FEDERAL NATIONAL MORTGAGE ASSOCIATION FANNIE MAE
Form 10-Q
November 05, 2009

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, 2009

OR

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

For the transition period from to

Commission File No.: 0-50231

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

Fannie Mae

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of September 30, 2009, there were 1,112,759,202 shares of common stock of the registrant outstanding.

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PART I FINANCIAL INFORMATION

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

We have been under conservatorship, with the Federal Housing Finance Agency (FHFA) acting as conservator, since September 6, 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of the company, and of any shareholder, officer or director of the company with respect to the company and its assets. The conservator has since delegated to our management and Board of Directors the authority to conduct our day-to-day operations. We describe the rights and powers of the conservator, the provisions of our agreements with the U.S. Department of Treasury (Treasury), and changes to our business, business strategies and objectives, corporate structure and liquidity since conservatorship in our Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K) in Part I Item 1 Business and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 (First Quarter 2009 Form 10-Q) and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (Second Quarter 2009 Form 10-Q).

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 2008 Form 10-K. This discussion contains forward-looking statements that are based upon management s current expectations and are subject to significant uncertainties and changes in circumstances. Our actual results may differ materially from those included in these forward-looking statements due to a variety of factors including, but not limited to, those described in this report in Part II Item 1A Risk Factors and in our 2008 Form 10-K in Part I Item 1A Risk Factors.

Please also refer to our 2008 Form 10-K in Part I Item 7 MD&A Glossary of Terms Used in This Report for an explanation of terms we use in this report.

INTRODUCTION

Fannie Mae is a government-sponsored enterprise (GSE) that was chartered by Congress in 1938. Fannie Mae has a public mission to support liquidity and stability in the secondary mortgage market, where existing mortgage loans are purchased and sold. We securitize mortgage loans originated by lenders in the primary mortgage market into mortgage-backed securities that we refer to as Fannie Mae MBS, which can then be bought and sold in the secondary mortgage market. We also participate in the secondary mortgage market by purchasing mortgage loans (often referred to as whole loans) and mortgage-related securities, including our own Fannie Mae MBS, for our mortgage portfolio. In addition, we make other investments that increase the supply of affordable housing. Under our charter, we may not lend money directly to consumers in the primary mortgage market. Although we are a corporation chartered by the U.S. Congress, and although our conservator is a U.S. government agency and Treasury owns our senior preferred stock and a warrant to purchase our common stock, the U.S. government does not guarantee, directly or indirectly, our securities or other obligations.

EXECUTIVE SUMMARY

Our Mission

In connection with our public mission to support liquidity and stability in the secondary mortgage market, and in addition to the investments we undertake to increase the supply of affordable housing, FHFA, as our conservator, and the Obama Administration have given us an important role in addressing housing and mortgage market conditions. As we discuss below in Our Business Objectives and Strategy, Homeowner Assistance Initiatives and Providing Mortgage Market Liquidity, pursuant to our mission, we are concentrating our efforts on keeping people in their homes and preventing foreclosures while continuing to support liquidity and stability in the secondary mortgage market.

Our Business Objectives and Strategy

Our Board of Directors and management consult with our conservator in establishing our strategic direction, taking into consideration our role in addressing housing and mortgage market conditions. FHFA has approved our business objectives.

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

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

We, therefore, regularly consult with and receive direction from our conservator on how to balance these objectives. Our pursuit of our mission creates conflicts in strategic and day-to-day decision-making that could hamper achievement of some or all of these objectives. Our financial results are likely to suffer, at least in the short term, as we expand our efforts to assist the mortgage market, thereby increasing the amount of funds that Treasury is required to provide to us and further limiting our ability to return to long-term profitability.

Pursuant to our mission, we currently are concentrating our efforts on keeping people in their homes and preventing foreclosures. We also are continuing our significant role in the secondary mortgage market through our guaranty business. These efforts are intended to support liquidity and affordability in the mortgage market, while we also work to implement foreclosure prevention programs. Currently, one of the principal ways in which we are pursuing these efforts is through our participation in the Obama Administration s Making Home Affordable Program. We provide an update on our participation in the Making Home Affordable Program below.

Concentrating our efforts on keeping people in their homes and preventing foreclosures while continuing to be active in the secondary mortgage market, rather than concentrating on returning to long-term profitability, is likely to contribute, at least in the short term, to additional financial losses and declines in our net worth. The ongoing adverse conditions in the housing and mortgage markets, along with the continuing deterioration throughout our book of business and the costs associated with these efforts pursuant to our mission, will increase the amount of funds that Treasury is required to provide to us. In turn, these factors put additional pressure on our ability to return to long-term profitability. If, however, the Making Home Affordable Program is successful in reducing foreclosures and keeping borrowers in their homes, it may benefit the overall housing market and help in reducing our long-term credit losses. Further, there is significant uncertainty regarding the future of our business, and our regulators, the Administration and Congress are discussing options for reform of the GSEs.

Housing and Mortgage Market and Economic Conditions

The U.S. residential mortgage market remained weak in the third quarter of 2009, which adversely affected our financial condition and results of operations. While home sales showed signs of beginning to stabilize in the second and third quarters of 2009, the number of mortgage delinquencies and mortgage foreclosures continued to increase.

We estimate that home prices on a national basis declined by 1.4% in the first nine months of 2009, although there was a slight increase in the second and third quarters of 2009. The second quarter typically is the highest growth quarter of the year because it is the peak home buying season. Accordingly, as described in Outlook, we believe that home prices will nonetheless continue to decline from current levels in the fourth quarter of 2009. We estimate that home prices on a national basis have declined by 15.6% from their peak in the third quarter of 2006. Our home price estimates are based on preliminary data and are subject to change as additional data become available.

The economic recession that started in December 2007 began to ease in the third quarter of 2009. The U.S. gross domestic product, or GDP, is estimated to have risen by approximately 3.5% on an annualized basis in the third quarter of 2009, compared with a reported decline of 0.7% on an annualized basis in the second quarter of 2009. However, the U.S. Bureau of Labor Statistics reported that the unemployment rate reached 9.8% in September, a 26-year high. The U.S. has lost a net total of 7.2 million non-farm jobs since the start of the recession. High levels of unemployment and severe declines in home prices have contributed to a continued increase in residential mortgage delinquencies; the unemployment rate is projected to rise in coming months.

The number of unsold single-family homes in inventory dropped in the third quarter of 2009 as compared with the second quarter, but the supply of homes as measured by the inventory/sales ratio remains high. In addition, we believe that there are a large number of foreclosed homes that are not yet on the market, as well as a considerable number of seriously delinquent loans that may ultimately end in foreclosure. These homes are likely to contribute to a significant additional increase in the market supply of single-family homes in the future.

The National Association of Realtors reported that existing home sales increased in September 2009, and sales activity was at its highest level in over two years. New home sales decreased in September for the first time since March, and total housing starts rose slightly in September for the fourth time in the last five months. Increased affordability and government support, including the first-time homebuyer tax credit, helped to boost sales figures. This boost has been modest due to adverse labor market conditions and continued tightening of bank lending standards, making qualification for mortgage credit more difficult for some borrowers.

Multifamily housing fundamentals remained stressed in the third quarter of 2009, despite the easing of the economic recession, because job losses remain high. As a result, new household formations are expected to remain well below average, which in turn is negatively affecting vacancy rates and rent levels. While apartment property sales increased slightly during the third quarter of 2009 compared with the second quarter of 2009, we believe the increase in sales was likely due to sellers reducing the sales prices. There is also concern that the number of distressed multifamily properties entering the sales market is likely to increase over the coming quarters, increasing supply. In addition, for multifamily loans that begin reaching maturity during the next several years, it is expected that some portion of those loans may be exposed to refinancing risk.

As of June 30, 2009, the latest date for which information was available, the amount of U.S. residential mortgage debt outstanding was estimated by the Federal Reserve to be approximately $11.9 trillion, including

$11.0 trillion of single-family mortgages. U.S. residential mortgage debt outstanding has been declining since the second quarter of 2008. Total U.S. residential mortgage debt outstanding decreased by 1.2% in the second quarter of 2009 on an annualized basis, compared with a decrease of 0.2% in the first quarter of 2009. Our mortgage credit book of business, which consists of the mortgage loans and mortgage-related securities we hold in our investment portfolio, Fannie Mae MBS held by third parties and other credit enhancements that we provide on mortgage assets, was $3.2 trillion as of June 30, 2009, or approximately 26.9% of total U.S. residential mortgage debt outstanding. See Part I Item 1A Risk Factors of our 2008 Form 10-K for a description of risks to our business associated with the housing market downturn and decline in home prices.

Summary of Our Financial Results and Condition for the Third Quarter and First Nine Months of 2009

Consolidated Results of Operations

<u>Quarterly Results</u>

We recorded a net loss of $18.9 billion for the third quarter of 2009. Including $883 million in dividends on the senior preferred stock, the net loss attributable to common stockholders was $19.8 billion, or $3.47 per diluted share. Our net loss was primarily driven by significant credit-related expenses, which totaled $22.0 billion in the third quarter, reflecting the continued build in our combined loss reserves and increasing numbers of credit-impaired loans acquired from MBS trusts for loan modifications, and $1.5 billion in fair value losses due primarily to losses on derivatives resulting from a decrease in swap rates, the time decay of our purchased options and losses on mortgage commitments. The impact of these items more than offset our net revenues of $5.9 billion generated primarily from net interest income and guaranty fee income.

In comparison, we recorded a net loss of $14.8 billion for the second quarter of 2009. Including $411 million in dividends on the senior preferred stock, the net loss attributable to common stockholders was $15.2 billion, or $2.67 per diluted share. The net loss for the second quarter of 2009 was driven by significant credit-related expenses of $18.8 billion, which more than offset our net revenues of $5.6 billion generated primarily from net interest income and guaranty fee income. The $4.1 billion increase in our net loss for the third quarter of 2009 compared with the second quarter of 2009 was driven principally by an increase in credit-related expenses and a shift to fair value losses from fair value gains, which more than offset the shift to investment gains from investment losses.

For the third quarter of 2008, the net loss was $29.0 billion, and the net loss attributable to common stockholders was $29.4 billion, or $13.00 per diluted share. This net loss was driven primarily by a $21.4 billion non-cash charge to establish a valuation allowance against deferred tax assets, as well as credit-related expenses of $9.2 billion, fair value losses of $3.9 billion and $1.8 billion in other-than-temporary impairments, which more than offset net revenues of $4.1 billion.

The $10.1 billion decrease in our net loss for the third quarter of 2009 from the third quarter of 2008 was primarily due to a $21.4 billion non-cash charge to establish a valuation allowance against deferred tax assets in the third quarter of 2008, as well as a $2.4 billion decrease in fair value losses and a $1.5 billion increase in net interest income that more than offset a $12.7 billion increase in credit-related expenses.

<u>Year-to-Date Results</u>

We recorded a net loss of $56.8 billion for the first nine months of 2009. Including $1.3 billion in dividends on the senior preferred stock, the net loss attributable to common stockholders was $58.1 billion, or $10.24 per diluted share. Our net loss was driven primarily by credit-related expenses of $61.6 billion due to the continued build in our combined loss reserves by $41.1 billion, other-than-temporary impairment of $7.3 billion, and fair value losses of

$2.2 billion. The impact of these items more than offset our net revenues of $16.7 billion. For the first nine months of 2008, we recorded a net loss of $33.5 billion, or $24.24 per diluted share, driven primarily by a $21.4 billion non-cash charge to establish a valuation allowance against deferred tax assets, $17.8 billion in credit-related expenses, $7.8 billion in fair value losses and $2.4 billion in other-than-temporary impairments, which more than offset our net revenues of $11.8 billion.

The $23.3 billion increase in our net loss for the first nine months of 2009 from the first nine months of 2008 was driven principally by a $43.8 billion increase in credit-related expenses, coupled with a $4.9 billion increase in other-than-temporary impairment, which more than offset a $21.4 billion non-cash charge to establish a valuation allowance against deferred tax assets, a $5.6 billion decrease in fair value losses and a $4.7 billion increase in net interest income.

Credit Overview

Table 1 below presents information about the credit performance of mortgage loans in our single-family guaranty book of business for each quarter of 2008 and the first three quarters of 2009, illustrating the deterioration in performance throughout 2008 and 2009. Our single-family guaranty book of business consists of single-family mortgage loans held in our mortgage portfolio, single-family Fannie Mae MBS held in our mortgage portfolio, single-family Fannie Mae MBS held by third parties, and other credit enhancements that we provide on single-family mortgage assets, such as long term-standby commitments. It excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guaranty.

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

	2009				**2008**				
	Q3 YTD	**Q3**	**Q2**	**Q1**	**Full Year**	**Q4**	**Q3**	**Q2**	**Q**
					(Dollars in millions)				
he end n :									
s uency	4.72%	4.72%	3.94%	3.15%	2.42%	2.42%	1.72%	1.36%	1
ance forming)	$ 33,525	$ 33,525	$ 26,300	$ 23,145	$ 20,484	$ 20,484	$ 14,148	$ 11,275	$ 10,
lance forming)	$ 163,890	$ 163,890	$ 144,183	$ 121,378	$ 98,428	$ 98,428	$ 49,318	$ 34,765	$ 23,
ned loss es[4]	$ 64,724	$ 64,724	$ 54,152	$ 41,082	$ 24,649	$ 24,649	$ 15,528	$ 8,866	$ 5,
osed ty ory er of ties)[5]	72,275	72,275	62,615	62,371	63,538	63,538	67,519	54,173	43,
g the :									

cations er of 6)	56,816	27,686	16,684	12,446	33,388	6,313	5,291	10,229	11,
Saver ce m loan uts er of 7)	36,440	4,347	11,662	20,431	70,967	25,788	27,278	16,749	1,
eclosure number s)(8)	24,162	11,076	7,629	5,457	10,355	4,171	2,997	2,018	1,
ment nd rances eted er of 9)	17,595	5,398	4,752	7,445	7,892	1,829	1,794	2,068	2,
osed ty tions er of ties)(10)	98,428	40,959	32,095	25,374	94,652	20,998	29,583	23,963	20,
-family related es(11)	$ 60,377	$ 21,656	$ 18,391	$ 20,330	$ 29,725	$ 11,917	$ 9,215	$ 5,339	$ 3,
-family osses(12)	$ 9,386	$ 3,620	$ 3,301	$ 2,465	$ 6,467	$ 2,197	$ 2,164	$ 1,249	$

(1) Calculated based on number of conventional single-family loans that are three or more months past due and loans that have been referred to foreclosure but not yet foreclosed upon, divided by the number of loans in our

conventional single-family guaranty book of business. We include all of the conventional single-family loans that we own and those that back Fannie Mae MBS in the calculation of the single-family serious delinquency rate.

(2) Represents the total amount of nonaccrual loans, troubled debt restructurings, and first-lien loans associated with unsecured HomeSaver Advance loans including troubled debt restructurings and HomeSaver Advance first-lien loans that are on accrual status. A troubled debt restructuring is a restructuring of a mortgage loan in which a concession is granted to a borrower experiencing financial difficulty. Prior to the fourth quarter of 2008, we generally classified loans as nonperforming when the payment of principal or interest on the loan was three months or more past due. In the fourth quarter of 2008, we began classifying loans as nonperforming at an earlier stage in the delinquency cycle, generally when the payment of principal or interest on the loan is two months or more past due.

(3) Represents unpaid principal balance of nonperforming loans in our outstanding and unconsolidated Fannie Mae MBS held by third parties, including first-lien loans associated with unsecured HomeSaver Advance loans that are not seriously delinquent. Prior to the fourth quarter of 2008, we generally classified loans as nonperforming when the payment of principal or interest on the loan was three months or more past due. In the fourth quarter of 2008, we began classifying loans as nonperforming at an earlier stage in the delinquency cycle, generally when the payment of principal or interest on the loan is two months or more past due. Loans have been classified as nonperforming according to the classification standard in effect at the time the loan became a nonperforming loan, and prior periods have not been revised to reflect changes in classification.

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

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

(6) Modifications are granted for borrowers experiencing financial difficulty and include troubled debt restructurings as well as other modifications to the terms of the loan. A troubled debt restructuring of a mortgage loan is a restructuring in which a concession is granted to the borrower. It is the only form of modification in which we agree to accept less than the full original contractual principal and interest amount due under the loan, although other resolutions and modifications may result in our receiving the full amount due, or certain installments due, under the loan over a period of time that is longer than the period of time originally provided for under the terms of the loans. These modifications do not include trial modifications under the Home Affordable Modification Program or repayment and forbearance plans that have been initiated but not completed. Trial modifications that have converted to permanent modifications under the Home Affordable Modification Program are included.

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

(8) Preforeclosure sales may involve a payoff of less than the full amount of the indebtedness to avoid the expense of foreclosure and includes short sales and third party sales.

(9) During the first three quarters of 2009, repayment plans reflected only those plans associated with loans that were 60 days or more delinquent. During 2008, repayment plans reflected only those plans associated with loans that were 90 days or more delinquent. If we had included repayment plans associated with loans that were 60 days or more delinquent during 2008, the number of loans that had repayment plans and forbearances completed for the full year of 2008 would have been 22,337 loans.

(10) Includes deeds in lieu of foreclosure.

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

(12) Consists of (a) charge-offs, net of recoveries and (b) foreclosed property expense; adjusted to exclude the impact of fair value losses resulting from credit-impaired loans acquired from MBS trusts and HomeSaver Advance loans for the reporting period. Interest forgone on single-family nonperforming loans in our mortgage portfolio is not reflected in our credit losses total. In addition, we exclude other-than-temporary impairment losses resulting from deterioration in the credit quality of our mortgage-related securities and accretion of interest income on single-family loans from credit losses. See Consolidated Results of Operations Credit-Related Expenses Provision for Credit Losses Attributable to Fair Value Losses on Credit-Impaired Loans Acquired from MBS Trusts and HomeSaver Advance Loans for a discussion of accounting for loans acquired with deteriorated credit quality.

