FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-Q
November 09, 2007

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

Form 10-Q

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from to

Commission File No.: 0-50231

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of October 22, 2007, there were 978,167,971 shares of common stock outstanding.

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MD&A TABLE REFERENCE

PART I FINANCIAL INFORMATION

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

You should read this Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in conjunction with our unaudited condensed consolidated financial statements and related notes, and the more detailed information contained in our Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K). The results of operations presented in our interim financial statements and discussed in MD&A are not necessarily indicative of the results that may be expected for the full year. Please refer to Glossary of Terms Used in This Report in our 2006 Form 10-K for an explanation of key terms used throughout this discussion.

EXPLANATORY NOTE ABOUT THIS REPORT

We are filing this Quarterly Report on Form 10-Q for the third quarter of 2007 concurrently with the filing of our Quarterly Reports on Form 10-Q for the first and second quarters of 2007.

We filed our 2006 Form 10-K on August 16, 2007, after filing our Annual Report on Form 10-K for the year ended December 31, 2005 (2005 Form 10-K) on May 2, 2007 and our Annual Report on Form 10-K for the year ended December 31, 2004 (2004 Form 10-K) on December 6, 2006. Our 2004 Form 10-K contained our consolidated financial statements and related notes for the year ended December 31, 2004, as well as a restatement of our previously issued consolidated financial statements and related notes for the years ended December 31, 2003 and 2002, and for the quarters ended June 30, 2004 and March 31, 2004. The filing of the 2004 Form 10-K, the 2005 Form 10-K and the 2006 Form 10-K were delayed significantly as a result of the substantial time and effort devoted to ongoing controls remediation, and systems reengineering and development in order to complete the restatement of our financial results for 2003 and 2002, as presented in our 2004 Form 10-K. We have made significant progress in our efforts to remediate material weaknesses that have prevented us from reporting our financial results on a timely basis.

With the filing of our Quarterly Report on Form 10-Q for the third quarter of 2007 on a timely basis, we have accomplished our goal of returning to current filing status. On June 8, 2007, we announced that we plan to file our Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K) with the U.S. Securities and Exchange Commission (SEC) on a timely basis. At this time, we are confirming our expectation that we will file our 2007 Form 10-K on a timely basis.

INTRODUCTION

Fannie Mae is a mission-driven company, owned by private shareholders (NYSE: FNM) and chartered by Congress to support liquidity and stability in the secondary mortgage market. Our business includes three integrated business segments Single-Family Credit Guaranty, Housing and Community Development, and Capital Markets that work together to provide services, products and solutions to our lender customers and a broad range of housing partners. Together, our business segments contribute to our chartered mission objectives, helping to increase the total amount of funds available to finance housing in the United States and to make homeownership more available and affordable for low-, moderate- and middle-income Americans. We also work with our customers and partners to increase the availability and affordability of rental housing.

Our **Single-Family Credit Guaranty** (Single-Family) business works with our lender customers to securitize single-family mortgage loans into Fannie Mae mortgage-backed securities (Fannie Mae MBS) and to facilitate the purchase of single-family mortgage loans for our mortgage portfolio. Revenues in the segment are derived primarily from the guaranty fees the segment receives as compensation for assuming the credit risk on the mortgage loans underlying single-family Fannie Mae MBS and on the single-family mortgage loans held in our portfolio.

Our **Housing and Community Development** (HCD) business works with our lender customers to securitize multifamily mortgage loans into Fannie Mae MBS and to facilitate the purchase of multifamily mortgage

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loans for our mortgage portfolio. Our HCD business also helps to expand the supply of affordable housing by investing in rental and for-sale housing projects, including rental housing that is eligible for federal low-income housing tax credits. Revenues in the segment are derived from a variety of sources, including the guaranty fees the segment receives as compensation for assuming the credit risk on the mortgage loans underlying multifamily Fannie Mae MBS and on the multifamily mortgage loans held in our portfolio, transaction fees associated with the multifamily business and bond credit enhancement fees. In addition, HCD s investments in rental housing projects eligible for the federal low-income housing tax credit generate both tax credits and net operating losses that reduce our federal income tax liability. Other investments in rental and for-sale housing generate revenue from operations and the eventual sale of the assets.

Our **Capital Markets** group manages our investment activity in mortgage loans and mortgage-related securities, and has responsibility for managing our assets and liabilities and our liquidity and capital positions. Through the issuance of debt securities in the capital markets, our Capital Markets group attracts capital from investors globally that the company uses to finance housing in the United States. Our Capital Markets group generates income primarily from the difference, or spread, between the yield on the mortgage assets we own and the cost of the debt we issue in the global capital markets to fund these assets.

Although we are a corporation chartered by the U.S. Congress, the U.S. government does not guarantee, directly or indirectly, our securities or other obligations. Our business is self-sustaining and funded exclusively with private capital.

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SELECTED FINANCIAL DATA

The selected consolidated financial data presented below is summarized from our condensed results of operations for the three and nine months ended September 30, 2007 and 2006, as well as from selected condensed consolidated balance sheet data as of September 30, 2007 and December 31, 2006. This data should be read in conjunction with this Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as with the unaudited condensed consolidated financial statements and related notes included in this report and with our audited consolidated financial statements and related notes included in our 2006 Form 10-K.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars and shares in millions, except per share amounts)			
Income Statement Data:				
Net interest income	$ 1,058	$ 1,528	$ 3,445	$ 5,407
Guaranty fee income[1]	1,232	1,084	3,450	2,968
Losses on certain guaranty contracts	(294)	(103)	(1,038)	(181)
Derivatives fair value losses, net	(2,244)	(3,381)	(891)	(854)
Other income (loss)[1][2]	242	659	449	(612)
Credit-related expenses[3]	(1,200)	(197)	(2,039)	(457)
Net income (loss)	(1,399)	(629)	1,509	3,455
Preferred stock dividends and issuance costs at redemption	(119)	(131)	(372)	(380)
Net income (loss) available to common stockholders	(1,518)	(760)	1,137	3,075
Common Share Data:				
Earnings (loss) per share:				
Basic	$ (1.56)	$ (0.79)	$ 1.17	$ 3.17
Diluted	(1.56)	(0.79)	1.17	3.16
Weighted-average common shares outstanding:				
Basic	974	972	973	971
Diluted	974	972	975	972
Cash dividends declared per common share	$ 0.50	$ 0.26	$ 1.40	$ 0.78
New Business Acquisition Data:				
Fannie Mae MBS issues acquired by third parties[4]	$ 148,320	$ 107,027	$ 407,962	$ 308,371
Mortgage portfolio purchases[5]	49,574	51,576	134,407	150,340
New business acquisitions	$ 197,894	$ 158,603	$ 542,369	$ 458,711

	As of	
	September 30,	December 31,

	2007	2006
	(Dollars in millions)	
Balance Sheet Data:		
Investments in securities:		
Trading	$ 48,683	$ 11,514
Available-for-sale	315,012	378,598
Mortgage loans:		
Loans held for sale	5,053	4,868
Loans held for investment, net of allowance	394,550	378,687
Total assets	839,783	843,936
Short-term debt	153,146	165,810
Long-term debt	608,619	601,236
Total liabilities	799,740	802,294
Preferred stock	9,008	9,108
Total stockholders equity	39,922	41,506

	As of September 30, 2007	As of December 31, 2006
	(Dollars in millions)	
Regulatory Capital Data:		
Core capital[6]	$ 41,713	$ 41,950
Total capital[7]	43,798	42,703
Mortgage Credit Book of Business Data:		
Mortgage portfolio[8]	$ 728,578	$ 728,932
Fannie Mae MBS held by third parties[9]	2,003,382	1,777,550
Other credit guaranties[10]	35,508	19,747
Mortgage credit book of business	$ 2,767,468	$ 2,526,229

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Ratios:				
Return on assets ratio[11]*	(0.72)%	(0.36)%	0.18%	0.49%
Return on equity ratio[12]*	(19.4)	(9.8)	4.8	13.1
Equity to assets ratio[13]*	4.7	4.7	4.8	4.8
Dividend payout ratio[14]*	N/A	N/A	120.4	24.7
Average effective guaranty fee rate (in basis points)[15]*	22.8bp	22.5bp	22.0bp	20.9bp
Credit loss ratio (in basis points)[16]*	5.0bp	2.3bp	4.0bp	1.8bp

(1) Certain prior period amounts that previously were included as a component of Fee and other income have been reclassified to Guaranty fee income to conform to the current period presentation.

(2) Consists of trust management income; investment gains (losses), net; debt extinguishment gains, net; losses from partnership investments; and fee and other income.

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

(4) Unpaid principal balance of Fannie Mae MBS issued and guaranteed by us and acquired by third-party investors during the reporting period. Excludes securitizations of mortgage loans held in our portfolio.

(5) Unpaid principal balance of mortgage loans and mortgage-related securities we purchased for our investment portfolio during the reporting period. Includes advances to lenders and mortgage-related securities acquired through the extinguishment of debt.

(6) The sum of (a) the stated value of outstanding common stock (common stock less treasury stock); (b) the stated value of outstanding non-cumulative perpetual preferred stock; (c) paid-in-capital; and (d) our retained earnings. Core capital excludes accumulated other comprehensive loss.

(7) The sum of (a) core capital and (b) the total allowance for loan losses and reserve for guaranty losses, less (c) the specific loss allowance (that is, the allowance required on individually impaired loans).

(8) Unpaid principal balance of mortgage loans and mortgage-related securities held in our portfolio.

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

(10) Includes single-family and multifamily credit enhancements that we have provided and that are not otherwise reflected in the table.

(11) Annualized net income available to common stockholders divided by average total assets during the period.

(12) Annualized net income available to common stockholders divided by average outstanding common equity during the period.

(13) Average stockholders equity divided by average total assets during the period.

(14) Common dividends declared during the period divided by net income available to common stockholders for the period. Because we experienced a loss for the three months ended September 30, 2007 and 2006, earnings for each of those periods were insufficient to cover dividends declared during those periods.

(15) Annualized guaranty fee income as a percentage of average outstanding Fannie Mae MBS and other guaranties during the period.

(16) Annualized charge-offs, net of recoveries and annualized foreclosed property expense, as a percentage of the average total mortgage credit book of business during the period. Effective January 1, 2007, we have excluded any initial losses recorded pursuant to Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, on loans purchased from trusts from our credit losses when the purchase price of delinquent loans that we purchase from Fannie Mae MBS trusts exceeds the fair value of the loans at the time of purchase. We have revised our presentation of credit losses for the three and nine months ended September 30, 2006 to conform to the current period presentation. Refer to Risk Management Credit Risk Management Mortgage Credit Risk Management Credit Losses for more information regarding this change in presentation.

Note:

* Average balances for purposes of the ratio calculations are based on beginning and end of period balances.

EXECUTIVE SUMMARY

Overview

We are in the midst of a significant correction in the housing and mortgage markets. The market downturn that began in 2006 has continued through the first three quarters of 2007, with substantial declines in new and existing home sales, housing starts, mortgage originations, and home prices, as well as significant increases in inventories of unsold homes, mortgage delinquencies, and foreclosures. In recent months, the capital markets also have been characterized by high levels of volatility, reduced levels of liquidity in the mortgage and corporate credit markets, significantly wider credit spreads, and rating agency downgrades on a growing number of mortgage-related securities. Beginning with the third quarter of 2007, these factors have had a significant effect on our business. We expect these factors will continue to affect our financial condition and results of operations through the end of 2007 and into 2008.

Management believes that some factors in this correction may benefit our business in the short or long term, and that other factors in the correction may have a material adverse effect on our business. In particular, the reduced liquidity accompanying this correction has affected observable market pricing data, causing disruptions of historical pricing relationships and pricing gaps. This has had a negative impact on our estimates of the fair value of our assets and obligations. Given this pricing disruption and the complexity of our accounting policies and estimates, the amounts that we actually realize could vary significantly from our fair value estimates.

Like other participants in the U.S. residential mortgage market, we have experienced and expect to continue to experience adverse effects from this market correction, which are reflected in our financial results. These include:

Our credit losses and credit-related expenses have increased significantly due to national home price declines and economic weakness in some regional markets.

Our Losses on certain guaranty contracts have increased significantly. As conditions in the housing market have deteriorated and market liquidity has declined, our estimates of the compensation required by market participants to assume our guaranty obligations, which is the basis we are required to use to estimate these losses, have increased significantly. Because of the manner in which we account for these contracts, we recognize an immediate loss in earnings at the time we issue MBS if our guaranty obligation exceeds the fair value of our guaranty asset. We expect to recover that loss over time as the associated MBS liquidates, while our credit losses over time will reflect our actual loss experience on these transactions.

Because of the significant disruption in the housing and mortgage markets during the third quarter of 2007, the indicative market prices we obtained from third parties in connection with our purchases of delinquent loans from our MBS trusts have decreased significantly. This has caused us to reduce our estimates of the fair value of these loans, resulting in a significant increase in our initial recorded losses from these purchases.

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Increasing credit spreads and estimates of declines in future home prices have resulted in declines in the fair value of our net assets.

These challenging market conditions have had a negative impact on our earnings, which has reduced the amount of capital we hold to satisfy our regulatory capital requirements. We continue to maintain a strong capital position, and our access to sources of liquidity has been adequate to meet our funding needs. If these market and economic conditions continue, we may take actions to ensure that we meet our regulatory capital requirements, including forgoing some business opportunities, selling assets or issuing additional preferred equity securities.

We believe that some benefits from the market correction may enhance our strategic position in our market. These include:

The market for Alt-A, subprime and other nontraditional mortgages has declined significantly. As that market has declined, the demand for more traditional mortgage products, such as 30-year fixed-rate conforming loans, has increased significantly. These products represent our core business and have historically accounted for the majority of our new business volume and profitability. Due to the higher mix of mortgage-related securities backed by more traditional products and reduced competition from private-label issuers of mortgage-related securities, our estimated market share of new single-family mortgage-related securities issuances increased to approximately 41.2% for the third quarter of 2007, from approximately 24.3% for the third quarter of 2006.

We also have increased the guaranty fees we charge on new business. This increased pricing compensates us for the added risk that we assume as a result of current market conditions.

As a result of the growing need for credit and liquidity in the multifamily market beginning in the third quarter of 2007, our HCD business produced higher guaranty fee rates on new multifamily business and faster growth in our multifamily guaranty book of business.

Our total mortgage credit book of business has increased by 10% during the first nine months of 2007, from $2.5 trillion outstanding at December 31, 2006 to $2.8 trillion outstanding at September 30, 2007.

In addition, following a thorough review of our costs, we implemented a broad reengineering initiative that we expect will reduce our total administrative expenses by more than $200 million in 2007 as compared with 2006. With the filing of our Forms 10-Q today, we have become current in our SEC periodic financial reporting.

Our business is also significantly affected by general conditions in the financial markets. During the first nine months of 2007, conditions in the financial markets contributed to the following financial results, compared with the first nine months of 2006:

A decrease in our net interest income and net interest yield due to the higher cost of debt.

An increase in losses on trading securities and unrealized losses on available-for-sale securities.

An increased level of period-to-period volatility in the fair value of our derivatives and securities.

During the first nine months of 2007, our ability to issue debt and equity at rates we consider attractive has not been impaired. In addition, we have experienced a lower level of impairments on investment securities during the first nine months of 2007 than we experienced during the same period in 2006.

Summary of Our Financial Results

We recorded a net loss and a diluted loss per share of $1.4 billion and $1.56, respectively, for the third quarter of 2007, compared with a net loss and a diluted loss per share of $629 million and $0.79, respectively, for the third quarter of 2006.

Net income for the first nine months of 2007 was $1.5 billion, a decrease of $1.9 billion, or 56%, from the first nine months of 2006. Diluted earnings per share decreased by 63% to $1.17 for the first nine months of 2007, from $3.16 for the first nine months of 2006.

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Refer to Consolidated Results of Operations below for a more detailed discussion of our financial results for the three and nine months ended September 30, 2007, compared with the three and nine months ended September 30, 2006.

Market and Economic Factors Affecting Our Business

Mortgage and housing market conditions, which significantly affect our business and our financial performance, have worsened since the end of 2006. The housing market downturn that began in the second half of 2006 continued through the first three quarters of 2007 and into the fourth quarter of 2007. The most recent available data for the quarter ended September 30, 2007 show substantial declines in new and existing home sales, housing starts and mortgage originations compared with prior year levels. Moreover, home prices declined on a national basis during the first three quarters of 2007. Additionally, overall housing demand decreased over the past year because of a slowdown in the overall economy, affordability constraints, and declines in demand for investor properties and second homes, which had been a key driver of overall housing activity. Housing market conditions have deteriorated significantly in some Midwestern states, particularly in Michigan, Ohio and Indiana, which have experienced weak economic conditions and job losses. Additionally, in recent quarters, housing market weakness has expanded to other states, including Arizona, California, Florida and Nevada, where home prices had risen most dramatically and investor demand had been the highest in recent years. Inventories of unsold homes have risen dramatically over the past year, putting additional downward pressure on home prices.

These challenging market and economic conditions caused a material increase in mortgage delinquencies and foreclosures during 2007. The resetting of a substantial number of adjustable-rate mortgages (ARMs) to higher interest rates has also contributed to the increase in mortgage delinquencies and foreclosures. A mortgage loan foreclosure may occur when the borrower on an ARM is unable to make the higher payments required after an interest-rate adjustment, and is unable to either refinance the loan or sell the home for an amount sufficient to pay off the mortgage. Based on data provided by LoanPerformance, an independent provider of mortgage market data, as of the end of 2006, we estimate that there were approximately $150 billion in ARMs backing private-label subprime mortgage-related securities that were scheduled to reset for the first time at some point during 2007, subjecting those borrowers to significant payment shock. In addition, as of the end of July 2007, we estimate that there were approximately $185 billion in ARMs backing private-label subprime mortgage-related securities with payments that were scheduled to reset initially sometime in 2008. These resets could result in a further sharp increase in delinquency and foreclosure rates. The rising number of mortgage defaults and foreclosures, combined with declining home prices on a national basis and weak economic conditions in some regions, has resulted in significant increases in credit losses.

The credit performance of subprime and Alt-A loans, as well as other higher risk loans, has deteriorated sharply during the past year, and even the prime conventional portion of the mortgage market has seen signs of credit distress. Concerns about the potential for even higher delinquency rates and more severe credit losses have resulted in increases in mortgage rates in the non-conforming and subprime portions of the market. Many lenders have tightened lending standards or elected to stop originating subprime and other higher risk loans completely, which has adversely affected many borrowers seeking alternative financing to refinance out of ARMs resetting to higher rates.

The reduction in liquidity and funding sources in the mortgage credit market has led to a substantial shift in mortgage originations. The share of traditional fixed-rate conforming mortgages has increased substantially, while the share of Alt-A and subprime mortgages has dropped significantly. Moreover, credit concerns and the resulting liquidity issues have affected the general financial markets. In recent months, the financial markets have been characterized by high levels of volatility, reduced levels of liquidity in the mortgage and corporate credit markets, significantly wider credit spreads and rating agency downgrades on a growing number of mortgage-related securities. In response to concerns over liquidity in the financial markets, the Federal Reserve reduced its discount rate in August, September and October 2007 by a total of 125 basis points to 5.00% and lowered the federal funds rate in September and October

2007 by a total of 75 basis points to 4.50%. After rising in the first half of the year, long-term bond yields declined during the third quarter of

2007. As short-term interest rates decreased in the third quarter of 2007, the spread between long- and short-term interest rates widened, resulting in a steepening of the yield curve.

Outlook

We expect housing market weakness to continue in 2007 and 2008. We believe the continued downturn in housing will lead to further declines in mortgage originations in 2007 and 2008, and contribute to slower growth in U.S. residential mortgage debt outstanding (MDO) in 2007 and 2008. Based on our current market outlook, we expect:

- A relatively stable net interest yield for the remainder of 2007.
- Growth in our single-family guaranty book of business at a faster rate than the rate of overall MDO growth.
- A continued increase in our guaranty fee income for 2007.
- A significant increase in losses on certain guaranty contracts for 2007 as compared with 2006, due to the continued weakening in the housing and mortgage market.
- A significant increase in credit-related expenses and credit losses for both 2007 and 2008 as compared with the previous years, due to continued home price declines.
- Continued volatility in our net income, stockholders equity and regulatory capital due to market conditions and the effects of the manner in which we account for changes in the fair value of our derivatives and trading securities.

We provide additional detail on trends that may affect our result of operations, financial condition and regulatory capital position in future periods in Consolidated Results of Operations below.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. In our 2006 Form 10-K, we identified the following as our critical accounting polices:

- Fair Value of Financial Instruments
- Amortization of Cost Basis Adjustments on Mortgage Loans and Mortgage-Related Securities
- Allowance for Loan Losses and Reserve for Guaranty Losses
- Assessment of Variable Interest Entities

Our 2006 Form 10-K contains a discussion of the judgments and assumptions made in applying these policies and how changes in assumptions may impact our consolidated financial statements. Refer to Notes to Condensed Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies for updated information regarding our significant accounting policies, including the expected impact on our consolidated financial statements of recently issued accounting pronouncements.

As noted in our 2006 Form 10-K, we evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. We consider the estimation of fair value of our financial instruments to be our most critical accounting estimate because a substantial portion of our assets and liabilities are recorded at estimated fair value, and, in certain circumstances, our valuation techniques involve a high degree of management judgment. The downturn in the housing market and reduced liquidity in the credit markets, along with the uncertainty in the financial markets arising from these conditions, resulted in significant market volatility and a disruption of historical pricing relationships between certain financial instruments during the third quarter of 2007. This significant change in market conditions has had widespread implications on how companies measure the fair value of certain financial instruments. Accordingly, we have provided an update to our critical accounting policy on fair value to discuss how these recent market conditions have affected the determination of fair value for some of our financial instruments, most notably our guaranty assets and guaranty obligations, and delinquent loans purchased from securitization trusts.

