Measuring Shareholder Value

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Value-based Performance Measures - Summary

Preliminary analysis using value-based measures shows that our businesses create shareholder value - past, present, and future

But, our current capital requirements constrain our relative shareholder performance; We need to remediate our control, operations and risk management issues to relieve excess capital drag

Going forward, we will apply these performance measures to the Business Units, as appropriate

Next steps are completing refinements of the measures, vetting with management groups, and implementing the capability to compute and use measures to manage operations

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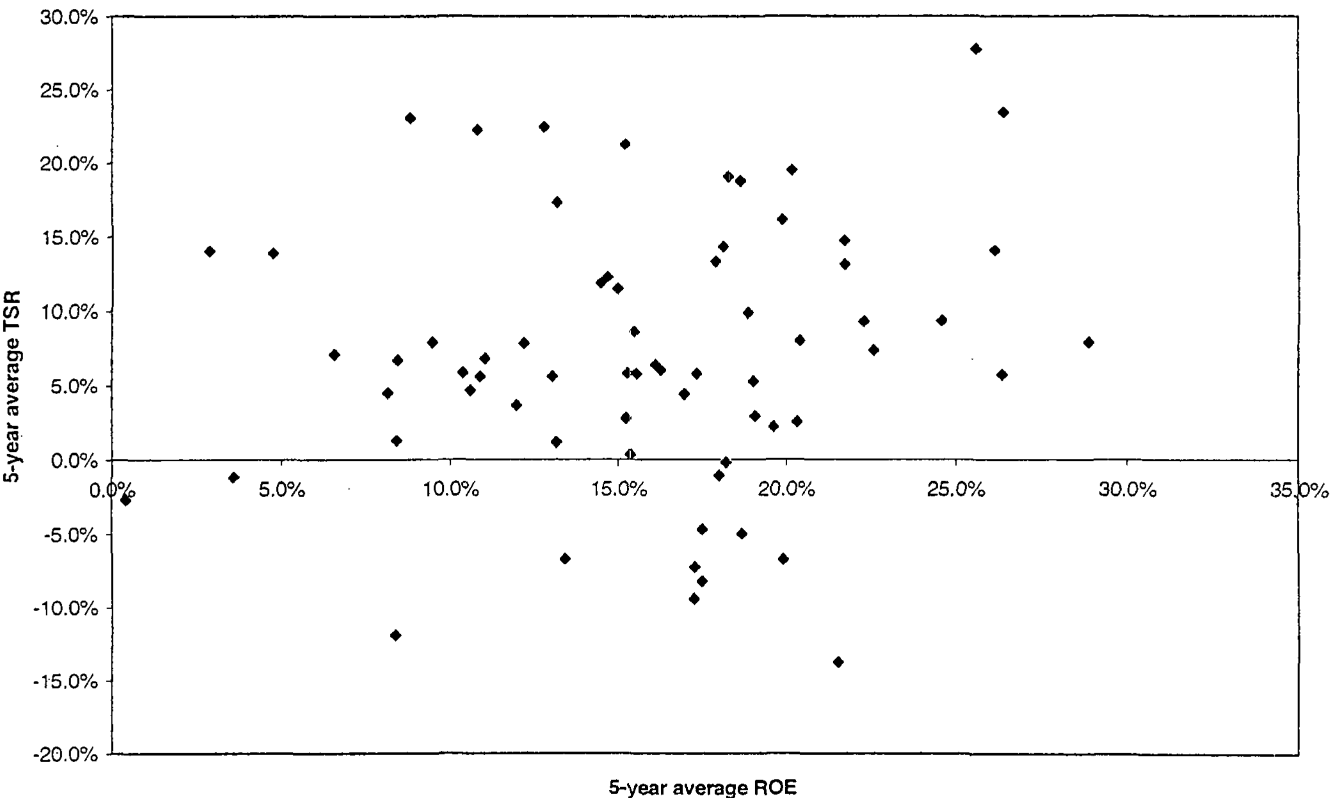
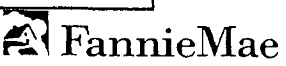
Why We Need a Broader Focus?