As shown in Table 1 above, we have experienced continuing deterioration in the credit performance of mortgage loans in our guaranty book of business since the beginning of 2008, reflecting the ongoing impact of the adverse conditions in the housing market, as well as rising unemployment. See Housing and Mortgage Market and Economic Conditions above for more detailed information regarding these conditions. We expect these conditions to continue to adversely affect our credit results for the remainder of 2009 and during 2010.

We increased our single-family loss reserves to $64.7 billion as of September 30, 2009, or 32.79% of the amount of our single-family nonperforming loans, from $54.2 billion as of June 30, 2009, or 31.76% of the amount of our single-family nonperforming loans, and $24.6 billion as of December 31, 2008, or 20.73% of the amount of our single-family nonperforming loans. The increase in our loss reserves in the third quarter and first nine months of 2009 reflected the continued deterioration in the overall credit performance of loans in our guaranty book of business, as evidenced by the significant increase in delinquent, seriously delinquent and nonperforming loans. In addition, our average loss severity, or average initial charge-off per default, increased during the first nine months of 2009 primarily as a result of the decline in home prices and a higher percentage of loan charge-offs that do not have mortgage insurance coverage.

We experienced a substantial increase in our population of seriously delinquent (90+ days delinquent) loans in the third quarter compared with the second quarter of 2009, primarily as a result of an increase in the number of loans transitioning to seriously delinquent status, accompanied by a decline in the proportion of already seriously delinquent loans curing or transitioning to foreclosure as our servicers work to find a home retention solution before proceeding to foreclosure. Further, a number of our seriously delinquent loans are in a workout that has been initiated but not yet completed. For example, a loan in the trial modification stage under the Home Affordable Modification Program continues to be reported as seriously delinquent throughout the trial period. The factors contributing to the substantial increase in serious delinquencies are described in Risk Management Credit Risk Management Mortgage Credit Risk Management.

We are experiencing increases in delinquency and default rates throughout our guaranty book of business, including on loans with fewer risk layers, such as loans with lower original loan-to-value ratios, higher FICO credit scores and mortgages with fixed rate mortgage terms. Risk layering is the combination of multiple risk characteristics that could increase the likelihood of default. This general deterioration in our guaranty book of business is a result of the stress on a broader segment of borrowers due to the rise in unemployment and the decline in home prices. Certain loan categories continued to contribute disproportionately to the increase in nonperforming loans and credit losses for the third quarter and first nine months of 2009. These categories include: loans on properties in the Midwest, California, Florida, Arizona and Nevada; loans originated in 2006 and 2007; and loans related to higher-risk product types, such as Alt-A loans. The term Alt-A loans generally refers to mortgage loans that can be underwritten with reduced or alternative documentation than that required for a full documentation mortgage loan but may also include other alternative product features. In reporting our credit exposure, we classify mortgage loans as Alt-A if the lenders that delivered the mortgage loans to us classified the loans as Alt-A based on documentation or other product features. See Risk Management Credit Risk Management Mortgage Credit Risk Management for more detailed information on the risk profile and the performance of the loans in our guaranty book of business.

In our efforts to keep people in their homes and address the deteriorating credit performance of mortgage loans in our single-family guaranty book of business, we are working hard to complete workouts for delinquent loans. Our workout solutions include loan modifications, both within the Home Affordable Modification Program and outside the program, and repayment and forbearance plans. We significantly increased the number of loan workouts during the third quarter and first nine months of 2009. In our experience, only a portion of loans that we attempt to modify or for which we begin a repayment or forbearance plan result in a completed workout. In addition, a significant number of completed loan workouts subsequently become delinquent again. For example, external factors such as high unemployment may result in the need for additional workouts to address new borrower delinquencies and prevent foreclosures. If we are unable to provide a viable home retention option, we provide foreclosure avoidance alternatives that may be appropriate if the borrower is no longer able to make the required mortgage payments. We have agreed to an increasing number of preforeclosure sales during the first nine months of 2009 as more borrowers have been adversely impacted by weak economic conditions.

Current market and economic conditions have also adversely affected the liquidity and financial condition of many of our institutional counterparties, particularly mortgage insurers and mortgage servicers, which has significantly increased the risk to our business of defaults by these counterparties due to bankruptcy or receivership, lack of liquidity, insufficient capital, operational failure or other reasons. See Risk

Management Credit Risk Management Institutional Counterparty Credit Risk Management for more information about our institutional counterparty credit risk.

Consolidated Balance Sheet

Total assets of $890.3 billion as of September 30, 2009 decreased by $22.1 billion, or 2.4%, from December 31, 2008. Total liabilities of $905.2 billion decreased by $22.3 billion, or 2.4%, from December 31, 2008. Total Fannie Mae stockholders deficit decreased by $249 million during the first nine months of 2009, to a deficit of $15.1 billion as of September 30, 2009 from a deficit of $15.3 billion as of December 31, 2008. The decrease in total Fannie Mae stockholders deficit was due to the $44.9 billion in funds received from Treasury under the senior preferred stock purchase agreement, $10.5 billion reduction in unrealized losses on available-for-sale securities, net of tax, and a $3.0 billion reduction in our deficit to reverse a portion of our deferred tax asset valuation allowance in conjunction with our April 1, 2009 adoption of the new accounting guidance for assessing other-than-temporary impairment. These factors were almost entirely offset by our net loss of $56.8 billion for the first nine months of 2009.

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

We intend to adopt two new accounting standards, effective January 1, 2010. These standards amend the accounting for transfers of financial assets and the consolidation guidance related to variable interest entities. The adoption of these new accounting standards will have a major impact on our consolidated financial statements, including the consolidation of the substantial majority of our MBS trusts which are currently off-balance sheet. We provide a more detailed discussion of this guidance and its impact in Off-Balance Sheet Arrangements and Variable Interest Entities Elimination of QSPEs and Changes in the Consolidation Model for Variable Interest Entities.

Net Worth Deficit

We had an estimated net worth deficit of $15.0 billion as of September 30, 2009, compared with a net worth deficit of $10.6 billion as of June 30, 2009 and $15.2 billion as of December 31, 2008. This net worth deficit equals the total deficit that we report in our condensed consolidated balance sheets, and is calculated by subtracting our total liabilities from our total assets, each as shown on our condensed consolidated balance sheets prepared in accordance with generally accepted accounting principles (GAAP) for that fiscal quarter.

Under the Federal Housing Finance Regulatory Reform Act of 2008 (Regulatory Reform Act), FHFA must place us into receivership if the Director of FHFA makes a written determination that our assets are, and during the preceding 60 days have been, less than our obligations. FHFA has notified us that the measurement period for such a determination begins no earlier than the date of the SEC filing deadline for our quarterly and annual financial statements and continues for a period of 60 days after that date. FHFA also has advised us that, if we receive funds from Treasury during that 60-day period in order to eliminate our net worth deficit as of the prior period end in accordance with the senior preferred stock purchase agreement, the Director of FHFA will not make a mandatory receivership determination.

Under the senior preferred stock purchase agreement, as amended, Treasury committed to provide us with funds of up to $200 billion under specified conditions. The agreement requires Treasury, upon the request of our conservator, to provide funds to us after any quarter in which we have a negative net worth (that is, our total liabilities exceed our total assets, as reflected on our GAAP balance sheet). The senior preferred stock purchase agreement does not terminate as of a particular time; however, we may no longer obtain new funds under the agreement once we have received a total of $200 billion under the agreement.

We describe the terms of the senior preferred stock purchase agreement in our 2008 Form 10-K in Part I Item 1 Business Conservatorship, Treasury Agreements, Our Charter and Regulation of Our Activities Treasury Agreements, and we describe the terms of the May 2009 amendment to the agreement in our First Quarter 2009 Form 10-Q in Part I Item 2 MD&A Executive Summary Amendment to Senior Preferred Stock Purchase Agreement.

We have received an aggregate of $44.9 billion from Treasury under the senior preferred stock purchase agreement to eliminate our net worth deficit as of the end of each of the last three quarters. On November 4, 2009, the Acting Director of FHFA submitted a request to Treasury for an additional $15.0 billion on our behalf to eliminate our net worth deficit as of September 30, 2009, and requested receipt of those funds on or prior to December 31, 2009.

Upon receipt of those funds from Treasury, the aggregate liquidation preference of our senior preferred stock, including the initial liquidation preference of $1.0 billion, will equal $60.9 billion and the annualized dividend on the senior preferred stock will be $6.1 billion, based on the 10% dividend rate. This dividend obligation exceeds our reported annual net income for five of the past seven years and will contribute to increasingly negative cash flows in future periods if we continue to pay the dividends on a quarterly basis. If we do not pay the dividend quarterly and in cash, the dividend rate would increase to 12% annually, and the unpaid dividend would accrue and be added to the liquidation preference of the senior preferred stock, further increasing the amount of the annual dividends.

Due to current trends in the housing and financial markets, we expect to have a net worth deficit in future periods, and therefore will be required to obtain additional funding from Treasury pursuant to the senior preferred stock purchase agreement. As a result, we are dependent on the continued support of Treasury in order to continue operating our business. Our ability to access funds from Treasury under the senior preferred stock purchase agreement is critical to keeping us solvent and avoiding the appointment of a receiver by FHFA under statutory mandatory receivership provisions.

Our senior preferred stock dividend obligation, combined with potentially substantial commitment fees payable to Treasury starting in 2010 (the amounts of which have not yet been determined) and our effective inability to pay down draws under the senior preferred stock purchase agreement, will have a significant adverse impact on our future financial position and net worth. See Part II Item 1A Risk Factors for more information on the risks to our business posed by our dividend obligations under the senior preferred stock purchase agreement.

Fair Value Deficit

Our fair value deficit as of September 30, 2009, which is reflected in our supplemental non-GAAP fair value balance sheet, was $90.4 billion, compared with a deficit of $102.0 billion as of June 30, 2009 and $105.2 billion as of December 31, 2008.

The fair value of our net assets, including capital transactions, increased by $14.8 billion during the first nine months of 2009, and includes $44.9 billion of capital received from Treasury under the senior preferred stock purchase agreement. The fair value of our net assets, excluding capital transactions, decreased by $28.8 billion during the first nine months of 2009. This decrease reflected the adverse impact on our net guaranty assets from the continued weakness in the housing market and increases in unemployment resulting from the weak economy, which contributed to a significant increase in the fair value of our guaranty obligations. We experienced a favorable impact on the fair value of our net assets attributable to an increase in the fair value of our net portfolio primarily due to changes in the spread between mortgage assets and associated debt and derivatives.

The amount that Treasury has committed to provide us under the senior preferred stock purchase agreement to eliminate our net worth deficit is determined based on our GAAP balance sheet, not our non-GAAP fair value

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balance sheet. There are significant differences between our GAAP balance sheet and our non-GAAP fair value balance sheet, which we describe in greater detail in Supplemental Non-GAAP Information Fair Value Balance Sheets.

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

Our net worth deficit, which equals our total deficit as reported on our condensed consolidated GAAP balance sheet, includes the effect of combined loss reserves of $65.9 billion that we recorded in our consolidated balance sheet as of September 30, 2009. Our non-GAAP fair value balance sheet presents all of our assets and liabilities at estimated fair value as of the balance sheet date. Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, which is also referred to as the exit price. In determining fair value, we use a variety of valuation techniques and processes. In general, fair value incorporates the market s current view of the future, and that view is reflected in the current price of the asset or liability. However, future market conditions may be different from what the market has currently estimated and priced into these fair value measures. We describe our use of assumptions and management judgment and our valuation techniques and processes for determining fair value in more detail in Supplemental Non-GAAP information Fair Value Balance Sheets, Critical Accounting Policies and Estimates Fair Value of Financial Instruments and Notes to Condensed Consolidated Financial Statements Note 18, Fair Value of Financial Instruments.

Our combined GAAP loss reserves reflect probable losses that we believe we have already incurred as of the balance sheet date. In contrast, the fair value of our guaranty obligation is based not only on future expected credit losses over the life of the loans underlying our guarantees as of September 30, 2009, but also on the estimated profit that a market participant would require to assume that guaranty obligation.

Liquidity

In response to the strong demand that we experienced for our debt securities during the first nine months of 2009, we issued a variety of non-callable and callable debt securities in a wide range of maturities to achieve cost-efficient funding and an appropriate debt maturity profile. In particular, we issued a significant amount of long-term debt during this period, which we then used to repay maturing debt and prepay more expensive long-term debt. As a result, as of September 30, 2009, our outstanding short-term debt, based on its original contractual term, decreased as a percentage of our total outstanding debt to 30%, compared with 38% as of December 31, 2008. In addition, the average interest rate on our long-term debt (excluding debt from consolidations), based on its original contractual term, decreased to 3.76% as of September 30, 2009, compared with 4.66% as of December 31, 2008.

We believe that our ready access to long-term debt funding during the first nine months of 2009 is due to the actions taken by the federal government to support us and the financial markets. Accordingly, we believe that continued federal government support of our business and the financial markets, as well as our status as a GSE, are essential to maintaining our access to debt funding. Changes or perceived changes in the government s support of us or the markets could lead to an increase in our debt roll-over risk in future periods and have a material adverse effect on our ability to fund our operations. Demand for our debt securities could decline in the future if the government does not extend or replace the Treasury credit facility, which expires on December 31, 2009, as the Federal Reserve concludes its agency debt and MBS purchase programs during the first quarter of 2010, or for other reasons. As of the date of this filing, however, we have experienced strong demand for our debt securities that mature after the scheduled expirations of the Treasury credit facility and Federal Reserve purchase programs.

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

Homeowner Assistance Initiatives

During the third quarter of 2009, we continued our efforts, pursuant to our mission, to help homeowners avoid foreclosure. A great deal of our effort during the quarter was focused on the Making Home Affordable Program, the details of which were first announced by the Obama Administration in March 2009. That program is designed to significantly expand the number of borrowers who can refinance or modify their mortgages to achieve a monthly payment that is more affordable now and into the future or to obtain a more stable loan product, such as a fixed-rate mortgage loan in lieu of an adjustable rate mortgage loan. If it is determined that a borrower facing foreclosure is not eligible for a modification under the Making Home Affordable Program, we attempt to find another home retention or foreclosure alternative solution for the borrower.

The Making Home Affordable Program

Key elements of the Making Home Affordable Program are the Home Affordable Refinance Program and the Home Affordable Modification Program.

The Home Affordable Refinance Program provides for us to acquire or guarantee loans that are refinancings of mortgage loans we own or guarantee, and for Freddie Mac to acquire or guarantee loans that are refinancings of mortgage loans that it owns or guarantees. Borrowers refinancing under the Home Affordable Refinance Program benefit from lower levels of mortgage insurance than those required under traditional standards. The program is targeted at borrowers who have demonstrated an acceptable payment history on their mortgage loans but may have been unable to refinance due to a decline in home values. We make refinancings under the Home Affordable Refinance Program through our Refi Plus^{tm} initiatives, which provide refinance solutions for eligible Fannie Mae loans. Under the Home Affordable Refinance Program, the new mortgage loan must either:

- reduce the borrower s monthly principal and interest payment, or

- provide a more stable loan product.

The Home Affordable Modification Program provides for the modification of mortgage loans owned or guaranteed by us or Freddie Mac, as well as non-GSE mortgage loans serviced by servicers who participate in the program. The program is aimed at helping borrowers whose loans are currently delinquent, and borrowers who are at imminent risk of default, by modifying their mortgage loans to make their monthly payments more affordable. The program is designed to provide a uniform, consistent regime for servicers to use in modifying mortgage loans to prevent foreclosures. Under the program, a borrower must satisfy the terms of a trial modification plan, typically for a period of at least three months, before the modification of the loan becomes effective. We have advised our servicers that we require borrowers who are at risk of foreclosure to be evaluated for eligibility under the Home Affordable Modification Program before any other workout alternative is considered. We also serve as the program administrator for Treasury for the Home Affordable Modification Program. More detailed information regarding our role as program administrator for the Home Affordable Modification Program is provided in Part I Item 2 MD&A Executive Summary Homeowner Assistance and Foreclosure Prevention Initiatives of our First Quarter 2009 Form 10-Q.

In an effort to expand the benefits available through the Making Home Affordable Program to more borrowers, a number of updates to the program have been announced. For example, in July 2009, FHFA authorized Fannie Mae and Freddie Mac to expand the Home Affordable Refinance Program to permit refinancings of their existing mortgage loans that have an unpaid principal balance of up to 125% of the current value of the property covered by the mortgage loan, an increase from the program s initial 105% limit.

Most recently, in August and September 2009, Treasury issued guidance and a waiver to servicers to address the fact that, in many cases, lenders did not receive the borrower documentation required to complete a modification within the time period initially required, even though the borrowers made payments on their trial modifications. Treasury s guidance allows servicers to offer borrowers an additional grace period to send in the necessary documents to complete their modifications. In October 2009, Treasury issued guidance to servicers that streamlined the borrower documentation required for modifying a loan under the program and further extended the grace period. For trial modifications that became effective on or before September 1, 2009 where all trial period payments have been made but all required documentation has not been received, the trial period may be extended until December 31, 2009 or, if later, two months after the trial period would otherwise have ended.

More detailed information regarding the Home Affordable Refinance Program and the Home Affordable Modification Program is provided in Part I Item 2 MD&A Executive Summary Homeowner Assistance and Foreclosure Prevention Initiatives of our First Quarter 2009 Form 10-Q.

