Maximizing Shareholder Value

Fannie Mae

Board presentation
July 18, 2005

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MAXIMIZING FM SHAREHOLDER VALUE – EXECUTIVE SUMMARY

- Market forces are challenging the viability of FM’s business model and earnings trajectory
  - Fannie Mae has historically had a successful business model and financial performance
  - Structural market forces, e.g., consolidation, disintermediation, consumer demand, the global supply and demand for investments, etc. are shifting the opportunity away from FM’s traditional “sweet spot”
  - Cyclical factors may affect the timing of market evolution, but the longer-term direction and implications for FM’s business model and future earnings trajectory are clear
  - In addition, recent and expected changes in the legislative and regulatory environment will put further downward pressure on the net benefits derived from GSE status

- Full “privatization” is not recommended at this time
  - Significant earnings and returns to capital will be derived from the charter for the foreseeable future
  - To significantly grow beyond its core, FM must build upon its proprietary assets, distinctive skills, and privileged relationships, all of which are based upon its advantaged position in the current businesses
  - Under most scenarios, privatization implies shifting rather than avoiding regulatory oversight
  - Privatization should be re-considered in the future, after FM has had the chance to build significant non-core businesses and at the point when (if) the guaranty businesses fail to return their cost of capital

- Optimizing existing businesses will, by itself, be insufficient to maximize shareholder value
  - In the guaranty markets in which FM is now focused (i.e., 15-yr, 30-yr FRM), growth over the next 10 years will be slower than the last 5 years; share gains are unlikely given aggressive competitors such as Freddie, Countrywide, and Lehman
  - The portfolio business will remain a market-timing driven/opportunistic business and will also be characterized by increasing competition from Wall Street banks, hedge funds and overseas investors
  - The positive impact from optimization will largely be captured over the next 2 years, with limited potential as a platform for sustaining longer-term earnings growth
  - Top talent will be harder to attract and retain with a reduced growth ambition and outlook
  - Once management has re-established its credibility for delivering on performance promises, additional shareholder value creation will significantly depend upon the investment community’s longer-term earnings growth expectations for FM
MAXIMIZING FM SHAREHOLDER VALUE – EXECUTIVE SUMMARY

- FM has significant opportunities to grow beyond its existing core businesses
  - FM currently has only ~10% share of the estimated $60 billion US mortgage market pre-tax profit pool and no presence outside the US; most of the mortgage profit pools in the US and beyond have favorable growth prospects
  - FM has the potential to build upon its proprietary assets (e.g., scale, information), privileged relationships (e.g., with medium-sized lenders) and distinctive skills (e.g., credit and interest rate risk management) to succeed in capturing a number of alternative business opportunities

- To maximize shareholder value, FM needs to reshape its performance culture to become more focused on innovation and strengthen its ability to develop significant new earnings streams
  - The Board and management team need to get aligned on and committed to the specific growth vision and themes, definition of what success will look like, and what it will take to get there
  - A compelling proposition needs to be urgently communicated and then delivered to re-energize employees about FM's future prospects and how they will benefit, starting with the top 250
  - A broader program should be implemented to reshape ~5,000 employees' mindsets and behaviors to enable them to succeed in the new FM environment
  - Processes should be redesigned to support rigorous management of initiatives and investments that will create growth engines beyond current year budget requirements

- A first-cut effort identified five broad types of new business opportunities representing an estimated range of $1-3 billion in potential annual pre-tax profits for FM in 3-5 years
  - Categories of available growth opportunities include: adjacent guaranty areas, asset management/alternative investments, ‘home value management' (i.e., helping Americans capture the full value of home ownership beyond the point of purchase or refinance), service businesses, and international
  - Capturing these opportunities will require FM to overcome explicit and implicit constraints, including exploring new structures such as establishing a holding company, negotiating strategic alliances, etc.
MARKET FORCES ARE CHALLENGING THE VIABILITY OF FANNIE MAE'S BUSINESS MODEL AND EARNINGS TRAJECTORY