The relationship between 5-year average GAAP-based Return on Equity and
5-year average Total Shareholder Return for 65 financial firms



Traditional measures of performance are not consistent drivers of shareholder returns



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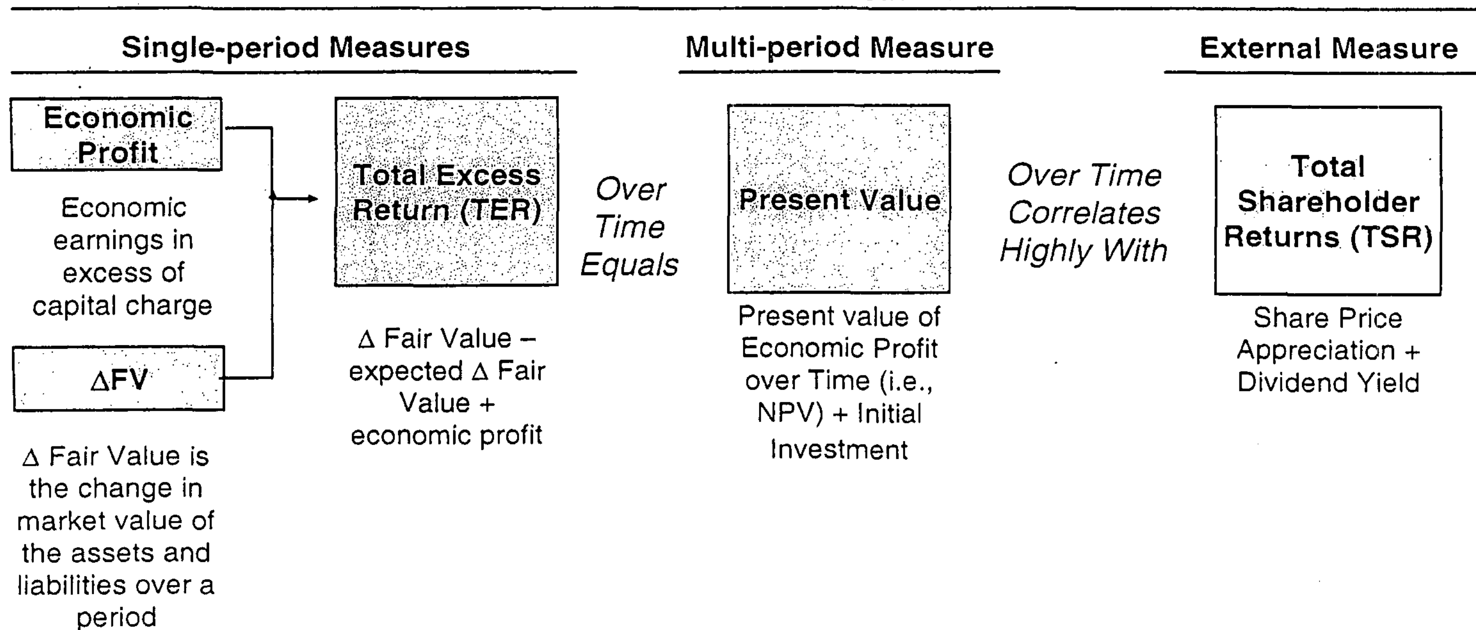
Financial Performance and Decisioning Measures

An integrated suite of measures is required to manage for value; no single measure is sufficient



Economic Profit and Total Excess Return will be calculated for all Business Units and for the Corporation

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What Does Actual Performance Look Like?