Our Support for the Making Home Affordable Program

We have taken a number of steps to let borrowers know that help may be available to them under the Home Affordable Refinance Program and the Home Affordable Modification Program. During the quarter, the loan-lookup tool we added to our Web site, which allows borrowers to find out instantly whether we own their loans, was used over one million times. Together with Treasury, the Department of Housing and Urban Development (HUD), NeighborWorks, and Freddie Mac, we are engaged in extensive outreach efforts. These efforts include a multi-city borrower outreach campaign scheduled to cover 40 communities experiencing high levels of foreclosure to raise awareness about the Making Home Affordable Program, educate borrowers about options available to them, prepare them to work more efficiently with their servicers, and help keep them from falling victim to foreclosure prevention scams. Since June, the campaign has reached 16 communities. The campaign includes a variety of outreach activities, including distribution of brochures and other informational materials, community partner roundtables, training sessions with local housing counselors, and foreclosure prevention workshops, where HUD-certified housing counselors and mortgage servicers meet one-on-one with borrowers.

We have also worked to support servicers, who face challenges in their efforts to put in place personnel, training, systems and operations to support the Making Home Affordable Program. We revised Desktop Underwriter® (DU®), our proprietary underwriting system that assists lenders in underwriting loans, to broaden the availability of refinancings under the Home Affordable Refinance Program.

In our capacity as program administrator for the Home Affordable Modification Program, we support the over 60 servicers that have signed up to offer modifications on non-agency loans under the program. On October 8, 2009, Treasury announced that (1) as of September 30, 2009, approximately 487,000 loans were in a trial period or a completed modification under the Home Affordable Modification Program as a whole, and (2) the goal Treasury set in July 2009 of having 500,000 trial modifications in progress by November 1, 2009 had been achieved.

As program administrator, to help servicers ramp up their operations to modify loans under the Home Affordable Modification Program we have provided information and resources through a special program Web site for servicers. We have also communicated aspects of and updates to the program to servicers and helped servicers implement and integrate the program with new systems and processes. Our servicer support as program administrator includes dedicating Fannie Mae personnel to participating servicers to work closely with the servicers to help them implement the program. We also have established a servicer support call center, conduct weekly conference calls with the leadership of participating servicers, and provide training through live Web seminars, recorded tutorials, checklists and job aids on the program Web site.

Our Refinance Activity

During the third quarter of 2009, we acquired or guaranteed approximately 626,000 loans that were refinances, including approximately 136,000 loans that represented refinances through our Refi Plus initiatives, of which approximately 46,000 loans were refinanced under the Home Affordable Refinance Program. On average, borrowers who refinanced during the quarter through our Refi Plus initiatives reduced their monthly mortgage payments by $154. In addition, borrowers refinancing under the Home Affordable Refinance Program were able to benefit from lower levels of mortgage insurance and higher loan-to-value (LTV) ratios than what would have been required under traditional standards. Our refinance acquisitions during the third quarter of 2009 reflect the many second quarter loan applications closed and delivered during the third quarter. We expect refinance activity, including under the Home Affordable Refinance Program, to slow in the fourth quarter of 2009 as compared with the third quarter of 2009.

We believe the most significant factor that will affect the number of borrowers refinancing under the program is mortgage interest rates. As interest rates increase, fewer borrowers benefit from refinancing their mortgage loan; as interest rates decrease, more borrowers benefit from refinancing. The number of borrowers who refinance under the Home Affordable Refinance Program is also likely to be constrained by a number of other factors, including lack of borrower awareness, lack of borrower action to initiate a refinancing, and borrower ineligibility due, for example, to severe home price declines or to borrowers failing to remain current in their mortgage payments. We believe, however, that the increase in the maximum allowable LTV ratio of the refinanced loan to up to 125% of the current value of the property, which was first implemented during the third quarter, and the increasing awareness of the availability of refinance options will help to lessen the effects of some of these constraints. The mortgage insurance flexibilities associated with the Home Affordable Refinance Program are set to expire June 10, 2010.

Our Loan Workout Activity

During the third quarter of 2009, we continued our efforts to help homeowners avoid foreclosure through a variety of home retention and foreclosure alternatives. We refer to actions taken by servicers with a borrower to resolve the problem of existing or potential delinquent loan payments as workouts. During the third quarter of 2009, for our single-family book of business, we completed approximately 49,000 loan workouts, of which 28,000 were loan modifications, compared with approximately 41,000 workouts, of which 17,000 were loan modifications, during the second quarter of 2009. The increase in loan modifications from the second to the third quarter was the result of the completion of a large number of loan modifications for borrowers who did not qualify for modifications under the Home Affordable Modification Program. Our modifications do not reflect loans in the trial modification stage under the Home Affordable Modification Program but do include completed modifications of our loans under that program. Approximately 56% of the modifications of delinquent loans completed during the third quarter resulted in an initial reduction in the borrower s monthly mortgage payment of more than 20%. In addition to loan modifications, other workouts we completed during the third quarter of 2009 consisted of loans under our HomeSaver Advance™ initiative, repayment plans and forbearances, deeds in lieu of foreclosure and preforeclosure sales. In addition to the workouts that were completed during the quarter, we also initiated a significant number of trial modifications under the Home Affordable Modification Program, as well as repayment and forbearance plans. As of September 30, 2009, approximately 189,000 Fannie Mae loans were in a trial period or a completed modification under the Home Affordable Modification Program, as reported by servicers to the system of record for the Home Affordable Modification Program.

Even though the volume of trial modifications that we have initiated on Fannie Mae loans under the Home Affordable Modification Program has been substantial, a low percentage of our trial modifications had converted into completed loan modifications as of September 30, 2009. One reason is that activity under the program has been increasing over time, so that many loans have not had enough time to complete the trial modification period prior to September 30, 2009. Additionally, in certain cases, lenders have not received the borrower documentation required to complete the modification within the initially required time period, even though the borrowers have made their required payments during their trial periods. Because some borrowers may not make all the required trial period payments, and because of the additional time that has now been provided to obtain the required documentation, it is difficult to predict the rate at which our trial modifications will convert into completed modifications.

Factors that have affected and may in the future continue to affect both the number of loans we put into trial modifications and the number of Fannie Mae loans that are ultimately modified under the Home Affordable Modification Program include the following:

Servicer Capacity to Handle a New and Complex Process. Modifications require servicers to follow a multi-step process that includes identifying loans that are candidates for modification, making contact with the borrower, obtaining current financial information and signed documentation from the borrower, evaluating whether the program is a viable workout option, structuring the terms of the modification, communicating those terms to the borrower, providing the legal documentation, working with the borrower to provide new modification terms or an alternative workout if necessary after the borrower s income is verified, and receiving the borrower s signed agreement to modify the loan. During the early phase of the Home Affordable Modification Program, servicers took a number of steps to implement the program, such as establishing or modifying systems and operations, and training personnel, which required time to put in place. Many servicers are still increasing their capacity to implement the program by hiring staff, enhancing technology, and changing their processes. Servicers need to continue to adapt and take actions to implement new program elements as they are introduced to the program in an effort to assist more borrowers. The number of loans we ultimately modify under the program depends on the extent to which servicers are able and willing to increase their capacity sufficiently to address the demand for modifications.

Borrower Awareness, Initiation, Documentation and Agreement. Before a loan can be modified under the program, a borrower must learn of the program, initiate a request for a modification or respond to solicitations to apply for the program, provide current, accurate financial information, agree to the terms of a proposed modification and successfully make payments and provide required documents supporting the modification during the trial period. Historically, many distressed borrowers have been reluctant or unwilling even to contact their servicers, as demonstrated by the substantial percentage of foreclosures completed without the borrower having ever contacted the lender. Thus, significant borrower outreach is required to encourage distressed borrowers to initiate a modification and, even after a trial modification is initiated under the program, a number of additional steps need to be taken for the modification to be completed.

Borrower Eligibility and Ability to Make Payments Even under a Modified Loan. Not all of our distressed borrowers will satisfy the eligibility requirements for the Home Affordable Modification Program. For example, for a borrower suffering from loss of income, the modification terms permitted under the program may not be sufficient to reduce the borrower s monthly mortgage payment to 31% of the borrower s gross monthly income, as the program requires. In addition, we recently provided guidance to servicers that, beginning December 1, 2009, a Home Affordable Modification should not be offered without our consent if the estimated value of not modifying the loan would exceed the estimated value of modifying the loan by more than $5,000. Finally, modifications under the Home Affordable Modification Program, or under any program, may not be sufficient to help some borrowers keep their homes, particularly borrowers who have significant non-mortgage debt obligations or who are facing other life events that impair their ability to maintain even a modified mortgage.

A number of market dynamics since the inception of the Making Home Affordable Program may affect the Program s ability to provide foreclosure alternatives for certain borrowers. For example, the significant increase in unemployment since the program s inception, and the likelihood of prolonged high levels of unemployment, may result in a greater proportion of distressed borrowers failing to meet the eligibility requirements for a Home Affordable Modification. Additionally, continued home price declines in certain regions have resulted in a dramatic increase in households with negative home equity. As a result, a growing contingent of distressed borrowers with negative home equity may be less likely to pursue a modification or to make payments even on a modified loan.

Our efforts to reach out to borrowers and support servicers, as well as program updates and efforts to streamline the required documentation, are designed to address these factors and maximize the program s ability to help as many borrowers as possible. In the coming months, we expect the pace of new trial modifications being initiated to moderate as servicers focus on converting modifications currently in trial periods into completed modifications.

The actions we are taking and the initiatives introduced to assist homeowners and limit foreclosures, including those under the Making Home Affordable Program, are significantly different from our historical approach to delinquencies, defaults and problem loans. It will take time for both us and the Administration to assess and provide information on the success of these efforts.

Expected Financial Impact of Making Home Affordable Program on Fannie Mae

The unprecedented nature of the Making Home Affordable Program and uncertainties related to interest rates and the broader economic environment make it difficult for us to predict the full extent of our activities under the program and how those will affect us, or the costs that we will incur either in the short term or over the long term, particularly in connection with the Home Affordable Modification Program. As we gain more experience under the program, we may recommend supplementing the program with other initiatives that would allow us, pursuant to our mission, to assist more homeowners.

We have included data relating to our borrower loss mitigation activities, including activities under the Making Home Affordable Program, in Risk Management Credit Risk Management Mortgage Credit Risk Management. A discussion of the risks to our business posed by the Making Home Affordable Program is included in Part II Item 1A Risk Factors.

Since we already own or guarantee the refinanced mortgages we acquire under the Home Affordable Refinance Program, we incur very limited incremental costs related to this program. We also incur some limited administrative costs for the Home Affordable Refinance Program.

We expect modifications of loans we own or guarantee under the Home Affordable Modification Program, pursuant to our mission, will adversely affect our financial results and condition due to a number of factors, including:

- The requirement that we acquire any loan held in a Fannie Mae MBS prior to modifying it which, prior to January 2010, will result in fair value loss charge-offs against the Reserve for guaranty losses at the time we acquire the loan;

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

- Incentives to some borrowers in the form of principal balance reductions if the borrowers continue to make payments due on the modified loan for specified periods;

- The effect of holding modified loans in our mortgage portfolio, to the extent the loans provide a below market yield, which may be lower than our cost of funds; and

- Our directive that servicers delay foreclosure sales until they verify that borrowers are not eligible for Home Affordable Modifications and have exhausted other foreclosure prevention alternatives may result in increased costs related to loans that ultimately transition to foreclosure.

Accordingly, the Making Home Affordable Program will likely have a material adverse effect on our business, results of operations and financial condition, including our net worth. To the extent that the program is successful in reducing foreclosures and keeping borrowers in their homes, it may benefit the overall housing market and help in reducing our long-term credit losses as long as other factors, such as continued declines in home prices or continuing high unemployment, do not result in the need for a significant number of new solutions for borrowers.

Housing Finance Agency Assistance Programs

In addition to our efforts under the Making Home Affordable Program, on October 19, 2009, we entered into a memorandum of understanding with Treasury, FHFA and Freddie Mac that establishes terms under which we, Freddie Mac and Treasury intend to provide assistance to state and local housing finance agencies (HFAs) so that the HFAs can continue to meet their mission of providing affordable financing for both single-family and multifamily housing. The memorandum of understanding contemplates providing assistance to the HFAs through three separate assistance programs: a temporary credit and liquidity facilities program, a new issue bond program and a multifamily credit enhancement program. The parties obligations with respect to transactions under the three assistance programs contemplated by the memorandum of understanding will become binding when the parties execute definitive transaction documentation. For more information on this memorandum of understanding, refer to the report on Form 8-K we filed with the SEC on October 23, 2009.

Deed for Lease Program

On November 5, 2009, we announced the Deed for Lease^{tm} Program under which qualifying homeowners facing foreclosure will be able to remain in their homes by signing a lease in connection with the voluntary transfer of the property back to the lender. The program is designed for borrowers who do not qualify for or have not been able to sustain other loan-workout solutions. Tenants of borrowers may also be eligible under the program.

Providing Mortgage Market Liquidity

Our mortgage credit book of business increased to $3.2 trillion as of September 30, 2009, from $3.1 trillion as of December 31, 2008 as our market share of mortgage-related securities issuance remained high and new business acquisitions outpaced liquidations. Our estimated market share of new single-family mortgage-related securities issuances was 44.0% for the third quarter of 2009 making us the largest single issuer of mortgage-related securities in the secondary market in the third quarter of 2009. In comparison, our estimated market share was 53.5% for the second quarter of 2009. Our estimated market share for the second quarter of 2009 included $94.6 billion of whole loans that have been held for investment in our mortgage portfolio and were securitized into Fannie Mae MBS in the second quarter, but retained in our mortgage portfolio and consolidated on our consolidated balance sheets. Excluding these Fannie Mae MBS from both Fannie Mae and total market mortgage-related securities issuance volumes, our estimated market share of new single-family mortgage-related securities issuance was 44.5% for the second quarter of 2009. The potential shift of the market away from refinance activity could have an adverse impact on our market share.

During the first nine months of 2009, we purchased or guaranteed an estimated $649.9 billion in new business, measured by unpaid principal balance, which included financing for approximately 2,540,000 conventional single-family loans and approximately 286,000 multifamily units. Most of these purchases and guarantees were of single-family loans and approximately 82% of our single-family business during the first nine months of 2009 consisted of refinancings. The $649.9 billion in new single-family and multifamily business for the first nine months of 2009 consisted of $392.2 billion in Fannie Mae MBS that were issued, and $257.7 billion in mortgage loans and mortgage-related securities that we purchased for our mortgage investment portfolio.

We remain a constant source of liquidity in the multifamily market and we have been successful with our goal of reinvigorating our multifamily MBS business and broadening our multifamily investor base. Approximately 76% of total multifamily production in the first nine months of 2009 was an MBS execution, compared to 16% in the first nine months of 2008.

In addition to purchasing and guaranteeing mortgage assets, we are taking a variety of other actions to provide liquidity to the mortgage market. These actions include:

Whole Loan Conduit. Whole loan conduit activities involve our purchase of loans principally for the purpose of securitizing them. We purchase loans from a large group of lenders and then securitize them as Fannie Mae MBS, which may then be sold to dealers and investors.

Early Funding. Normally, lenders who deliver whole loans or pools of whole loans to us in exchange for MBS must wait 30 to 45 days between the closing and settlement of the loans or pools and the issuance of the MBS. This delay may limit lenders ability to originate new loans. Our early lender funding programs allow lenders to receive payment for whole loans and pools delivered on an accelerated basis, which replenishes their funds and allows them to originate more mortgage loans.

Dollar Roll Transactions. We continued to have a significant amount of dollar roll activity in the third quarter of 2009 as a result of attractive discount note funding and a desire to increase market liquidity. A dollar roll transaction is a commitment to purchase a mortgage-related security with a concurrent agreement to re-sell a substantially similar security at a later date or vice versa. An entity who sells a mortgage-related security to us with a concurrent agreement to repurchase a security in the future gains immediate financing for their balance sheet.

Legislation

The Obama Administration has proposed a financial regulatory reform plan that would significantly alter the current regulatory framework applicable to the financial services industry, with enhanced and more comprehensive regulation of financial firms and markets. Such regulation could directly and indirectly affect many aspects of our business and that of our business partners. The plan includes proposals relating to the enhanced regulation of securitization markets, changes to existing capital and liquidity requirements for financial firms, additional regulation of the over-the-counter derivatives market, stronger consumer protection regulations, regulations on compensation practices and changes in accounting standards. Congress is currently considering legislation on these topics.

Congress is also considering other legislation that could affect our business, including various measures that would regulate mortgage origination and limit the rights of creditors in residential property foreclosures. These measures could impact the manner in which we underwrite, acquire and engage in loss mitigation on mortgage loans.

In addition, legislation has been enacted or is being considered in some jurisdictions that would provide loans for residential energy efficiency improvements, repayment of which is made via the homeowner s real property tax bill. This structure is designed to grant lenders of energy efficiency loans the equivalent of a tax lien, giving them priority over other existing liens on the property, including first lien mortgage loans. Consequently, the legislation could increase our credit losses.

On October 29, 2009, the Obama Administration reiterated past statements that it would provide ideas about the future of our business in early 2010.

We cannot predict the prospects for the enactment, timing or content of federal or state legislation, or the impact that any enacted legislation could have on our company or our industry.

Outlook

We anticipate that adverse market conditions and certain of our activities undertaken, pursuant to our mission, to stabilize and support the housing and mortgage markets will continue to negatively affect our financial condition and performance through the remainder of 2009 and into 2010.