**Potential threat**

- Increasing concentration in deliveries by large lenders leading to pricing pressure
- Broad shift in consumer demand from standardized products to customized products
- Growing investor acceptance driving rapid private label securities issuance
- Increasing importance of second liens/home equity
- Large influx of capital and expertise into the market from large lenders and capital markets
- Increasingly integrated commercial and MF markets exerting pressure on Fannie Mae's MF-only business
- Elimination of arbitrage between MBS and agency debt securities
- Influx of new investors (e.g., Asian Central Banks)
- Active participation of total return investors
- Accounting standards for hedging and market gains challenging returns

**Illustration/example**

- Share of deliveries from Fannie Mae's top 10 customers increased from 28% in 1994 to 68% in 2004
- Guarantee fee under pressure approximately 8 bps better gap (i.e., charged fee - modelled fee) for small vs. large lenders
- DUS guarantee fee down from 46 bps in 01/02 to 36 bps in 03/05
- Fannie Mae current coupon yield MBS OAS spread to 7-year agency debt tightened from 34 bps in 2/99 to -15 bps in 05/05

Source: Interviews; McKinsey analysis
MARKET FORCES ARE SHIFTING THE OPPORTUNITY AWAY FROM FANNIE MAE'S TRADITIONAL "SWEET SPOT"

Macroeconomic drivers
- Strong home price appreciation, low credit default rates, historically low interest rates
- Unlocking of capital from international markets
- Changing US demographics – aging population facing significant retirement, healthcare challenges, growing immigration

Consolidation and disintermediation
- Primary mortgage markets consolidating
  - Technology and operations cost advantage in servicing
  - Driven in part by overall industry M&A
  - Arbitrage opportunity open to aggregators
- Accelerating vertical integration from both primary and secondary ends of market fueling private label issuance

Changing consumer demand and product mix
- Increased risk based pricing and changing demographics driving rapid growth in sub-prime and Alt-A originations
- Current rate environment, consumer sophistication, and home price appreciation driving high demand for ARMs and IOs
- Consumers increasingly using homes as active financing vehicles
  - Rapid home equity growth
  - Proliferation of more complex, bundled products

Shift in product mix away from Fannie Mae's traditional "sweet spot" (i.e., 15- and 30-year FRM)
- Reduced market power in guarantee business
  - Pressure on credit guaranty fees from large lenders
  - Large lenders acting to potentially substitute GSEs by aggregating loans from smaller lenders
- Challenges to portfolio business earning historical average returns with traditional business model

Challenging investing environment
- Greater investor comfort with mortgage securities through better understanding of credit risk, indexing
- Excess capital chasing yield and putting downward pressure on agency MBS spreads
- Alternative investment vehicles (e.g., REITs, hedge funds) and investor appetite for lower credit collateral driving non-agency MBS liquidity
- Depositories holding of mortgage assets rising in search of yield - Basel II to reinforce this trend
FANNIE MAE'S RELATIVE SIZE AND MARKET POWER HAS DIMINISHED SIGNIFICANTLY OVER THE LAST 15 YEARS