Fair Value of Financial Instruments

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing, unrelated parties, other than in a forced or liquidation sale. We use one of the following three practices for estimating fair value, the selection of which is based on the availability and reliability of relevant market data: (1) actual, observable market prices or market prices obtained from multiple third parties when available; (2) market data and model-based interpolations using standard models widely accepted within the industry if market prices are not available; or (3) internally developed models that employ techniques such as a discounted cash flow approach and that include market-based assumptions, such as prepayment speeds and default and severity rates, derived from internally developed models. Price transparency tends to be limited in less liquid markets where quoted market prices or observable market data may not be available. We regularly refine and enhance our valuation methodologies to correlate more closely to observable market data. When observable market prices or data are not readily available or do not exist, the estimation of fair value may require significant management judgment and assumptions. See Part II Item 1A Risk Factors for a discussion of the risks and uncertainties related to our use of valuation models.

Guaranty Assets and Guaranty Obligations

The recent changes in market conditions have had a significant impact on the estimation of the net fair value of our guaranty assets and guaranty obligations. As guarantor of our Fannie Mae MBS issuances, at inception we recognize a non-contingent liability for the fair value of our obligation to stand ready to perform over the term of the guaranty as a component of Guaranty obligations in our consolidated balance sheets. The fair value of this obligation represents management s estimate of the amount that we would expect to pay a third party of similar credit standing to assume our obligation.

Our guaranty business volume is generated through either our flow or bulk transaction channels. The contract terms and level of pricing flexibility for loans guaranteed through these channels differ and may adversely impact the estimated fair value of our guaranty obligations and losses on certain guaranty contracts. In our flow business, we enter into agreements that generally set base guaranty fee pricing for a lender s future delivery of individual loans to us over a specified time period. Because we have established the base guaranty fee pricing for a specified time period, we may be limited in our ability to renegotiate the pricing on our flow transactions with individual lenders to reflect changes in market conditions and the credit risk of mortgage loans that meet our eligibility standards. As a result, the estimated amount that we would be required to pay a third party of similar credit standing to assume our obligation may be higher than our contractual price. Our bulk business consists of transactions in which a defined set of loans are to be delivered to us in bulk, and we have the opportunity to review the loans for eligibility and pricing prior to delivery in accordance with the terms of the specific contract for such transactions. We generally have greater ability to select risks in the bulk transaction channel and to adjust our pricing more rapidly to reflect changes in market conditions and the credit risk of the specific transactions.

Our guaranty obligations consist of future expected credit losses, including any unrecoverable principal and interest over the expected life of the underlying mortgages of our Fannie Mae MBS and foreclosure costs, estimated administrative and other costs related to our guaranty, and any deferred profit amounts. We base the fair value of the guaranty obligations that we record when we issue Fannie Mae MBS on market information obtained from spot transaction prices, when available. In the absence of spot transaction data, which is the case for the substantial majority of our Fannie Mae MBS issuances, we estimate the fair value using simulation models that estimate our potential future credit losses and calculate the present value of the expected cash flows associated with our guaranty obligations under various economic scenarios. The key inputs and assumptions for our models include default and severity rates. We also incorporate a market rate of return that we derive from observable market data. The objective of our valuation models is to estimate the amount that we would expect to pay a third party of similar credit standing to assume our guaranty obligation under current market conditions. Because of the recent significant reduction in liquidity in the mortgage and credit markets and increased volatility, estimating the fair value of our guaranty obligations has become more difficult in some cases and the degree of management judgment involved has increased. Although we review the reasonableness of the results of our simulation models by comparing those results with available market information, it is possible that different assumptions and inputs could produce a materially different estimate of the fair value of our guaranty obligations, particularly in the current market environment.

The fair value of our guaranty obligations is highly sensitive to changes in the market s expectation for future levels of home price appreciation. When there is a market expectation of a decline in home prices, the level of credit risk for a mortgage loan tends to increase because the market anticipates a likelihood of higher credit losses. Incorporating this expectation of higher credit losses into our simulation models results in a significant increase in the estimated fair value of our guaranty obligations and increases the losses recognized at inception on certain guaranty contracts. Based on our experience, however, we expect our actual future credit losses to be significantly less than the estimated increase in the fair value of our guaranty obligations, as the fair value of our guaranty obligations includes not only future expected credit losses but also the economic return that we believe a third party would require to assume that credit risk. Our combined allowance for loan losses and reserve for guaranty losses reflects our estimate of the probable credit losses inherent in our mortgage credit book of business. We disclose on a quarterly basis the estimated impact on our expected credit losses from an immediate 5% decline in single-family home prices for the entire United States. See Risk Management Credit Risk Management Mortgage Credit Risk Management for our credit loss sensitivity disclosures.

Loans Purchased with Evidence of Credit Deterioration

For securitization trusts that include a Fannie Mae guaranty, we have the option to purchase loans from those trusts, at par plus accrued interest, after required payments have not been made in full for four consecutive months. Under long-term standby commitments, we also purchase loans from lenders when the loans subject to these commitments meet certain delinquency criteria. We record the acquisition of such defaulted loans at the lower of the loan s acquisition price or its fair value.

During the period of reduced liquidity and market volatility that began in July 2007, we obtained indicative bids for delinquent loans from brokers. We used these bids to value delinquent loans that we purchased from trusts during the third quarter of 2007. The recent change in market conditions has had a significant impact on our estimate of the fair value of these delinquent loans. Given that the primary market for delinquent loans is currently illiquid, there is more limited price transparency. Therefore, the estimated fair value of defaulted loans is highly sensitive to changes in market conditions.

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CONSOLIDATED RESULTS OF OPERATIONS

The following discussion of our consolidated results of operations is based on a comparison of our results between the third quarters of 2007 and 2006 and between the first nine months of 2007 and 2006. Table 1 presents a summary of our unaudited condensed consolidated results of operations for these periods.

Table 1: Summary of Condensed Consolidated Results of Operations

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2007	2006	2007	2006	$	%	$	%
	(Dollars in millions, except per share amounts)							
Net interest income	$ 1,058	$ 1,528	$ 3,445	$ 5,407	$ (470)	(31)%	$ (1,962)	(36)%
Guaranty fee income[1]	1,232	1,084	3,450	2,968	148	14	482	16
Trust management income[2]	146		460		146		460	
Fee and other income[1]	76	234	546	567	(158)	(68)	(21)	(4)
Net revenues	**2,512**	**2,846**	**7,901**	**8,942**	**(334)**	**(12)**	**(1,041)**	**(12)**
Losses on certain guaranty contracts	(294)	(103)	(1,038)	(181)	(191)	(185)	(857)	(473)
Investment gains (losses), net	136	550	(102)	(758)	(414)	(75)	656	87
Derivatives fair value losses, net	(2,244)	(3,381)	(891)	(854)	1,137	34	(37)	(4)
Losses from partnership investments	(147)	(197)	(527)	(579)	50	25	52	9
Administrative expenses	(660)	(761)	(2,018)	(2,249)	101	13	231	10
Credit-related expenses[3]	(1,200)	(197)	(2,039)	(457)	(1,003)	(509)	(1,582)	(346)
Other non-interest expenses[4]	(87)	(29)	(242)	(40)	(58)	(200)	(202)	(505)
Income (loss) before federal income taxes and extraordinary gains (losses)	(1,984)	(1,272)	1,044	3,824	(712)	(56)	(2,780)	(73)
Benefit (provision) for federal income taxes	582	639	468	(380)	(57)	(9)	848	223
Extraordinary gains (losses), net of tax effect	3	4	(3)	11	(1)	(25)	(14)	(127)
Net income (loss)	**$ (1,399)**	**$ (629)**	**$ 1,509**	**$ 3,455**	**$ (770)**	**(122)%**	**$ (1,946)**	**(56)%**
	$ (1.56)	**$ (0.79)**	**$ 1.17**	**$ 3.16**	**$ (0.77)**	**(97)%**	**$ (1.99)**	**(63)%**

Diluted earnings (loss) per common share

(1) Certain prior period amounts that previously were included as a component of Fee and other income have been reclassified to Guaranty fee income to conform to the current period presentation.

(2) We began separately reporting the revenues from trust management fees in our condensed consolidated statements of income effective January 1, 2007. We previously included these revenues, which totaled approximately $148 million and approximately $447 million for the three and nine months ended September 30, 2006, respectively, as a component of interest income.

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

(4) Consists of debt extinguishment gains (losses), net, minority interest in earnings of consolidated subsidiaries and other expenses.

Our business generates revenues from four principal sources: net interest income, guaranty fee income, trust management income, and fee and other income. Other significant factors affecting our net income include changes in the fair value of our derivatives, the timing and size of investment gains and losses, equity investments, losses on certain guaranty contracts, credit-related expenses and administrative expenses. We provide a comparative discussion of the effect of our principal revenue sources and other listed items on our

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condensed consolidated results of operations for the three and nine months ended September 30, 2007 and 2006 below. We also discuss other significant items presented in our unaudited condensed consolidated statements of income.

Net Interest Income

Table 2 presents analyses of our net interest income and net interest yield for the three and nine months ended September 30, 2007 and 2006.

Table 2: Analysis of Net Interest Income and Yield

	For the Three Months Ended September 30,					
	2007			2006		
	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid
	(Dollars in millions)					
Interest-earning assets:						
Mortgage loans[2]	$ 397,349	$ 5,572	5.61%	$ 376,792	$ 5,209	5.53%
Mortgage securities	330,872	4,579	5.54	355,024	4,912	5.53
Non-mortgage securities[3]	72,075	999	5.43	59,464	812	5.34
Federal funds sold and securities purchased under agreements to resell	17,994	246	5.35	15,551	214	5.38
Advances to lenders	8,561	76	3.45	4,368	38	3.44
Total interest-earning assets	$ 826,851	$ 11,472	5.54%	$ 811,199	$ 11,185	5.50%
Interest-bearing liabilities:						
Short-term debt	$ 166,832	$ 2,400	5.63%	$ 163,903	$ 2,121	5.07%
Long-term debt	613,801	8,013	5.22	613,374	7,533	4.91
Federal funds purchased and securities sold under agreements to repurchase	161	1	4.46	181	3	4.99
Total interest-bearing liabilities	$ 780,794	$ 10,414	5.31%	$ 777,458	$ 9,657	4.94%
Impact of net non-interest bearing funding	$ 46,057		0.29%	$ 33,741		0.21%
Net interest income/net interest yield[4]		$ 1,058	0.52%		$ 1,528	0.77%

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	For the Nine Months Ended September 30,					
	2007			2006		
	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid	Average Balance[1]	Interest Income/ Expense	Average Rates Earned/Paid
	(Dollars in millions)					
Interest-earning assets:						
Mortgage loans[2]	$ 391,318	$ 16,582	5.65%	$ 372,798	$ 15,495	5.54%
Mortgage securities	329,126	13,606	5.51	360,115	14,599	5.41
Non-mortgage securities[3]	67,595	2,763	5.39	52,531	1,983	4.98
Federal funds sold and securities purchased under agreements to resell	15,654	633	5.33	13,294	504	5.00
Advances to lenders	6,097	160	3.45	4,063	103	3.36
Total interest-earning assets	$ 809,790	$ 33,744	5.55%	$ 802,801	$ 32,684	5.42%
Interest-bearing liabilities:						
Short-term debt	$ 163,062	$ 6,806	5.50%	$ 163,647	$ 5,671	4.57%
Long-term debt	609,018	23,488	5.14	607,106	21,596	4.74
Federal funds purchased and securities sold under agreements to repurchase	136	5	4.91	265	10	4.73
Total interest-bearing liabilities	$ 772,216	$ 30,299	5.22%	$ 771,018	$ 27,277	4.71%
Impact of net non-interest bearing funding	$ 37,574		0.24%	$ 31,783		0.19%
Net interest income/net interest yield[4]		$ 3,445	0.57%		$ 5,407	0.90%

(1) The average balances for mortgage loans, advances to lenders and short- and long-term debt have been calculated based on the average of the amortized cost amount as of the beginning of each period and the amortized cost amount as of the end of each month within the respective period. This method was also used to calculate the average balance for mortgage securities for the three and nine months ended September 30, 2006. The average balances for all other categories and periods have been calculated based on a daily average.

(2) Includes nonaccrual loans with an average balance totaling $6.2 billion and $6.1 billion for the three months ended September 30, 2007 and 2006, respectively, and $6.0 billion and $7.0 billion for the nine months ended September 30, 2007 and 2006, respectively.

(3) Includes cash equivalents.

(4)

We calculate our net interest yield by dividing our annualized net interest income for the period by the average balance of our total interest-earning assets during the period.

Table 3 presents the total variance, or change, in our net interest income between the three months ended September 30, 2007 and 2006, and the nine months ended September 30, 2007 and 2006, and the extent to which that variance is attributable to (1) changes in the volume of our interest-earning assets and interest-bearing liabilities or (2) changes in the interest rates of these assets and liabilities.

Table 3: Rate/Volume Analysis of Net Interest Income

	For the Three Months Ended September 30, 2007 vs. 2006			For the Nine Months Ended September 30, 2007 vs. 2006		
	Total Variance	Variance Due to:[1] Volume	Rate	Total Variance	Variance Due to:[1] Volume	Rate
	(Dollars in millions)					
Interest income:						
Mortgage loans	$ 363	$ 288	$ 75	$ 1,087	$ 781	$ 306
Mortgage securities	(333)	(334)	1	(993)	(1,277)	284
Non-mortgage securities[2]	187	175	12	780	605	175
Federal funds sold and securities purchased under agreements to resell	32	33	(1)	129	94	35
Advances to lenders	38	37	1	57	54	3
Total interest income	287	199	88	1,060	257	803
Interest expense:						
Short-term debt	279	39	240	1,135	(20)	1,155
Long-term debt	480	5	475	1,892	68	1,824
Federal funds purchased and securities sold under agreements to repurchase	(2)	(1)	(1)	(5)	(5)	
Total interest expense	757	43	714	3,022	43	2,979
Net interest income	$ (470)	$ 156	$ (626)	$ (1,962)	$ 214	$ (2,176)

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

(2) Includes cash equivalents.

Net interest income of $1.1 billion for the third quarter of 2007 decreased by 31% from the third quarter of 2006, driven by a 32% (25 basis points) decline in our net interest yield to 0.52%. The overall increase of 37 basis points in the average cost of our debt, to 5.31%, more than offset a 4 basis points increase in the average yield on our interest-earning assets, to 5.54%.

Net interest income of $3.4 billion for the first nine months of 2007 decreased by 36% from the first nine months of 2006, driven by a 37% (33 basis points) decline in our net interest yield to 0.57%. The overall increase of 51 basis points in the average cost of our debt, to 5.22%, more than offset a 13 basis points increase in the average yield on our interest-earning assets, to 5.55%.

We continued to experience compression in our net interest yield during the first nine months of 2007, largely attributable to the increase in our short-term and long-term debt costs as we continued to replace, at higher interest rates, maturing debt that we had issued at lower interest rates during the past few years. In addition, as discussed below, effective January 1, 2007, we reclassified the fees we receive from the interest earned on cash flows between the date of remittance by servicers and the date of distribution to MBS certificateholders, which we refer to as float income, from Interest income to Trust management income. The reclassification of these fees contributed to the decrease in our net interest yield, resulting in a reduction of approximately 7 and 8 basis points for the three and nine months ended September 30, 2007, respectively.

As discussed below in Derivatives Fair Value Losses, Net, we consider the net contractual interest accruals on our interest rate swaps to be part of the cost of funding our mortgage investments. These amounts, however, are reflected in our condensed consolidated statements of income as a component of Derivatives fair value losses, net. Although we experienced an increase in the average cost of our debt for the three and nine months ended September 30, 2007, we recorded net contractual interest income on our interest rate swaps totaling $95 million and $193 million for the three and nine months ended September 30, 2007, respectively. In comparison, we recorded net contractual interest income of $82 million and net contractual interest expense of $157 million for the three and nine months ended September 30, 2006, respectively. The economic effect of the interest accruals on our interest rate swaps, which is not reflected in the comparative net interest yields presented above, resulted in a reduction in our funding costs of approximately 5 and 3 basis points for the three and nine months ended September 30, 2007, respectively. The effect of interest accruals on our interest rate swaps also resulted in a reduction in our funding costs of approximately 4 basis points for the three months ended September 30, 2006 and an increase in our funding costs of approximately 2 basis points for the nine months ended September 30, 2006.

Based on the current composition of our portfolio, our expected investment activity for the remainder of the year and the current interest rate environment, we expect our net interest yield to remain relatively stable for the remainder of 2007.

Guaranty Fee Income

Table 4 shows the components of our guaranty fee income, our average effective guaranty fee rate, and Fannie Mae MBS activity for the three and nine months ended September 30, 2007 and 2006.

Table 4: Guaranty Fee Income and Average Effective Guaranty Fee Rate[1]

	For the Three Months Ended September 30,				
	2007		2006		
	Amount	Rate[2]	Amount	Rate[2]	Variance
	(Dollars in millions)				
Guaranty fee income/average effective guaranty fee rate, excluding buy-up impairment	$ 1,235	22.8bp	$ 1,092	22.6bp	13%
Buy-up impairment	(3)		(8)	(0.1)	(63)
Guaranty fee income/average effective guaranty fee rate[4][5]	$ 1,232	22.8bp	$ 1,084	22.5bp	14%
Average outstanding Fannie Mae MBS and other guaranties[6]	$ 2,163,173		$ 1,929,303		12%
Fannie Mae MBS issues[7]	171,204		124,019		38

	For the Nine Months Ended September 30,				
	2007		2006		
	Amount	Rate[2]	Amount	Rate[2]	Variance
	(Dollars in millions)				
Guaranty fee income/average effective guaranty fee rate, excluding certain fair value adjustments and buy-up impairment	$ 3,439	21.9bp	$ 2,978	21.0bp	15%
Net change in fair value of buy-ups and guaranty assets[3]	19	0.1			
Buy-up impairment	(8)		(10)	(0.1)	(20)
	$ 3,450	22.0bp	$ 2,968	20.9bp	16%

Guaranty fee income/average effective guaranty fee rate[4][5]			
Average outstanding Fannie Mae MBS and other guaranties[6]	$ 2,090,322	$ 1,893,843	10%
Fannie Mae MBS issues[7]	453,506	357,480	27

(1) Guaranty fee income consists of contractual guaranty fees related to Fannie Mae MBS held in our portfolio and held by third-party investors, adjusted for (1) the amortization of upfront fees and impairment of guaranty assets, net of a proportionate reduction in the related guaranty obligation and deferred profit, and (2) impairment of buy-ups. The average effective guaranty fee rate reflects our average contractual guaranty fee rate adjusted for the impact of amortization of deferred amounts and buy-up impairment. Losses recognized at inception on certain guaranty contracts are excluded from guaranty fee income and the average effective guaranty fee rate, but as described in footnote 5 below, the subsequent recovery of these losses over the life of the loans underlying the MBS issuances is reflected in our guaranty fee income and average effective guaranty fee rate.

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

(3) Consists of the effect of the net change in fair value of buy-ups and guaranty assets from portfolio securitization transactions subsequent to January 1, 2007. We include the net change in fair value of buy-ups and guaranty assets

from portfolio securitization transactions in guaranty fee income in our condensed consolidated statements of income pursuant to our adoption of Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*, *an amendment of SFAS 133 and SFAS 140* (SFAS 155). We prospectively adopted SFAS 155 effective January 1, 2007. Accordingly, we did not record a fair value adjustment in earnings during 2006.

(4) Certain prior period amounts that previously were included as a component of Fee and other income have been reclassified to Guaranty fee income to conform to the current period presentation.

(5) Losses recognized at inception on certain guaranty contracts are recorded as a component of our guaranty obligation. We amortize a portion of our guaranty obligation, which includes these losses, into income each period in proportion to the reduction in the guaranty asset for payments received. This amortization increases our guaranty fee income and reduces the related guaranty obligation. The amortization of the guaranty obligation associated with losses recognized at inception on certain guaranty contracts totaled $144 million and $60 million for the three months ended September 30, 2007 and 2006, respectively, and $327 million and $157 million for the nine months ended September 30, 2007 and 2006, respectively.

(6) Other guaranties includes $35.5 billion and $19.7 billion as of September 30, 2007 and December 31, 2006, respectively, and $21.7 billion and $19.2 billion as of September 30, 2006 and December 31, 2005, respectively, related to long-term standby commitments we have issued and credit enhancements we have provided.

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

The 14% increase in guaranty fee income for the third quarter of 2007 from the third quarter of 2006 resulted from a 12% increase in average outstanding Fannie Mae MBS and other guaranties, and a 1% increase in the average effective guaranty fee rate to 22.8 basis points from 22.5 basis points.

The 16% increase in guaranty fee income for the first nine months of 2007 from the first nine months of 2006 resulted from a 10% increase in average outstanding Fannie Mae MBS and other guaranties, and a 5% increase in the average effective guaranty fee rate to 22.0 basis points from 20.9 basis points.

Growth in average outstanding Fannie Mae MBS and other guaranties for the three and nine months ended September 30, 2007 was attributable to an increase in Fannie Mae MBS issuances and a slower liquidation rate on our mortgage credit book of business. Although mortgage origination volumes fell during the first nine months of 2007, our market share of MBS issuances increased due to the shift in the product mix of mortgage originations back to more traditional conforming products, such as 30-year fixed-rate loans, which represent our core product and historically have accounted for the majority of our new business volume, and reduced competition from private-label issuers of mortgage-related securities.