Overall Market Conditions. The financial markets have begun to heal, but remain weak on an historical basis. We expect this weakness in the real estate financial markets to continue through the end of 2009 and into 2010. We expect rising default and severity rates and home price declines to continue during this period, particularly in some geographic areas. All of these may worsen if the increase in the unemployment rate exceeds current expectations. We continue to expect further increases in the level of foreclosures and single-family delinquency rates in 2009 and into 2010, as well as in the level of multifamily defaults and loss severity. We expect residential mortgage debt outstanding to decline by nearly 2% in 2009 and increase by less than 1% in 2010.

Home Price Declines: Following a decline of approximately 10% in 2008, we expect that home prices will decline up to another 6% on a national basis in 2009, an improvement from the 7% to 12% decline that we anticipated in prior quarters. We also expect that we will experience a peak-to-trough home price decline on a national basis of 17% to 27%, a change from the 20% to 30% decline that we anticipated in prior quarters. These estimates are based on our home price index, which is calculated differently from the S&P/Case-Shiller U.S. National Home Price Index and therefore results in different percentages for comparable declines. These estimates also contain significant inherent uncertainty in the current market environment, due to historically unprecedented levels of uncertainty regarding a variety of critical assumptions we make when formulating these estimates, including: the effect of actions the federal government has taken and may take with respect to national economic recovery; the impact of those actions on home prices, unemployment and the general economic environment; and the rate of unemployment and/or wage decline. Because of these uncertainties, the actual home price decline we experience may differ significantly from these estimates. We also expect significant regional variation in home price declines.

Our estimate of an up to 6% decline in home prices for 2009 compares with a home price decline of approximately 1% to 7% using the S&P/Case-Shiller index method, and our 17% to 27% peak-to-trough home price decline estimate compares with an approximately 32% to 40% peak-to-trough decline using the S&P/Case-Shiller index method. Our estimates differ from the S&P/Case-Shiller index in two principal ways: (1) our estimates weight expectations for each individual property by number of properties, whereas the S&P/Case-Shiller index weights expectations of home price declines based on property value, causing declines in home prices on higher priced homes to have a greater effect on the overall result; and (2) our estimates do not include known sales of foreclosed homes because we believe that differing maintenance practices and the forced nature of the sales make foreclosed home prices less representative of market values, whereas the S&P/Case-Shiller index includes sales of foreclosed homes. The S&P/Case-Shiller comparison numbers shown above are calculated using our models and assumptions, but modified to use these two factors (weighting of expectations based on property value and the inclusion of foreclosed property sales). In addition to these differences, our estimates are based on our own internally available data combined with publicly available data, and are therefore based on data collected nationwide, whereas the S&P/Case-Shiller index is based only on publicly available data, which may be limited in certain geographic areas of the country. Our comparative calculations to the S&P/Case-Shiller index provided above are not modified to account for this data pool difference.

Credit-Related Expenses. The credit-related expenses we have recognized for the first nine months of 2009 are more than twice as large as the credit-related expenses we recorded for all of 2008. We expect that our credit-related expenses will remain high in 2010, as we believe that the level of our nonperforming loans will remain elevated for a period of time. Absent further economic deterioration, however, we anticipate that our credit-related expenses will be lower in 2010 than they will be in 2009. Our expectation is based on several factors, including (1) the slow-down in the rate of increase in average loss severities as home price declines have begun to moderate and stabilize in some regions, (2) our current expectation that, as 2010 progresses, the rate of credit deterioration will begin to decline and result in a slower rate of increase in delinquencies and (3) our January 1, 2010 adoption of the new accounting standards that affect the consolidation of our MBS trusts and change the accounting for credit-impaired loans acquired from MBS trusts. The adoption of these new accounting standards will eliminate fair value losses recorded on credit-impaired loans acquired from MBS trusts, which we expect will reduce our provision for credit losses and result in a net reduction in our credit-related expenses.

Credit Losses and Credit Loss Ratio. Our credit losses and our credit loss ratio (each of which excludes fair value losses attributable to the acquisition of credit-impaired loans from MBS trusts and HomeSaver Advance loans) for the first nine months of 2009 have already exceeded our credit losses and our credit loss ratio for all of 2008. We expect that our credit losses and credit loss ratio will continue to increase during the remainder of 2009 and during 2010 as a result of the continued high unemployment we have experienced and an expected increase in our charge-offs as we foreclose on seriously delinquent loans for which we are not able to provide a sustainable workout solution.

There is significant uncertainty in the current market environment, and any changes in the trends in macroeconomic factors that we currently anticipate, such as home prices and unemployment, may cause our future credit-related expenses, credit losses and credit loss ratio to vary significantly from our current expectations.

Expected Lack of Profitability for Foreseeable Future. We expect to continue to have losses throughout our guaranty book of business in response to the dual stresses of high unemployment and continuing declines in home prices, and as we continue to incur ongoing costs in our efforts to keep people in their homes and provide liquidity to the mortgage market. We do not expect to operate profitably in the foreseeable future.

Uncertainty Regarding our Future Status and Long-Term Financial Sustainability. We expect that we will experience adverse financial effects as we seek to fulfill our mission by concentrating our efforts on keeping people in their homes and preventing foreclosures, including our efforts under the Making Home Affordable Program, while remaining active in the secondary mortgage market. In addition, future activities that our regulators, other U.S. government agencies or Congress may request or require us to take to support the

mortgage market and help borrowers may contribute to further deterioration in our results of operations and financial condition. Although Treasury s additional funds under the senior preferred stock purchase agreement permit us to remain solvent and avoid receivership, the resulting dividend payments are substantial and will increase as we request additional funds from Treasury under the senior preferred stock purchase agreement. As a result of these factors, along with current and expected market and economic conditions and the deterioration in our single-family and multifamily books of business, there is significant uncertainty as to our long-term financial sustainability. We expect that, for the foreseeable future, the earnings of the company, if any, will not be sufficient to pay the dividends on the senior preferred stock. As a result, future dividend payments will be effectively funded from equity drawn from the Treasury.

There is significant uncertainty regarding the future of our business, including whether we will continue to exist, and we expect this uncertainty to continue. See Legislation in this report and Part I Item 2 MD&A Legislative and Regulatory Matters Obama Administration Financial Regulatory Reform Plan and Congressional Hearing of our Second Quarter 2009 Form 10-Q for a discussion of legislation being considered that could affect our business, including a list of possible reform options for the GSEs outlined in the Administration s white paper describing its proposed financial regulatory reform plan.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

We have identified four of our accounting policies as critical because they involve significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition. These critical accounting policies and estimates are as follows:

Fair Value of Financial Instruments

Other-Than-Temporary Impairment of Investment Securities

Allowance for Loan Losses and Reserve for Guaranty Losses

Deferred Tax Assets

We evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. We describe below significant changes in the judgments and assumptions we made during the first nine months of 2009 in applying our critical accounting policies and estimates. Management has discussed any significant changes in judgments and assumptions in applying our critical accounting policies with the Audit Committee of the Board of Directors. See Part II Item 7 MD&A Critical Accounting Policies and Estimates of our 2008 Form 10-K for additional information about our critical accounting policies and estimates.

Fair Value of Financial Instruments

The use of fair value to measure our financial instruments is fundamental to our financial statements and is a critical accounting estimate because we account for and record a substantial portion of our assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as an exit price).

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance on how to determine the fair value when the volume and level of activity for the asset or liability have significantly decreased. If there has been a significant decrease in the volume and level of activity for an asset or liability as compared to the normal level of market activity for the asset or liability, there is an increased likelihood that quoted prices or transactions for the instrument are not reflective of an orderly transaction and may therefore require significant adjustment to estimate fair value. We evaluate the existence of the following conditions in determining whether there is an inactive market for our financial instruments: (1) there are few transactions for the financial instrument; (2) price quotes are not based on current market information; (3) the price quotes we receive vary significantly either over time or among independent pricing services or dealers; (4) price indices that were previously highly correlated are demonstrably uncorrelated; (5) there is a significant increase in implied liquidity risk premiums, yields or performance indicators, such as delinquency rates or loss severities, for observed transactions or quoted prices when compared with our estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the financial instrument; (6) there is a wide bid-ask spread or significant increase in the bid-ask spread; (7) there is a significant decline or absence of a market for new issuances (*i.e.,* primary market) for the financial instrument or similar financial instruments; or (8) there is limited availability of public market information.

In determining fair value, we use various valuation techniques. We disclose the carrying value and fair value of our financial assets and liabilities and describe the specific valuation techniques used to determine the fair value of these financial instruments in Notes to Condensed Consolidated Financial Statements Note 18, Fair Value of Financial Instruments. Our April 1, 2009 adoption of the FASB s guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased did not result in a change in our valuation techniques for estimating fair value.

The fair value accounting rules provide a three-level fair value hierarchy for classifying financial instruments. This hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Each asset or liability is assigned to a level based on the lowest level of any input that is significant to the fair value measurement. The three levels of the fair value hierarchy are described below:

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

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

Level 3: Unobservable inputs.

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

Fair Value Hierarchy Level 3 Assets and Liabilities

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

Fair value measurements related to financial instruments that are reported at fair value in our condensed consolidated financial statements each period, such as our trading and available-for-sale securities and derivatives, are referred to as recurring fair value measurements. Fair value measurements related to financial instruments that are not reported at fair value each period, such as held-for-sale mortgage loans, are referred to as non-recurring fair value measurements. The following discussion identifies the primary types of financial assets and liabilities within each balance sheet category that are reported at fair value on a recurring basis and also are based on level 3 inputs. We also describe the valuation techniques we use to determine their fair values, including key inputs and assumptions.

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

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

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

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

Table 2 presents a comparison, by balance sheet category, of the amount of financial assets carried in our consolidated balance sheets at fair value on a recurring basis and classified as level 3 as of September 30, 2009 and December 31, 2008. The availability of observable market inputs to measure fair value varies based on changes in market conditions, such as liquidity. As a result, we expect the amount of financial instruments carried at fair value on a recurring basis and classified as level 3 to vary each period.

Table 2: Level 3 Recurring Financial Assets at Fair Value

Balance Sheet Category	As of September 30, 2009	As of December 31, 2008
	(Dollars in millions)	
Trading securities	$ 9,237	$ 12,765
Available-for-sale securities	38,242	47,837
Derivatives assets	265	362
Guaranty assets and buy-ups	2,100	1,083
Level 3 recurring assets	$ 49,844	$ 62,047
Total assets	$ 890,275	$ 912,404
Total recurring assets measured at fair value	$ 370,711	$ 359,246
Level 3 recurring assets as a percentage of total assets	6%	7%
Level 3 recurring assets as a percentage of total recurring assets measured at fair value	13%	17%
Total recurring assets measured at fair value as a percentage of total assets	42%	39%

Level 3 recurring assets totaled $49.8 billion, or 6% of our total assets, as of September 30, 2009, compared with $62.0 billion, or 7% of our total assets, as of December 31, 2008. The decrease in assets classified as level 3 during the first nine months of 2009 was principally the result of a net transfer of approximately $8.3 billion in assets to level 2 from level 3. The transferred assets consisted primarily of private-label mortgage-related securities backed by non-fixed rate Alt-A loans. The market for Alt-A securities continues to be relatively illiquid. However, during the first nine months of 2009, price transparency improved as a result of recent transactions, and we noted some convergence in prices obtained from third party vendors. As a result, we determined that our fair value estimates for these securities did not rely on significant unobservable inputs.

Financial assets measured at fair value on a non-recurring basis and classified as level 3, which are not presented in the table above, include held-for-sale loans that are measured at lower of cost or fair value and that were written down to fair value during the period. Held-for-sale loans that were reported at fair value, rather than amortized cost, totaled $2.8 billion as of September 30, 2009 and $1.3 billion as of December 31, 2008. In addition, certain other financial assets carried at amortized cost that have been written down to fair value during the period due to impairment are classified as non-recurring. The fair value of these level 3 non-recurring financial assets, which primarily consisted of certain guaranty assets, low income housing tax credit (LIHTC) partnership investments and acquired property, totaled $21.3 billion as of September 30, 2009 and $22.4 billion as of December 31, 2008.

Our LIHTC investments trade in a market with limited observable transactions. There is decreased market demand for LIHTC investments because there are fewer tax benefits derived from these investments by traditional investors, as these investors are currently projecting much lower levels of future profits than in previous years. This decreased demand has reduced the value of these investments. We determine the fair value of our LIHTC investments using internal models that estimate the present value of the expected future tax benefits (tax credits and tax deductions for net operating losses) expected to be generated from the properties underlying these investments. Our estimates are based on assumptions that other market participants would use in valuing these investments. The key assumptions used in our models, which require significant management judgment, include discount rates and projections related to the amount and timing of tax benefits. We compare our model results to independent third party valuations to validate the reasonableness of our assumptions and valuation results. We also compare our model results to the limited number of observed market transactions and make adjustments to reflect differences between the risk profile of the observed market transactions and our LIHTC investments.

Financial liabilities measured at fair value on a recurring basis and classified as level 3 consisted of long-term debt with a fair value of $684 million as of September 30, 2009 and $2.9 billion as of December 31, 2008, and derivatives liabilities with a fair value of $5 million as of September 30, 2009 and $52 million as of December 31, 2008.

Fair Value Control Processes

We have control processes that are designed to ensure that our fair value measurements are appropriate and reliable, that they are based on observable inputs wherever possible and that our valuation approaches are consistently applied and the assumptions used are reasonable. Our control processes consist of a framework that provides for a segregation of duties and oversight of our fair value methodologies and valuations and validation procedures. See Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Financial Instruments of our 2008 Form 10-K for additional information about our fair value control processes.

Other-Than-Temporary Impairment of Investment Securities

We evaluate available-for-sale securities in an unrealized loss position as of the end of each quarter for other-than-temporary impairment. In April 2009, the FASB issued new accounting guidance that modifies the model for assessing other-than-temporary impairment for investments in debt securities. Under this guidance, a debt security is evaluated for other-than-temporary impairment if its fair value is less than its amortized cost basis. Other-than-temporary impairment is recognized in earnings if one of the following conditions exists: (1) the intent is to sell the security; (2) it is more likely than not that we will be required to sell the security before the impairment is recovered; or (3) the amortized cost basis is not expected to be recovered. If, however, we do not intend to sell the security and will not be required to sell prior to recovery of the amortized cost basis, only the credit component of other-than-temporary impairment is recognized in earnings. The noncredit component is recorded in other comprehensive income (OCI). The credit component is the difference between the security s amortized cost basis and the present value of its expected future cash flows, while the noncredit component is the remaining difference between the security s fair value and the present value of expected future cash flows. We adopted this new accounting guidance effective April 1, 2009, which resulted in a cumulative-effect pre-tax reduction of $8.5 billion ($5.6 billion after tax) in our accumulated deficit to reclassify to accumulated other comprehensive income (AOCI) the noncredit component of other-than-temporary impairment losses previously recognized in earnings. We also reversed $3.0 billion of our deferred tax asset valuation allowance, which resulted in a $3.0 billion reduction in our accumulated deficit, because we continue to have the intent and ability to hold these securities to recovery.

We conduct periodic reviews of each investment security that has an unrealized loss to determine whether other-than-temporary impairment has occurred. As a result of our April 1, 2009 adoption of the new other-than-temporary impairment guidance, we revised our approach for measuring and recognizing impairment losses on our investment securities. Our evaluation continues to require significant management judgment and a consideration of various factors to determine if we will receive the amortized cost basis of our investment securities. These factors include, but are not limited to, the severity and duration of the impairment; recent events specific to the issuer and/or industry to which the issuer belongs; the payment

structure of the security; external credit ratings and the failure of the issuer to make scheduled interest or principal payments. We rely on expected future cash flow projections to determine if we will recover the amortized cost basis of our available-for-sale securities. These cash flow projections are derived from internal models that consider particular attributes of the loans underlying our securities and assumptions about changes in the economic environment, such as home prices and interest rates, to predict borrower behavior and the impact on default frequency, loss severity and remaining credit enhancement.

We provide more detailed information on our accounting for other-than-temporary impairment in Notes to Condensed Consolidated Financial Statements Note 2, Summary of Significant Accounting Policies. Also refer to Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities Investments in Private-Label Mortgage-Related Securities for a discussion of other-than-temporary impairment recognized on our investments in Alt-A and subprime private-label securities.

Allowance for Loan Losses and Reserve for Guaranty Losses

We maintain an allowance for loan losses for loans in our mortgage portfolio classified as held-for-investment. We maintain a reserve for guaranty losses for loans that back Fannie Mae MBS we guarantee and loans that we have guaranteed under long-term standby commitments. We report the allowance for loan losses and reserve for guaranty losses as separate line items in the consolidated balance sheets. These amounts, which we collectively refer to as our combined loss reserves, represent probable losses incurred in our guaranty book of business as of the balance sheet date. We maintain separate loss reserves for single-family and multifamily loans. Our single-family and multifamily loss reserves consist of a specific loss reserve for impaired loans and a collective loss reserve for all other loans.

We have an established process, using analytical tools, benchmarks and management judgment, to determine our loss reserves. Although our loss reserve process benefits from extensive historical loan performance data, this process is subject to risks and uncertainties, including a reliance on historical loss information that may not be representative of current conditions. We continually monitor delinquency and default trends and make changes in our historically developed assumptions and estimates as necessary to better reflect the impact of present conditions, including current trends in borrower risk and/or general economic trends, changes in risk management practices, and changes in public policy and the regulatory environment. Because of the stress in the housing and credit markets, and the speed and extent of deterioration in these markets, our process for determining our loss reserves has become significantly more complex and involves a greater degree of management judgment.

Single-Family Loss Reserves

We establish a specific single-family loss reserve for individually impaired loans, which includes loans we restructure in a troubled debt restructuring and credit-impaired loans we acquire from our MBS trusts. We typically measure impairment based on the difference between our recorded investment in the loan and the present value of the estimated cash flows we expect to receive, which we calculate using the effective interest rate of the original loan. However, when foreclosure is probable, we measure impairment based on the difference between our recorded investment in the loan and the fair value of the underlying collateral property, less the estimated discounted costs to sell the property, and adjusted for estimated insurance or other proceeds we expect to receive.