- Preliminary analysis indicates that all Business Units are expected to create shareholder value
- Timing differences will cause Economic Profit and Total Excess Return to generate different views of performance in a specific time period
- Currently, Economic Profit is most meaningful for our Guarantee fee businesses; Total Excess Return is most meaningful for the Capital Markets business
  - As we develop the ability to more actively manage our credit exposures, this may change

	2004	2007-2010
Capital Markets ($B)		
Adjusted earnings	4.5	5.1
Capital charge	-2.4	-7.3
Economic profit	2.1	-2.2
Total excess return	0.6	4.9
Single Family ($B)		
Adjusted earnings	2.7	13.4
Capital charge	-1.2	5.5
Economic profit	1.5	7.9
HCD ($B)		
Adjusted earnings	0.5	3.6
Capital charge	-0.5	2.3
Economic profit	0.0	1.3

If we accomplish our plans, all businesses are expected to add value

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Regulatory Capital Significantly Exceeds Economic Capital

Economic Capital as of December 31, 2005

($B)	Economic	Regulatory	Regulatory + Surcharge
Capital Markets	12.6	18.2	23.7
Single Family	3.7	8.7	11.3
HCD	3.8	0.6	0.7
Sub-Total[1]	20.2	28.8	37.4
Excess			3.4
Total			40.8

The surplus is big

1. Includes capital required for "Other Assets" not shown

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Translating Market Expectations to the Business Units

- The stock market implied cost of equity capital for Fannie Mae is ~ 8%
- For an investment to add value, the return on invested capital must exceed cost of capital
- Capital can be divided into two pieces: capital invested in the businesses and excess capital
- Regulatory capital impacts the way we think about invested capital and the cost of capital. For example, alternative ways to implement the regulatory capital constraint include:
  - Investments must earn an acceptable return on regulatory capital since it is the binding capital constraint
  - Investments must earn an acceptable return on the higher of the economic or regulatory capital associated with that investment

Recommendation: Investments must earn a market return on their economic capital; excess capital replaces debt

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Translating Market Expectations to the Business Units

- We can use a top-down approach to establish the impact of the excess capital on expected performance
- From the shareholders' perspective, our current 46% excess capital is not invested in business activities – it reduces corporate debt; the cost of corporate debt is 3.4% (after tax)
- That means the remaining 54% of capital has a required rate of return of 12%
- Together these equate to the 8% required return for Fannie Mae

The excess capital should not impact investment decisions or dollars of economic profit

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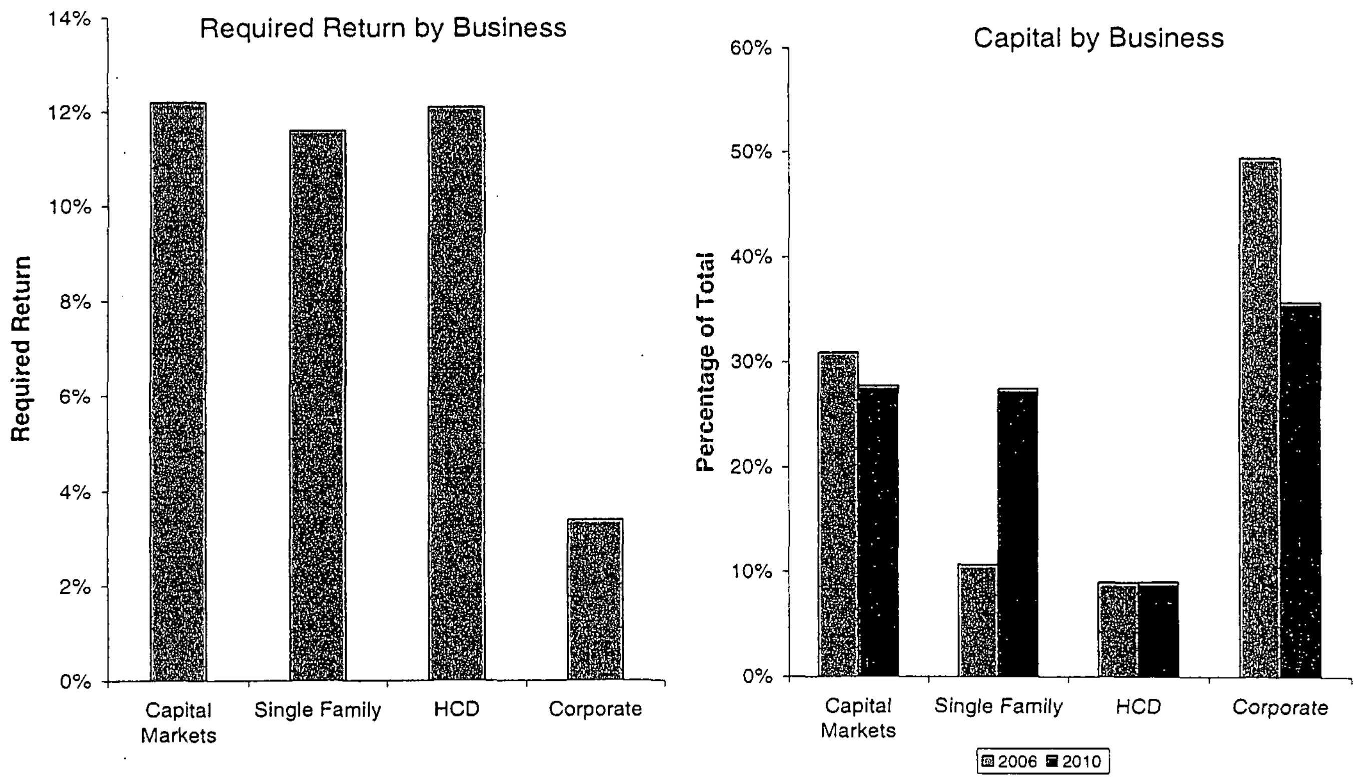
Translating Market Expectations to the Business Units