The increase in our average effective guaranty fee rate, which excludes the effect of losses recorded at inception on certain guaranty contracts, was attributable to targeted pricing increases on new business to reflect the higher risk premium resulting from the overall market increase in mortgage credit risk pricing, an increase in our acquisition of Alt-A mortgage loans, which generally have higher guaranty fee rates, and an increase in the accretion of our guaranty obligation and deferred profit into income.

Because of our increased market share, we expect our single-family guaranty book of business to grow at a faster rate than the rate of overall MDO growth in 2007, and our guaranty fee income to continue to increase for the remainder of

2007.

Trust Management Income

Trust management income totaled $146 million and $460 million for the three and nine months ended September 30, 2007, respectively. Trust management income consists of the fees we earn as master servicer, issuer and trustee for Fannie Mae MBS. We derive these fees from the interest earned on cash flows between the date of remittance by servicers and the date of distribution to MBS certificateholders, which we refer to as float income. Prior to November 2006, funds received from servicers were commingled with our corporate assets. Because our compensation for these roles could not be segregated, we included these amounts, which totaled approximately $148 million and approximately $447 million for the three and nine months ended September 30, 2006, as a component of Interest income in our condensed consolidated statements of income. In November 2006, we made operational changes to segregate these funds from our corporate assets.

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Accordingly, we began separately reporting this compensation as Trust management income in our condensed consolidated statements of income effective January 1, 2007.

Fee and Other Income

Fee and other income decreased to $76 million for the third quarter of 2007, from $234 million for the third quarter of 2006. The $158 million decrease in fee and other income in the third quarter of 2007 resulted from changes in foreign currency exchange rates. We recorded a foreign currency exchange loss of $133 million on our foreign-denominated debt in the third quarter of 2007, due to the weakening of the U.S. dollar against the Japanese yen during the third quarter of 2007. In contrast, we recorded a foreign currency exchange gain of $37 million in the third quarter of 2006. Our foreign currency exchange gains (losses) are offset in part by corresponding net losses (gains) on foreign currency swaps, which are recognized in our condensed consolidated statements of income as a component of Derivatives fair value losses, net. We seek to eliminate our exposure to fluctuations in foreign exchange rates by entering into foreign currency swaps that effectively convert debt denominated in a foreign currency to debt denominated in U.S. dollars.

Fee and other income decreased to $546 million for the first nine months of 2007, from $567 million for the first nine months of 2006. The $21 million decrease in fee and other income for the first nine months of 2007 was due in part to the recognition of a foreign currency exchange loss of $188 million on our foreign-denominated debt for the first nine months of 2007, compared with a foreign currency exchange loss of $123 million for the first nine months of 2006. The increase in foreign currency exchange losses was due to the weakening of the U.S. dollar against the Japanese yen during the first nine months of 2007. The decrease in fee and other income was also due to a decrease in certain multifamily fees related to consolidated loans, partially offset by increased multifamily loan prepayment and yield maintenance fees.

Losses on Certain Guaranty Contracts

Losses on certain guaranty contracts increased by $191 million to $294 million for the third quarter of 2007, from $103 million for the third quarter of 2006. Losses on certain guaranty contracts increased by $857 million to $1.0 billion for the first nine months of 2007, from $181 million for the first nine months of 2006.

We recognize an immediate loss in earnings on new guaranteed Fannie Mae MBS issuances when our expectation of returns is below what we believe a market participant would require for that credit risk inclusive of a reasonable profit margin. We expect, however, to recover the losses that we recognize at inception on certain guaranty contracts in our consolidated income statements over time in proportion to our receipt of contractual guaranty fees on those guaranties and the decline in the unpaid principal balance on the mortgage loans underlying the MBS.

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

Accounting Upon Initial Issuance of MBS:

We record a guaranty asset of $100, which represents the present value of the guaranty fees we expect to receive over time.

We record a guaranty obligation of $120, which represents the estimated amount that a market participant would require to assume this obligation.

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We record the difference of $20, or the amount by which the guaranty obligation exceeds the guaranty asset, in our income statement as losses on certain guaranty contracts.

Accounting in Each of Years 1 to 5:

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

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

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

As illustrated in the example, the $20 loss recognized at inception of the guaranty contract will be accreted into earnings over time as a component of guaranty fee income. For additional information on our accounting for guaranty transactions, which is more complex than the example presented, refer to our 2006 Form 10-K in Notes to Consolidated Financial Statements Note 1, Summary of Significant Accounting Policies.

As credit conditions deteriorated during the first nine months of 2007, the market s expectation of future credit risk increased. This change in market conditions increased the estimated risk premium or compensation that a market participant would require to assume our guaranty obligations. As a result, the estimated fair value of our guaranty obligations related to MBS issuances increased, contributing to a higher level of losses at inception on certain of our MBS issuances. Our losses on certain guaranty contracts also were affected by the following during the first nine months of 2007:

Lender Flow Transaction Contracts: We enter into flow transaction contracts that establish our base guaranty fee pricing with a lender for a specified period of time. Because pricing is fixed for a period of time, these contracts may limit our ability to immediately adjust our base guaranty fee pricing to reflect changes in market conditions. As the market risk premium increased during the first nine months of 2007, we experienced an increase in the losses related to some of these contracts because we had established our base guaranty fee pricing for a specified time period and could not increase our prices to reflect the increased market risk. To address this in part, we have expanded our use of standard risk-based price adjustments that apply to all deliveries of loans with certain risk characteristics.

Affordability Mission Housing Goals: Our efforts to increase the amount of mortgage financing that we make available to target populations and geographic areas to support our housing goals contributed to an increase in losses on certain guaranty contracts for the first nine months of 2007, due to the higher credit risk premium associated with these MBS issuances. In addition, certain contracts that support our affordability mission are priced at a discounted rate.

Contract-Level Pricing: We negotiate guaranty contracts with our customers based upon the overall economics of the transaction; however, the accounting for our guaranty-related assets and liabilities is not determined at the contract level for the substantial majority of our guaranty transactions. Instead, it is determined separately for each individual MBS issuance within a contract. Although we determine losses at an individual MBS issuance level, we largely price our guaranty business on an overall contract basis and establish a single price for all loans included in the contract. Accordingly, a single guaranty transaction may result in some loan pools for which we recognize a loss immediately in earnings and other loan pools for which we record deferred profits that are recognized as a component of guaranty fee income over the life of the loans underlying the MBS issuance.

We expect that the vast majority of our MBS guaranty transactions will generate positive economic returns over the lives of the related MBS because we expect our guaranty fees to exceed our incurred credit losses based on our experience. Losses on certain guaranty contracts do not reflect our estimate of incurred credit

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losses in our mortgage credit book of business. Instead, these losses are recognized as charges against our allowance for loan losses or reserve for guaranty losses, and are reflected in our credit losses. Our combined allowance for loan losses and reserve for guaranty losses reflects our estimate of the probable credit losses inherent in our mortgage credit book of business. See Credit-Related Expenses for a discussion of our current year provision for credit losses.

We have increased guaranty pricing for some of our loan products during 2007. Additionally, we have made targeted eligibility changes during 2007 to enhance the risk profile characteristics of mortgage loans that we guarantee. We previously disclosed that we expected losses on certain guaranty contracts to more than double in 2007 from the $439 million recorded in 2006. Based on the losses reported for the first nine months of 2007, we expect our losses on certain guaranty contracts for the full year 2007 to be significantly higher than previously estimated.

Investment Gains (Losses), Net

Table 5 summarizes the components of investment gains (losses), net for the three and nine months ended September 30, 2007 and 2006.

Table 5: Investment Gains (Losses), Net

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in millions)			
Other-than-temporary impairment on investment securities[1]	$ (81)	$ (6)	$ (84)	$ (852)
Lower-of-cost-or-market adjustments on held-for-sale loans	3	47	(115)	(45)
Gains (losses) on Fannie Mae portfolio securitizations, net	(65)	45	(27)	74
Gains on sale of investment securities, net	99	115	414	125
Unrealized gains (losses) on trading securities, net	249	364	(180)	(25)
Other investment losses, net	(69)	(15)	(110)	(35)
Investment gains (losses), net	$ 136	$ 550	$ (102)	$ (758)

(1) Excludes other-than-temporary impairment on guaranty assets and buy-ups as these amounts are recognized as a component of guaranty fee income.

The $414 million decrease in investment gains for the third quarter of 2007 from the third quarter of 2006 was primarily attributable to the combined effect of the following:

A decrease of $115 million in unrealized gains on trading securities. We recorded $249 million in unrealized gains on trading securities during the third quarter of 2007, primarily due to a decline in interest rates during the quarter, which increased the fair value of our trading securities. This increase was partially offset by a decline in the fair value of private-label mortgage-related securities backed by subprime and Alt-A loans due to a widening of credit spreads on these securities during the quarter. In contrast, we recorded $364 million in unrealized gains on trading securities during the third quarter of 2006, due to a decline in interest rates during the quarter.

A net loss of $65 million for the third quarter of 2007 on Fannie Mae portfolio securitizations, compared with a net gain of $45 million for the third quarter of 2006. We securitized some subprime mortgage assets that were in a loss position during the third quarter of 2007. Cash proceeds related to portfolio securitizations accounted for as sales totaled $9.2 billion and $5.7 billion for the third quarter of 2007 and 2006, respectively.

An increase of $75 million in other-than-temporary impairment on investment securities. We recognized other-than-temporary impairment of $81 million for the third quarter of 2007, due to credit ratings downgrades and other credit-related events relating to certain non-mortgage investments that we had designated as available for sale, which caused the fair value of these securities to decline below their carrying value, and a deterioration in the credit quality of some of our mortgage revenue bond investments. In contrast, we recognized other-than-temporary impairment of $6 million for the third quarter of 2006.

The $656 million decrease in investment losses for the first nine months of 2007 from the first nine months of 2006 was primarily attributable to the combined effect of the following:

A decrease of $768 million in other-than-temporary impairment on investment securities. We recognized other-than-temporary impairment of $84 million for the first nine months of 2007, largely due to the impairments recorded during the third quarter of 2007. In contrast, we recognized other-than-temporary impairment of $852 million for the first nine months of 2006 due to a general increase in interest rates during the period, which caused the fair value of certain securities that we designated for sale to decline below the carrying value of those securities. We expect other-than-temporary impairment on investment securities for the full year 2007 to be significantly lower than the amount recorded in 2006.

An increase of $289 million in gains on sale of investment securities, net. We recorded net gains of $414 million and $125 million for the first nine months of 2007 and 2006, respectively, related to the sale of securities totaling $45.3 billion and $46.3 billion, respectively. The investment gains recorded during the first nine months of 2007 were attributable to the recovery in value of securities we sold that we had previously written down due to other-than-temporary impairment.

An increase of $155 million in unrealized losses on trading securities. As described in Consolidated Balance Sheet Analysis Trading Securities, we increased our portfolio of trading securities during the first nine months of 2007 to approximately $48.7 billion as of September 30, 2007, from $11.5 billion as of December 31, 2006. We recorded unrealized losses of $180 million on our trading securities for the first nine months of 2007, reflecting the combined effect of an increase in our portfolio of mortgage-related securities classified as trading and a decrease in the fair value of these securities due to the significant widening of credit spreads during the period.

While changes in the fair value of our trading securities generally move inversely to changes in the fair value of our derivatives, we recorded losses on both our trading securities and derivatives for the first nine months of the year, due to the effect on our trading securities of the significant widening of credit spreads. Because the fair value of our trading securities is affected by market fluctuations that cannot be predicted, we cannot estimate the impact of changes in the fair value of our trading securities for the full year. We provide information on the sensitivity of changes in the fair value of trading securities to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks Measuring Interest Rate Risk.

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Derivatives Fair Value Losses, Net

Table 6 presents, by type of derivative instrument, the fair value gains and losses on our derivatives for the three and nine months ended September 30, 2007 and 2006. Table 6 also includes an analysis of the components of derivatives fair value gains and losses attributable to net contractual interest income (expense) on our interest rate swaps, the net change in the fair value of terminated derivative contracts through the date of termination and the net change in the fair value of outstanding derivative contracts. The five-year interest rate swap rate, which is shown below in Table 6, is a key reference interest rate affecting the estimated fair value of our derivatives.

Table 6: Derivatives Fair Value Losses, Net

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in millions)			
Risk management derivatives:				
Swaps:				
Pay-fixed	$ (7,500)	$ (7,198)	$ (1,780)	$ 1,852
Receive-fixed	3,834	3,329	956	(11)
Basis	90	38	(35)	25
Foreign currency[1]	140	(65)	97	32
Swaptions:				
Pay-fixed	(237)	(822)	32	(925)
Receive-fixed	1,460	1,405	(199)	(1,951)
Interest rate caps	(3)	(33)	5	92
Other[2]	3	2	4	4
Risk management derivatives fair value losses, net	(2,213)	(3,344)	(920)	(882)
Mortgage commitment derivatives fair value gains (losses), net	(31)	(37)	29	28
Total derivatives fair value losses, net	$ (2,244)	$ (3,381)	$ (891)	$ (854)
Risk management derivatives fair value gains (losses) attributable to:				
Net contractual interest income (expense) on interest rate swaps	$ 95	$ 82	$ 193	$ (157)
Net change in fair value of terminated derivative contracts from end of prior period to date of termination	(50)	(110)	(187)	(154)
Net change in fair value of outstanding derivative contracts, including derivative contracts entered into during the period	(2,258)	(3,316)	(926)	(571)
Risk management derivatives fair value losses, net[3]	$ (2,213)	$ (3,344)	$ (920)	$ (882)

	2007	2006

5-year swap rate:		
As of January 1	5.10%	4.88%
As of March 31	4.99	5.31
As of June 30	5.50	5.65
As of September 30	4.87	5.08

(1) Includes the effect of net contractual interest expense of approximately $16 million and $20 million for the three months ended September 30, 2007 and 2006, respectively, and $50 million and $55 million for the nine months ended September 30, 2007 and 2006, respectively. The change in fair value of foreign currency swaps excluding this item resulted in a net gain of $156 million and a net loss of $45 million for the three months ended September 30, 2007 and 2006, respectively, and net gains of $147 million and $87 million for the nine months ended September 30, 2007 and 2006, respectively.

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

(3) Reflects net derivatives fair value gains (losses) recognized in the condensed consolidated statements of income, excluding mortgage commitments.

As shown in Table 6 above, we recorded net contractual interest income on interest rate swaps for the three and nine months ended September 30, 2007. In comparison, we recorded net contractual interest income for the three months ended September 30, 2006 and net contractual interest expense for the nine months ended September 30, 2006. Although these amounts are included in the net derivatives fair value losses recognized in our condensed consolidated statements of income, we consider the interest accruals on our interest rate swaps to be part of the cost of funding our mortgage investments.

We recorded derivatives fair value losses totaling $2.2 billion and $3.4 billion for the third quarter of 2007 and 2006, respectively, due to fair value losses on our interest rate swaps that were partially offset by fair value gains on our option-based derivatives. The fair value losses on our interest rate swaps were attributable to a decrease in swap rates during each period, which resulted in fair value losses on our pay-fixed swaps that exceeded the fair value gains on our receive-fixed swaps. We experienced fair value gains on our option-based derivatives in each period due to an increase in fair value resulting from an increase in implied volatility that more than offset a decrease in fair value resulting from the combined effect of the decrease in swap rates and the time decay of these options. Time decay refers to the diminishing value of an option over time as less time remains to exercise the option. The less time left on an option, the greater the effects of time decay.

We recorded derivatives fair value losses totaling $891 million and $854 million for the first nine months of 2007 and 2006, respectively. The derivatives fair value losses recorded in the third quarter of 2007 and 2006 more than offset the cumulative derivatives fair value gains recorded for the first six months of each year.

Because the fair value of our derivatives is affected by market fluctuations that cannot be predicted, we cannot estimate the impact of changes in the fair value of our derivatives for the remainder of 2007. We provide information on the sensitivity of changes in the fair value of our derivatives to changes in interest rates in Risk Management Interest Rate Risk Management and Other Market Risks Measuring Interest Rate Risk.

Losses from Partnership Investments

Losses from partnership investments decreased to $147 million for the third quarter of 2007, from $197 million for the third quarter of 2006. The decrease in losses for the third quarter of 2007 was attributable to the recognition of a gain on the sale of investments in federal low-income housing tax credit (LIHTC) partnerships in July 2007, as well as a lower LIHTC portfolio balance compared to the third quarter of 2006, which resulted in fewer net operating losses. LIHTC partnerships generate tax credits and incur operational losses for which we obtain tax benefits through tax deductions. See Benefit (Provision) for Federal Income Taxes for further discussion of LIHTC tax benefits.

Losses from partnership investments decreased to $527 million for the first nine months of 2007, from $579 million for the first nine months of 2006. The decrease in losses for the first nine months of 2007 was due to the recognition of gains on sales of investments in LIHTC partnerships in March 2007 and July 2007, which was partially offset by an increase in losses from our continuing investments in LIHTC partnerships.

Administrative Expenses

Table 7 details the components of our administrative expenses, which include ongoing operating costs, as well as costs associated with our efforts to return to timely financial reporting.

Table 7: Administrative Expenses

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2007	2006	Variance	2007	2006	Variance
	(Dollars in millions)					
Ongoing operating costs[1]	$ 528	$ 509	4%	$ 1,563	$ 1,424	10%
Restatement and related regulatory expenses[2]	132	252	(48)	455	825	(45)
Total administrative expenses	$ 660	$ 761	(13)%	$ 2,018	$ 2,249	(10)%

(1) Excludes costs associated with our efforts to return to timely financial reporting and also excludes various costs that we do not expect to incur on a regular basis.

(2) Includes costs of restatement and related regulatory examinations, investigations and litigation, and costs associated with our efforts to return to timely financial reporting.

The decreases in administrative expenses for the third quarter of 2007 from the third quarter of 2006, and for the first nine months of 2007 from the first nine months of 2006, were due to a significant reduction in restatement and related regulatory expenses. This reduction was partially offset by an increase in our ongoing operating costs, resulting from costs associated with an early retirement program and various involuntary severance initiatives implemented in 2007, as well as costs associated with the significant investment we have made to remediate material weaknesses in our internal control over financial reporting by enhancing our organizational structure and systems. Due to these costs, we expect our ongoing operating costs for 2007 to exceed those for 2006.

As we have previously disclosed, we undertook a thorough review of our costs beginning in January 2007 as part of a broad reengineering initiative to increase productivity and lower administrative costs. As a result of this effort, we expect to reduce our total administrative expenses by more than $200 million in 2007 as compared with 2006, primarily through a reduction in employee and contract resources. We estimate that our 2007 productivity and cost reduction reengineering initiative will reduce our ongoing operating costs to approximately $2 billion in 2008.

Credit-Related Expenses

Our credit-related expenses consist of our provision for credit losses and our foreclosed property expense. Our credit-related expenses increased to $1.2 billion for the third quarter of 2007, from $197 million for the third quarter of 2006. Credit-related expenses increased to $2.0 billion for the first nine months of 2007, from $457 million for the first nine months of 2006. Following is a discussion of changes in the components of our credit-related expenses for each comparable period.

The provision for credit losses increased by $942 million, or 650%, to $1.1 billion for the third quarter of 2007, from $145 million for the third quarter of 2006. The provision for credit losses increased by $1.4 billion, or 381%, to

$1.8 billion for the first nine months of 2007, from $368 million for the first nine months of 2006.

Approximately $670 million and $805 million of the provision for credit losses for the three and nine months ended September 30, 2007, respectively, relates to charge-offs recorded when we purchase delinquent loans from MBS trusts and the purchase price, which is equal to the par amount, exceeds the fair value at the purchase date. These charges totaled $37 million and $153 million for the three and nine months ended September 30, 2006, respectively. Accordingly, $633 million and $652 million of the increase in the provision for credit losses for the three and nine months ended September 30, 2007, respectively, was attributable primarily to a substantial decrease in the market value of delinquent loans we purchased from MBS trusts. The decrease began in July 2007 as housing and credit market conditions deteriorated, causing increased credit spread requirements and decreased liquidity for this type of asset.

Pursuant to our MBS trust agreement, we have the option to purchase loans from the MBS trust, at par plus accrued interest, after required payments have not been made in full for four consecutive months. We record these loans at their estimated fair value at the date of purchase from the trust and recognize the difference between the amount paid and the fair value as a component of charge-offs. Based on our past experience, the majority of the loans we purchase from MBS trusts cure or pay off; however, our cure rate has declined in recent periods and may decline further. If a loan pays off in full, we recover the loss previously recognized as a component of net interest income. If a loan cures, meaning that the borrower is no longer past due, we recover the loss previously recorded as a component of net interest income over the contractual life of the loan. If we foreclose upon a mortgage loan purchased from an MBS trust, the charge-off recognized at the date of foreclosure and the foreclosed property expense would be reduced because of the loss we previously recorded when we purchased the loan from the MBS trust. In some cases, losses that we record when we purchase loans from MBS trusts may result in our recording gains when we dispose of the foreclosed properties.

We are required by our MBS trust agreement to purchase loans from an MBS trust when specified predetermined triggers are met. Accordingly, we would expect to continue to incur these charges as part of our provision for credit losses in our consolidated financial statements. We do not expect the market prices for these delinquent loans to improve in the reasonably foreseeable future.

The remaining increase in our provision for credit losses of $309 million and $750 million for the three and nine months ended September 30, 2007, respectively, is attributable to an increase in net charge-offs and incremental additions to the allowance for loan losses and reserve for guaranty losses during each period. The increase in net charge-offs in each period reflects higher default rates and an increase in the average amount of loss per loan, or charge-off severity, resulting from continued economic weakness in the Midwest region and the national decline in home prices during the first nine months of 2007. The higher default rates are, in part, due to earlier than anticipated defaults on loans originated in 2006 and 2007. The increase in charge-off severity is attributable to the combined effect of the national decline in home prices and the higher unpaid principal balances of loans going to foreclosure.