<table>
<thead>
<tr>
<th>Top 10 financial institutions*, 1990</th>
<th>Market capitalization</th>
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<tbody>
<tr>
<td>American Express</td>
<td>10</td>
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<td>JPMorgan</td>
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<td>Nat West</td>
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<td>BankAmerica</td>
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<td>Bank One</td>
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<td>SLM Corporation</td>
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<td>Citicorp</td>
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<td>Bankers Trust</td>
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<td>Wells Fargo</td>
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<td>Wachovia</td>
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<td>Fannie Mae</td>
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<tr>
<td>Freddie Mac</td>
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<thead>
<tr>
<th>Top 10 financial institutions*, 2005</th>
<th>Market capitalization</th>
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<tr>
<td>Citigroup</td>
<td>242</td>
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<tr>
<td>Bank of America</td>
<td>182</td>
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<tr>
<td>JPMorganChase</td>
<td>122</td>
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<tr>
<td>Wells Fargo</td>
<td>103</td>
</tr>
<tr>
<td>Wachovia Corp</td>
<td>79</td>
</tr>
<tr>
<td>American Express</td>
<td>67</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>58</td>
</tr>
<tr>
<td>US Bancorp</td>
<td>54</td>
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<tr>
<td>Merrill Lynch</td>
<td>53</td>
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<tr>
<td>Goldman Sachs</td>
<td>51</td>
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<tr>
<td>Fannie Mae</td>
<td>57</td>
</tr>
<tr>
<td>Freddie Mac</td>
<td>46</td>
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</tbody>
</table>

* Excluding insurance companies

Source: McKinsey Corporate Performance Database
CONTINUED CONSOLIDATION IN ORIGINATION AND SERVICING CONSISTENT WITH OTHER CONSUMER CREDIT INDUSTRIES

Mortgage origination share
Percent

1994  2004
22   59

Mortgage servicing share
Percent

1994  2004
22   54

Credit card outstandings
Percent

1994  2004
62   86

Source: Mortgage Market Statistical Annual, "Inside Mortgage Finance"; Big Wheels; Nilson; McKinsey analysis
ACCELERATING VERTICAL INTEGRATION ESPECIALLY IN SUBPRIME

Sub-prime market share across value chain

<table>
<thead>
<tr>
<th></th>
<th>Origination</th>
<th>Servicing</th>
<th>MBS Issuance</th>
<th>Underwriting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Countrywide</strong></td>
<td>6.0</td>
<td>5.6</td>
<td>5.8</td>
<td>6.8</td>
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<tr>
<td><strong>AMERIQUEST®</strong></td>
<td>1.7</td>
<td>7.0</td>
<td>7.6</td>
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<td><strong>citi financial</strong></td>
<td>6.5</td>
<td>7.2</td>
<td></td>
<td>7.5</td>
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<tr>
<td><strong>JPMorganChase</strong></td>
<td></td>
<td>4.0</td>
<td>3.6</td>
<td>4.5</td>
</tr>
</tbody>
</table>

* Subprime servicing balances

Source: IMF-PUBS Top Subprime Mortgage Market Players, McKinsey analysis

- Top 3 rank
- Top 10 rank
# Evolution of More Distinct Consumer Segments Requiring Customization of Products

## 1. Affluent relationship-oriented, conservative home owner
- Predominantly use mortgage company
- Finances in good order
- Value long-term relationships and quality (potentially at the expense of lowest costs)
- Unlikely to try new financial services
- 62% identified as Boomers
- 33% identified as generation X
- 54% with incomes between $50-100K

## 2. Affluent, well-informed, low-loyalty value shopper
- Finances in good order
- Prefer machines to face-to-face interactions
- Very confident about financial decisions
- Primarily work through banks
- Will shop for best value
- Low loyalty to financial institutions
- Very willing to try new services
- Affluent consumer segment
  - 46% income between $75-100K
  - 25% above $100K

## 3. Lower income skeptic
- High use of banks
- Like to spend money rather than save
- Not happy with current financial situation
- Distrust of financial system
- Not confident with decisions and feel need for help in managing finances
- Prefer single contact for various financial services
- High ethnic proportion

## 4. Lower-income worried consumers
- Low home equity
- Highly price sensitive with regards to financial services
- High use of mortgage companies
- Very organized with financial affairs but worried about finances
- Do not value long-term relationships
- Lowest income segment (70% under $50K)
- High ethnic proportion

## 5. Face-to-face relationship valuing retiree
- Experienced with mortgages
- Highest proportion of home equity
- Highest use of banks
- Finances in good order
- Value long-term relationships
- Prefer to do business in person and like to chat with financial advisors
- 92% identified as Retirees or WWII generation (Oldest non-retired age segment)