We establish a collective single-family loss reserve, which represents the substantial majority of our total single-family loss reserve, for all other single-family loans in our single-family guaranty book of business by aggregating homogeneous loans into pools based on common underlying risk characteristics, such as origination year, original LTV ratio and loan product type, to derive an overall estimate. Our historical loan performance data indicates a pattern of default rates and credit losses that typically occur over time, which are strongly dependent on the age of a mortgage loan. We historically have relied on internally developed default patterns, or loss curves, derived from observed default trends for each homogeneous pool of loans to develop our collective single-family loss reserve. Our default loss curves are shaped by the normal pattern of defaults, based on the age of the book, and informed by historical default trends and the performance of the loans in our book to date. We use these loss curve models to estimate, based on current events and conditions, the number of loans that will default (default rate) and how much of a loan s balance will be lost in the event of default (loss severity). For the majority of our loan risk categories, our default rate estimates have traditionally been based on loss curves developed from available historical loan performance data dating back to 1980.

As a result of the decline in home prices, the weakened economy and high unemployment, mortgage delinquencies have reached record levels. We have observed significant changes in traditional loan performance and delinquency patterns, including an increase in early-stage delinquencies and a larger number of loans transitioning to later stage delinquencies. Because of these observed changes in our historical loan performance, during 2007 and 2008, we transitioned to using a shorter, more near-term default loss curve based on a one quarter look-back period to generate estimated default rates for loans originated in 2006 and 2007 and for Alt-A loans originated in 2005. We also transitioned during this period to using a one quarter look-back period to develop loss severity estimates for all of our loan categories. At the end of the third quarter of 2009, we began using the one quarter look-back period to estimate default rates for loans originated in 2008. Based on our loss reserve process, we believe that the loss severity estimates used in determining our loss reserves reflect current available information on actual events and conditions as of each balance sheet date, including current home price and unemployment trends. Our loss severity estimates do not incorporate assumptions about future changes in home prices.

We began observing additional changes in delinquency patterns during the fourth quarter of 2008 and into 2009 due to government policies and our initiatives to prevent foreclosures. For example, our level of foreclosures and associated charge-offs were lower during the fourth quarter of 2008 and the first quarter of 2009 than they otherwise would have been due to our foreclosure suspension that was in effect during the periods November 26, 2008 through January 31, 2009 and February 17, 2009 through March 6, 2009. In addition, our requirement that servicers pursue loan modification options with borrowers before proceeding to a foreclosure sale, along with state-driven changes in foreclosure rules to slow and extend the foreclosure process, have resulted in foreclosure delays and longer delinquency periods. Because of the distortion in defaults caused by these actions, we adjusted our loss curves to incorporate default estimates derived from an assessment of our most recently observed loan delinquencies and the related transition of loans through the various delinquency categories. We used this delinquency assessment and our most recent default information prior to the foreclosure suspension to estimate the number of defaults that we would have expected to occur during each quarter of 2009 if the foreclosure moratoria and our new foreclosure guidelines had not been in effect. We then used these estimated defaults, rather than the actual number of defaults that occurred during each quarter, to estimate our loss curves and derive the default rates used in determining our single-family loss reserves as of September 30, 2009.

Consistent with the approach we used as of December 31, 2008, management made adjustments to our model-generated results to capture incremental losses that may not be fully reflected in our models related to geographically concentrated areas that are experiencing severe stress as a result of significant home price declines. At the end of December 31, 2008 and the end of the first and second quarters of 2009, management also made adjustments to our model-generated results to capture incremental losses attributable to the sharp rise in unemployment, which had not been fully captured in our models. Because we believe our models incorporate the current high rate of unemployment and the increase in unemployment slowed during the third quarter of 2009, we did not include an incremental loss adjustment for unemployment in determining our loss reserves as of September 30, 2009.

Multifamily Loss Reserves

We establish a specific multifamily loss reserve for multifamily loans that we determine are individually impaired. We use an internal credit-risk rating system and the delinquency status to evaluate the credit quality of our multifamily loans and to determine which loans we believe are impaired. Our risk-rating system, which results in an assigned risk rating for each multifamily loan, is based on an incurred loss model. We estimate the probability of incurred losses by assessing the credit risk profile and repayment prospects of each loan, taking into consideration available operating statements and expected cash flows from the underlying property, the estimated value of the collateral property, the historical loan payment experience and current relevant market conditions that may impact credit quality. Because our multifamily loans are collateral-dependent, if we conclude that a multifamily loan is impaired, we measure the impairment based on the difference between our recorded investment in the loan and the fair value of the underlying collateral property less the estimated discounted costs to sell the property. We generally obtain property appraisals from independent third-parties to determine the fair value of multifamily loans that we consider to be individually impaired. We also obtain property appraisals when we foreclose on a multifamily property.

The collective multifamily loss reserve for all other multifamily loans in our multifamily guaranty book of business is established using an internal model that applies loss factors to loans with similar risk ratings. Our loss factors are developed based on our historical data of default and loss severity experience. Management may also apply judgment to adjust the loss factors derived from our models, taking into consideration model imprecision and specifically known events, such as current credit conditions, that may affect the credit quality of our multifamily loan portfolio but are not yet reflected in our model-generated loss factors. For example, in the first and second quarters of 2009, we made several enhancements to the models used in determining our multifamily loss reserves to reflect the impact of the continuing deterioration in the credit performance of loans in our multifamily guaranty book of business, as evidenced by a significant increase in multifamily loan defaults and loss severities. These model enhancements involved weighting more heavily recent loan default and severity experience, which has been higher than in previous periods, to derive the key parameters used in calculating our expected default rates.

Combined Loss Reserves

Our combined loss reserves increased by $41.1 billion during the first nine months of 2009 to $65.9 billion as of September 30, 2009, reflecting further deterioration in both our single-family and multifamily guaranty book of business, as evidenced by the significant increase in delinquent, seriously delinquent and nonperforming loans, as well as an increase in our average loss severities as a result of the decline in home prices during 2009. Our combined loss reserves of $65.9 billion as of September 30, 2009 included an incremental adjustment for geographic stress of approximately $5.8 billion. In comparison, our combined loss reserves of $24.8 billion as of December 31, 2008 included an incremental adjustment for geographic and unemployment stresses of approximately $2.3 billion.

We provide additional information on our combined loss reserves and the impact of adjustments to our loss reserves on our condensed consolidated financial statements in Consolidated Results of Operations Credit-Related Expenses and Notes to Condensed Consolidated Financial Statements Note 5, Allowance for Loan Losses and Reserve for Guaranty Losses.

CONSOLIDATED RESULTS OF OPERATIONS

Our business generates revenues from three principal sources: net interest income; guaranty fee income; and fee and other income. Other significant factors affecting our results of operations include: fair value gains and losses; the timing and size of investment gains and losses; other-than-temporary impairments; credit-related expenses; losses from partnership investments; administrative expenses and our effective tax rate. We expect high levels of period-to-period volatility in our results of operations and financial condition, principally due to changes in market conditions that result in periodic fluctuations in the estimated fair value of financial instruments that we mark-to-market through our earnings. These instruments include trading securities and derivatives. The estimated fair value of our trading securities and derivatives may fluctuate substantially from period to period because of changes in interest rates, credit spreads and expected interest rate volatility, as well as activity related to these financial instruments.

Table 3 presents a condensed summary of our consolidated results of operations for the three and nine months ended September 30, 2009 and 2008 and selected performance metrics that we believe are useful in evaluating changes in our results between periods.

Table 3: Summary of Condensed Consolidated Results of Operations and Select Performance Metrics

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-D Varianc
	2009	2008	2009	2008	$	%	$
	(Dollars in millions, except per share amounts)						
income	$ 3,830	$ 2,355	$ 10,813	$ 6,102	$ 1,475	63%	$ 4,711
e income	1,923	1,475	5,334	4,835	448	30	499
gement income	12	65	36	247	(53)	(82)	(211)
er income	182	164	547	616	18	11	(69)
es	**5,947**	**4,059**	**16,730**	**11,800**	**1,888**	**47**	**4,930**
gains (losses), net(1)	785	219	963	(213)	566	258	1,176
han-temporary impairments(1)	(939)	(1,843)	(7,345)	(2,405)	904	49	(4,940)
osses, net(2)	(1,536)	(3,947)	(2,173)	(7,807)	2,411	61	5,634
n partnership investments	(520)	(587)	(1,448)	(923)	67	11	(525)
tive expenses	(562)	(401)	(1,595)	(1,425)	(161)	(40)	(170)
ed expenses(3)	(21,960)	(9,241)	(61,616)	(17,833)	(12,719)	(138)	(43,783)
nterest expenses(1)(4)	(242)	(172)	(1,108)	(960)	(70)	(41)	(148)
federal income taxes and ry losses	(19,027)	(11,913)	(57,592)	(19,766)	(7,114)	(60)	(37,826)
ovision) for federal income	143	(17,011)	743	(13,607)	17,154	101	14,350
ry losses, net of tax effect		(95)		(129)	95	100	129
	(18,884)	**(29,019)**	**(56,849)**	**(33,502)**	**10,135**	**35**	**(23,347)**
ncome) loss attributable to the ing interest	12	25	55	22	(13)	(52)	33
tributable to Fannie Mae	**$ (18,872)**	**$ (28,994)**	**$ (56,794)**	**$ (33,480)**	**$ 10,122**	**35%**	**$ (23,314)**
s per common share	**$ (3.47)**	**$ (13.00)**	**$ (10.24)**	**$ (24.24)**	**$ 9.53**	**73.31%**	**$ 14.00**
ormance metrics:							
yield(5)	1.76%	1.10%	1.63%	0.98%			
fective guaranty fee rate (in)(6)	29.1bp	23.6bp	27.3bp	26.4bp			
ratio (in basis points)(7)	48.1	29.7	41.8	20.1			

(1) Prior to the April 2009 change in impairment accounting, net other-than-temporary impairments also included the non credit portion, which in subsequent periods is recorded in other comprehensive income. Certain prior period amounts have been reclassified to conform with the current period presentation in our condensed consolidated statements of operations.

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

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

(4) Consists of the following: (a) debt extinguishment gains (losses), net and (b) other expenses.

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

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

(7) Calculated based on annualized (a) charge-offs, net of recoveries; plus (b) foreclosed property expense; adjusted to exclude (c) the impact of fair value losses resulting from credit-impaired loans acquired from MBS trusts and HomeSaver Advance loans for the reporting period divided by the average guaranty book of business during the period, expressed in basis points.

The section below provides a comparative discussion of our condensed consolidated results of operations for the three and nine months ended September 30, 2009 and 2008. Following this section, we provide a discussion of our business segment results. You should read this section together with our Executive

Summary where we discuss trends and other factors that we expect will affect our future results of operations.

Net Interest Income

Net interest income represents the difference between our interest income and interest expense and is a primary source of our revenue. Our net interest yield represents the difference between the yield on our interest-earning assets and the cost of our debt. We supplement our issuance of debt with interest rate-related derivatives to manage the prepayment and duration risk inherent in our mortgage investments. The effect of these derivatives, in particular the periodic net interest expense accruals on interest rate swaps, is not reflected in net interest income. See Fair Value Gains (Losses), Net for additional information.

We expect net interest income and our net interest yield to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities. Table 4 presents an analysis of our net interest income and net interest yield for the three and nine months ended September 30, 2009 and 2008.

Table 4: Analysis of Net Interest Income and Yield

	For the Three Months Ended September 30,					
	2009			2008		
	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)	$ 419,177	$ 5,290	5.05%	$ 424,609	$ 5,742	5.41%
Mortgage securities	354,664	4,285	4.83	335,739	4,330	5.16
Non-mortgage securities(3)	58,077	52	0.35	58,208	381	2.56
Federal funds sold and securities purchased under agreements to resell	34,393	23	0.26	42,037	274	2.55
Advances to lenders	4,951	25	1.98	3,226	36	4.37
Total interest-earning assets	$ 871,262	$ 9,675	4.44%	$ 863,819	$ 10,763	4.98%
Interest-bearing liabilities:						
Short-term debt	$ 265,760	$ 390	0.57%	$ 271,007	$ 1,677	2.42%
Long-term debt	569,624	5,455	3.83	560,540	6,728	4.80
Federal funds purchased and securities sold under agreements to repurchase	41		1.68	526	3	2.23
Total interest-bearing liabilities	$ 835,425	$ 5,845	2.79%	$ 832,073	$ 8,408	4.02%
Impact of net non-interest bearing funding	$ 35,837		0.11%	$ 31,746		0.14%

Net interest income/net interest yield[4]	$ 3,830	1.76%	$ 2,355	1.10%
Selected benchmark interest rates at end of period:[5]				
3-month LIBOR		0.29%		4.05%
2-year swap interest rate		1.29		3.48
5-year swap interest rate		2.65		4.11
30-year Fannie Mae MBS par coupon rate		4.24		5.65

	For the Nine Months Ended September 30,					
	2009			2008		
	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)	$ 428,981	$ 16,499	5.13%	$ 417,764	$ 17,173	5.48%
Mortgage securities	348,212	13,067	5.00	323,334	12,537	5.17
Non-mortgage securities(3)	53,957	211	0.52	60,771	1,459	3.15
Federal funds sold and securities purchased under agreements to resell	49,326	237	0.63	35,072	853	3.20
Advances to lenders	5,062	77	2.01	3,594	147	5.37
Total interest-earning assets	$ 885,538	$ 30,091	4.53%	$ 840,535	$ 32,169	5.10%
Interest-bearing liabilities:						
Short-term debt	$ 295,224	$ 2,097	0.94%	$ 257,020	$ 5,920	3.03%
Long-term debt	566,813	17,181	4.04	552,343	20,139	4.86
Federal funds purchased and securities sold under agreements to repurchase	41		1.39	422	8	2.49
Total interest-bearing liabilities	$ 862,078	$ 19,278	2.98%	$ 809,785	$ 26,067	4.28%
Impact of net non-interest bearing funding	$ 23,460		0.08%	$ 30,750		0.16%
Net interest income/net interest yield(4)		$ 10,813	1.63%		$ 6,102	0.98%

(1) We have calculated the average balances for mortgage loans based on the average of the amortized cost amounts as of the beginning of the period and as of the end of each month in the period. For all other categories, the average balances have been calculated based on a daily average.

(2) Average balance amounts include nonaccrual loans with an average balance totaling $24.8 billion and $9.2 billion for the three months ended September 30, 2009 and 2008, respectively, and $20.5 billion and $8.7 billion for the nine months ended September 30, 2009 and 2008, respectively. Interest income includes interest income on acquired credit-impaired loans, which totaled $142 million and $166 million for the three months ended September 30, 2009 and 2008, respectively, and $551 million and $479 million for the nine months ended September 30, 2009 and 2008, respectively. These interest income amounts included accretion of $79 million and $37 million for the three months ended September 30, 2009 and 2008, respectively, and $342 million and $125 million for the nine months ended September 30, 2009 and 2008, respectively, relating to a portion of the fair value losses recorded upon the acquisition of the loans.

(3) Includes cash equivalents.

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

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

Table 5 presents the change in our net interest income between periods and the extent to which that variance is attributable to: (1) changes in the volume of our interest-earning assets and interest-bearing liabilities or (2) changes in the interest rates of these assets and liabilities.

Table 5: Rate/Volume Analysis of Net Interest Income

	For the Three Months Ended September 30, 2009 vs. 2008			For the Nine Months Ended September 30, 2009 vs. 2008		
	Total	Variance Due to:[1]		Total	Variance Due to:[1]	
	Variance	Volume	Rate	Variance	Volume	Rate
	(Dollars in millions)					
Interest income:						
Mortgage loans	$ (452)	$ (73)	$ (379)	$ (674)	$ 452	$ (1,126)
Mortgage securities	(45)	237	(282)	530	943	(413)
Non-mortgage securities[2]	(329)	(1)	(328)	(1,248)	(147)	(1,101)
Federal funds sold and securities purchased under agreements to resell	(251)	(42)	(209)	(616)	253	(869)
Advances to lenders	(11)	14	(25)	(70)	45	(115)
Total interest income	(1,088)	135	(1,223)	(2,078)	1,546	(3,624)
Interest expense:						
Short-term debt	(1,287)	(32)	(1,255)	(3,823)	772	(4,595)
Long-term debt	(1,273)	107	(1,380)	(2,958)	516	(3,474)
Federal funds purchased and securities sold under agreements to repurchase	(3)	(2)	(1)	(8)	(5)	(3)
Total interest expense	(2,563)	73	(2,636)	(6,789)	1,283	(8,072)
Net interest income	$ 1,475	$ 62	$ 1,413	$ 4,711	$ 263	$ 4,448

(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 increased 63% in the third quarter of 2009 compared with the third quarter of 2008 driven primarily by a 60% expansion in our net interest yield and a 1% increase in our average interest earning assets. The 66 basis point increase in our net interest yield in the third quarter was primarily attributable to a 123 basis point reduction in the average cost of our debt to 2.79%, which more than offset the 54 basis point decline in the average yield on our interest-earning assets to 4.44%. The significant reduction in the average cost of our debt during the third quarter of 2009 from the comparable prior year period was primarily attributable to a decline in borrowing rates.

For the first nine months of 2009, net interest income increased 77% compared with the first nine months of 2008, driven primarily by a 66% expansion in our net interest yield and a 5% increase in our average interest earning assets. The 65 basis point increase in our net interest yield in the first nine months of 2009 was primarily attributable to a 130 basis point reduction in the average cost of our debt to 2.98%, which more than offset the 57 basis point decline in the average yield on our interest-earning assets to 4.53%. The decline in the average cost of our debt for the first nine months of 2009 was primarily attributable to a decline in borrowing rates and redemption of maturing debt, which was replaced by lower-cost debt.