Foreclosed property expense increased by $61 million, or 117%, to $113 million for the third quarter of 2007, from $52 million for the third quarter of 2006. Foreclosed property expense increased by $180 million, or 202%, to $269 million for the first nine months of 2007, from $89 million for the first nine months of 2006. These increases were driven by an increase in the inventory of foreclosed properties and rapidly declining sales prices on foreclosed properties, particularly in the Midwest, which accounted for the majority of the increase in our foreclosed property expense in each period. The national decline in home prices has contributed to further increases in foreclosure activity.

Any amounts due from mortgage insurance companies on primary mortgage insurance in excess of the amount of a loan charge-off and all pool mortgage insurance are recognized as a reduction to our credit losses when such amounts are collected from insurance companies. As such, a significant amount of our current year credit losses will result in a reduction in our credit losses in subsequent periods as cash collections are received from mortgage insurance companies, either as a recovery to our allowance for loan losses or reserve for guaranty losses or as a reduction of foreclosed property expense.

Home prices have declined in the first nine months of 2007, and we expect they will continue to decline for the remainder of 2007 and in 2008. As a result, we expect significant increases in our serious delinquency rates, foreclosure activity, credit losses and credit-related expenses for 2007 compared with 2006, and for 2008 compared with 2007. We provide additional detail on our credit losses and factors affecting our allowance for loan losses and reserve for guaranty losses in Risk Management Credit Risk Management Mortgage Credit Risk Management.

Other Non-Interest Expenses

We recorded other non-interest expenses of $87 million for the third quarter of 2007, compared with $29 million for the third quarter of 2006. We recorded other non-interest expenses of $242 million and $40 million for the first nine months of 2007 and 2006, respectively. The increase in expenses for each period was predominately due to higher credit enhancement expenses and a reduction in the amount of net gains recognized on the extinguishment of debt.

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Federal Income Taxes

We recorded net tax benefit amounts for the third quarter of 2007 and 2006, which produced an effective tax rate of 29% and 50%, respectively. We recorded a net tax benefit for the first nine months of 2007 that produced an effective tax rate of (45)%, compared with a net tax provision and an effective tax rate of 10% for the first nine months of 2006. The difference between our federal statutory rate of 35% and our effective tax rate is primarily due to the tax benefits we receive from our investments in LIHTC partnerships and other equity investments that help to support our affordable housing mission. In calculating our interim provision for income taxes, we use an estimate of our annual effective tax rate, which we update each quarter based on actual historical information and forward-looking estimates. The estimated annual effective tax rate may fluctuate each period based upon changes in facts and circumstances, if any, as compared to those forecasted at the beginning of the year and each interim period thereafter. The variance in our effective tax rate between periods is primarily due to the combined effect of fluctuations in our actual pre-tax income and our estimated annual taxable income, which affects the relative tax benefit we expect to receive from tax-exempt income and tax credits, and changes in the actual dollar amount of these tax benefits.

BUSINESS SEGMENT RESULTS

Results of our three business segments are intended to reflect each segment as if it were a stand-alone business. We describe the management reporting and allocation process used to generate our segment results in our 2006 Form 10-K in Notes to Consolidated Financial Statements Note 15, Segment Reporting. We summarize our segment results for the three and nine months ended September 30, 2007 and 2006 in the tables below and provide a discussion of these results. We include more detail on our segment results in Notes to Condensed Consolidated Financial Statements Note 13, Segment Reporting.

Single-Family Business

Our Single-Family business recorded a net loss of $186 million for the third quarter of 2007, compared with net income of $529 million for the third quarter of 2006. Our Single-Family business recorded net income of $305 million for the first nine months of 2007, a decrease of $1.3 billion, or 81%, from net income of $1.6 billion for the first nine months of 2006. Table 8 summarizes the financial results for our Single-Family business for the periods indicated. The primary source of revenue for our Single-Family business is guaranty fee income. Other sources of revenue include trust management income and technology and other fees. Expenses primarily include credit-related expenses, losses on certain guaranty contracts and administrative expenses.

Table 8: Single-Family Business Results

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2007	2006	2007	2006	$	%	$	%
	(Dollars in millions)							
Income Statement Data:								
Guaranty fee income	$ 1,424	$ 1,242	$ 4,015	$ 3,406	$ 182	15%	$ 609	18%
Trust management income(1)	138		433		138		433	
Other income(2)	125	345	476	1,030	(220)	(64)	(554)	(54)

Losses on certain guaranty contracts	(292)	(101)	(1,023)	(175)	(191)	(189)	(848)	(485)
Credit-related expenses[3]	(1,195)	(192)	(2,040)	(450)	(1,003)	(522)	(1,590)	(353)
Other expenses[4]	(484)	(482)	(1,397)	(1,304)	(2)		(93)	(7)
Income (loss) before federal income taxes	(284)	812	464	2,507	(1,096)	(135)	(2,043)	(81)
Benefit (provision) for federal income taxes	98	(283)	(159)	(871)	381	135	712	82
Net income (loss)	$ (186)	$ 529	$ 305	$ 1,636	$ (715)	(135)%	$ (1,331)	(81)%

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2007	2006	2007	2006	$	%	$	%
	(Dollars in millions)							
Other Key Performance Data:								
Average single-family guaranty book of business[5]	$ 2,432,904	$ 2,198,281	$ 2,359,126	$ 2,158,428	$ 234,623	11%	$ 200,698	9%

(1) Effective January 1, 2007, we began separately reporting our float income as Trust management income. Float income for 2006 is included in Other income.

(2) Consists of net interest income, investment gains and losses, and fee and other income.

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

(4) Consists of administrative expenses and other expenses.

(5) The single-family guaranty book of business consists of single-family mortgage loans held in our portfolio, single-family Fannie Mae MBS held in our portfolio, single-family Fannie Mae MBS held by third parties, and other single-family credit enhancements that we provide.

Key factors affecting the results of our Single-Family business for the three and nine months ended September 30, 2007, compared with the three and nine months ended September 30, 2006 included the following.

Increased guaranty fee income for both the three and nine months ended September 30, 2007, attributable to an increase in the average single-family guaranty book of business, coupled with an increase in the average effective single-family guaranty fee rate.

The growth in our average single-family guaranty book of business was due to strong growth in single-family Fannie Mae MBS issuances and a decrease in the liquidation rate of the single-family guaranty book of business. Total single-family Fannie Mae MBS outstanding increased to $2.1 trillion as of September 30, 2007, from $1.9 trillion as of December 31, 2006. Our estimated overall market share of new single-family mortgage-related securities issuances increased to approximately 41.2% for the third quarter of 2007, from approximately 24.3% for the third quarter of 2006. Our market share has increased in the first nine months of 2007, due to the shift in the product mix of mortgage originations to more traditional conforming fixed-rate loans and reduced competition from private-label issuers of mortgage-related securities. These market share estimates are based on publicly available data and exclude previously securitized mortgages.

The growth in our average effective single-family guaranty fee rate resulted from targeted pricing increases on new business due to the increase in the market pricing of mortgage credit risk, an increase in our acquisition of Alt-A mortgage loans, which generally have higher guaranty fee rates, and an increase in the accretion of our guaranty obligation and deferred profit into income in the first nine months of 2007 as compared with the same period in 2006.

Significantly higher losses on certain guaranty contracts for both the three and nine months ended September 30, 2007, due to the deterioration in home prices and overall housing market conditions during the first nine months of 2007, which led to an increase in mortgage credit risk pricing that resulted in an increase in the estimated fair value of our guaranty obligations. As a result, we recorded increased losses on certain guaranty contracts, in conjunction with our MBS issuances during the third quarter and first nine months of 2007.

A substantial increase in credit-related expenses for both the three and nine months ended September 30, 2007, reflecting an increase in both the provision for credit losses and foreclosed property expense due to the continued impact of weak economic conditions in the Midwest and the effect of the national decline in home prices.

A net tax benefit for the third quarter of 2007, which produced an effective tax rate of 35%, and a net tax provision and an effective tax rate of 34% for the nine months ended September 30, 2007. In comparison, we recorded a net tax provision for the three and nine months ended September 30, 2006 and an effective tax rate of 35% for each period.

HCD Business

Net income for our HCD business increased by $8 million, or 9%, to $97 million for the third quarter of 2007, from $89 million for the third quarter of 2006. Net income for our HCD business increased by $46 million, or 14%, to $370 million for the first nine months of 2007, from $324 million for the first nine months of 2006. Table 9 summarizes the financial results for our HCD business for the periods indicated. The primary sources of revenue for our HCD business are guaranty fee income and other income. Expenses primarily include administrative expenses, credit-related expenses and net operating losses associated with LIHTC investments. The losses on our LIHTC investments are offset by the tax benefits generated from these investments.

Table 9: HCD Business Results

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2007	2006	2007	2006	$	%	$	%
	(Dollars in millions)							
Income Statement Data:								
Guaranty fee income[1]	$ 115	$ 120	$ 326	$ 381	$ (5)	(4)%	$ (55)	(14)%
Other income[1][2]	78	50	278	156	28	56	122	78
Losses on partnership investments	(147)	(197)	(527)	(579)	50	25	52	9
Credit-related expenses[3]	(5)	(5)	1	(7)			8	114
Other expenses[4]	(245)	(239)	(755)	(672)	(6)	(3)	(83)	(12)
Loss before federal income taxes	(204)	(271)	(677)	(721)	67	25	44	6
Benefit for federal income taxes	301	360	1,047	1,045	(59)	(16)	2	
Net income	$ 97	$ 89	$ 370	$ 324	$ 8	9%	$ 46	14%
Other Key Performance Data:								
Average multifamily guaranty book of business[5]	$ 131,643	$ 117,629	$ 127,061	$ 117,845	$ 14,014	12%	$ 9,216	8%

(1) Certain prior period amounts that previously were included as a component of Fee and other income have been reclassified to Guaranty fee income to conform to the current period presentation.

(2) Consists of trust management income and fee and other income.

(3) Consists of the (provision) benefit for credit losses and foreclosed property income.

(4) Consists of net interest expense, losses on certain guaranty contracts, administrative expenses, minority interest in earnings of consolidated subsidiaries and other expenses.

(5) The multifamily guaranty book of business consists of multifamily mortgage loans held in our portfolio, multifamily Fannie Mae MBS held in our portfolio, multifamily Fannie Mae MBS held by third parties and other multifamily credit enhancements that we provide.

Key factors affecting the results of our HCD business for the three and nine months ended September 30, 2007, compared with the three and nine months ended September 30, 2006 included the following.

Decreased guaranty fee income for both the three and nine months ended September 30, 2007, resulting from a decline in the average effective multifamily guaranty fee rate, which was partially offset by an increase in the average multifamily guaranty book of business. The decline in our average effective multifamily guaranty fee rate for both the three and nine months ended September 30, 2007 was due in part to the amortization and recognition of deferred profits in 2006 related to a large multifamily transaction that was terminated in December 2006. In addition, our HCD business continued to experience competitive fee pressure from private-label issuers of commercial mortgage-backed securities during the first six months of 2007. In the third quarter of 2007, this trend began to reverse as a result of the growing need for credit and liquidity in the multifamily mortgage market. These market factors contributed to a higher fee rate on new multifamily business and to faster growth in our multifamily guaranty book of business during the third quarter of 2007.

A decrease in losses on partnership investments for the third quarter of 2007, due to the recognition of a gain on the sale of investments in LIHTC partnerships in July 2007, as well as a lower LIHTC portfolio balance compared to the third quarter of 2006, which resulted in fewer net operating losses. Losses on partnership investments declined slightly for the first nine months of 2007 as a result of the recognition of gains on sales of investments in LIHTC partnerships in March 2007 and July 2007, which was partially offset by increased operating losses on retained LIHTC partnerships.

An increase in other income for the first nine months of 2007, due to an increase in loan prepayment and yield maintenance fees resulting from higher liquidations in the first nine months of 2007 relative to the first nine months of 2006.

An increase in other expenses for the first nine months of 2007, primarily resulting from higher net interest expense associated with an increase in segment assets.

Capital Markets Group

Our Capital Markets group recorded a net loss of $1.3 billion for the third quarter of 2007, compared with a net loss of $1.2 billion for the third quarter of 2006. Our Capital Markets group recorded net income of $834 million for the first nine months of 2007, a decrease of $661 million, or 44%, from net income of $1.5 billion for the first nine months of 2006. Table 10 summarizes the financial results for our Capital Markets group for the periods indicated. The primary sources of revenue for our Capital Markets group are net interest income and fee and other income. Expenses primarily consist of administrative expenses. Derivatives fair value gains and losses, investment gains and losses, and debt extinguishment gains and losses also have a significant impact on the financial performance of our Capital Markets group.

Table 10: Capital Markets Business Results

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2007	2006	2007	2006	$	%	$	%
	(Dollars in millions)							
Net interest income	$ 1,064	$ 1,352	$ 3,455	$ 4,879	$ (288)	(21)%	$ (1,424)	(29)%
Investment gains (losses), net	183	529	(56)	(831)	(346)	(65)	775	93
Derivatives fair value losses, net	(2,244)	(3,381)	(891)	(854)	1,137	34	(37)	(4)
Fee and other income (expense)	(66)	117	66	219	(183)	(156)	(153)	(70)
Other expenses[1]	(433)	(430)	(1,317)	(1,375)	(3)	(1)	58	4
	(1,496)	(1,813)	1,257	2,038	317	17	(781)	(38)

Income (loss) before federal income taxes and extraordinary gains (losses), net of tax effect								
Benefit (provision) for federal income taxes	183	562	(420)	(554)	(379)	(67)	134	24
Extraordinary gains (losses), net of tax effect	3	4	(3)	11	(1)	(25)	(14)	(127)
Net income (loss)	$ (1,310)	$ (1,247)	$ 834	$ 1,495	$ (63)	(5)%	$ (661)	(44)%

(1) Includes debt extinguishment gains (losses), guaranty fee expense, administrative expenses and other expenses.

Key factors affecting the results of our Capital Markets group for the three and nine months ended September 30, 2007, compared with the three and nine months ended September 30, 2006 included the following.

A significant reduction in net interest income for both the three and nine months ended September 30, 2007 due to continued compression in our net interest yield, largely attributable to the increase in our short-term and long-term debt costs as we continued to replace, at higher interest rates, maturing debt that we had issued at lower interest rates during the past few years.

A reduction in investment gains for the three months ended September 30, 2007, due to a decrease in unrealized gains on trading securities, a net loss on Fannie Mae portfolio securitizations and an increase in other-than-temporary impairment on investment securities. In addition, a reduction in investment losses for the nine months ended September 30, 2007, due to a lower level of other-than-temporary impairment on investment securities and an increase in gains on the sale of investment securities, which were partially offset by an increase in unrealized losses on trading securities.

We recognized $81 million and $84 million in other-than-temporary impairment on investment securities for the three and nine months ended September 30, 2007. The impairment recognized in the third quarter of 2007 was the result of credit ratings downgrades and other credit-related events relating to certain non-mortgage investments that we had designated as available for sale, which caused the fair value of these securities to decline below their carrying value, and a deterioration in the credit quality of some of our mortgage revenue bond investments. In contrast, we recognized other-than-temporary impairment on investment securities totaling $6 million and $852 million for the three and nine months ended September 30, 2006, due to a decline in fair value below carrying value of certain securities that we designated for sale.

We experienced a decrease in gains on the sale of investment securities for the three months ended September 30, 2007. We experienced an increase in gains on the sale of investment securities for the nine months ended September 30, 2007, due to the recovery in value of securities we sold that we had previously written down due to other-than-temporary impairment.

We recorded a decreased level of unrealized gains on trading securities for the three months ended September 30, 2007, and an increased level of unrealized losses on trading securities for the nine months ended September 30, 2007, reflecting the decrease in the fair value of these securities due to wider mortgage-to-debt spreads.

Derivatives fair value losses of $2.2 billion and $3.4 billion for the third quarter of 2007 and 2006, respectively, which were largely attributable to fair value losses on our interest rate swaps due to a decline in interest rates during each period. The derivatives fair value losses recorded in the third quarter of 2007 and 2006 more than offset the cumulative derivatives fair value gains for the first six months of each year.

A shift to fee and other expense for the three months ended September 30, 2007, compared with fee and other income for the three months ended September 30, 2006. We experienced a decrease in fee and other income for the nine months ended September 30, 2007, as compared with the nine months ended September 30, 2006. The variance between each period was attributable to an increase in foreign currency exchange losses on our foreign-denominated debt and a decrease in the recognition of certain multifamily fees.

A net tax benefit for the third quarter of 2007, which produced an effective tax rate of 12%, and a net tax provision and effective tax rate of 33% for the nine months ended September 30, 2007. In comparison, we recorded a net tax benefit for the third quarter of 2006, which produced an effective tax rate of 31%, and a net tax provision and effective tax rate of 27% for the nine months ended September 30, 2006. The variance in the effective tax rate and statutory rate was primarily due to fluctuations in our pre-tax income and the relative benefit of tax-exempt income generated from our investments in mortgage revenue bonds.

CONSOLIDATED BALANCE SHEET ANALYSIS

Our total assets of $839.8 billion as of September 30, 2007 decreased by $4.2 billion, or less than 1%, from December 31, 2006. Our total liabilities of $799.7 billion as of September 30, 2007 decreased by $2.6 billion, or less than 1%, from December 31, 2006. Stockholders equity of $39.9 billion as of September 30, 2007 reflected a decrease of $1.6 billion, or 4%, from December 31, 2006. Following is a discussion of material changes since December 31, 2006 in the major components of our assets and liabilities.

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Mortgage Investments

Table 11 shows the composition of our mortgage portfolio by product type and the carrying value, which reflects the net impact of our purchases, sales and liquidations, of these products as of September 30, 2007 and December 31, 2006.

Table 11: Mortgage Portfolio Composition[1]

	As of September 30, 2007	As of December 31, 2006
	(Dollars in millions)	
Mortgage loans:[2]		
Single-family:		
Government insured or guaranteed	$ 23,101	$ 20,106
Conventional:		
Long-term, fixed-rate	199,200	202,339
Intermediate-term, fixed-rate[3]	48,358	53,438
Adjustable-rate	51,296	46,820
Total conventional single-family	298,854	302,597
Total single-family	321,955	322,703
Multifamily:		
Government insured or guaranteed	859	968
Conventional:		
Long-term, fixed-rate	5,272	5,098
Intermediate-term, fixed-rate[3]	64,144	50,847
Adjustable-rate	7,190	3,429
Total conventional multifamily	76,606	59,374
Total multifamily	77,465	60,342
Total mortgage loans	399,420	383,045
Unamortized premiums and other cost basis adjustments, net	679	943
Lower of cost or market adjustments on loans held for sale	(101)	(93)
Allowance for loan losses for loans held for investment	(395)	(340)
Total mortgage loans, net	399,603	383,555
Mortgage-related securities:		
Fannie Mae single-class MBS	102,506	124,383
Non-Fannie Mae single-class mortgage securities	28,015	27,980
Fannie Mae structured MBS	72,784	75,261

Non-Fannie Mae structured mortgage securities[4]	106,217	97,399
Mortgage revenue bonds	16,156	16,924
Other mortgage-related securities	3,480	3,940
Total mortgage-related securities	329,158	345,887
Market value adjustments[5]	(3,385)	(1,261)
Other-than-temporary impairments	(619)	(1,004)
Unamortized premiums (discounts) and other cost basis adjustments, net[6]	(990)	(1,083)
Total mortgage-related securities, net	324,164	342,539
Mortgage portfolio, net[7]	$ 723,767	$ 726,094

(1) Mortgage loans and mortgage-related securities are reported at unpaid principal balance.

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(2) Mortgage loans include unpaid principal balance totaling $100.0 billion and $105.5 billion as of September 30, 2007 and December 31, 2006, respectively, related to mortgage-related securities that were consolidated under Financial Accounting Standards Board Interpretation (FIN) No. 46R (revised December 2003), *Consolidation of Variable Interest Entities (an interpretation of ARB No. 51)* (FIN 46R), and mortgage-related securities created from securitization transactions that did not meet the sales criteria under SFAS No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement No. 125)* (SFAS 140), which effectively resulted in mortgage-related securities being accounted for as loans.

(3) Intermediate-term, fixed-rate consists of mortgage loans with contractual maturities at purchase equal to or less than 15 years.

(4) As of September 30, 2007, $76.2 billion of this amount consists of private-label mortgage-related securities backed by subprime or Alt-A mortgage loans. Refer to Risk Management Credit Risk Management Mortgage Credit Risk Management Mortgage Credit Book of Business for a description of our investments in subprime and Alt-A securities.

(5) Includes unrealized gains and losses on mortgage-related securities and securities commitments classified as trading and available-for-sale.

(6) Includes the impact of other-than-temporary impairments of cost basis adjustments.

(7) Includes consolidated mortgage-related assets acquired through the assumption of debt. Also includes $2.3 billion and $448 million as of September 30, 2007 and December 31, 2006, respectively, of mortgage loans and mortgage-related securities that we have pledged as collateral and for which counterparties have the right to sell or repledge.