## 6. Young spender
- First mortgage predominantly use mortgage companies (70%) but prefer convenience of single contact where possible
- Highest use of mortgage companies
- Spenders rather than savers
- Not disciplined with finances and tend to dislike managing finances
- Not satisfied with current financial situation and distrustful of institutions
- Large proportion of first mortgage
- Likely to try new things
- Will shop for value

Source: McKinsey cluster analysis

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**Users of non-standard products**

**Potential size of customer base (Percent of households)**
HEALTHCARE AND RETIREMENT COSTS WILL REQUIRE TAPPING INTO THE VALUE OF THE U.S. HOUSING STOCK

What was it like to retire in 1985

- Almost 65% of retirement income came from social security
- Defined benefit plans from high quality employers covered 53% of households
- Healthcare expenses were largely covered by employee retirement health plans

What it will be like to retire in future

- Social security already provides less than 40% of retirement income
- Defined benefit pension plans cover only 35% of households
- Shortfall of $450 billion in pension plans (up 27% from 2003) and rising
- PBGC paid out $3 billion in 2004, having to take over ~190 pension plans
- Healthcare expenses of 1.9 trillion in 2005, growing at 10-15% per year, and expected to reach 17% of GDP by 2010
- Retirees likely to spend ~40% of income on healthcare by 2020; the last few years of life tend to require significantly higher healthcare expenditures (i.e., 10x the previous 10-year average)

Estimated equity in U.S. residential property of $8 - 10 trillion will need to be tapped to offset increasing healthcare and retirement costs

Source: Analyst reports; literature search; Fed Flow of Funds; McKinsey analysis
INCREASING DEMAND FOR MBS FROM ASIAN CENTRAL BANKS

Central Bank FX reserves
$ Trillion, percent

<table>
<thead>
<tr>
<th>Year</th>
<th>Asian</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>48</td>
<td>52</td>
<td>100</td>
</tr>
<tr>
<td>2005</td>
<td>71</td>
<td>29</td>
<td>100</td>
</tr>
</tbody>
</table>

65% of FX reserves invested in U.S. dollar assets

Central Banks with MBS/ABS as approved asset classes
Percent of banks surveyed, UBS Central Bank Survey

<table>
<thead>
<tr>
<th>Year</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<td>2</td>
<td>12</td>
<td>19</td>
<td>17</td>
<td>22</td>
<td>27</td>
<td>39</td>
<td>39</td>
</tr>
</tbody>
</table>

“Foreign assets should be invested in...Agency bonds, supranational bonds and securitized bonds which offer high liquidity and certainty of redemption”

– Ministry of Finance, Japan

“We have sufficient reserves to secure our sovereign credibility... We now need to take more consideration of profitability... manage our reserves in a more useful way”

– Governor Park Seung, Bank of Korea

Source: UBS Mortgage Strategist

PROPRIETARY AND CONFIDENTIAL
CONFIDENTIAL TREATMENT REQUESTED
BY FANNIE MAE
Many of the shifts observed in the mortgage industry appear structural.