The 1% increase in our average interest-earning assets for the third quarter of 2009 and 5% increase for the first nine months of 2009 compared with comparable periods in 2008 was attributable to growth in the second half of 2008, when we increased portfolio purchases as mortgage-to-debt spreads hit historic highs, and liquidations were reduced due to the disruption of the housing and credit markets. Due to this growth in 2008, the average balance of assets during 2009 was larger than for most of 2008, leading to larger average assets for the first nine months of 2009.

Although we consider the periodic net contractual interest accruals on our interest rate swaps to be part of the cost of funding our mortgage investments, these amounts are not reflected in our net interest income and net interest yield. Instead, these amounts are included in our derivatives gains (losses) and reflected in our condensed consolidated statements of operations as a component of Fair value losses, net. As shown in Table 8, we recorded net contractual interest expense on our interest rate swaps totaling $968 million for the third quarter of 2009 compared with $681 million for the third quarter of 2008 and $2.7 billion for the first nine months of 2009 compared with $1.0 billion for the first nine months of 2008. The economic effect of the interest accruals on our interest rate swaps increased our funding costs by 46 basis points for the third quarter of 2009 compared with 33 basis points for the third quarter of 2008 and 42 basis points for the first nine months of 2009 compared with 17 basis points for the first nine months of 2008.

Under the senior preferred stock purchase agreement, we are limited in the amount of mortgage assets we are allowed to own and the amount of debt we are allowed to have outstanding. Although the debt and mortgage portfolio caps did not have a significant impact on our portfolio activities during the third quarter or first nine months of 2009, these limits may have a significant adverse impact on our future portfolio activities and net interest income. For additional information on our portfolio investment and funding activity, see Consolidated Balance Sheet Analysis Mortgage Investments and Liquidity and Capital Management Liquidity Management Debt Funding.

Guaranty Fee Income

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

Table 6 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, 2009 and 2008.

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

	For the Three Months Ended September 30,				
	2009		2008		
	Amount	Rate[2]	Amount	Rate[2]	% Change
	(Dollars in millions)				
Guaranty fee income/average effective guaranty fee rate excluding certain fair value adjustments and buy-up impairment	$ 1,587	24.0bp	$ 1,546	24.7bp	3%
Net change in fair value of buy-ups and certain guaranty assets	338	5.1	(63)	(1.0)	637
Buy-up impairment	(2)		(8)	(0.1)	75
Guaranty fee income/average effective guaranty fee rate	$ 1,923	29.1bp	$ 1,475	23.6bp	30%
Average outstanding Fannie Mae MBS and other guarantees[3]	$ 2,642,484		$ 2,502,254		6%
Fannie Mae MBS issues[4]	201,142		106,991		88

For the Nine Months Ended September 30,

	2009		2008		
	Amount	**Rate[2]**	**Amount**	**Rate[2]**	**% Change**
			(Dollars in millions)		
Guaranty fee income/average effective guaranty fee rate excluding certain fair value adjustments and buy-up impairment	$ 4,858	24.9bp	$ 4,723	25.8bp	3%
Net change in fair value of buy-ups and certain guaranty assets	500	2.5	151	0.8	231
Buy-up impairment	(24)	(0.1)	(39)	(0.2)	38
Guaranty fee income/average effective guaranty fee rate	$ 5,334	27.3bp	$ 4,835	26.4bp	10%
Average outstanding Fannie Mae MBS and other guarantees[3]	$ 2,600,954		$ 2,438,143		7%
Fannie Mae MBS issues[4]	671,373		453,346		48

(1) Guaranty fee income includes the accretion of losses recognized at inception on certain guaranty contracts for periods prior to January 1, 2008. Guaranty fee income includes an estimated $103 million and $436 million for the third quarter and first nine months of 2009, respectively, and $131 million and $555 million for the third quarter and first nine months of 2008, related to the accretion of deferred amounts on guarantee contracts where we recognized losses at the inception of the contract.

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

(3) Includes unpaid principal balance of other guarantees totaling $25.0 billion and $27.8 billion as of September 30, 2009 and December 31, 2008, respectively, and $32.2 billion and $41.6 billion as of September 30, 2008 and December 31, 2007, respectively.

(4) 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.

Guaranty fee income increased 30% in the third quarter of 2009 compared with the third quarter of 2008 driven by a 6% increase in our average outstanding Fannie Mae MBS and other guarantees and a 23% increase in the average effective guaranty fee rate. For the first nine months of 2009, guaranty fee income increased 10% compared with the first nine months of 2008 driven by a 7% increase in our average outstanding Fannie Mae MBS and other guarantees and a 3% increase in the average effective guaranty fee rate. The increase in our average outstanding Fannie Mae MBS and other guarantees for the third quarter and first nine months of 2009 was driven by continued high market share of new single-family mortgage-related securities issuances and because new MBS issuances outpaced liquidations. The increase in our average effective guaranty fee rate for both periods was primarily attributable to higher fair value of buy-ups and certain guaranty assets recorded in the third quarter and first nine months of 2009 due to increased market prices on interest-only strips. We use interest-only strips pricing as a component in estimating the fair value of our buy-ups and certain guaranty assets.

The average charged guaranty fee on our new single-family business was 24.7 basis points for the third quarter of 2009 compared with 31.9 basis points for the third quarter of 2008 and 23.2 basis points for the first nine months of 2009 compared with 28.1 basis points for the first nine months of 2008. The average charged guaranty fee represents the average contractual fee rate for our single-family guaranty arrangements plus the recognition of any upfront cash payments ratably over an estimated average life. The decrease in the average charged guaranty fee was primarily the result of a shift in the composition of our new business given changes in underwriting and eligibility standards, which resulted in a reduction in our acquisition of loans with higher risk, higher fee categories such as higher LTV and lower FICO credit scores.

Trust Management Income

Trust management income consists of the fees we earn as master servicer, issuer and trustee for Fannie Mae MBS. We derive these fees from the interest earned on cash flows between the date of remittance of mortgage and other payments to us by servicers and the date of distribution of these payments to MBS certificateholders, which we refer to as float income. Trust management income decreased to $12 million for the third quarter of 2009 from $65 million for the third quarter of 2008 and decreased to $36 million for the first nine months of 2009 from $247 million for the first nine months of 2008. The decrease during each period was attributable to significantly lower short-term interest rates.

Fee and Other Income

Fee and other income consists primarily of transaction fees, technology fees and multifamily fees. These fees are largely driven by our business volume. Fee and other income increased to $182 million for the third quarter of 2009 from $164 million for the third quarter of 2008. The increase was driven by higher structured transaction fees offset by lower multifamily fees due to slower multifamily loan prepayments during 2009. For the first nine months of 2009, fee and other income decreased to $547 million from $616 million for the first nine months of 2008. The decrease was primarily attributable to lower multifamily fees due to slower multifamily prepayments.

Investment Gains (Losses), Net

Investment gains and losses, net includes lower of cost or fair value adjustments on held-for-sale loans; gains and losses recognized on the securitization of loans or securities from our portfolio; gains and losses recognized from the sale of available-for-sale securities; and other investment gains and losses. Investment gains and losses may fluctuate significantly from period to period depending upon our portfolio investment and securitization activities. The $566 million increase in investment gains for the third quarter of 2009 compared with the third quarter of 2008 and the $1.2 billion shift from losses to gains for the first nine months of 2009 compared with the first nine months of 2008 was primarily attributable to an increase in gains on portfolio securitizations in the third quarter and first nine months of 2009 as compared with 2008 as we increased our MBS issuance volumes and sales related to whole loan conduit activity and due to an increase in realized gains on sales of available-for-sale securities as tightening of investment spreads on agency MBS led to higher sale prices. These gains were partially offset by increased lower of cost or fair value adjustments on loans, primarily driven by a decline in the credit quality of these loans.

Net Other-Than-Temporary Impairment

Net other-than-temporary impairment decreased to $939 million for the third quarter of 2009 from $1.8 billion for the third quarter of 2008. The decrease was driven primarily by the change in our impairment accounting policies on April 1, 2009. As a result, beginning with the second quarter of 2009, only the credit portion of other-than-temporary impairment is recognized in our consolidated statement of operations. The net other-than-temporary impairment charge recorded in the third quarter of 2009 was driven by increased loss expectations on our investments in private-label securities, primarily Alt-A securities.

Net other-than-temporary impairment increased to $7.3 billion for the first nine months of 2009 from $2.4 billion for the first nine months of 2008 due to increased loss expectations for our investments in private-label securities, primarily Alt-A and subprime securities, and a significant decline in the fair value of our private-label securities portfolio. Of the total net other-than-temporary impairment charge for the first nine months of 2009, $5.7 billion was recorded in the first quarter of 2009 before the change in the impairment accounting guidance took effect.

See Consolidated Balance Sheet Analysis Trading and Available-for-Sale Investment Securities Investments in Private-Label Mortgage-Related Securities for additional information on the other-than-temporary impairment recognized on our investments in Alt-A and subprime private-label mortgage-related securities. See Part II Item 1A Risk Factors for a discussion of the risks associated with possible future write-downs of our investment securities.

Fair Value Gains (Losses), Net

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

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

Table 7 summarizes the components of fair value gains (losses), net for the three and nine months ended September 30, 2009 and 2008.

Table 7: Fair Value Gains (Losses), Net

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in millions)			
Derivatives fair value losses, net[1]	$ (3,123)	$ (3,302)	$ (5,366)	$ (4,012)
Trading securities gains (losses), net[2]	1,683	(2,934)	3,411	(5,126)
Hedged mortgage assets gains, net[3]		2,028		1,225
Fair value losses on derivatives, trading securities, and hedged mortgage assets, net	(1,440)	(4,208)	(1,955)	(7,913)
Debt foreign exchange gains (losses), net	(47)	227	(161)	58
Debt fair value gains (losses), net	(49)	34	(57)	48
Fair value losses, net	$ (1,536)	$ (3,947)	$ (2,173)	$ (7,807)

(1) Includes losses of approximately $104 million for the three and nine months ended September 30, 2008, which resulted from the termination of our derivative contracts with a subsidiary of Lehman Brothers.

(2) Includes trading losses of $559 million recorded during the third quarter of 2008, which resulted from the write-down to fair value of our investment in corporate debt securities issued by Lehman Brothers.

(3) Represents adjustments to the carrying value of mortgage assets designated for hedge accounting that are attributable to changes in interest rates. We did not apply hedge accounting in 2009, or in the first quarter of 2008.

Derivatives Fair Value Gains (Losses), Net

Derivative instruments are an integral part of our management of interest rate risk. We supplement our issuance of debt with derivative instruments to manage our duration and prepayment risks. Table 8 presents, by type of derivative instrument, the fair value gains and losses on our derivatives for the three and nine months ended September 30, 2009 and 2008. Table 8 also includes an analysis of the components of derivatives fair value gains and losses attributable to net contractual interest accruals on our interest rate swaps, the net change in the fair value of terminated derivative contracts through the date of termination and the net change in the fair value of outstanding derivative contracts. The 5-year swap interest rate, which is shown below in Table 8, is a key reference interest rate that affects the fair value of our derivatives.

Table 8: Derivatives Fair Value Gains (Losses), Net

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in millions)			
Risk management derivatives:				
Swaps:				
Pay-fixed	$ (11,345)	$ (9,492)	$ 11,399	$ (9,605)
Receive-fixed	9,134	5,417	(9,105)	7,117
Basis	78	(145)	100	(213)
Foreign currency[1]	62	(145)	148	(19)
Swaptions:				
Pay-fixed	(690)	(159)	195	(78)
Receive-fixed	882	1,218	(6,606)	(1,008)
Interest rate caps	(20)	(1)	1	2
Other[2][3]	22	(61)	(1)	(10)
Total risk management derivatives fair value losses, net	(1,877)	(3,368)	(3,869)	(3,814)
Mortgage commitment derivatives fair value gains (losses), net	(1,246)	66	(1,497)	(198)
Total derivatives fair value losses, net	$ (3,123)	$ (3,302)	$ (5,366)	$ (4,012)
Risk management derivatives fair value gains (losses) attributable to:				
Net contractual interest expense accruals on interest rate swaps	$ (968)	$ (681)	$ (2,687)	$ (1,011)
Net change in fair value of terminated derivative contracts from end of prior period to date of termination[3]	(350)	(310)	(1,377)	(275)
Net change in fair value of outstanding derivative contracts, including derivative contracts entered into during the period	(559)	(2,377)	195	(2,528)
Total risk management derivatives fair value losses, net[4]	$ (1,877)	$ (3,368)	$ (3,869)	$ (3,814)

	2009	2008
5-year swap interest rate:		
As of January 1	2.13%	4.19%
As of March 31	2.22	3.31

As of June 30	2.97	4.26
As of September 30	2.65	4.11

(1) Includes the effect of net contractual interest income accruals of $11 million and $6 million for the three months ended September 30, 2009 and 2008, respectively, and $26 million and $9 million for the nine months ended September 30, 2009 and 2008, respectively. The change in fair value of foreign currency swaps excluding this item resulted in a net gain of $51 million and a net loss of $151 million for the three months ended September 30, 2009 and 2008, respectively, and a net gain of $122 million and a net loss of $28 million for the nine months ended September 30, 2009 and 2008, respectively.

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

(3) Includes losses of approximately $104 million for the three and nine months ended September 30, 2008, which resulted from the termination of our derivative contracts with a subsidiary of Lehman Brothers.

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

The derivative losses for the third quarter of 2009 were driven by a decrease in swap rates which resulted in net losses on our net pay-fixed swap position and by time decay associated with our purchased options. In addition, we recognized increased losses on our mortgage commitments to sell securities, primarily associated with dollar roll transactions, as mortgage prices increased. Any gains or losses recognized on these commitments are recorded as securities cost basis adjustments upon settlement of the commitment.

For the first nine months of 2009, increases in swap rates resulted in gains on our net pay-fixed swap book; however, these gains were more than offset by losses on our option-based derivatives, as swap rate increases drove losses on our receive-fixed swaptions, and by time decay associated with our purchased options. In addition, we recognized increased losses on our mortgage commitments to sell securities, primarily driven by losses in the third quarter of 2009.

The derivatives fair value losses for the third quarter of 2008, which included $2.2 billion of losses on pay-fixed swaps designated as fair value hedges, reflected the combined impact of a decrease in swap interest rates during the quarter and time decay associated with our purchased options, which was partially offset by an increase in value due to an increase in implied volatility during the quarter. The decrease in swap interest rates resulted in fair value losses on our pay-fixed swaps that exceeded the fair value gains on our receive-fixed swaps. The derivatives fair value losses for the first nine months of 2008 were largely attributable to losses resulting from the decrease in interest rates, the time decay of our purchased options and rebalancing activity.

For additional information on our interest rate risk management strategy and our use of derivatives in managing our interest rate risk, see Part II Item 7 MD&A Risk Management Interest Rate Risk Management and Other Market Risks Interest Rate Risk Management Strategies of our 2008 Form 10-K and Risk Management Interest Rate Risk Management and Other Market Risks Interest Rate Risk Management Strategies below.

Trading Securities Gains (Losses), Net

We recorded net gains on trading securities of $1.7 billion for the third quarter of 2009. The gains were primarily attributable to the narrowing of spreads on commercial mortgage-backed securities (CMBS) as well as from the decline in interest rates.

For the first nine months of 2009, we recorded net gains on trading securities of $3.4 billion. The gains were primarily attributable to the narrowing of spreads on CMBS, asset-backed securities, corporate debt securities and agency MBS, partially offset by an increase in interest rates in the first nine months of 2009.

The losses on our trading securities of $2.9 billion for the third quarter of 2008 and $5.1 billion for the first nine months of 2008 were attributable, in part, to the significant widening of spreads, particularly related to private-label mortgage-related securities backed by Alt-A and subprime loans and CMBS and were also due to significant declines in the market value of the non-mortgage securities in our cash and other investment portfolio during the third quarter of 2008 resulting from the financial market crisis.

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

Hedged Mortgage Assets Gains (Losses), Net

Due to our discontinuation of hedge accounting in the fourth quarter of 2008, we had no gains or losses on hedged mortgage assets during the third quarter or first nine months of 2009, compared with $2.0 billion in gains on hedged mortgage assets for the third quarter of 2008 and $1.2 billion in gains on hedged mortgage assets for first nine months of 2008.

Losses from Partnership Investments

Losses from partnership investments decreased to $520 million for the third quarter of 2009 from $587 million for the third quarter of 2008 due to a decline in net operating losses we recognized on our LIHTC and other affordable housing investments, as our past impairments of these investments result in our currently recognizing fewer net operating losses on these impaired investments than we otherwise would have recognized.

For the first nine months of 2009, losses from partnership investments increased to $1.4 billion compared with $923 million for the first nine months of 2008, primarily due to the recognition of higher other-than-temporary impairment on a portion of our LIHTC and other affordable housing investments, reflecting the decline in value of these investments as a result of the weak economy. In addition, our partnership losses for the first nine months of 2008 were partially reduced by gains on sales of some of our LIHTC investments. We did not have any sales of LIHTC investments that are currently generating tax credits during the first nine months of 2009.

Prior to September 30, 2009, we entered into a nonbinding letter of intent to transfer equity interests in our LIHTC investments. Under the terms of the transaction as currently contemplated, we would transfer to unrelated third-party investors approximately one-half of our LIHTC investments for a price that exceeds their current carrying value. Upon completion of the contemplated transfer, the unrelated third-party investors would be entitled to receive substantially all of the tax benefits from our LIHTC investments for a specified period of time. At a specified future date, the percentage of tax benefits the investors would receive would automatically be reduced and the percentage of tax benefits we would receive would be increased by the same amount. In addition, we could have the obligation to reacquire all or a portion of the transferred interests.