Pursuant to a May 2006 consent order with the Office of Federal Housing Enterprise Oversight (OFHEO), we are currently subject to a limit on the size of our mortgage portfolio. For the first two quarters of 2007, we were restricted from increasing our net mortgage portfolio assets above $727.75 billion. On September 19, 2007, OFHEO issued an interpretation of the consent order revising the existing portfolio cap. The mortgage portfolio cap is no longer based on the amount of our net mortgage portfolio assets, which reflects GAAP adjustments, but is now based on our average monthly mortgage portfolio balance. Our average monthly mortgage portfolio balance is based on the unpaid principal balance of our mortgage portfolio as defined and reported in our Monthly Summary, which is a statistical measure rather than an amount computed in accordance with GAAP, and excludes both consolidated mortgage-related assets acquired through the assumption of debt and the impact on the unpaid principal balances recorded on our purchases of delinquent loans from MBS trusts pursuant to Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). The mortgage portfolio cap was set at $735 billion for the third quarter of 2007. For the fourth quarter of 2007, the portfolio cap increased by 1% to $742.35 billion. For each subsequent quarter, the portfolio cap increases by 0.5%, not to exceed 2% per year. Except as described below, compliance with the portfolio cap will be determined by comparing the applicable portfolio cap to the cumulative average month-end portfolio balances, measured by unpaid principal balance, since July 2007 (until the cumulative average becomes and remains a 12-month moving average). For purposes of this calculation, OFHEO s interpretation sets the July 2007 month-end balance at $725 billion. In addition, any net increase in delinquent loan balances in our portfolio after September 30, 2007 will be excluded from the month-end portfolio balance. Our average monthly mortgage portfolio balance was $725.9 billion as of September 30, 2007, which was $9.1 billion below our applicable portfolio limit of $735 billion. We will be subject to the OFHEO-directed minimum capital requirement and portfolio cap until the Director of OFHEO determines that these requirements should be modified or allowed to expire, taking into account certain specified factors.

Table 12 compares our mortgage portfolio activity for the three and nine months ended September 30, 2007 and 2006.

Table 12: Mortgage Portfolio Activity[1]

	For the Three Months Ended September 30,		Variance		For the Nine Months Ended September 30,		Variance	
	2007	2006	$	%	2007	2006	$	%
	(Dollars in millions)							
Purchases	$ 49,574	$ 51,576	$ (2,002)	(4)%	$ 134,407	$ 150,340	$ (15,933)	(11)%
Sales	20,222	21,415	(1,193)	(6)	45,301	46,251	(950)	(2)
Liquidations	28,013	35,528	(7,515)	(21)	90,007	106,110	(16,103)	(15)

(1) The amounts provided represent the unpaid principal balances. These unpaid principal balance amounts, which represent statistical measures of business activity, do not reflect certain GAAP adjustments, including market valuation adjustments, allowance for loan losses, impairments, unamortized premiums and discounts, and the impact of consolidation of variable interest entities.

We selectively identify and purchase mortgage assets that meet our targeted risk-adjusted return thresholds. We typically are a more active purchaser when mortgage-to-debt spreads are wider and the prices of mortgage assets are lower. We generally reduce our purchases when mortgage-to-debt spreads are narrower and prices are higher. Our level of portfolio purchases decreased during the nine months ended September 30, 2007 as compared with the same period in 2006, due to lower market volumes resulting from the reduction in mortgage origination activity and a more limited availability of mortgage assets that met our risk-adjusted return thresholds for most of the period. Our level of portfolio purchases for the third quarter of 2007 was comparable with that of the third quarter of 2006. Beginning in the third quarter of 2007, there was a significant widening of mortgage-to-debt spreads due to the reduction in liquidity and market estimates of slower prepayments. These market conditions presented more opportunities for us to purchase mortgage assets at attractive prices and spreads during the quarter. However, our ability to capitalize on these opportunities was limited by the OFHEO-directed minimum capital requirement and portfolio cap imposed by our May 2006 consent order with OFHEO.

While our levels of portfolio sales for the first nine months of 2007 were comparable to the first nine months of 2006, we experienced a decrease in sales activity during the third quarter of 2007 due to the widening of mortgage-to-debt spreads. The decrease in mortgage liquidations for the three and nine months ended September 30, 2007 was largely attributable to the decline in home prices, which reduced the level of refinancing activity relative to the same periods in the prior year.

We continue to manage the size of our mortgage portfolio to meet the OFHEO-directed portfolio cap. In addition to the portfolio cap, our investment activities may be constrained by our regulatory capital requirements, certain operational limitations, tax classifications and our intent to hold certain temporarily impaired securities until recovery, as well as risk parameters applied to the mortgage portfolio.

Liquid Investments

Our liquid assets consist of non-mortgage investments, cash and cash equivalents, and funding agreements with our lenders, including advances to lenders and repurchase agreements. Our non-mortgage investments, which account for the majority of our liquid assets, primarily consist of high-quality securities that are readily marketable or have short-term maturities, such as commercial paper. Our liquid assets, net of cash equivalents pledged as collateral, totaled approximately $62.6 billion and $69.4 billion as of September 30, 2007 and December 31, 2006, respectively. Our non-mortgage investments, which are carried at fair value in our condensed consolidated balance sheets, totaled $39.5 billion and $47.6 billion as of September 30, 2007 and December 31, 2006, respectively. We provide additional detail on our non-mortgage investments in Notes to Condensed Consolidated Financial Statements Note 5, Investments in Securities.

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Trading Securities

During 2007, we began designating an increasingly large portion of the securities we purchase as trading securities. This change in practice was principally driven by our adoption of Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*, *an amendment of SFAS 133 and SFAS 140* (SFAS 155), which requires us to evaluate securities for embedded derivatives unless they are designated as trading securities. We increased our portfolio of trading securities during the first nine months of 2007 to approximately $48.7 billion as of September 30, 2007, from $11.5 billion as of December 31, 2006.

Available-for-Sale Securities

Although we report both our trading and available-for-sale (AFS) securities at fair value in our condensed consolidated balance sheets, changes in the fair value of our trading securities are reported in our earnings while changes in the fair value of our AFS securities are reported as a separate component of stockholders equity in accumulated other comprehensive income (AOCI). The estimated fair value and amortized cost of our AFS securities totaled $315.0 billion and $318.2 billion, respectively, as of September 30, 2007, and gross unrealized gains and gross unrealized losses recorded in AOCI related to these securities totaled $1.8 billion and $5.0 billion, respectively. In comparison, the estimated fair value and amortized cost of our AFS securities totaled $378.6 billion and $379.5 billion, respectively, as of December 31, 2006, and gross unrealized gains and gross unrealized losses recorded in AOCI totaled $2.8 billion and $3.7 billion, respectively.

The fair value of our investment securities, which are primarily mortgage-backed securities, are affected by changes in interest rates, credit spreads and other market factors. We generally view changes in the fair value of our investment securities caused by movements in interest rates to be temporary, which is consistent with our experience. While we experienced a significant decrease in the fair value of our AFS securities at the end of the third quarter of 2007, we believe that substantially all of the decline in fair value was due to the significant widening of credit spreads during the first nine months of 2007. We have the intent and ability to hold these securities until the earlier of recovery of the unrealized loss amounts or maturity. Accordingly, we believe that it is probable that we will collect the full principal and interest due in accordance with the contractual terms of the securities, although we may experience future declines in value as a result of movements in interest rates.

Debt Instruments

We issue debt instruments as the primary means to fund our mortgage investments and manage our interest rate risk exposure. Table 13 shows the amount of our outstanding short-term borrowings and long-term debt as of September 30, 2007 and December 31, 2006.

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Table 13: Outstanding Debt[1]

	As of September 30, 2007		As of December 31, 2006	
	Outstanding	Weighted Average Interest Rate	Outstanding	Weighted Average Interest Rate
	(Dollars in millions)			
Federal funds purchased and securities sold under agreements to repurchase	$ 1,645	5.60%	$ 700	5.36%
Short-term debt:				
Fixed-rate	152,469	5.06	164,686	5.16
From consolidations	677	5.35	1,124	5.32
Total short-term debt	$ 153,146	5.06%	$ 165,810	5.16%
Long-term debt:				
Senior fixed-rate	$ 575,346	5.20%	$ 576,099	4.98%
Senior floating-rate	15,651	5.87	5,522	5.06
Subordinated fixed-rate	10,980	6.13	12,852	5.91
From consolidations	6,642	5.84	6,763	5.98
Total long-term debt[2]	$ 608,619	5.25%	$ 601,236	5.01%

(1) Outstanding debt amounts and weighted average interest rate reported in this table include the effect of unamortized discounts, premiums and other cost basis adjustments. The unpaid principal balance of outstanding debt, which excludes unamortized discounts, premiums and other cost basis adjustments, totaled $770.2 billion as of September 30, 2007, compared with $773.4 billion as of December 31, 2006.

(2) Reported amounts include a net premium and cost basis adjustments of $12.4 billion and $11.9 billion as of September 30, 2007 and December 31, 2006, respectively.

Despite our portfolio limit, we have been an active issuer of both short- and long-term debt for refunding and rebalancing purposes. We present our debt activity in Table 18 in Liquidity and Capital Management Liquidity Debt Funding.

Derivative Instruments

We supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. We present, by derivative instrument type, the estimated fair value of derivatives recorded in our condensed consolidated balance sheets and the related outstanding notional amount as of September 30, 2007 and December 31, 2006 in Notes to Condensed Consolidated Financial Statements Note 9, Derivative Instruments.

Table 14 provides an analysis of the change in the estimated fair value of the net derivative asset (liability) amounts, excluding mortgage commitments, recorded in our condensed consolidated balance sheets between December 31, 2006 and September 30, 2007. As indicated in Table 14, we recorded a net derivative asset of $1.8 billion as of September 30, 2007 related to our risk management derivatives, compared with a net derivative asset of $3.7 billion as of December 31, 2006. The related outstanding notional amounts totaled $814.4 billion and $745.4 billion as of September 30, 2007 and December 31, 2006, respectively.

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Table 14: Changes in Risk Management Derivative Assets (Liabilities) at Fair Value, Net[1]

	(Dollars in millions)	
Net derivative asset as of December 31, 2006[2]	$	3,725
Effect of cash payments:		
Fair value at inception of contracts entered into during the period[3]		155
Fair value at date of termination of contracts settled during the period[4]		42
Periodic net cash contractual interest receipts		(1,191)
Total cash receipts, net		(994)
Income statement impact of recognized amounts:		
Periodic net contractual interest income on interest rate swaps		193
Net change in fair value during the period		(1,113)
Derivatives fair value losses, net[5]		(920)
Net derivative asset as of September 30, 2007[2]	$	1,811

(1) Excludes mortgage commitments.

(2) Represents the net of Derivative assets at fair value and Derivative liabilities at fair value recorded in our condensed consolidated balance sheets, excluding mortgage commitments.

(3) Primarily includes upfront premiums paid on option contracts.

(4) Primarily represents cash paid upon termination of derivative contracts.

(5) Reflects net derivatives fair value losses recognized in our condensed consolidated statements of income, excluding mortgage commitments.

The $1.9 billion decrease in the fair value of the net derivative asset was largely attributable to the decrease in the aggregate net fair value of our interest rate swaps due to the decrease in swap rates between December 31, 2006 and September 30, 2007. We present, by derivative instrument type, our risk management derivative activity for the nine months ended September 30, 2007, along with the stated maturities of our derivatives outstanding as of September 30, 2007, in Table 28 in Risk Management Interest Rate Risk Management and Other Market Risks.

SUPPLEMENTAL NON-GAAP INFORMATION FAIR VALUE BALANCE SHEETS

Our assets and liabilities consist predominately of financial instruments. The balance sheets presented in our condensed consolidated financial statements reflect some financial assets measured and reported at fair value while other financial assets, along with most of our financial liabilities, are measured and reported at historical cost. Each of the non-GAAP supplemental consolidated fair value balance sheets presented below in Table 15 reflects all of our assets and liabilities at estimated fair value. Estimated fair value is the amount at which an asset or liability could be exchanged between willing parties, other than in a forced or liquidation sale. The non-GAAP estimated fair value of our net assets (net of tax effect) is derived from our non-GAAP fair value balance sheet.

The non-GAAP supplemental consolidated fair value balance sheets and estimated fair value of our net assets are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. In addition, they are not intended as a substitute for amounts reported in our condensed consolidated financial statements prepared in accordance with GAAP. However, we routinely use fair value measures to make investment decisions and to measure, monitor and manage our risk because our assets and liabilities consist predominately of financial instruments. Management, particularly our Capital Markets group, uses this information to analyze changes in our assets and liabilities from period to period and understand how the overall value of the company is changing from period to period and to measure the performance of our capital markets investment activities. Accordingly, we believe that the non-GAAP supplemental consolidated fair value balance sheets and the fair value of our net assets are useful to investors because they provide consistency in the measurement and reporting of all of our assets and liabilities. We believe that the non-GAAP supplemental consolidated fair value balance sheets and the fair value of our net assets, when used in conjunction with our condensed consolidated financial statements prepared in accordance with GAAP, can serve as valuable incremental tools for investors to assess changes in our overall value over time relative to changes in market conditions.

Cautionary Language Relating to Supplemental Non-GAAP Financial Measures

In reviewing our supplemental non-GAAP consolidated fair value balance sheets, there are a number of important factors and limitations to consider. The presentation of some of the line items in our non-GAAP consolidated fair value balance sheets may differ from the presentation in our consolidated GAAP balance sheets, as we have disaggregated certain line items and aggregated certain other line items. We describe these differences in the notes to the non-GAAP consolidated fair value balance sheets. We believe this revised presentation, for purposes of analyzing our non-GAAP consolidated fair value balance sheets, provides greater transparency into the components of our balance sheet associated with our guaranty business activities and the components associated with our capital markets business activities, which is consistent with the way we manage risks and allocate revenues and expenses for segment reporting purposes.

Moreover, as discussed in Critical Accounting Policies Fair Value of Financial Instruments, when quoted market prices or observable market data are not available, we rely on internally developed models that may require management judgment and assumptions to estimate fair value. Differences in assumptions used in our models could result in significant changes in our estimates of fair value. In addition, the estimated fair value of our net assets is calculated as of a particular point in time based on our existing assets and liabilities and does not incorporate other factors that may have a significant impact on that value, most notably any value from future business activities in which we expect to engage. As a result, the estimated fair value of our net assets presented in our non-GAAP supplemental consolidated fair value balance sheets does not represent an estimate of our net realizable value, liquidation value or our market value as a whole. Amounts we ultimately realize from the disposition of assets or settlement of liabilities may vary significantly from the estimated fair values presented in our non-GAAP supplemental consolidated fair value balance sheets. Because temporary changes in market conditions can substantially affect the fair value of our net assets, we do not believe that short-term fluctuations in the fair value of our net assets attributable to mortgage-to-debt option-adjusted spreads (OAS) or changes in the fair value of our net guaranty assets are necessarily representative of the effectiveness of our investment strategy or the long-term underlying value of our business. We believe the long-term value of our business depends primarily on our ability to acquire new assets and funding at attractive prices, to effectively manage the risks of these assets and liabilities over time and to earn attractive returns on our guaranty business. However, we believe that assessing the factors that affect near-term changes in the estimated fair value of our net assets helps us evaluate our long-term value and assess whether temporary market factors have caused our net assets to become overvalued or undervalued relative to the level of risk and expected long-term fundamentals of our business.

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Table 15: Non-GAAP Supplemental Consolidated Fair Value Balance Sheets

	As of September 30, 2007			As of December 31, 2006		
	GAAP Carrying Value	Fair Value Adjustment(1)	Estimated Fair Value	GAAP Carrying Value	Fair Value Adjustment(1)	Estimated Fair Value
	(Dollars in millions)					
Assets:						
Cash and cash equivalents	$ 4,976	$	$ 4,976(2)	$ 3,972	$	$ 3,972(2)
Federal funds sold and securities purchased under agreements to resell	8,349	2	8,351(2)	12,681		12,681(2)
Trading securities	48,683		48,683(2)	11,514		11,514(2)
Available-for-sale securities	315,012		315,012(2)	378,598		378,598(2)
Mortgage loans:						
Mortgage loans held for sale	5,053	21	5,074(3)	4,868	(88)	4,780(3)
Mortgage loans held for investment, net of allowance for loan losses	394,550	(3,601)	390,949(3)	378,687	(2,821)	375,866(3)
Guaranty assets of mortgage loans held in portfolio		4,105	4,105(3)(4)		3,669	3,669(3)(4)
Guaranty obligations of mortgage loans held in portfolio		(5,299)	(5,299)(3)(4)		(2,831)	(2,831)(3)(4)
Total mortgage loans	399,603	(4,774)	394,829(2)(3)	383,555	(2,071)	381,484(2)(3)
Advances to lenders	11,738	(122)	11,616(2)	6,163	(152)	6,011(2)
Derivative assets at fair value	3,172		3,172(2)	4,931		4,931(2)
Guaranty assets and buy-ups	10,332	4,212	14,544(2)(4)	8,523	3,737	12,260(2)(4)
Total financial assets	801,865	(682)	801,183(2)	809,937	1,514	811,451(2)
Master servicing assets and credit enhancements	1,668	1,752	3,420(4)(5)	1,624	1,063	2,687(4)(5)
Other assets	36,250	2,901	39,151(5)(6)	32,375	(948)	31,427(5)(6)
Total assets	$ 839,783	$ 3,971	$ 843,754	$ 843,936	$ 1,629	$ 845,565
Liabilities:						
Federal funds purchased and securities sold under agreements to repurchase	$ 1,645	$ 2	$ 1,647(2)	$ 700	$	$ 700(2)
Short-term debt	153,146	199	153,345(2)	165,810	(63)	165,747(2)
Long-term debt	608,619	10,316	618,935(2)	601,236	5,358	606,594(2)

Derivative liabilities at fair value	1,336		1,336(2)	1,184		1,184(2)
Guaranty obligations	14,322	1,771	16,093(2)	11,145	(2,960)	8,185(2)
Total financial liabilities	779,068	12,288	791,356(2)	780,075	2,335	782,410(2)
Other liabilities	20,672	(2,572)	18,100(7)	22,219	(2,101)	20,118(7)
Total liabilities	799,740	9,716	809,456	802,294	234	802,528
Minority interests in consolidated subsidiaries	121		121	136		136
Stockholders Equity:						
Preferred	9,008	(287)	8,721(8)	9,108	(90)	9,018(8)
Common	30,914	(5,458)	25,456(9)	32,398	1,485	33,883(9)
Total stockholders equity/non-GAAP fair value of net assets	**$ 39,922**	**$ (5,745)**	**$ 34,177**	**$ 41,506**	**$ 1,395**	**$ 42,901**
Total liabilities and stockholders equity	$ 839,783	$ 3,971	$ 843,754	$ 843,936	$ 1,629	$ 845,565

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Explanation and Reconciliation of Non-GAAP Measures to GAAP Measures

(1) Each of the amounts listed as a fair value adjustment represents the difference between the carrying value included in our GAAP condensed consolidated balance sheets and our best judgment of the estimated fair value of the listed asset or liability.

(2) We determined the estimated fair value of these financial instruments in accordance with the fair value guidelines outlined in SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* (SFAS 107), as described in Notes to Condensed Consolidated Financial Statements Note 15, Fair Value of Financial Instruments. In Note 15, we also disclose the carrying value and estimated fair value of our total financial assets and total financial liabilities as well as discuss the methodologies and assumptions we use in estimating the fair value of our financial instruments.

(3) We have separately presented the estimated fair value of Mortgage loans held for sale, Mortgage loans held for investment, net of allowance for loan losses, Guaranty assets of mortgage loans held in portfolio and Guaranty obligations of mortgage loans held in portfolio. These combined line items together represent total mortgage loans reported in our GAAP condensed consolidated balance sheets. This presentation provides transparency into the components of the fair value of our mortgage loans associated with our guaranty business activities and the components of our capital markets business activities, which is consistent with the way we manage risks and allocate revenues and expenses for segment reporting purposes. While the carrying values and estimated fair values of the individual line items may differ from the amounts presented in Note 15, the combined amounts together equal the carrying value and estimated fair value amounts of total mortgage loans in Note 15.

(4) In our GAAP condensed consolidated balance sheets, we report the guaranty assets associated with our outstanding Fannie Mae MBS and other guaranties as a separate line item and include buy-ups, master servicing assets and credit enhancements associated with our guaranty assets in Other assets. The GAAP carrying value of our guaranty assets reflects only those guaranty arrangements entered into subsequent to our adoption of FIN No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FIN No. 34)* (FIN 45), on January 1, 2003. On a GAAP basis, our guaranty assets totaled $9.4 billion and $7.7 billion as of September 30, 2007 and December 31, 2006, respectively. The associated buy-ups totaled $894 million and $831 million as of September 30, 2007 and December 31, 2006, respectively. In our non-GAAP supplemental consolidated fair value balance sheets, we also disclose the estimated guaranty assets and obligations related to mortgage loans held in our portfolio. The aggregate estimated fair value of the guaranty asset-related components totaled $16.8 billion as of September 30, 2007, compared with $15.8 billion as of December 31, 2006. These components represent the sum of the following line items in this table: (i) Guaranty assets of mortgage loans held in portfolio; (ii) Guaranty obligations of mortgage loans held in portfolio, (iii) Guaranty assets and buy-ups; and (iv) Master servicing assets and credit enhancements.

(5) The line items Master servicing assets and credit enhancements and Other assets together consist of the assets presented on the following five line items in our GAAP condensed consolidated balance sheets: (i) Accrued interest receivable; (ii) Acquired property, net; (iii) Deferred tax assets; (iv) Partnership investments; and (v) Other assets. The carrying value of these items in our GAAP condensed consolidated balance sheets together totaled $38.8 billion and $34.8 billion as of September 30, 2007 and December 31, 2006, respectively. We deduct the carrying value of the buy-ups associated with our guaranty obligation, which totaled $894 million and $831 million as of September 30, 2007 and December 31, 2006, respectively, from Other assets reported in our GAAP condensed consolidated balance sheets because buy-ups are a financial instrument that we combine with guaranty assets in our SFAS 107 disclosure in Note 15. We have estimated the fair value of master

servicing assets and credit enhancements based on our fair value methodologies discussed in Note 15.