<table>
<thead>
<tr>
<th>Major trend</th>
<th>Nature of trend</th>
<th>Rationale</th>
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<tbody>
<tr>
<td>Primary market consolidation</td>
<td>Structural</td>
<td>Scale benefits in technology, operations and retail access</td>
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<tr>
<td>Depository mortgage assets</td>
<td>Structural</td>
<td>Search for yield structural – likely to be reinforced by Basel II</td>
</tr>
<tr>
<td>Vertical integration</td>
<td>Structural</td>
<td>Build up of skills; ability to &quot;cherry-pick&quot; best assets</td>
</tr>
<tr>
<td>Global capital markets deepening</td>
<td>Structural</td>
<td>Improving efficiency in global markets</td>
</tr>
<tr>
<td>Home equity growth</td>
<td>Mostly structural</td>
<td>Shift in consumer behavior toward using homes as active financing vehicles</td>
</tr>
<tr>
<td>Narrowing of portfolio OAS</td>
<td>Mostly structural</td>
<td>Structural deepening of global capital markets; increased investor comfort in substituting agency debt with MBS</td>
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<tr>
<td>Sub-prime, Alt-A growth</td>
<td>Both structural and cyclical</td>
<td>Expansion of product availability through risk based pricing structural; low credit defaults cyclical</td>
</tr>
<tr>
<td>Private label issuance</td>
<td>Both structural and cyclical</td>
<td>Increased investor appetite for subordinate bonds</td>
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<tr>
<td>ARMs and IOs demand</td>
<td>Mostly cyclical</td>
<td>Fueled by current rate environment and home price appreciation, hybrid ARMs structural</td>
</tr>
<tr>
<td>Home price appreciation</td>
<td>Cyclical</td>
<td>Benefiting from long economic &quot;bull run&quot;</td>
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</table>

Source: McKinsey Analysis
DECISION FRAMEWORK FOR STRATEGIC OPTIONS

Recommended approach

To what extent will the value of the current business be competed or regulated away?

What is the ability to grow beyond today's businesses based on current skills, assets, and relationships?

What is Fannie Mae's ability to compete in the market absent its charter?

Likelihood and change required

Lower

Optimize current businesses (stay the course)

Higher

Optimize plus pursue growth opportunities

Higher

Fully privatize

Lower

TBD

"Fall back" option, if additional growth not feasible

"Preferred" option, but need to address explicit and implicit constraints

"Unlikely" and would require radical change

Extract value/sell?

"Preferred" option, but need to address explicit and implicit constraints

Proprietary and Confidential Treatment Requested by Fannie Mae
WHY "PRIVATIZATION" IS NOT RECOMMENDED AT THIS TIME

1. Significant earnings and returns to capital will be derived from the charter for the foreseeable future
   - Credit guaranty: Scale and liquidity benefits derived from the implied guarantee and TBA privilege
   - Portfolio: Funding advantage of ~15-20 bps as unsecured debt trades at AAA levels compared to most banks' AA-/A unsecured debt
   - Capital advantage of 2-3% relative to banks, although this may be eliminated through future legislation

2. Fannie Mae's strengths, from which to grow beyond its core, are based upon its advantaged position, particularly in the guaranty business, e.g.
   - Scale: Over $500 billion of MBS issuance in 2004
   - Ready access to capital for specified purposes, making rapid expansion possible
   - Proprietary information: Loan performance data on over 54 million loans dating back 25 years; 500 million transaction records supporting valuation of ~70 million properties