We have requested the approval of FHFA, as our conservator, to complete this transaction. FHFA has advised us that it has no objection to this transaction as it is consistent with the conservation of the assets of the corporation and that FHFA has requested Treasury s approval under the senior preferred stock purchase agreement. As of November 5, 2009, FHFA has not yet received this approval. If in the future we determine we no longer have the intent and ability to sell or otherwise transfer our LIHTC investments for value, we would record additional other-than-temporary impairment to reduce the carrying value of our LIHTC investments to zero. As of September 30, 2009, the carrying value of our LIHTC investments was $5.2 billion.

Administrative Expenses

Administrative expenses include ongoing operating costs, such as salaries and employee benefits, professional services, occupancy costs and technology expenses. Administrative expenses were $562 million for the third quarter of 2009 compared with $401 million for the third quarter of 2008 and were $1.6 billion for the first nine months of 2009 compared with $1.4 billion for the first nine months of 2008. We took steps in the first nine months of 2009 to realign our organization, personnel and resources to focus on our most critical priorities, which include providing liquidity to the mortgage market and preventing foreclosures. As part of this realignment, we reduced staffing levels in some areas of the company. The impact of this reduction in staff, however, has been offset by an increase in resources and third party services in other areas, particularly those divisions of the company that focus on our foreclosure-prevention efforts. We expect these costs to increase as we continue these efforts. In addition, we reversed amounts that we had previously accrued for 2008 bonuses in the third quarter of 2008, which resulted in lower administrative expenses for the third quarter and first nine months of 2008 compared with the third quarter and first nine months of 2009.

Credit-Related Expenses

Credit-related expenses included in our condensed consolidated statements of operations consist of the provision for credit losses and foreclosed property expense. We detail the components of our credit-related expenses below in Table 9. The substantial increase in our credit-related expenses in the third quarter and first nine months of 2009 from the third quarter and first nine months of 2008 was largely due to the significant increase in our provision for credit losses, reflecting the deteriorating credit performance of the loans in our

guaranty book of business combined with an increase in credit-impaired loans acquired from MBS trusts as we undertake an increased number of modifications of delinquent loans.

Table 9: Credit-Related Expenses

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in millions)			
Provision for credit losses attributable to guaranty book of business	$ 14,184	$ 8,244	$ 49,053	$ 15,171
Provision for credit losses attributable to fair value losses on credit-impaired loans acquired from MBS trusts and Homesaver Advance loans	7,712	519	11,402	1,750
Total provision for credit losses[(1)]	21,896	8,763	60,455	16,921
Foreclosed property expense	64	478	1,161	912
Credit-related expenses	$ 21,960	$ 9,241	$ 61,616	$ 17,833

(1) Reflects total provision for credit losses reported in our condensed consolidated statements of operations and in Table 10 below under Combined loss reserves.

Provision for Credit Losses Attributable to Guaranty Book of Business

Our allowance for loan losses and reserve for guaranty losses, which we collectively refer to as our combined loss reserves, provide for probable credit losses inherent in our guaranty book of business as of each balance sheet date. We build our loss reserves through the provision for credit losses for losses that we believe have been incurred and will eventually be reflected over time in our charge-offs. When we determine that a loan is uncollectible, typically upon foreclosure, we record the charge-off against our loss reserves. We record recoveries of previously charged-off amounts as a credit to our loss reserves. Table 10, which summarizes changes in our loss reserves for the three and nine months ended September 30, 2009 and 2008, details the provision for credit losses recognized in our condensed consolidated statements of operations each period and the charge-offs recorded against our combined loss reserves.

Table 10: Allowance for Loan Losses and Reserve for Guaranty Losses (Combined Loss Reserves)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in millions)			
Changes in combined loss reserves:				
Allowance for loan losses:				
Beginning balance	$ 6,841	$ 1,476	$ 2,923	$ 698
Provision for credit losses	2,546	1,120	7,670	2,544
Charge-offs(1)	(448)	(829)	(1,757)	(1,603)
Recoveries	52	36	155	164
Ending balance(2)	$ 8,991	$ 1,803	$ 8,991	$ 1,803
Reserve for guaranty losses:				
Beginning balance	48,280	7,450	21,830	2,693
Provision for credit losses	19,350	7,643	52,785	14,377
Charge-offs(3)(4)	(10,901)	(1,369)	(18,159)	(3,395)
Recoveries	176	78	449	127
Ending balance	$ 56,905	$ 13,802	$ 56,905	$ 13,802
Combined loss reserves:				
Beginning balance	55,121	8,926	24,753	3,391
Provision for credit losses	21,896	8,763	60,455	16,921
Charge-offs(1)(3)(4)	(11,349)	(2,198)	(19,916)	(4,998)
Recoveries	228	114	604	291
Ending balance(2)	$ 65,896	$ 15,605	$ 65,896	$ 15,605

	As of September 30, 2009	As of December 31, 2008
	(Dollars in millions)	
Combined loss reserves		
Allocation of combined loss reserves:	$ 65,896	$ 24,753
Balance at end of each period attributable to:		
Single-family	$ 64,724	$ 24,649
Multifamily	1,172	104

Total	$ 65,896	$ 24,753
Single-family and multifamily loss reserve ratios:[5]		
Single-family loss reserves as a percentage of single-family guaranty book of business	2.23%	0.88%
Multifamily loss reserves as a percentage of multifamily guaranty book of business	0.64	0.06
Combined loss reserves as a percentage of:		
Total guaranty book of business	2.14%	0.83%
Total nonperforming loans[6]	33.24	20.76

(1) Includes accrued interest of $416 million and $229 million for the three months ended September 30, 2009 and 2008, respectively, and $990 million and $468 million for the nine months ended September 30, 2009 and 2008, respectively.

(2) Includes $1.1 billion and $108 million as of September 30, 2009 and 2008, respectively, for acquired credit-impaired loans.

(3) Includes charges of $24 million and $171 million for the three months ended September 30, 2009 and 2008, respectively, and $212 million and $294 million for the nine months ended September 30, 2009 and 2008, respectively, related to unsecured HomeSaver Advance loans.

(4) Includes charges recorded at the date of acquisition totaling $7.7 billion and $348 million for the three months ended September 30, 2009 and 2008, respectively, and $11.2 billion and $1.5 billion for the nine months ended September 30, 2009 and 2008, respectively, for acquired credit-impaired loans where the acquisition cost exceeded the fair value of the acquired loan.

(5) Represents amount of loss reserves attributable to each loan type as a percentage of the guaranty book of business for each loan type.

(6) Loans are classified as nonperforming when we believe collectability of interest or principal on the loan is not reasonably assured, which typically occurs when payment of principal or interest on the loan is two months or more past due. Additionally, all troubled debt restructurings and HomeSaver Advance first-lien loans are classified as nonperforming loans. See Table 42: Nonperforming Single-Family and Multifamily Loans for additional information on our nonperforming loans.

We have continued to build our combined loss reserves, both in absolute terms and as a percentage of our total guaranty book of business and nonperforming loans, through provisions that have been well in excess of our charge-offs due to the general deterioration in the overall credit performance of loans in our guaranty book of business. Certain states, certain higher risk loan categories and our 2006 and 2007 loan vintages continue to exhibit higher than average delinquency rates and account for a disproportionate share of our credit losses. The states exhibiting higher delinquency rates and disproportionately higher credit losses include states in the Midwest, which has experienced prolonged economic weakness, and California, Florida, Arizona and Nevada, which have experienced the most significant declines in home prices coupled with rising unemployment rates. Loans in our Alt-A book, particularly the 2006 and 2007 loan vintages, also have exhibited significantly higher delinquency rates and accounted for a disproportionate share of our credit losses. The Midwest accounted for approximately 12% of our combined single-family loss reserves as of September 30, 2009, compared with approximately 18% as of December 31, 2008. Our mortgage loans in California, Florida, Arizona and Nevada together accounted for approximately 73% of our combined single-family loss reserves as of September 30, 2009, compared with approximately 67% as of December 31, 2008. Our Alt-A loans represented approximately 42% of our combined single-family loss reserves as of September 30, 2009, compared with approximately 50% as of December 31, 2008, and our 2006 and 2007 loan vintages together accounted for approximately 83% of our combined single-family loss reserves as of September 30, 2009, compared with approximately 90% as of December 31, 2008. We also are experiencing deterioration in the credit performance of other loan categories in our single-family guaranty book of business not specifically identified as higher risk, reflecting the adverse impact of the sharp rise in unemployment and home price declines. As a result, during 2009, these loans have accounted for an increasing share of our loss reserves, and the portion of our loss reserves attributable to the higher risk categories identified above has generally declined since the end of 2008.

The provision for credit losses attributable to our guaranty book of business of $14.2 billion for the third quarter of 2009 exceeded net charge-offs of $3.4 billion for the third quarter of 2009. In comparison, we recorded a provision for credit losses attributable to our guaranty book of business of $8.3 billion and net charge-offs of $1.6 billion for the third quarter of 2008. For the first nine months of 2009, the provision for credit losses attributable to our guaranty book of business of $49.1 billion exceeded net charge-offs of $7.9 billion. In comparison, we recorded a provision for credit losses attributable to our guaranty book of business of $15.2 billion and net charge-offs of $3.0 billion for the first nine months of 2008. Our increased provision levels in both the third quarter and the first nine months of 2009 were largely driven by a substantial increase in nonperforming single-family loans, higher delinquencies and an increase in the average loss severity. In addition, the increased level of troubled debt restructurings, particularly through workouts initiated from our foreclosure prevention efforts, increased the number of individually impaired loans, which contributed to the increase in the provision for credit losses.

Our conventional single-family serious delinquency rate increased to 4.72% as of September 30, 2009, from 3.94% as of June 30, 2009, 2.42% as of December 31, 2008 and 1.72% as of September 30, 2008. The average default rate was 0.30% for the third quarter of 2009 compared with 0.19% for the third quarter of 2008. Excluding fair value losses related to credit-impaired loans acquired from MBS trusts and HomeSaver Advance loans, the average loss severity rate was 38% for the third quarter of 2009 compared with 28% for the third quarter of 2008.

We increased the portion of our combined loss reserves attributable to our multifamily guaranty book of business to $1.2 billion, or 0.64% of our multifamily guaranty book of business, as of September 30, 2009, from $104 million, or 0.06% of our multifamily guaranty book of business, as of December 31, 2008. The increase in the multifamily reserve was primarily driven by larger loans within the non-performing loan population and increased reliance on the most recent severity and default experience, which is a reflection of the weak economy and lack of liquidity in the market.

Provision for Credit Losses Attributable to Fair Value Losses on Credit-Impaired Loans Acquired from MBS Trusts and HomeSaver Advance Loans

In our capacity as guarantor of our MBS trusts, we have the option under the trust agreements to purchase specified mortgage loans from our MBS trusts. We generally are not permitted to complete a modification of a loan while the loan is held in the MBS trust. As a result, we must exercise our option to purchase any delinquent loan that we intend to modify from an MBS trust prior to the time that the modification becomes effective. The proportion of delinquent loans purchased from MBS trusts for the purpose of modification varies from period to period, driven primarily by changes in our loss mitigation efforts, as well as changes in interest rates and other market factors. See Part I Item 1 Business Business Segments Single-Family Credit Guaranty Business MBS Trusts of our 2008 10-K for additional information on the provisions in our MBS trusts agreements that govern the purchase of loans from our MBS trusts and the factors that we consider in determining whether to purchase delinquent loans from our MBS trusts.

We generally record our net investment in acquired credit-impaired loans at the lower of the acquisition cost of the loan or the estimated fair value at the date of purchase or consolidation. To the extent the acquisition cost exceeds the estimated fair value, we record a fair value loss charge-off against the Reserve for guaranty losses at the time we acquire the loan.

We introduced HomeSaver Advance in the first quarter of 2008. HomeSaver Advance serves as a foreclosure prevention tool early in the delinquency cycle and does not conflict with our MBS trust requirements because it allows borrowers to cure their payment defaults without modifying their mortgage loan. HomeSaver Advance allows servicers to provide qualified borrowers with a 15-year unsecured personal loan in an amount equal to all past due payments relating to their mortgage loan, generally up to the lesser of $15,000 or 15% of the unpaid principal balance of the delinquent first lien loan. We record HomeSaver Advance loans at their estimated fair value at the date we purchase these loans from servicers, and, to the extent the acquisition cost exceeds the estimated fair value, we record a fair value loss charge-off against the Reserve for guaranty losses at the time we acquire the loans. We significantly reduced the number of HomeSaver Advance workouts for the first nine months of 2009 compared with the first nine months of 2008 as borrowers were offered workouts under the Home Affordable Modification Program as well as other repayment and forbearance plans.

As indicated in Table 9, fair value losses on credit-impaired loans acquired from MBS trusts and HomeSaver Advance loans increased to $7.7 billion for the third quarter of 2009 from $519 million for the third quarter of 2008 and to $11.4 billion for the first nine months of 2009 from $1.8 billion for the first nine months of 2008, reflecting both an increase in the number of acquired credit-impaired loans and a decrease in the fair value of these loans.

Table 11 provides a quarterly comparison of the number of credit-impaired loans acquired from MBS trusts, the unpaid principal balance and accrued interest of these loans, and the average fair value based on indicative

market prices. The decline in home prices and significant reduction in liquidity in the mortgage markets, along with the increase in mortgage credit risk, have resulted in downward pressure on the fair value of these loans.

Table 11: Statistics on Credit-Impaired Loans Acquired from MBS Trusts

	2009			2008			
	Q3	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
	(Dollars in millions)						
Number of credit-impaired loans acquired from MBS Trusts	62,546	17,580	12,223	6,124	3,678	4,618	10,586
Average indicative market price(1)	44%	43%	45%	50%	53%	53%	60%
Unpaid principal balance and accrued interest of loans acquired	$ 13,757	$ 3,717	$ 2,561	$ 1,286	$ 744	$ 807	$ 1,704

(1) Calculated based on the estimated fair value at the date of acquisition of credit-impaired loans divided by the unpaid principal balance and accrued interest of these loans at the date of acquisition. The value of primary mortgage insurance is included as a component of the average market price. Beginning in the first quarter of 2009, we incorporated the average fair value of acquired credit-impaired multifamily loans into the calculation of our average indicative market price. We have revised the previously reported prior period amounts to reflect this change.

During the second and third quarters of 2009, we significantly increased the level of workout volume, particularly through workouts initiated through our foreclosure prevention efforts, and as a result increased the amount of credit-impaired loans we acquired from MBS trusts which increased fair value losses. These fair value losses may accrete back into interest income for the loans that are performing. We provide additional information on how we account for credit-impaired loans acquired from MBS trusts in Part II Item 7 MD&A Critical Accounting Policies and Estimates Fair Value of Financial Instruments Fair Value of Loans Purchased with Evidence of Credit Deterioration of our 2008 Form 10-K.

Beginning January 1, 2010, we will no longer record fair value losses on the acquisition of credit-impaired loans from MBS trusts due to the new accounting guidance that eliminates the concept of qualified special purpose entities (QSPEs) and changes the consolidation model for variable interest entities. We provide additional information on the impact of the new accounting guidance in Off-Balance Sheet Arrangements and Variable Interest Entities Elimination of QSPEs and Changes in the Consolidation Model for Variable Interest Entities.

We provide additional information on our loan workout activities in Risk Management Credit Risk Management Mortgage Credit Risk Management Problem Loan Management and Foreclosure Prevention and additional information on credit-impaired loans acquired from MBS trusts in Notes to Consolidated Financial Statements Note 4, Mortgage Loans.

Foreclosed Property Expense

Foreclosed property expense declined to $64 million for the third quarter of 2009 compared with $478 million for the third quarter of 2008. The decline was driven primarily by a $235 million cash fee received from the cancellations and restructurings of some of our mortgage insurance coverage. This fee represented an acceleration of, and discount on, claims to be paid pursuant to the coverage. Foreclosed property expense increased to $1.2 billion for the first nine months of 2009 compared with $912 million for the first nine months of 2008 driven by a rise in foreclosed property acquisitions reflecting the deterioration in the credit performance of our book of business, partially offset by the $235 million mortgage insurance cancellation and restructuring fee received in the third quarter of 2009.

Credit Loss Performance Metrics

Management views our credit loss performance metrics, which include our historical credit losses and our credit loss ratio, as significant indicators of the effectiveness of our credit risk management strategies. Management uses these metrics together with other credit risk measures to: assess the credit quality of our existing guaranty book of business; make determinations about our loss mitigation strategies; evaluate our historical credit loss performance; and determine the level of our loss reserves. These metrics, however, are not defined terms within GAAP and may not be calculated in the same manner as similarly titled measures reported by other companies. Because management does not view changes in the fair value of our mortgage loans as credit losses, we exclude fair value losses associated with HomeSaver Advance loans and the acquisition of credit-impaired loans from MBS trusts from our credit loss performance metrics. However, we include in our credit loss performance metrics the impact of any credit losses we experience on acquired credit-impaired loans or first lien loans associated with HomeSaver Advance loans that ultimately result in foreclosure.

We believe that our credit loss performance metrics are useful to investors because they reflect how management evaluates our credit performance and the effectiveness of our credit risk management strategies and loss mitigation efforts. They also provide a consistent treatment of credit losses for on- and off-balance sheet loans. Moreover, by presenting credit losses with and without the effect of fair value losses associated with the acquisition of credit-impaired loans from MBS trusts and HomeSaver Advance loans, investors are able to evaluate our credit performance on a more consistent basis among periods.