(6) With the exception of partnership investments and deferred tax assets, the GAAP carrying values of other assets generally approximate fair value. While we have included partnership investments at their carrying value in each of the non-GAAP supplemental consolidated fair value balance sheets, the fair values of these items are generally different from their GAAP carrying values, potentially materially. For example, our LIHTC partnership investments had a carrying value of $8.0 billion and an estimated fair value of $9.1 billion as of September 30, 2007. We assume that other deferred assets, consisting primarily of prepaid expenses, have no fair value. We adjust the GAAP-basis deferred income taxes for purposes of each of our non-GAAP supplemental consolidated fair value balance sheets to include estimated income taxes on the difference between our non-GAAP supplemental consolidated fair value balance sheets net assets, including deferred taxes from the GAAP condensed consolidated balance sheets, and our GAAP condensed consolidated balance sheets stockholders equity. Because our adjusted deferred income taxes are a net asset in each year, the amounts are included in our non-GAAP fair value balance sheets as a component of other assets.

(7) The line item Other liabilities consists of the liabilities presented on the following four line items in our GAAP condensed consolidated balance sheets: (i) Accrued interest payable; (ii) Reserve for guaranty losses; (iii) Partnership liabilities; and (iv) Other liabilities. The carrying value of these items in our GAAP condensed consolidated balance sheets together totaled $20.7 billion and $22.2 billion as of September 30, 2007 and December 31, 2006, respectively. The GAAP carrying values of these other liabilities generally approximate fair value. We assume that deferred liabilities, such as deferred debt issuance costs, have no fair value.

(8) Preferred stockholders equity is reflected in our non-GAAP supplemental consolidated fair value balance sheets at the estimated fair value amount.

(9) Common stockholders equity consists of the stockholders equity components presented on the following five line items in our GAAP condensed consolidated balance sheets: (i) Common stock; (ii) Additional paid-in capital; (iii) Retained earnings; (iv) Accumulated other comprehensive loss; and (v) Treasury stock, at cost. Common stockholders equity is the residual of the excess of the estimated fair value of total assets over the estimated fair value of total liabilities, after taking into consideration preferred stockholders equity and minority interest in consolidated subsidiaries.

Changes in Non-GAAP Estimated Fair Value of Net Assets

Table 16 summarizes the change in the estimated fair value of our net assets for the first nine months of 2007.

Table 16: Non-GAAP Estimated Fair Value of Net Assets (Net of Tax Effect)

	(Dollars in millions)	
Balance as of December 31, 2006	$	42,901
Capital transactions:[1]		
Common dividends, common share repurchases and issuances, net		(1,279)
Preferred dividends, redemptions and issuances		(472)
Capital transactions, net		(1,751)
Change in estimated fair value of net assets, excluding capital transactions		(6,973)
Decrease in estimated fair value of net assets, net		(8,724)
Balance as of September 30, 2007[2]	$	34,177

(1) Represents net capital transactions, which are reflected in the condensed consolidated statements of changes in stockholders equity.

(2) Represents estimated fair value of net assets (net of tax effect) presented in Table 15: Non-GAAP Supplemental Consolidated Fair Value Balance Sheets.

Summary of Fair Value Results

The estimated fair value of our net assets decreased by $8.7 billion to $34.2 billion as of September 30, 2007, from $42.9 billion as of December 31, 2006. The $8.7 billion decrease included the effect of a reduction of $1.8 billion attributable to capital transactions, consisting primarily of payments of $1.1 billion for the redemption of preferred stock and $1.7 billion for dividends to holders of our common and preferred stock, which were partially offset by proceeds of $1.0 billion from the issuance of preferred stock.

Excluding the effect of capital transactions, we experienced a $7.0 billion decrease in the estimated fair value of our net assets for the first nine months of 2007. The primary factors affecting the fair value of our net assets for the first nine months of 2007 included the benefit from the economic income generated by our businesses, which was more than offset by a decrease in value resulting from the decline in home prices and wider mortgage-to-debt OAS. We expect periodic fluctuations in the estimated fair value of our net assets due to our business activities, as well as due to changes in market conditions, including changes in interest rates, changes in relative spreads between our mortgage assets and debt, and changes in implied volatility. Below we provide selected market information in Table 17 and discuss how changes in market conditions have contributed to the significant decrease in the estimated fair value of our net assets.

Table 17: Selected Market Information[1]

	As of September 30, 2007	As of December 31, 2006	Change
10-year U.S. Treasury note yield	4.59%	4.70%	(0.11)%
Implied volatility[2]	17.20%	15.70%	1.50%
30-year Fannie Mae MBS par coupon rate	5.97%	5.79%	0.18%
Lehman U.S. MBS Index OAS (in basis points) over LIBOR yield curve	21.4bp	(2.7) bp	24.1bp
Lehman U.S. Agency Debt Index OAS (in basis points) over LIBOR yield curve	(18.8) bp	(13.8)bp	(5.0) bp

(1) Information obtained from Lehman Live, Lehman POINT and Bloomberg.

(2) Implied volatility for an interest rate swaption with a 3-year option on a 10-year final maturity.

Estimated Impact of Changes in Market Conditions on Fair Value Results

For the first nine months of 2007, we experienced a decrease in the fair value of our net guaranty assets, including related deferred tax assets, of $4.5 billion. This fair value change does not include the impact of the economic earnings of the guaranty business during the period. The decline is primarily due to a substantial increase in the estimated fair value of our guaranty obligations attributable to the decline in the home prices and the market s expectation of future home price declines. This increase more than offset an increase in the fair value of our guaranty assets that resulted from growth in our guaranty book of business.

We estimate that the significant widening of mortgage-to-debt spreads during the first nine months of 2007 caused a decline of approximately $4.5 billion to $5.0 billion in the fair value of our net portfolio. As displayed in Table 17 above, the Lehman U.S. MBS index, which primarily includes 30-year and 15-year mortgages, reflected a significant widening of OAS during the first nine months of 2007. The OAS on securities held by us that are not in the index, such as AAA-rated 10-year commercial mortgage-backed securities and AAA-rated private-label mortgage-related securities, widened even more dramatically, resulting in an overall decrease in the fair value of our mortgage assets. Debt OAS based on the Lehman U.S. Agency Debt Index to the London Interbank Offered Rate (LIBOR) tightened by 5 basis points to minus 18.8 basis points as of September 30, 2007, resulting in an increase in the fair value of our debt. Our economic earnings from our portfolio investments resulted in an increase in fair value of our net assets that partially offset the decrease that resulted from the change in market conditions.

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LIQUIDITY AND CAPITAL MANAGEMENT

Liquidity

Debt Funding

Our primary source of cash is proceeds from the issuance of our debt securities. As a result, we are dependent on our continuing ability to issue debt securities in the capital markets to meet our cash requirements. Table 18 summarizes our debt activity for the three and nine months ended September 30, 2007 and 2006.

Table 18: Debt Activity

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in millions)			
Issued during the period:[1]				
Short-term:[2]				
Amount[3]	$ 341,033	$ 432,575	$ 1,124,200	$ 1,715,094
Weighted average interest rate	4.91%	5.16%	5.07%	4.78%
Long-term:				
Amount[3]	$ 37,462	$ 40,833	$ 150,753	$ 140,046
Weighted average interest rate	5.58%	5.73%	5.57%	5.52%
Total issued:				
Amount[3]	$ 378,495	$ 473,408	$ 1,274,953	$ 1,855,140
Weighted average interest rate	4.98%	5.21%	5.13%	4.84%
Redeemed during the period:[1][4]				
Short-term:[2]				
Amount[3]	$ 351,130	$ 455,380	$ 1,135,352	$ 1,735,420
Weighted average interest rate	4.97%	5.08%	5.07%	4.68%
Long-term:				
Amount[3]	$ 45,725	$ 43,339	$ 142,973	$ 119,899
Weighted average interest rate	4.68%	4.15%	4.58%	3.73%
Total redeemed:				
Amount[3]	$ 396,855	$ 498,719	$ 1,278,325	$ 1,855,319
Weighted average interest rate	4.93%	5.00%	5.02%	4.62%

(1) Excludes debt activity resulting from consolidations and intraday loans.

(2) Includes Federal funds purchased and securities sold under agreements to repurchase.

(3) Represents the face amount at issuance or redemption.

(4) Represents all payments on debt, including regularly scheduled principal payments, payments at maturity, payments as the result of a call and payments for any other repurchases.

The amount of our total outstanding debt remained relatively consistent between December 31, 2006 and September 30, 2007, as we managed the size of our mortgage portfolio to meet the OFHEO-directed portfolio cap. In addition, the mix between our outstanding short-term and long-term debt remained relatively consistent. Despite a lack of portfolio growth for the first nine months of 2007, we remained an active participant in the international capital markets to meet our consistent need for funding and rebalancing our portfolio. Changes in the amount of our debt issuances and redemptions between periods are influenced by investor demand for our debt, changes in interest rates, and the maturity of existing debt. For information on our outstanding short-term and long-term debt as of September 30, 2007, refer to Consolidated Balance Sheet Analysis Debt Instruments.

Our sources of liquidity remained adequate to meet both our short-term and long-term funding needs during the first nine months of 2007, and we anticipate that they will remain adequate. Despite the overall reduction in liquidity and funding sources in the mortgage credit market in recent months, our ability to issue debt at rates we consider attractive has not been impaired. In addition, we issued $1.375 billion in preferred stock in September and October 2007.

Liquidity Contingency Plan

We maintain a liquidity contingency plan in the event that factors, whether internal or external to our business, temporarily compromise our ability to access capital through normal channels. Our contingency plan provides for alternative sources of liquidity that would allow us to meet all of our cash obligations for 90 days without relying upon the issuance of unsecured debt. In the event of a liquidity crisis in which our access to the unsecured debt funding market becomes impaired, our primary source of liquidity is the sale or pledge of mortgage assets in our unencumbered mortgage portfolio. Another source of liquidity in the event of a liquidity crisis is the sale of assets in our liquid investment portfolio.

Pursuant to our September 1, 2005 agreement with OFHEO, we periodically test our liquidity contingency plan. We believe we were in compliance with our agreement with OFHEO to maintain and test our liquidity contingency plan as of March 31, 2007, June 30, 2007 and September 30, 2007.

Credit Ratings and Risk Ratings

Our ability to borrow at attractive rates is highly dependent upon our credit ratings. Our senior unsecured debt (both long-term and short-term), benchmark subordinated debt and preferred stock are rated and continuously monitored by Standard & Poor s, a division of The McGraw Hill Companies (Standard & Poor s), Moody s Investors Service (Moody s), and Fitch Ratings (Fitch), each of which is a nationally recognized statistical rating organization. Table 19 below sets forth the credit ratings issued by each of these rating agencies of our long-term and short-term senior unsecured debt, qualifying benchmark subordinated debt and preferred stock as of November 8, 2007. To date, we have not experienced any limitations in our ability to access the capital markets due to a credit ratings downgrade. Table 19 also sets forth our risk to the government rating and our Bank Financial Strength Rating as of November 8, 2007.

Table 19: Fannie Mae Debt Credit Ratings and Risk Ratings

	Senior Long-Term Unsecured Debt	Senior Short-Term Unsecured Debt	Qualifying Benchmark Subordinated Debt	Preferred Stock	Risk to the Government[1]	Bank Financial Strength[1]
Standard & Poor s	AAA	A-1+	AA-(2)	AA-(2)	AA-(2)	
Moody s	Aaa	P-1	Aa2	Aa3		B+
Fitch	AAA	F1+	AA-	AA-		

(1) Pursuant to our September 1, 2005 agreement with OFHEO, we agreed to seek to obtain a rating, which will be continuously monitored by at least one nationally recognized statistical rating organization, that assesses, among other things, the independent financial strength or risk to the government of Fannie Mae operating under its authorizing legislation but without assuming a cash infusion or extraordinary support of the government in the

event of a financial crisis.

(2) Negative outlook.

Cash Flows

Our primary sources of funding include proceeds from our issuance of our debt securities, principal and interest payments on mortgage assets, and guaranty fees. Our primary uses of funds include the purchase of mortgage assets, repayment of debt and interest payments, payment of dividends, administrative expenses and taxes.

Nine Months Ended September 30, 2007. Our cash and cash equivalents of $4.5 billion as of September 30, 2007 increased by $1.2 billion from December 31, 2006. We generated cash flows from operating activities of

$16.9 billion, largely attributable to net cash provided from trading securities. We also generated cash flows from investing activities of $746 million, attributable to funds provided from a reduction in federal funds sold and securities purchased under agreements to resell. These cash flows were partially offset by net cash used in financing activities of $16.5 billion, as amounts paid to extinguish debt exceeded the proceeds from the issuance of debt.

Nine Months Ended September 30, 2006. Our cash and cash equivalents of $3.1 billion as of September 30, 2006 increased by $259 million from December 31, 2005. We generated cash flows from operating activities of $25.6 billion, largely attributable to net cash provided from trading securities. These cash flows were partially offset by net cash used in financing activities of $20.5 billion, as amounts paid to extinguish debt exceeded the proceeds from the issuance of debt, and net cash used in investing activities of $4.9 billion, attributable to an increase in federal funds sold and securities purchased under agreements to resell.

Because our cash flows are complex and interrelated and bear little relationship to our net earnings and net assets, we do not rely on this traditional cash flow analysis to evaluate our liquidity position. Instead, we rely on our liquidity contingency plan described above to ensure that we preserve stable, reliable and cost effective sources of cash to meet all obligations from normal operations and maintain sufficient excess liquidity to withstand both a severe and moderate liquidity stress environment.

Capital Management

Regulatory Capital

Table 20 displays our regulatory capital classification measures as of September 30, 2007 and December 31, 2006, with the exception of our statutory risk-based capital measure and related total capital measure, which have been provided as of June 30, 2007 (the most recent date for which our statutory risk-based capital measure is available) and December 31, 2006. The regulatory capital classification measures as of September 30, 2007 provided in the table below represent amounts that will be resubmitted to OFHEO for its certification and are subject to its review and approval. They do not represent OFHEO s announced capital classification measures.

Table 20: Regulatory Capital Measures

	As of September 30, 2007[1]	As of December 31, 2006
	(Dollars in millions)	
Core capital[2]	$ 41,713	$ 41,950
Statutory minimum capital[3]	30,303	29,359
Surplus of core capital over required minimum capital	$ 11,410	$ 12,591
Surplus of core capital percentage over required minimum capital[4]	37.7%	42.9%
Core capital[2]	$ 41,713	$ 41,950
OFHEO-directed minimum capital[5]	39,393	38,166
Surplus of core capital over OFHEO-directed minimum capital	$ 2,319	$ 3,784
Surplus of core capital percentage over OFHEO-directed minimum capital[6]	5.9%	9.9%
Total capital[7]	$ 43,798	$ 42,703
Statutory risk-based capital[8]	10,225	26,870
Surplus of total capital over required risk-based capital	$ 33,573	$ 15,833
Surplus of total capital percentage over required risk-based capital[9]	328.3%	58.9%
Core capital[2]	$ 41,713	$ 41,950
Statutory critical capital[10]	15,682	15,149
Surplus of core capital over required critical capital	$ 26,031	$ 26,801
Surplus of core capital percentage over required critical capital[11]	166.0%	176.9%

(1) Statutory risk-based capital and total capital measures have been provided as of June 30, 2007 (the most recent date for which the statutory risk-based capital measure is available) and December 31, 2006. The regulatory capital classification measures as of September 30, 2007 provided in this table represent estimates that will be resubmitted to OFHEO for its certification.

(2) The sum of (a) the stated value of our outstanding common stock (common stock less treasury stock); (b) the stated value of our outstanding non-cumulative perpetual preferred stock; (c) our paid-in capital; and (d) our retained earnings. Core capital excludes accumulated other comprehensive income (loss).

(3) Generally, the sum of (a) 2.50% of on-balance sheet assets; (b) 0.45% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties; and (c) up to 0.45% of other off-balance sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances (See 12 CFR 1750.4 for

existing adjustments made by the Director of OFHEO).

(4) Defined as the surplus of core capital over statutory minimum capital expressed as a percentage of statutory minimum capital.

(5) Defined as a 30% surplus over the statutory minimum capital requirement. We are currently required to maintain this surplus under the OFHEO consent order until such time as the Director of OFHEO determines that the requirement should be modified or allowed to expire, taking into account certain specified factors.

(6) Defined as the surplus of core capital over OFHEO-directed minimum capital expressed as a percentage of OFHEO-directed minimum capital.

(7) The sum of (a) core capital and (b) the total allowance for loan losses and reserve for guaranty losses, less (c) the specific loss allowance (that is, the allowance required on individually impaired loans). The specific loss allowance totaled $51 million as of June 30, 2007 and $106 million as of December 31, 2006.

(8) Defined as the amount of total capital required to be held to absorb projected losses flowing from future adverse interest rate and credit risk conditions specified by statute (see 12 CFR 1750.13 for conditions), plus 30% mandated by statute to cover management and operations risk.

(9) Defined as the surplus of total capital over statutory risk-based capital expressed as a percentage of statutory risk-based capital.

(10) Generally, the sum of (a) 1.25% of on-balance sheet assets; (b) 0.25% of the unpaid principal balance of outstanding Fannie Mae MBS held by third parties and (c) up to 0.25% of other off-balance sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances.

(11) Defined as the surplus of core capital over statutory critical capital expressed as a percentage of statutory critical capital.

Based on financial estimates that we provided to OFHEO, on September 27, 2007, OFHEO announced that we were classified as adequately capitalized as of June 30, 2007 (the most recent date for which results have been published by OFHEO).

In September 2007 we issued $1.0 billion in preferred stock, which was intended to partially replace the $1.1 billion in preferred stock we redeemed in February and April 2007. We issued an additional $375 million in preferred stock in October 2007. Our core capital and our capital surplus have decreased since September 30, 2007, due to market trends that have adversely affected our earnings. If these market trends continue to negatively affect our net income, they will continue to cause a reduction in our retained earnings and, as a result, in the amount of our core capital. We may be required to take actions, or refrain from taking actions, in order to maintain or increase our statutory and OFHEO-directed minimum capital surplus. Like the portfolio cap, our need to maintain capital at specific levels limits our ability to increase our portfolio investments. In order to maintain our regulatory capital at required levels, we may forgo purchase opportunities or sell assets. We also may issue additional preferred securities. Refer to Item 1A Risk Factors for a more detailed discussion of how continued declines in our earnings could negatively impact our regulatory capital position.

The significant reduction in our statutory risk-based capital requirement from December 31, 2006 to June 30, 2007 resulted from risk management actions that served to lower our investment portfolio s exposure to extreme interest rate movements. On October 11, 2007, OFHEO announced a proposed rule that would change the mortgage loan loss severity formulas used in the regulatory risk-based capital stress test. If adopted, the proposed changes would increase our risk-based capital requirement. Using data from the third and fourth quarters of 2006, OFHEO s recalculation of the risk-based capital requirement for those periods using the proposed formulas showed that our total capital base would continue to exceed all risk-based capital requirements.

Capital Activity

Common Stock

Shares of common stock outstanding, net of shares held in treasury, totaled approximately 974 million, 973 million, 973 million and 972 million as of September 30, 2007, June 30, 2007, March 31, 2007 and December 31, 2006, respectively. We issued 0.3 million, 0.3 million and 1.0 million shares of common stock from treasury for our employee benefit plans during the quarters ended September 30, 2007, June 30, 2007 and March 31, 2007, respectively. We did not issue any common stock during the first three quarters of 2007 other than in accordance with these plans.

From April 2005 to November 2007, we prohibited all of our employees from engaging in purchases or sales of our securities except in limited circumstances relating to financial hardship. In May 2006, we implemented a stock repurchase program that authorized the repurchase of up to $100 million of our shares from our non-officer employees, who are employees below the level of vice president. From May 31, 2006 to September 30, 2007, we purchased an aggregate of approximately 122,000 shares of common stock from our employees under the program. In November 2007, the prohibition on employee sales and purchases of our securities was lifted and the employee stock repurchase program was terminated.

Non-Cumulative Preferred Stock

On February 28, 2007, we redeemed all of the shares of our Variable Rate Non-Cumulative Preferred Stock, Series J, with an aggregate stated value of $700 million.

On April 2, 2007, we redeemed all of the shares of our Variable Rate Non-Cumulative Preferred Stock, Series K, with an aggregate stated value of $400 million.

On September 28, 2007, we issued 40 million shares of Variable Rate Non-Cumulative Preferred Stock, Series P, with an aggregate stated value of $1.0 billion. The Series P Preferred Stock has a variable dividend rate that will reset quarterly on each March 31, June 30, September 30 and December 31, beginning December 31, 2007, at a per annum rate equal to the greater of (i) 3-Month LIBOR plus 0.75% and (ii) 4.50%. The Series P Preferred Stock may be redeemed, at our option, on or after September 30, 2012. The net proceeds from the issuance of Series P Preferred Stock were added to our working capital and will be used for general corporate purposes.

On October 4, 2007, we issued 15 million shares of 6.75% Non-Cumulative Preferred Stock, Series Q, with an aggregate stated value of $375 million. The Series Q Preferred Stock has a dividend rate of 6.75% per annum. The Series Q Preferred Stock may be redeemed, at our option, on or after September 30, 2010. The net proceeds from the issuance of Series Q Preferred Stock were added to our working capital and will be used for general corporate purposes.

Subordinated Debt

Pursuant to our September 1, 2005 agreement with OFHEO, we agreed to issue qualifying subordinated debt, rated by at least two nationally recognized statistical rating organizations, in a quantity such that the sum of our total capital plus the outstanding balance of our qualifying subordinated debt equals or exceeds the sum of (1) outstanding Fannie Mae MBS held by third parties times 0.45% and (2) total on-balance sheet assets times 4%, which we refer to as our subordinated debt requirement.