3. Privatization implies shifting, rather than avoiding regulatory oversight (e.g., SEC, other bank regulators)

4. Privatization should be re-considered in the future, after Fannie Mae has had the chance to build significant non-core businesses and at the point when (if) the guaranty businesses fail to return their cost of capital
<table>
<thead>
<tr>
<th><strong>Market conditions</strong></th>
<th><strong>Size and market power</strong></th>
<th><strong>Business presence</strong></th>
<th><strong>Nature of guarantee</strong></th>
<th><strong>Rationale for privatization</strong></th>
<th><strong>Fannie Mae - 2005</strong></th>
<th><strong>Sallie Mae - 1994</strong></th>
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<td></td>
<td>$9 trillion mortgage debt outstanding</td>
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<td>Moderate origination growth expected in the medium term</td>
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<td>Critical to overall economy</td>
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<td>Mature secondary market - 7% CAGR projected for MBS through 2010</td>
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<td></td>
<td>$1.3 trillion of MBS outstanding</td>
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<tr>
<td>$80 billion student loans outstanding, poised for rapid growth in originations</td>
<td>Market capitalization of $2.4 billion</td>
<td>Credit guaranty</td>
<td>Student loans had guarantee on underlying asset - consumers continue to benefit from subsidy even with privatization of GSE</td>
<td>Federal government entering student lending directly - legislation allowing up to 60% of originations to be direct lending</td>
<td></td>
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<tr>
<td>Small role in overall economy</td>
<td>Net income of $400 million</td>
<td>Portfolio</td>
<td>Implicit guarantee on agency debt benefits conforming borrowers - GSE privatization would eliminate this consumer benefit</td>
<td>30 bps user fee on all loans acquired after 8/1993 - estimated 33% reduction in profit margins over 5 years</td>
<td></td>
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<tr>
<td>Exploding secondary market with creation of ABS in 1991-65% CAGR from 1993-97</td>
<td>$14 billion of ABS outstanding (1997)</td>
<td>Servicing</td>
<td>ABS funding model proven to be successful alternative to holding whole loans on balance sheet</td>
<td>ABS funding model proven to be successful alternative to holding whole loans on balance sheet</td>
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<td></td>
<td>~55% of student loan ABS origination</td>
<td>Operations and IT services/consulting</td>
<td></td>
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<td>Market trends driving shift away from charter-linked businesses</td>
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<td>Affordable housing fund: 5% of profits; estimated impact of ~$400 million reduction on 2003 NI of $7.9 billion</td>
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<td>No alternative funding model beyond MBS</td>
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</table>

Source: Literature search; McKinsey analysis
WHY OPTIMIZATION BY ITSELF WILL NOT BE SUFFICIENT TO MAXIMIZE SHAREHOLDER VALUE

- In the guaranty markets in which Fannie Mae has traditionally focused (i.e., 15-yr, 30-yr FRM), growth over the next 10 years will be slower than the last 5 years, share gains are unlikely given aggressive competitors such as Freddie, Countrywide, and Lehman
  - Origination CAGR of 16.5% over last 5 years vs. long term average of 7-8%
  - Home price appreciation CAGR of 8% over last 5 years vs. the long term average of 4-5%
  - Portfolio spreads likely to be tighter in future (down from 98 bps MBS OAS over 6-month treasury in 2000 to 39 bps over treasury in 2005)

- The portfolio business will remain a market-timing driven/opportunistic business and will also be characterized by increasing competition from Wall Street banks, hedge funds and overseas investors

- The positive impact from optimization will largely be captured over the next 2 years, with limited potential as a platform for sustaining longer-term earnings growth

- Top talent will be harder to attract and retain with a reduced growth outlook

- Creating additional shareholder value will significantly depend upon the investment community's longer-term earnings growth expectations for Fannie Mae
  - Average terminal value for top 20 North American financial institutions = 22%
  - Terminal value for Freddie Mac = 8%
  - Terminal value for Fannie Mae = -8% (for current market capitalization)

- Optimization by itself could improve market capitalization by ~$1 billion over 2-3 years

- Optimization by itself would likely result in:
  - Limited investment in business given lower underlying growth
  - Focus on cost containment/reduction
  - Increased return of capital to shareholders
  - Increased challenges in attracting and retaining talent

- By comparison, however, a 2-3% increase in the long-term earnings growth rate from new growth opportunities will have a $7-10 billion impact on shareholder value

PROPRIETARY AND CONFIDENTIAL - CONFIDENTIAL TREATMENT REQUESTED BY FANNIE MAE
OPTIMIZING EXISTING BUSINESSES CAN PROVIDE SIGNIFICANT NEAR-TERM EARNINGS LIFT

Critical business needs

- Grow beyond traditional 30-year and 15-year FRMs focus and capture value from emerging segments (e.g., expand further in ARMs)
- Develop flexibility in technology and operations to support multiple, customized products
- Adapt to changing needs of consumers and offer competitive products and services
- Optimize capital to invest in growth initiatives

Illustrative optimization levers

- Risk based micro-pricing across customer segments
- Technology re-architecting and productivity improvement
- