outstanding subordinated obligations may not exceed two times stockholders' equity. Subordinated obligations include the capital debentures and the convertible capital debentures. The secured obligations, mortgage-backed bonds, of which \$547 million were outstanding at December 31, 1981 and \$613 million at December 31, 1980, 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, and there is no limitation on the amount of such obligations that may be outstanding. Under the provisions of a Trust Indenture entered into as of May 15, 1970 with Government National Mortgage Association (GNMA), as amended, mortgage-backed bonds are guaranteed as to principal and interest by GNMA Trust assets of approximately \$947 million at December 31, 1981 and \$971 million at December 31, 1980, consisting of the aggregate unpaid principal balances of specified mortgages, and U.S. government and Federal Agency securities, are restricted for the payment of principal and interest on the mortgage-backed bonds and are included in the accompanying balance sheets. Interest earned on trust assets exceeds bond interest requirements.

Annual maturities of all debt for the years 1983-1987 are \$10.0, \$10.4, \$9.5, \$5.2 and \$2.2 billion, respectively.

Common Stock

Net proceeds in excess of stated value of newly issued shares of common stock and net proceeds in excess of cost of treasury stock sold are credited to additional paid-in capital. Purchases of treasury stock are recorded at cost. Transactions in common stock, treasury stock and additional paid-in capital accounts for the years 1981, 1980 and 1979 are summarized as follows:

Transactions in Common Stock, Treasury Stock and Additional Paid-in Capital Accounts

Dollars and shares in thousands	Shares Out- standing	Common Stock	Additional Paid-in Capital	Treasury Stock
Balance, January 1, 1979	56,074	\$351,770	\$230,429	\$1,895
Conversion of convertible debentures	2,592	16,196	34,364	—
Balance, December 31, 1979	58,666	367,966	264,793	1,895
Conversion of convertible debentures	443	2,769	5,877	—
Balance, December 31, 1980	59,109	370,735	270,670	1,895
Conversion of convertible debentures	—	2	3	—
Balance, December 31, 1981	59,109	\$370,737	\$270,673	\$1,895

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

COMMITMENTS AND CONTINGENCIES

Portfolio

The corporation had commitments outstanding at December 31, 1981, to purchase \$1.5 billion of mortgages (including \$0.2 billion of mortgages to be refinanced) at an average net yield of 16.18 percent compared with \$2.2 billion at 14.56 percent at December 31, 1980. Further, the corporation had market-rate and standby commitments outstanding of \$1.7 billion at December 31, 1981, compared with \$1.1 billion at December 31, 1980. The yield on market-rate commitments and conversions of standby commitments is set on the date of conversion. Delivery of mortgages under all of the above mortgage commitments is optional at the discretion of the seller.

In addition to the above optional delivery commitments, the corporation had \$0.4 billion of mandatory delivery commitments outstanding at December 31, 1981 at an average net yield of 16.12 percent.

Mortgage-backed Securities

In 1981, the corporation began packaging pools of conventional mortgages in pass-through securities (FNMA Mortgage-backed Certificates) and guaranteed the payment of principal and interest. The outstanding principal balance of the pools was approximately \$700 million at December 31, 1981. These securities represent interests in pools of fixed-rate conventional mortgages acquired from participating lenders and held in trust by FNMA. The pools of mortgages are not assets of FNMA, nor are the outstanding securities liabilities of the corporation. FNMA as issuer and guarantor of the mortgage-backed securities 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. An allowance for loss has been provided by charges to income related to approximately \$300 million of mortgage-backed securities for which the corporation has assumed the foreclosure loss risk. No allowance was provided on the remaining approximate \$400 million of mortgage-backed securities since the participating lenders from whom the mortgages were acquired have assumed the foreclosure loss risk.

At December 31, 1981, the corporation had \$300 million of outstanding mandatory delivery commitments to acquire conventional mortgages to be placed in pools and to issue a like amount of guaranteed conventional mortgage-backed securities. At December 31, 1981, the corporation also had outstanding commitments to issue and guarantee an additional \$2.3 billion of conventional mortgage-backed securities when the related mortgages are delivered by participating lenders at their option.