As of March 31, 2007, June 30, 2007 and September 30, 2007, we were in compliance with our subordinated debt requirement. As of March 31, 2007, our total capital plus the outstanding balance of our qualifying subordinated debt was approximately $49.8 billion and exceeded our subordinated debt requirement by $7.9 billion. As of June 30, 2007, our total capital plus the outstanding balance of our qualifying subordinated debt was approximately $51.0 billion and exceeded our subordinated debt requirement by $8.1 billion. Our total capital plus the outstanding balance of our qualifying subordinated debt was approximately $49.5 billion and exceeded our subordinated debt requirement by $6.9 billion as of September 30, 2007.

We have not issued any subordinated debt securities since 2003. We had qualifying subordinated debt totaling $2.0 billion, based on redemption value, that matured in January 2007. As of the date of this filing, we have $9.0 billion in outstanding qualifying subordinated debt.

Dividends

We paid common stock dividends of $0.40 per share for the first quarter of 2007 and $0.50 per share for the second and third quarters of 2007. On October 16, 2007, our Board of Directors declared common stock dividends of $0.50 per share for the fourth quarter of 2007, payable on November 26, 2007.

We paid preferred stock dividends of $138 million, $121 million and $115 million in the first, second and third quarter of 2007, respectively. On October 16, 2007, our Board of Directors declared total preferred stock dividends of $137 million for the fourth quarter of 2007, payable on December 31, 2007.

OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES

We enter into certain business arrangements that are not recorded in our condensed consolidated balance sheets or may be recorded in amounts that are different from the full contract or notional amount of the transaction. These arrangements are commonly referred to as off-balance sheet arrangements, and expose us to potential losses in excess of the amounts recorded in the condensed consolidated balance sheets. The most significant off-balance sheet arrangements that we engage in result from the mortgage loan securitization and resecuritization transactions that we routinely enter into as part of the normal course of our business operations. We also hold limited partnership interests in LIHTC partnerships that are established to finance the construction or development of low-income affordable multifamily housing and other limited partnerships. LIHTC and other limited partnerships may involve off-balance sheet entities, some of which are consolidated on our balance sheets and some of which are accounted for under the equity method.

Fannie Mae MBS Transactions and Other Financial Guaranties

Table 21 presents a summary of our on- and off-balance sheet Fannie Mae MBS and other guaranties as of September 30, 2007 and December 31, 2006.

Table 21: On- and Off-Balance Sheet MBS and Other Guaranty Arrangements

	As of September 30, 2007	As of December 31, 2006
	(Dollars in millions)	
Fannie Mae MBS and other guaranties outstanding[1]	$ 2,214,180	$ 1,996,941
Less: Fannie Mae MBS held in portfolio[2]	175,290	199,644
Fannie Mae MBS held by third parties and other guaranties	$ 2,038,890	$ 1,797,297

(1) Includes $35.5 billion and $19.7 billion in unpaid principal balance of other guaranties as of September 30, 2007 and December 31, 2006, respectively. Excludes $99.1 billion and $105.6 billion in unpaid principal balance of consolidated Fannie Mae MBS as of September 30, 2007 and December 31, 2006, respectively.

(2) Amounts represent unpaid principal balance and are recorded in Investments in securities in our condensed consolidated balance sheets.

LIHTC Partnership Interests

As of September 30, 2007, we had a recorded investment in LIHTC partnerships of $8.0 billion, compared with $8.8 billion as of December 31, 2006. In March 2007, we sold a portfolio of investments in LIHTC partnerships reflecting approximately $676 million in future LIHTC tax credits and the release of future capital obligations relating to the investments. In July 2007, we sold a portfolio of investments in LIHTC partnerships reflecting approximately $254 million in future LIHTC tax credits and the release of future capital obligations relating to the investments. For additional information regarding our holdings in off-balance sheet limited partnerships, refer to Notes to Condensed Consolidated Financial Statements Note 2, Consolidations.

RISK MANAGEMENT

Credit Risk Management

Mortgage Credit Risk Management

Mortgage credit risk is the risk that a borrower will fail to make required mortgage payments. We are exposed to credit risk on our mortgage credit book of business because we either hold the mortgage assets or have issued a guaranty in connection with the creation of Fannie Mae MBS backed by mortgage assets.

Mortgage Credit Book of Business

Table 22 displays the composition of our entire mortgage credit book of business, which consists of both on- and off-balance sheet arrangements, as of September 30, 2007 and December 31, 2006. Our single-family mortgage credit book of business accounted for approximately 94% of our entire mortgage credit book of business as of both September 30, 2007 and December 31, 2006.

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Table 22: Composition of Mortgage Credit Book of Business

	As of September 30, 2007					
	Single-Family[1]		Multifamily[2]		Total	
	Conventional[3]	Government[4]	Conventional[3]	Government[4]	Conventional[3]	Government[4]
	(Dollars in millions)					
Mortgage portfolio:[5]						
Mortgage loans[6]	$ 298,854	$ 23,101	$ 76,606	$ 859	$ 375,460	$ 23,960
Fannie Mae MBS	172,518	2,246	312	214	172,830	2,460
Agency mortgage-related securities[7]	30,898	1,723		50	30,898	1,773
Mortgage revenue bonds	3,186	2,896	7,616	2,458	10,802	5,354
Other mortgage-related securities[8]	80,692	968	23,350	31	104,042	999
Total mortgage portfolio	586,148	30,934	107,884	3,612	694,032	34,546
Fannie Mae MBS held by third parties[9]	1,948,986	15,467	37,780	1,149	1,986,766	16,616
Other credit guaranties[10]	18,638		16,810	60	35,448	60
Mortgage credit book of business	$ 2,553,772	$ 46,401	$ 162,474	$ 4,821	$ 2,716,246	$ 51,222
Guaranty book of business[11]	$ 2,438,996	$ 40,814	$ 131,508	$ 2,282	$ 2,570,504	$ 43,096

	As of December 31, 2006					
	Single-Family[1]		Multifamily[2]		Total	
	Conventional[3]	Government[4]	Conventional[3]	Government[4]	Conventional[3]	Government[4]
	(Dollars in millions)					
Mortgage portfolio:[5]						
Mortgage loans[6]	$ 302,597	$ 20,106	$ 59,374	$ 968	$ 361,971	$ 21,074
Fannie Mae MBS	198,335	709	277	323	198,612	1,032
Agency mortgage-related securities[7]	29,987	1,995		56	29,987	2,051
Mortgage revenue bonds	3,394	3,284	7,897	2,349	11,291	5,633
Other mortgage-related securities[8]	85,339	2,084	9,681	177	95,020	2,261
Total mortgage portfolio	619,652	28,178	77,229	3,873	696,881	32,051
Fannie Mae MBS held by third parties[9]	1,714,815	19,069	42,184	1,482	1,756,999	20,551
Other credit guaranties[10]	3,049		16,602	96	19,651	96

Mortgage credit book of business	$	2,337,516	$	47,247	$	136,015	$	5,451	$	2,473,531	$	52,698
Guaranty book of business[11]	$	2,218,796	$	39,884	$	118,437	$	2,869	$	2,337,233	$	42,753

(1) The amounts reported reflect our total single-family mortgage credit book of business. Of these amounts, the portion of our conventional single-family mortgage credit book of business for which we have access to detailed loan-level information represented approximately 95% of our total conventional single-family mortgage credit book of business as of both September 30, 2007 and December 31, 2006. Unless otherwise noted, the credit statistics we provide in the Mortgage Credit Risk Management discussion that follows relate only to this specific portion of our conventional single-family mortgage credit book of business. The remaining portion of our single-family mortgage credit book of business consists of non-Fannie Mae mortgage-related securities backed by single-family mortgage loans, credit enhancements that we provide on single-family mortgage assets and all other single-family government related loans and securities. Non-Fannie Mae mortgage-related securities held in our portfolio include Freddie Mac securities, Ginnie Mae securities, private-label mortgage-related securities, Fannie Mae MBS backed by private-label mortgage-

related securities, and housing-related municipal revenue bonds. Our Capital Markets group prices and manages credit risk related to this specific portion of our single-family mortgage credit book of business. We may not have access to detailed loan-level data on these particular mortgage-related assets and therefore may not manage the credit performance of individual loans. However, a substantial majority of these securities benefit from significant forms of credit enhancement, including guaranties from Ginnie Mae or Freddie Mac, insurance policies, structured subordination and similar sources of credit protection. All non-Fannie Mae agency securities held in our portfolio as of September 30, 2007 and December 31, 2006 were rated AAA/Aaa by Standard & Poor s and Moody s. Over 90% of non-agency mortgage-related securities held in our portfolio as of both September 30, 2007 and December 31, 2006 were rated AAA/Aaa by Standard & Poor s and Moody s.

(2) The amounts reported reflect our total multifamily mortgage credit book of business. Of these amounts, the portion of our multifamily mortgage credit book of business for which we have access to detailed loan-level information represented approximately 78% and 84% of our total multifamily mortgage credit book as of September 30, 2007 and December 31, 2006, respectively. Unless otherwise noted, the credit statistics we provide in the Mortgage Credit Risk Management discussion that follows relate only to this specific portion of our multifamily mortgage credit book of business.

(3) Refers to mortgage loans and mortgage-related securities that are not guaranteed or insured by the U.S. government or any of its agencies.

(4) Refers to mortgage loans and mortgage-related securities guaranteed or insured by the U.S. government or one of its agencies.

(5) Mortgage portfolio data is reported based on unpaid principal balance.

(6) Includes unpaid principal totaling $100.0 billion and $105.5 billion as of September 30, 2007 and December 31, 2006, respectively, related to mortgage-related securities that were consolidated under FIN 46R and mortgage-related securities created from securitization transactions that did not meet the sales criteria under SFAS 140, which effectively resulted in mortgage-related securities being accounted for as loans.

(7) Consists of mortgage-related securities issued by Freddie Mac and Ginnie Mae.

(8) Consists of mortgage-related securities issued by entities other than Fannie Mae, Freddie Mac or Ginnie Mae.

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

(10) Includes single-family and multifamily credit enhancements that we have provided and that are not otherwise reflected in the table.

(11) Consists of mortgage loans held in our portfolio, Fannie Mae MBS held in our portfolio, Fannie Mae MBS held by third parties and other credit guaranties. Excludes agency mortgage-related securities, mortgage revenue bonds and other mortgage-related securities held in our portfolio for which we do not provide a guaranty.

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Single-Family

Table 23 provides information on the product distribution of our conventional single-family business volumes for the three months ended September 30, 2007 and 2006, and our conventional single-family mortgage credit book of business as of September 30, 2007 and December 31, 2006.

Table 23: Product Distribution of Conventional Single-Family Business Volume and Mortgage Credit Book of Business[(1)]

	Percent of Business Volume[(2)] For the Three Months Ended September 30,		Percent of Book of Business[(3)] As of	
	2007	**2006**	**September 30, 2007**	**December 31, 2006**
Fixed-rate:				
Long-term	74%	69%	70%	68%
Intermediate-term	5	7	15	18
Interest-only	9	6	3	1
Total fixed-rate	88	82	88	87
Adjustable-rate:				
Interest-only	7	9	5	4
Negative-amortizing	1	4	1	2
Other ARMs	4	5	6	7
Total adjustable-rate	12	18	12	13
Total	100%	100%	100%	100%

(1) As noted in Table 22 above, we generally have access to detailed loan-level statistics only on conventional single-family mortgage loans held in our portfolio and backing Fannie Mae MBS (whether held in our portfolio or held by third parties).

(2) Percentages calculated based on unpaid principal balance of loans at time of acquisition. Single-family business volume refers to both single-family mortgage loans we purchase for our mortgage portfolio and single-family mortgage loans we securitize into Fannie Mae MBS.

(3) Percentages calculated based on unpaid principal balance of loans as of the end of each period.

Fixed-Rate and ARM Loans: As presented in Table 23 above, our conventional single-family mortgage credit book of business continues to consist mostly of long-term fixed-rate mortgage loans. In addition, a greater proportion of our conventional single-family business volumes consisted of fixed-rate loans for the third quarter of 2007, as compared with the third quarter of 2006.

Alt-A Loans: An Alt-A mortgage loan generally refers to a loan that can be underwritten with lower or alternative documentation than a full documentation mortgage loan but that may also include other alternative product features. Alt-A mortgage loans generally have a higher risk of default than non-Alt-A mortgage loans. In reporting our Alt-A exposure, we have classified mortgage loans as Alt-A if the lenders that deliver the mortgage loans to us have classified the loans as Alt-A based on documentation or other product features. As of September 30, 2007, we estimate that approximately 12% of our total single-family mortgage credit book of business consisted of Alt-A mortgage loans or Fannie Mae MBS backed by Alt-A mortgage loans. During 2007, we restricted our eligibility standards for Alt-A mortgage loans eligible for delivery to us. Our acquisitions of Alt-A mortgage loans have a combination of credit enhancement and pricing that we believe adequately reflects the higher credit risk posed by these mortgages. We will determine the timing and level of our acquisition of Alt-A mortgage loans in the future based on our assessment of the availability and cost of credit enhancement with adequate levels of pricing to compensate for the risks.

Subprime Loans: A subprime mortgage loan generally refers to a mortgage loan made to a borrower with a weaker credit profile than that of a prime borrower. As a result of the weaker credit profile, subprime borrowers have a higher likelihood of default than prime borrowers. Subprime mortgage loans are typically originated by lenders specializing in this type of business or by subprime divisions of large lenders, using processes unique to subprime loans. In reporting our subprime exposure, we have classified mortgage loans as subprime if the mortgage loans are originated by one of these specialty lenders or a subprime division of a large lender. Approximately 0.3% of our total single-family mortgage credit book of business as of September 30, 2007 consisted of subprime mortgage loans or Fannie Mae MBS backed by subprime mortgage loans. Less than 1% of our single-family business volume for the nine months ended September 30, 2007 consisted of subprime mortgage loans or Fannie Mae MBS backed by subprime mortgage loans. Our acquisitions of subprime mortgage loans have a combination of credit enhancement and pricing that we believe adequately reflects the higher credit risk posed by these mortgages. In order to respond to the current subprime mortgage crisis and provide liquidity to the market, we intend to increase our purchase of subprime mortgages. We will determine the timing and level of our acquisition of subprime mortgage loans in the future based on our assessment of the availability and cost of credit enhancement with adequate levels of pricing to compensate for the risks.

Alt-A and Subprime Securities: We held approximately $106.2 billion in non-Fannie Mae structured mortgage-related securities in our investment portfolio as of September 30, 2007. Of this amount, $76.2 billion consisted of private-label mortgage-related securities backed by subprime or Alt-A mortgage loans. As of September 30, 2007, we held in our investment portfolio approximately $33.8 billion in private-label mortgage-related securities backed by Alt-A mortgage loans and approximately $42.4 billion in private-label mortgage-related securities backed by subprime mortgage loans. We also guaranteed approximately $6.2 billion in resecuritized subprime mortgage-related securities as of September 30, 2007. Approximately $18.6 billion of these Alt-A- and subprime-backed private-label mortgage-related securities were classified as trading securities in our condensed consolidated balance sheets as of September 30, 2007. In reporting our Alt-A and subprime exposure, we have classified private-label mortgage-related securities as Alt-A or subprime if the securities were labeled as such when issued.

To date, we generally have focused our purchases of private-label mortgage-related securities backed by subprime or Alt-A loans on the highest-rated tranches of these securities available at the time of acquisition. For our private-label mortgage-related securities backed by subprime loans that were rated AAA at acquisition, the weighted average credit enhancement, which is predominantly in the form of subordination, is 32%. In 2007, we began to acquire a limited amount of subprime-backed private-label mortgage-related securities of investment grades below AAA. As of September 30, 2007, approximately $441 million in unpaid principal balance, or 1%, of the subprime-backed private-label mortgage-related securities in our portfolio had a credit rating of less than AAA. All of these subprime-backed mortgage-related securities with a credit rating of less than AAA were classified as trading securities in our condensed consolidated balance sheets as of September 30, 2007.

In October 2007, the credit ratings of nine subprime private-label mortgage-related securities held in our portfolio, with an aggregate unpaid principal balance of $263 million as of September 30, 2007, were downgraded by Standard & Poor s. One of these downgraded securities, with an unpaid principal balance of $178 million as of September 30, 2007, classified as available-for-sale, was downgraded from AAA to AA. The other eight downgraded securities, with an aggregate unpaid principal balance of $85 million as of September 30, 2007, are classified as trading. Prior to these downgrades, these eight securities had credit ratings that were less than AAA. During October 2007 and through November 8, 2007, seven of our AAA-rated subprime private-label mortgage-related securities, with an aggregate unpaid principal balance of approximately $1.3 billion, have been put under review for possible credit rating downgrade or on negative watch. As of November 8, 2007, all of these securities continue to be rated AAA. Of these securities, one security with an unpaid principal balance of $255 million is classified as trading, while the remaining six securities, with an aggregate unpaid principal balance of $1.0 billion, are classified as available-for-sale.

We have not recorded any impairment of the securities classified as available-for-sale, as they continue to be rated investment grade and we have the intent and ability to hold these securities until the earlier of recovery of the unrealized amounts or maturity. As of November 8, 2007, all of our private-label mortgage-related securities backed by Alt-A mortgage loans were rated AAA and none had been downgraded or placed under review for possible downgrade.

For the nine months ended September 30, 2007, we estimate that the fair value of the subprime private-label mortgage-related securities held in our portfolio decreased by $896 million. Of this decrease, $285 million related to securities classified as trading and is therefore reflected in our earnings as losses on trading securities, which are recorded as a component of Investment gains (losses), net, for the nine months ended September 30, 2007. The remaining $611 million of this decrease related to securities classified as available-for-sale and is therefore reflected after-tax in AOCI. In addition, we estimate that the fair value of the Alt-A private-label mortgage-related securities held in our portfolio decreased by $344 million for the nine months ended September 30, 2007. Of this decrease, $91 million was reflected in our earnings as losses on trading securities.

Credit Characteristics: The weighted average credit score, the weighted average original loan-to-value ratio and the weighted average estimated mark-to-market loan-to-value ratio for our conventional single-family mortgage credit book of business were 721, 71% and 59%, respectively, as of September 30, 2007, as compared with 721, 70% and 55% , respectively, as of December 31, 2006. Approximately 16% of our conventional single-family mortgage credit book of business had an estimated mark-to-market loan-to-value ratio greater than 80% as of September 30, 2007, up from 10% as of December 31, 2006.

Multifamily

As of September 30, 2007, the weighted average original loan-to-value ratio for our multifamily mortgage credit book of business remained at 68%, and the percentage of our multifamily mortgage credit book of business with an original loan-to-value ratio greater than 80% remained at 6%.

Serious Delinquency

The serious delinquency rate is an indicator of potential future foreclosures, although most loans that become seriously delinquent do not result in foreclosure. Table 24 below compares the serious delinquency rates for all conventional single-family loans and multifamily loans with credit enhancements and without credit enhancements.

Table 24: Serious Delinquency Rates

	September 30, 2007		December 31, 2006		September 30, 2006	
	Book Outstanding[(1)]	Serious Delinquency Rate[(2)]	Book Outstanding[(1)]	Serious Delinquency Rate[(2)]	Book Outstanding[(1)]	Serious Delinquency Rate[(2)]
Conventional single-family delinquency rates by geographic region:[(3)]						
Midwest	17%	1.14%	17%	1.01%	17%	0.94%
Northeast	19	0.79	19	0.67	19	0.62
Southeast	25	0.88	24	0.68	24	0.64
Southwest	16	0.69	16	0.69	16	0.69
West	23	0.33	24	0.20	24	0.17
Total conventional single-family loans	100%	0.78%	100%	0.65%	100%	0.61%
Conventional single-family loans:						
Credit enhanced	20%	2.18%	19%	1.81%	19%	1.74%
Non-credit enhanced	80	0.43	81	0.37	81	0.35
Total conventional single-family loans	100%	0.78%	100%	0.65%	100%	0.61%
Multifamily loans:						
Credit enhanced	89%	0.08%	96%	0.07%	96%	0.13%
Non-credit enhanced	11	0.11	4	0.35	4	0.12
Total multifamily loans	100%	0.08%	100%	0.08%	100%	0.12%

(1) Reported based on unpaid principal balance of loans, where we have detailed loan-level information.

(2) Calculated based on number of loans for single-family and unpaid principal balance for multifamily. We include all of the conventional single-family loans that we own and that back Fannie Mae MBS in the calculation of the single-family delinquency rate. We include the unpaid principal balance of all multifamily loans that we own or that back Fannie Mae MBS and any housing bonds for which we provide credit enhancement in the calculation of the multifamily serious delinquency rate.

(3) Midwest consists of IL, IN, IA, MI, MN, NE, ND, OH, SD and WI. Northeast includes CT, DE, ME, MA, NH, NJ, NY, PA, PR, RI, VT and VI. Southeast consists of AL, DC, FL, GA, KY, MD, MS, NC, SC, TN, VA and WV. Southwest consists of AZ, AR, CO, KS, LA, MO, NM, OK, TX and UT. West consists of AK, CA, GU, HI, ID, MT, NV, OR, WA and WY.