Peer companies similarly levered require ~12% return on capital; our excess capital reduces borrowing at ~3.4% after tax; weighted average is 8% now vs. 9% in 2010

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Do Current Capital Requirements Constrain Our Relative Shareholder Performance?

	Fannie Mae
Regulatory to Economic Capital Ratio	~ 2 to 1

- Some believe our excess capital is 2-3x higher than other financial services companies
- Based on history, we would need a 15% TSR to achieve "top quartile" returns in our peer set
- Achieving this level of performance on economic capital implies only 10% TSR on actual capital….and median performance relative to peers

The low rate of return on excess capital will reduce our TSR compared to less constrained peer companies

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Fannie Mae – Valuation Sensitivity

Fannie Mae Stock Price Sensitivity

	2010 Projected Intrinsic Share Value	Annual TSR 7/06-12/10	Beyond 2010: Annual Increase in Economic Capital	Beyond 2010: Rate of Return on Incremental Economic Capital Transitions to
Base Case	$54	4%	6%	12%
Base Case +	$64	8%	6%	14%
Base Case +, w/repurchase	$69	10%	6%	14%
Scenario 3	$70	10%	8%	14%
Scenario 4	$85	15%	8%	16%

Methodology

1) No additional distribution of capital (except where shares are repurchased to maintain capital at $3.5 billion in excess of minimum regulatory capital.)
2) New Investments after 2020 earn the rate of return indicated above
3) Excess returns on new investment from 2011 to 2020 decline at a constant rate starting with 2011
4) Growth in Investment reflects the rate of growth of economic capital beginning in 2011
5) Projected Intrinsic Share Value is calculated based on the intrinsic value of the firm, divided by shares outstanding (970M)
6) The Required Return on Economic Capital is assumed to be 12%.
7) TSR based uses $49 price on 7/6/2006 and $1 annual dividend (except where total dollar payout is maintained on post repurchase shares).

Strategic plan implies a stock price between ~$54 and ~$85 in 2010 depending upon investment opportunities beyond 2010

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Opportunities Exist To Improve Our Relative Performance

1. Invest in value creating growth initiatives where we get paid for taking additional risk
2. Optimize capital deployment by allocating to the highest value opportunities
3. Return capital to shareholders (e.g., buybacks, dividends) when appropriate
4. Improve processes, controls and risk management and earn the ability to reduce or eliminate the excess capital

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