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 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 FNMA, the definition of net monetary assets includes virtually all assets and liabilities of the corporation. 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.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

In accordance with the FASB statement, a five-year comparison of the impact of changing prices on certain financial data is shown below

Financial Data Adjusted for Effects of Changing Prices

Dollars in millions, except per share amounts	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
Return (loss) from portfolio:					
As reported	\$ (485)	\$ (42)	\$ 241	\$ 294	\$ 251
In constant dollars (1).....	(485)	(46)	302	410	377
Net income (loss):					
As reported..	(190)	14	162	209	165
In constant dollars (1).....	(190)	16	203	291	248
Net monetary assets at end of year:					
As reported....	1,204	1,419	1,461	1,329	1,152
In constant dollars (1). ...	1,160	1,493	1,726	1,778	1,681
Loss in purchasing power for the year of average net monetary assets.. ..					
	119	186	219	149	104
Per share:					
Fully diluted earnings (loss):					
As reported.....	(3.22)	.23	2.68	3.47	2.77
In constant dollars (1).....	(3.22)	.25	3.36	4.84	4.16
Cash dividends:					
As reported..... .....	.40	1.12	1.28	1.15	1.00
In constant dollars (1).....	.40	1.24	1.60	1.60	1.50
Year-end market price:					
As reported	8.50	11.88	16.13	16.25	14.88
In constant dollars (1).. ..	8.19	12.50	19.05	21.75	21.71
Average consumer price index.....	2,724	2,468	2,174	1,954	1,815

(1) Constant dollars are computed by reference to the Consumer Price Index for All Urban Consumers and are expressed in average 1981 dollars

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Concluded

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

Dollars in thousands, except per share amounts

	1981 Quarter Ended*			
	December	September	June	March
Mortgage portfolio loss, net of costs	\$(194,025)	\$(187,677)	\$(53,841)	\$(49,249)
Commitment and other fees.....	62,806	35,936	18,391	7,637
Gain (loss) on sales of mortgages	371	(73)	(146)	—
Loss before Federal income taxes	(130,848)	(151,814)	(35,596)	(41,612)
Federal income taxes	(60,100)	(72,300)	(17,100)	(20,000)
Net loss	<u>\$ (70,748)</u>	<u>\$ (79,514)</u>	<u>\$ (18,496)</u>	<u>\$ (21,612)</u>
Per share:				
Loss:				
Primary.....	\$ (1.20)	\$ (1.34)	\$ (.31)	\$ (.37)
Fully diluted	(1.20)	(1.34)	(.31)	(.37)
Cash dividends.....	.04	.04	.16	.16
	1980 Quarter Ended			
	December	September	June	March
Mortgage portfolio income (loss), net of costs	\$ (11,741)	\$ (12,662)	\$(42,343)	\$ 25,047
Commitment and other fees.	13,012	23,580	11,664	19,809
Gain on sales of mortgages	—	—	42	—
Income (loss) before Federal income taxes.....	1,271	10,918	(30,637)	44,856
Federal income taxes.....	600	5,000	(14,100)	20,700
Net income (loss).....	<u>\$ 671</u>	<u>\$ 5,918</u>	<u>\$ (16,537)</u>	<u>\$ 24,156</u>
Per share.				
Earnings (loss):				
Primary.....	\$.01	\$.10	\$ (.28)	\$.41
Fully diluted .....	.01	.10	(.28)	.40
Cash dividends.. ..	.16	.32	.32	.32

* Results for the second quarter of 1981 and year ended December 31, 1981 include a \$42.0 million reduction in the allowance for loan losses. There was also a decrease in the rate of providing for losses on conventional loans which resulted in a reduction in the loss provision of \$1.0 million in the second quarter, \$3.2 million in the third quarter and \$4.1 million in the fourth quarter of 1981. Exclusive of these reductions, the 1981 second quarter, third quarter, fourth quarter and yearly loss would have been \$40.9 million, \$81.2 million, \$73.3 million and \$217.0 million or \$.69, \$1.37, \$1.24, and \$3.67 per share, respectively.