The increase in our single-family serious delinquency rate as of September 30, 2007 from our rate as of September 30, 2006 was due to continued economic weakness in the Midwest, particularly in Ohio, Michigan and Indiana, and to the continued housing market downturn and decline in home prices throughout much of the country. We have experienced increases in serious delinquency rates across our conventional single-family mortgage credit book, including in higher risk loan categories, such as subprime loans, Alt-A loans, adjustable-rate loans, interest-only loans, loans made for the purchase of investment properties, negative-amortizing loans, loans to borrowers with lower credit scores and loans with high loan-to-value ratios. We have seen particularly rapid increases in serious delinquency rates in some higher risk loan categories, such as Alt-A loans, interest-only loans, loans with subordinate financing and loans made for the purchase of condominiums. Many of these higher risk loans were originated in 2006 and the first half of 2007. We have also experienced a significant increase in delinquency rates in loans originated in California, Florida, Nevada and Arizona. These states had previously experienced very rapid home price appreciation and are now experiencing home price declines. The conventional single-family serious delinquency rates for California and Florida, which represent the two largest states in our single-family mortgage credit book of business in terms of unpaid principal balance, climbed to 0.30% and 0.99%, respectively, as of September 30, 2007, from 0.11% and 0.37%, respectively, as of September 30, 2006. We expect the housing market to continue to deteriorate

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and home prices to continue to decline in these states and on a national basis. Accordingly, we expect our single-family serious delinquency rate to continue to increase for the remainder of 2007 and in 2008.

The decline in our multifamily serious delinquency rate as of September 30, 2007 from our rate as of September 30, 2006 was due primarily to payoffs and the resolution of problems associated with loans secured by properties affected by Hurricane Katrina.

Foreclosure and REO Activity

Foreclosure and real estate owned (REO) activity affect the level of our credit losses. Table 25 below provides information, by region, on our foreclosure activity for the first nine months of 2007 and 2006. Regional REO acquisition and charge-off trends generally follow a pattern that is similar to, but lags, that of regional delinquency trends.

Table 25: Single-Family and Multifamily Foreclosed Properties

	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006
Single-family foreclosed properties (number of properties):		
Beginning of year inventory of single-family foreclosed properties (REO)[1]	25,125	20,943
Acquisitions by geographic area:[2]		
Midwest	14,754	11,799
Northeast	2,826	1,944
Southeast	8,559	6,857
Southwest	7,230	5,858
West	1,586	408
Total properties acquired through foreclosure	34,955	26,866
Dispositions of REO	(30,456)	(23,743)
End of period inventory of single-family foreclosed properties (REO)[1]	29,624	24,066
Carrying value of single-family foreclosed properties (dollars in millions)[3]	$ 2,913	$ 1,905
Single-family foreclosure rate[4]	0.2%	0.2%
Multifamily foreclosed properties (number of properties):		
Ending inventory of multifamily foreclosed properties (REO)	12	9
Carrying value of multifamily foreclosed properties (dollars in millions)[3]	$ 63	$ 57

(1) Includes deeds in lieu of foreclosure.

(2) See footnote 3 to Table 24 for states included in each geographic region.

(3) Excludes foreclosed property claims receivables, which are reported in our condensed consolidated balance sheets as a component of Acquired property, net.

(4) Estimated based on the total number of properties acquired through foreclosure as a percentage of the total number of loans in our conventional single-family mortgage credit book as of the end of each respective period.

The increase in foreclosures during the first nine months of 2007 was driven by the housing market downturn and the continued impact of weak economic conditions in the Midwest, particularly Ohio, Indiana and Michigan. The Midwest accounted for approximately 20% of the loans in our conventional single-family mortgage credit book of business as of December 31, 2006; however, this region accounted for approximately 42% of the single-family properties we acquired through foreclosure during the first nine months of 2007.

The continued weakness in regional economic conditions in the Midwest and the continued housing market downturn and decline in home prices on a national basis has resulted in a higher percentage of our mortgage loans that transition from delinquent to foreclosure status, as well as a faster transition from delinquent to foreclosure status, particularly for loans originated in 2006 and 2007. In addition, the combined effect of the disruption in the subprime market, the overall erosion of property values and near record levels of unsold properties have slowed the sale of, and reduced the sales prices of, our foreclosed single-family properties. As a result, we expect an increase in our overall level of foreclosures and credit losses for 2007 as compared with 2006. We believe that our level of foreclosures and credit losses is likely to continue to increase in 2008.

Credit Losses

Credit losses consist of (1) charge-offs, excluding losses on delinquent loans we purchase from our MBS trusts, net of recoveries, plus (2) foreclosed property expense. Table 26 below presents credit losses for the three and nine months ended September 30, 2007 and 2006.

Table 26: Credit Loss Performance

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2007	Rate[(1)]	2006	Rate[(1)]	2007	Rate[(1)]	2006	Rate[(1)]
	(Dollars in millions)							
Charge-offs, net of recoveries	$ 838	12.3bp	$ 104	1.7bp	$ 1,222	6.2bp	$ 330	1.8bp
Foreclosed property expense	113	1.7	52	0.8	269	1.3	89	0.5
Less excess of purchase price over fair value of delinquent loans purchased from trusts[(2)]	(670)	(9.9)	(37)	(0.6)	(805)	(4.1)	(153)	(0.8)
Impact of SOP 03-3 on charge-offs and foreclosed property expense[(3)]	62	0.9	20	0.4	113	0.6	56	0.3
Credit losses[(4)(5)]	$ 343	5.0bp	$ 139	2.3bp	$ 799	4.0bp	$ 322	1.8bp

(1) Based on annualized amount for line item presented divided by the average total mortgage credit book of business during the period.

(2) Represents the amount we record as a loss when the purchase price we pay to purchase delinquent loans from Fannie Mae MBS trusts exceeds the fair value of the loan at the time of purchase. Under our MBS trust agreements, we have the option to purchase loans from the MBS trust, at par plus accrued interest, if four or more consecutive monthly payments have not been made. When we purchase a delinquent loan from one of our MBS trusts, we record the delinquent loan at the lower of the loan s acquisition price or its fair value in accordance with SOP 03-3. To the extent that the purchase price of the loan exceeds the fair value of the loan, we recognize a loss at the time we acquire the loan.

(3) Represents the impact of previously recorded SOP 03-3 reductions to the amount of charge-offs and foreclosed property expense for delinquent loans purchased from MBS trusts that go to foreclosure. Because the carrying value of these loans has been reduced below the purchase price, any charge-off and foreclosed property expense amounts that we record if we foreclose on the mortgage also are reduced. In order to reflect in our credit losses the total loss associated with SOP 03-3 loans that we subsequently determine are uncollectible, we have added back to our credit losses the loss we record at the date of purchase when the fair value is below the purchase price.

(4) Excludes impact of excess of purchase price over fair value of delinquent loans purchased from trusts.

(5) Interest forgone on nonperforming loans in our mortgage portfolio reduces our net interest income but is not reflected in our credit losses total. In addition, other-than-temporary impairment resulting from deterioration in credit quality of our mortgage-related securities is not included in our credit losses total.

The decline in home prices on a national basis during the first nine months of 2007 contributed to higher default rates and loss severities, causing an increase in charge-offs and foreclosed property expense for the first nine months of 2007. In addition, we experienced a substantial increase in losses recorded on delinquent loans we purchased from our MBS trusts during the third quarter of 2007, as the disruption in the mortgage credit market and the continued decline in home prices substantially reduced the fair value of the delinquent loans we purchased from our MBS trusts.

We have revised our presentation of credit losses to reflect only our realized credit losses. Accordingly, we have excluded from our credit losses, and from our credit loss ratio, any initial losses that we are required to record pursuant to SOP 03-3 when the purchase price of delinquent loans that we purchase from Fannie Mae MBS trusts exceeds the fair value of the loans at the time of purchase. These initial losses affect our provision for credit losses and are reported as a component of our charge-offs, net of recoveries in our condensed consolidated financial statements.

In our 2006 Form 10-K, we provided an estimate that our credit loss ratio for 2007 would be within a range of 4 to 6 basis points. As of the date of this filing, we believe our credit loss ratio for 2007, based on our credit losses as reported in Table 26, will remain within our normal historical average range of 4 to 6 basis points. In certain periods, we expect our credit loss ratio is likely to move outside of this historical average range, primarily due to market conditions and the risk profile of our mortgage credit book of business. We expect that, in 2008, our credit loss ratio will increase above our normal historical average range of 4 to 6 basis points.

Pursuant to our September 1, 2005 agreement with OFHEO, we agreed to disclose on a quarterly basis the estimated impact on our expected credit losses from an immediate 5% decline in single-family home prices for the entire United States, which we believe is a stressful scenario based on housing data from OFHEO. Table 27 shows our single-family credit loss sensitivity, before and after consideration of the effect of projected credit risk sharing proceeds, such as private mortgage insurance claims and other credit enhancement, as of September 30, 2007, June 30, 2007, March 31, 2007 and December 31, 2006. The significant increase in the net credit loss sensitivity that occurred during the first nine months of 2007 from the end of 2006 was primarily attributable to the decline in home prices during the first nine months of 2007.

Table 27: Single-Family Credit Loss Sensitivity[1]

	As of			
	September 30, 2007	**June 30, 2007**	**March 31, 2007**	**December 31, 2006**
	(Dollars in millions)			
Gross credit loss sensitivity[2]	$ 5,808	$ 5,185	$ 4,258	$ 3,887
Less: Projected credit risk sharing proceeds	(2,969)	(2,577)	(2,069)	(1,926)
Net credit loss sensitivity	$ 2,839	$ 2,608	$ 2,189	$ 1,961
Single-family whole loans and Fannie Mae MBS	$ 2,421,550	$ 2,333,256	$ 2,260,575	$ 2,203,246
Single-family net credit loss sensitivity as a percentage of single-family whole loans and Fannie Mae MBS	0.12%	0.11%	0.10%	0.09%

(1) Represents total economic credit losses, which include net charge-offs/recoveries, foreclosed property expenses, forgone interest and the cost of carrying foreclosed properties. Excludes amounts recorded as losses in accordance with SOP 03-3 when the purchase price we pay to purchase delinquent loans from Fannie Mae MBS trusts exceeds the fair value of the loan at the time of purchase. Calculations based on approximately 93% of our total single-family mortgage credit book of business as of September 30, 2007, June 30, 2007, March 31, 2007 and 92% as of December 31, 2006. The mortgage loans and mortgage-related securities that are included in these estimates consist of: (i) single-family Fannie Mae MBS (whether held in our portfolio or held by third parties), excluding certain whole loan REMICs and private-label wraps; (ii) single-family mortgage loans, excluding mortgages secured only by second liens, subprime mortgages, manufactured housing chattel loans and reverse mortgages; and (iii) long-term standby commitments. We expect the inclusion in our estimates of the

excluded products may impact the estimated sensitivities set forth in the preceding paragraphs.

(2) Reflects the gross sensitivity of our expected future credit losses to an immediate 5% decline in home values for first lien single-family whole loans we own or that back Fannie Mae MBS. After the initial shock, we estimate home price growth rates return to the rate projected by our credit pricing models.

Allowance for Loan Losses and Reserve for Guaranty Losses

The combined allowance for loan losses and reserve for guaranty losses increased to $1.4 billion as of September 30, 2007, from $859 million as of December 31, 2006. This increase was due to higher charge-offs, attributable to the increase in loan loss severities and default rates due to the national decline in home prices and the impact of continued economic weakness in the Midwest.

OFHEO Direction on Interagency Guidance on Nontraditional Mortgages and Subprime Lending

In September 2006, five federal financial regulatory agencies jointly issued Interagency Guidance on Nontraditional Mortgage Product Risks to address risks posed by mortgage products that allow borrowers to defer repayment of principal or interest, and the layering of risks that results from combining these product types with other features that may compound risk. In June 2007, the same financial regulatory agencies issued the Statement on Subprime Mortgage Lending, which addresses risks relating to certain subprime mortgages. The September 2006 and June 2007 interagency guidance directed regulated financial institutions that originate nontraditional and subprime mortgage loans to follow prudent lending practices, including safe and sound underwriting practices and providing borrowers with clear and balanced information about the relative benefits and risks of these products sufficiently early in the process to enable them to make informed decisions.

OFHEO directed us to apply the risk management, underwriting and consumer protection principles of both the September 2006 and June 2007 interagency guidance to the mortgage loans and mortgage-related securities that we acquire for our portfolio and for securitization into Fannie Mae MBS. Accordingly, we have made changes to our underwriting standards implementing the interagency guidance. In addition to the changes made to implement the interagency guidance, we have tightened loan eligibility in most high risk loan categories. We are actively managing our single-family eligibility standards and pricing to account for rapidly changing market conditions.

Institutional Counterparty Credit Risk Management

Institutional counterparty risk is the risk that institutional counterparties may be unable to fulfill their contractual obligations to us. Our primary exposure to institutional counterparty risk exists with our lending partners and servicers, mortgage insurers, dealers who distribute our debt securities or who commit to sell mortgage pools or loans, issuers of investments included in our liquid investment portfolio, and derivatives counterparties. Refer to Part I Item 1A Risk Factors of our 2006 Form 10-K, filed with the SEC on August 16, 2007, as updated by Part II Item 1A Risk Factors of this report for a description of the risks associated with our institutional counterparties.

Mortgage Insurers

As of September 30, 2007, we were the beneficiary of primary mortgage insurance coverage on $329.0 billion of single-family loans in our portfolio or underlying Fannie Mae MBS, which represented approximately 14% of our single-family mortgage credit book of business, compared with $272.1 billion, or approximately 12%, of our single-family mortgage credit book of business as of December 31, 2006. In addition, as of September 30, 2007, we were the beneficiary of pool mortgage insurance coverage on $128.3 billion of single-family loans, including conventional and government loans, in our portfolio or underlying Fannie Mae MBS, compared with $106.6 billion as of December 31, 2006.

Two of our seven primary mortgage insurers have recently had their external ratings for claims paying ability or insurer financial strength downgraded by Fitch from AA to AA-. Both have maintained their Standard & Poor s and Moody s ratings of AA and Aa3, respectively. As of September 30, 2007, these two mortgage insurers provided primary and pool mortgage insurance coverage on $59.1 billion and $27.8 billion, respectively, of the single-family loans in our portfolio or underlying Fannie Mae MBS, which represented approximately 2% and 1%, respectively, of our single-family mortgage credit book of business. Ratings downgrades imply an increased risk that these mortgage insurers will fail to fulfill their obligations to reimburse us for claims under insurance policies. We continue to closely monitor our exposure to our mortgage insurer counterparties.

Before we consider an insurer to be a qualified mortgage insurer, we generally require that an insurer obtain and maintain external ratings of claims paying ability of at least Aa3 from Moody s and AA- from Standard & Poor s and

Fitch. If a mortgage insurer were downgraded below AA-/Aa3 by any of the three national rating agencies, we would evaluate the insurer, the current market environment and our alternative sources of credit enhancement. Based on the outcome of our evaluation, we could restrict that insurer from conducting certain types of business with us and we may take actions that may include not purchasing loans insured by that mortgage insurer. Restricting our business activity with one or more of the seven primary mortgage insurers would increase our concentration risk with the remaining insurers in the industry.

Recent Events Relating to Lender Customers and Mortgage Servicers

Mortgage and credit market conditions deteriorated rapidly in the third quarter of 2007. Factors negatively affecting the mortgage and credit markets in recent months include significant volatility, lower levels of liquidity, wider credit spreads, rating agency downgrades and significantly higher levels of mortgage foreclosures and delinquencies, particularly with respect to subprime mortgage loans. These challenging market conditions have adversely affected, and are expected to continue to adversely affect, the liquidity and financial condition of a number of our lender customers and mortgage servicers. Several of our lender customers and servicers have experienced ratings downgrades and liquidity constraints, including Countrywide Financial Corporation and its affiliates, our largest lender customer and servicer. The weakened financial condition and liquidity position of some of our lender customers and mortgage servicers may negatively affect their ability to perform their obligations to us and the quality of the services that they provide to us. In addition, our arrangements with our lender customers and mortgage servicers could result in significant exposure to us if any one of our significant lender customers were to default or experience a serious liquidity event. The failure of any of our primary lender customers or mortgage servicers to meet their obligations to us could have a material adverse effect on our results of operations and financial condition.

In response to these market conditions, we have increased the frequency and depth of our counterparty monitoring, including targeting higher risk counterparties for additional financial and on-site reviews. We have also changed the assumptions of our stress analyses to reflect deteriorating market conditions and are implementing measures to reduce our potential loss exposure to some of our higher risk counterparties.

Interest Rate Risk Management and Other Market Risks

Market risk represents the exposure to potential changes in the fair value of our net assets from changes in prevailing market conditions. A significant market risk we face and actively manage for our net portfolio is interest rate risk the risk of changes in our long-term earnings or in the value of our net assets due to changes in interest rates. Our net portfolio consists of our existing investments in mortgage assets, investments in non-mortgage securities, our outstanding debt used to fund those assets, and the derivatives used to supplement our debt instruments and manage interest rate risk. It also includes any priced asset, debt and derivatives commitments, but excludes our existing guaranty business. Our Capital Markets group, which has primary responsibility for managing the interest rate risk of our net portfolio, employs an integrated interest rate risk management strategy that includes asset selection and structuring of our liabilities, including debt and derivatives, to match and offset the interest rate characteristics of our balance sheet assets and liabilities as much as possible.

Derivatives Activity

The primary tool we use to manage the interest rate risk implicit in our mortgage assets is the variety of debt instruments we issue. We supplement our issuance of debt with derivative instruments, which are an integral part of our strategy in managing interest rate risk. Table 28 presents, by derivative instrument type, our risk management derivative activity for the nine months ended September 30, 2007, along with the stated maturities of derivatives outstanding as of September 30, 2007.

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Table 28: Activity and Maturity Data for Risk Management Derivatives[1]

	Interest Rate Swaps				Interest Rate Swaptions				
	Pay-Fixed[2]	Receive-Fixed[3]	Basis[4]	Foreign Currency	Pay-Fixed	Receive-Fixed	Interest Rate Caps	Other[5]	Tota
	(Dollars in millions)								
nal balance									
nber 31,									
	$ 268,068	$ 247,084	$ 950	$ 4,551	$ 95,350	$ 114,921	$ 14,000	$ 469	$ 745
ons	153,321	115,994	7,951	791	3,120	22,408	100	255	303
nations[6]	(91,732)	(106,176)	(500)	(1,700)	(12,276)	(11,014)	(11,350)	(220)	(234
nal balance									
nber 30,									
	$ 329,657	$ 256,902	$ 8,401	$ 3,642	$ 86,194	$ 126,315	$ 2,750	$ 504	$ 814
maturities onal nts:[7]									
han 1 year	$ 14,530	$ 77,330	$	$ 2,269	$ 7,480	$ 13,530	$ 2,000	$	$ 117
to 5 years	146,872	125,023	25	504	41,514	36,415	750	194	351
s to 10 years	138,457	43,883	7,350		32,700	65,020		310	287
0 years	29,798	10,666	1,026	869	4,500	11,350			58
	$ 329,657	$ 256,902	$ 8,401	$ 3,642	$ 86,194	$ 126,315	$ 2,750	$ 504	$ 814
ted-average st rate as of nber 30,									
te	5.17%	5.48%	5.13%		6.25%				
ve rate	5.43%	5.17%	6.68%			4.86%			
							4.16%		
ted-average st rate as of nber 31,									
te	5.10%	5.35%	5.29%		6.18%				
ve rate	5.36%	5.01%	6.58%			4.92%			
							3.55%		

(1) Excludes mortgage commitments accounted for as derivatives. Dollars represent notional amounts, which indicate only the amount on which payments are being calculated and do not represent the amount at risk of loss.

(2) Notional amounts include swaps callable by Fannie Mae of $8.2 billion and $10.8 billion as of September 30, 2007 and December 31, 2006, respectively.

(3) Notional amounts include swaps callable by derivatives counterparties of $18.5 billion and $6.7 billion as of September 30, 2007 and December 31, 2006, respectively.

(4) Notional amounts include swaps callable by derivatives counterparties of $8.0 billion and $600 million as of September 30, 2007 and December 31, 2006, respectively.

(5) Includes MBS options, forward starting debt and swap credit enhancements.

(6) Includes matured, called, exercised, assigned and terminated amounts. Also includes changes due to foreign exchange rate movements.

(7) Based on contractual maturities.

The outstanding notional balance of our risk management derivatives increased by $69.0 billion during the first nine months of 2007, to $814.4 billion as of September 30, 2007, from $745.4 billion as of December 31, 2006. As the expected duration of our mortgage assets lengthened during the first nine months of 2007, we increased our net pay-fixed swap position to extend the duration of our liabilities to more closely match the expected duration of our mortgage assets.

Measuring Interest Rate Risk

Because no single measure can reflect all aspects of the interest rate risk inherent in our mortgage portfolio, we utilize various risk metrics that together provide a more complete assessment of our interest rate risk.

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Pursuant to our September 1, 2005 agreement with OFHEO, we committed to present to OFHEO proposals for enhanced and uniform public disclosures of our risk measures. Our proposals entailed reporting additional market risk measures with the filing of current financial statements. We now disclose on a monthly basis two interest rate risk sensitivity measures: (i) duration gap and (ii) fair value sensitivity to interest rate level and slope shock. We provide these measures in our Monthly Summary Report, which is submitted to the SEC in a Current Report on Form 8-K and made available on our Web site.

These interest rate risk measures are based on our net portfolio defined above. The measures exclude the interest rate sensitivity of our existing guaranty business. We discuss these measures below, and we also describe the potential effect of changes in interest rates and other market conditions on the fair value of our guaranty business.

Duration Gap

Duration measures the price sensitivity of our assets and liabilities to changes in interest rates by quantifying the difference between the estimated durations of our assets and liabilities. Duration gap summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time and across interest rate scenarios. A positive duration gap signals a greater exposure to rising interest rates because it indicates that the duration of our assets exceeds the duration of our liabilities. Our average effective monthly duration gap did not exceed plus or minus one month during the period December 2006 through September 2007 (the most recent date for which this information is available.) The table below presents our monthly effective duration gap for December 2006, March 2007, June 2007 and September 2007.

Month	Effective