Table 12 below details the components of our credit loss performance metrics, which exclude the effect of fair value losses associated with the acquisition of credit-impaired loans from MBS trusts and HomeSaver Advance loans, for the three and nine months ended September 30, 2009 and 2008.

Table 12: Credit Loss Performance Metrics

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2009		2008		2009		2008	
	Amount	Ratio(1)	Amount	Ratio(1)	Amount	Ratio(1)	Amount	Ratio(1)
	(Dollars in millions)							
Charge-offs, net of recoveries	$ 11,121	145.0 bp	$ 2,084	28.6bp	$ 19,312	85.0 bp	$ 4,707	22.0 bp
Foreclosed property expense	64	0.9	478	6.5	1,161	5.1	912	4.3
Less: Fair value losses resulting from acquired credit-impaired loans and HomeSaver Advance loans(2)	(7,712)	(100.6)	(519)	(7.2)	(11,402)	(50.2)	(1,750)	(8.2)
Plus: Impact of acquired credit-impaired loans on	213	2.8	128	1.8	441	1.9	426	2.0

charge-offs and foreclosed property expense[3]											
Credit losses[4]	$	3,686	48.1 bp	$	2,171	29.7bp	$	9,512	41.8 bp	$	4,295	20.1 bp

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

(2) Represents the amount recorded as a loss when the acquisition cost of a credit-impaired loan exceeds the fair value of the loan at acquisition. Also includes the difference between the unpaid principal balance of unsecured HomeSaver Advance loans at origination and the estimated fair value of these loans that we record in our consolidated balance sheets.

(3) For acquired credit-impaired loans that are recorded at a fair value amount at acquisition that is lower than the acquisition cost, any loss recorded at foreclosure is less than it would have been if we had recorded the loan at its acquisition cost. Accordingly, we have added back to our credit losses the amount of charge-offs and foreclosed property expense that we would have recorded if we had calculated these amounts based on the acquisition cost.

(4) Interest forgone on nonperforming loans in our mortgage portfolio, which is presented in Table 42, reduces our net interest income but is not reflected in our credit losses total. In addition, other-than-temporary impairment losses resulting from deterioration in the credit quality of our mortgage-related securities and accretion of interest income on acquired credit-impaired loans are excluded from credit losses.

Our credit loss ratio increased to 48.1 basis points in the third quarter of 2009 from 29.7 basis points in the third quarter of 2008 and increased to 41.8 basis points in the first nine months of 2009 from 20.1 basis points in the first nine months of 2008. Our credit loss ratio including the effect of fair value losses on credit-impaired loans acquired from MBS trusts and HomeSaver Advance loans would have been 145.9 basis points for the third quarter of 2009 compared with 35.1 basis points for the third quarter of 2008 and 90.1 basis points for the first nine months of 2009, compared with 26.3 basis points for the first nine months of 2008. The substantial increase in our credit losses in the third quarter and first nine months of 2009 from the third quarter and first nine months of 2008 reflected the adverse impact of the decline in home prices and high unemployment, as well as the weak economy. These conditions have resulted in an increase in delinquencies, defaults and loss severities across our entire guaranty book of business as we are also now experiencing deterioration in the credit performance of loans with fewer risk layers. Additionally, certain higher risk loan categories, loan vintages and loans within certain states that have had the greatest home price depreciation from their peaks continue to account for a disproportionate share of our credit losses.

Table 13 below provides an analysis of our credit losses in certain higher risk loan categories as compared with our other loans. As described in Table 13 below, these loan categories have accounted for a disproportionate share of our credit losses.

Table 13: Credit Loss Concentration Analysis

	Percentage of Single-Family Book Outstanding as of[1]		Percentage of Single-Family Credit Losses			
			For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	September 30, 2009	December 31, 2008	2009	2008	2009	2008
Geographical distribution:						
Arizona, California, Florida and Nevada	28%	27%	57%	55%	57%	48%
Select Midwest states[2]	11	11	15	18	15	22
All other states	61	62	28	27	28	29
Select Higher Risk Product features[3]	25	28	69	77	70	75
Vintages:						
2006	11	14	30	35	31	35
2007	16	20	38	31	36	26
All other vintages	73	66	32	34	33	39

(1) Calculated based on the unpaid principal balance of loans, where we have detailed loan-level information, for each category divided by the unpaid principal balance of our single-family guaranty book of business.

(2) Consists of Illinois, Indiana, Michigan and Ohio.

(3) Includes Alt-A loans, subprime loans, interest-only loans, loans with original loan-to-value ratio greater than 90%, and loans with FICO credit scores less than 620.

The suspension of foreclosure sales on occupied single-family properties between the periods November 26, 2008 through January 31, 2009 and February 17, 2009 through March 6, 2009 and our directive to delay foreclosure sales until the loan servicer has exhausted all other foreclosure prevention alternatives reduced our foreclosure activity in 2009, which resulted in a reduction in our charge-offs and credit losses below what we believe we would have otherwise recorded in the first nine months of 2009 had the moratoria not been in place. We record a charge-off upon foreclosure for loans subject to the foreclosure moratoria that we are not able to modify and that ultimately result in foreclosure. While the foreclosure moratoria affect the timing of when we incur a credit loss, they do not necessarily affect the credit-related expenses recognized in our consolidated statements of operations because we estimate probable losses inherent in our guaranty book of business as of each balance sheet date in determining our loss reserves. See Critical Accounting Policies and Estimates Allowance for Loan Losses and Reserve for Guaranty Losses for a discussion of changes we made in our loss reserve estimation process to address the impact of the foreclosure moratoria and the change in our foreclosure requirements.

We provide more detailed credit performance information, including serious delinquency rates by geographic region, statistics on nonperforming loans and foreclosure activity, in Risk Management Credit Risk Management Mortgage Credit Risk Management.

Regulatory Hypothetical Stress Test Scenario

Under a September 2005 agreement with the Office of Federal Housing Enterprise Oversight (OFHEO), the predecessor to FHFA, we are required to disclose on a quarterly basis the present value of the change in future expected credit losses from our existing single-family guaranty book of business from an immediate 5% decline in single-family home prices for the entire United States. Although this agreement was suspended on March 18, 2009 by FHFA until further notice, the disclosure requirement was not suspended. For purposes of this calculation, we assume that, after the initial 5% shock, home price growth rates return to the average of the possible growth rate paths used in our internal credit pricing models. The sensitivity results represent the difference between future expected credit losses under our base case scenario, which is derived from our internal home price path forecast, and a scenario that assumes an instantaneous nationwide 5% decline in home prices.

Table 14 compares the credit loss sensitivities as of September 30, 2009 and December 31, 2008 for first lien single-family whole loans we own or that back Fannie Mae MBS, before and after consideration of projected credit risk sharing proceeds, such as private mortgage insurance claims and other credit enhancement.

Table 14: Single-Family Credit Loss Sensitivity[1]

	As of September 30, 2009	As of December 31, 2008
	(Dollars in millions)	
Gross single-family credit loss sensitivity	$ 23,193	$ 13,232
Less: Projected credit risk sharing proceeds	(3,804)	(3,478)
Net single-family credit loss sensitivity	$ 19,389	$ 9,754
Outstanding single-family whole loans and Fannie Mae MBS	$ 2,818,263	$ 2,724,253
Single-family net credit loss sensitivity as a percentage of outstanding single-family whole loans and Fannie Mae MBS	0.69%	0.36%

(1) Represents total economic credit losses, which consist of credit losses and forgone interest. Calculations are based on approximately 97% of our total single-family guaranty book of business as of both September 30, 2009 and December 31, 2008. The mortgage loans and mortgage-related securities that are included in these estimates consist of: (i) single-family Fannie Mae MBS (whether held in our mortgage portfolio or held by third parties), excluding certain whole loan Real Estate Mortgage Investment Conduits (REMICs) and private-label wraps; (ii) single-family mortgage loans, excluding mortgages secured only by second liens, subprime mortgages, manufactured housing chattel loans and reverse mortgages; and (iii) long-term standby commitments. We expect the inclusion in our estimates of the excluded products may impact the estimated sensitivities set forth in this table.

The increase in the projected credit loss sensitivities during the first nine months of 2009 reflected the decline in home prices and the ongoing negative outlook for the housing and credit markets. Because these sensitivities represent hypothetical scenarios, they should be used with caution. Our regulatory stress test scenario is limited in that it assumes an instantaneous uniform 5% nationwide decline in home prices, which is not representative of the historical pattern of changes in home prices. Changes in home prices generally vary on a regional, as well as a local, basis. In addition, these stress test scenarios are calculated independently without considering changes in other interrelated assumptions, such as unemployment rates or other economic factors, which are likely to have a significant impact on our future expected credit losses.

Other Non-Interest Expenses

Other non-interest expenses consist of credit enhancement expenses, which reflect the amortization of the credit enhancement asset we record at the inception of guaranty contracts, costs associated with the purchase of additional mortgage insurance to protect against credit losses, net gains and losses on the extinguishment of debt, and other miscellaneous expenses. Other non-interest expenses increased to $242 million for the third quarter of 2009 from $172 million for the third quarter of 2008. The increase was driven by recording reserves for legal claims. For the first nine months of 2009, other non-interest expenses increased to $1.1 billion from $960 million for the first nine months of 2008. The increase was largely due to recording reserves for legal claims and an increase in net losses recorded on the extinguishment of debt offset by a reduction in expense associated with unrecognized tax benefits related to certain unresolved tax positions.

Federal Income Taxes

We recorded a tax benefit for federal income taxes of $143 million for the third quarter of 2009 and $743 million for the first nine months of 2009. We recorded a provision for federal income taxes of $17.0 billion for the third quarter of 2008 and $13.6 billion for the first nine months of 2008. The tax benefit for the third quarter and the first nine months of 2009 represents the benefit of carrying back a portion of our expected current year tax loss, net of the reversal of the use of certain tax credits, to prior years. We were not able to recognize a net tax benefit associated with the majority of our pre-tax loss of $19.0 billion for the third quarter of 2009 and $57.6 billion for the first nine months of 2009 as there has been no change in our 2008 conclusion that it was more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize our net deferred tax assets. As a result, we recorded an increase in our valuation allowance of $7.0 billion for the third quarter of 2009 and $21.1 billion for the first nine months of 2009 in our condensed consolidated statements of operations, which represented the tax effect associated with the majority of the pre-tax losses we recorded in the third quarter and the first nine months. The valuation allowance recorded against our deferred tax assets totaled $48.9 billion as of September 30, 2009, resulting in a net deferred tax asset of $1.4 billion as of September 30, 2009 and includes the reversal of $3.0 billion of previously recorded valuation allowance as a result of our adoption of the FASB modified guidance for assessing other-than-temporary impairments. Our net deferred tax asset totaled $3.9 billion as of December 31, 2008. We discuss the factors that led us to record a partial valuation allowance against our net deferred tax assets in Part II Item 7 MD&A Critical Accounting Policies and Estimates Deferred Tax Assets and Notes to Consolidated Financial Statements Note 12, Income Taxes of our 2008 Form 10-K.

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 2008 Form 10-K in Notes to Consolidated Financial Statements Note 16, Segment Reporting. We summarize our segment results for the three and nine months ended September 30, 2009 and 2008 in the tables below and provide a comparative discussion of these results. See Notes to Condensed Consolidated Financial Statements Note 15, Segment Reporting of this report for additional information on our segment results.

Single-Family Business

Our Single-Family business recorded a net loss of $19.5 billion in the third quarter of 2009 compared with $14.2 billion in the third quarter of 2008 and a net loss of $54.2 billion in the first nine months of 2009 compared with $17.6 billion in the first nine months of 2008. Table 15 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 other fee

income, primarily related to technology fees. Expenses primarily consist of credit-related expenses and administrative expenses.

Table 15: Single-Family Business Results

	For the Three Months Ended September 30, 2009	For the Three Months Ended September 30, 2008	For the Nine Months Ended September 30, 2009	For the Nine Months Ended September 30, 2008	Quarterly Variance $	Quarterly Variance %	Year-to-Date Variance $	Year-to-Date Variance %
	(Dollars in millions)							
ement of operations :								
ranty fee income	$ 2,112	$ 1,674	$ 5,943	$ 5,435	$ 438	26%	$ 508	9
t management income	11	63	35	242	(52)	(83)	(207)	(86
er income(1)	252	184	689	569	68	37	120	21
lit-related expenses(2)	(21,656)	(9,215)	(60,377)	(17,808)	(12,441)	(135)	(42,569)	(239
er expenses(3)	(542)	(383)	(1,594)	(1,377)	(159)	(42)	(217)	(16
s before federal me taxes	(19,823)	(7,677)	(55,304)	(12,939)	(12,146)	(158)	(42,365)	(327
efit (provision) for ral income taxes	276	(6,550)	1,059	(4,702)	6,826	104	5,761	123
loss attributable to nie Mae	$ (19,547)	$ (14,227)	$ (54,245)	$ (17,641)	$ (5,320)	(37)%	$ (36,604)	(207
er key performance :								
rage single-family anty book of ness(4)	$ 2,886,496	$ 2,753,293	$ 2,852,977	$ 2,693,909	$ 133,203	5%	$ 159,068	6

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

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

(3) Consists of administrative expenses and other expenses.

(4) The single-family guaranty book of business consists of single-family mortgage loans held in our mortgage portfolio, single-family Fannie Mae MBS held in our mortgage portfolio, single-family Fannie Mae MBS held by third parties, and other credit enhancements that we provide on single-family mortgage assets. Excludes non-Fannie Mae mortgage-related securities held in our investment portfolio for which we do not provide a guarantee.

Key factors affecting the results of our Single-Family business for the third quarter and first nine months of 2009 compared with the third quarter and first nine months of 2008 included the following:

An increase in guaranty fee income, primarily due to an increase in our average effective guaranty fee rate, and to growth in the average single-family guaranty book of business.

The increase in our average effective guaranty fee rate for the third quarter and the first nine months of 2009 was primarily attributable to higher fair value of buy ups and certain guaranty assets due to increased market prices on interest-only strips. We use interest-only strips pricing as a component in estimating the fair value of our buy-ups and certain guaranty assets.

Our average single-family guaranty book of business increased by 5% for the third quarter of 2009 over the third quarter of 2008 and 6% for the first nine months of 2009 over the first nine months of 2008. We experienced an increase in our average outstanding Fannie Mae MBS and other guarantees throughout 2008 and for the first nine months of 2009 as our market share of new single-family mortgage-related securities issuances remained high and new MBS issuances outpaced liquidations.

The average charged guaranty fee on our new single-family business for the third quarter of 2009 was 24.7 basis points compared with 31.9 basis points for the third quarter of 2008 and 23.2 basis points for the first nine months of 2009 compared with 28.1 basis points for the first nine months of 2008. The average charged guaranty fee represents the average contractual fee rate for our single-family guaranty arrangements plus the recognition of any upfront cash payments ratably over an estimated average life. The decrease in the average charged fee was primarily the result of a shift in the composition of our new business given changes in underwriting and eligibility standards, which resulted in a reduction in our acquisition of loans with higher risk, higher fee categories such as higher LTV and lower FICO scores.

A substantial increase in credit-related expenses, reflecting a significantly higher incremental provision for credit losses as well as higher charge-offs.

The increase in credit-related expenses was due to worsening credit performance trends, including significant increases in delinquencies, defaults and loss severities, throughout our guaranty book of business, reflecting the adverse impact of the decline in home prices, the weak economy and high unemployment. Certain higher risk loan categories, loan vintages and loans within certain states that have had the greatest home price depreciation from their peaks continue to account for a disproportionate share of our credit losses, but we are also experiencing deterioration in the credit performance of loans with fewer risk layers. In addition, the increased level of troubled debt restructurings, particularly through workouts initiated from our foreclosure prevention efforts, increased the number of loans that were individually impaired, contributing to the increase in the provision for credit losses.

We also experienced a significant increase in fair value losses on credit-impaired loans acquired from MBS trusts for the purpose of modifying them during the third quarter and first nine months of 2009, reflecting the increase in the number of delinquent loans acquired from MBS trusts, and the decrease in the estimated fair value of these loans compared with the third quarter and first nine months of 2008.

Credit-related expenses in the Single-Family business represent the substantial majority of the company s total credit-related expenses. We provide additional information on total credit-related expenses in Consolidated Results of Operations Credit-Related Expenses.

A non-cash charge during the third quarter of 2008 to establish a partial deferred tax asset valuation allowance against our net deferred tax assets as of September 30, 2008. We recorded a valuation allowance for the majority of the tax benefits associated with the pre-tax losses recognized in the third quarter and first nine months of 2009 as there has been no change in the conclusion we reached in 2008 that it was more likely than not that we would not generate sufficient taxable income in the foreseeable future to realize all of the tax benefits generated from these losses.

HCD Business

Our HCD business recorded a net loss attributable to Fannie Mae of $870 million for the third quarter of 2009 compared with $2.6 billion for the third quarter of 2008 and a net loss attributable to Fannie Mae of $2.8 billion for the first nine months of 2009 compared with $2.4 billion for the first nine months of 2008. Table 16 summarizes the financial results for our HCD business for the periods indicated. The primary sources of revenue for our HCD business are guaranty fee income and other income, consisting primarily of transaction fees associated with our multifamily business. Expenses primarily include administrative expenses, credit-related expenses and net operating losses associated with our partnership investments, the majority of which generate tax benefits that may reduce our federal income tax liability. However, during the second half of 2008 and first nine months of 2009, we were unable to recognize tax benefits generated from our partnership investments.

Table 16: HCD Business Results

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Quarterly Variance		Year-to-Date Variance	
	2009	2008	2009	2008	$	%	$	%
	(Dollars in millions)							
Statement of operations data:[1]								&nbs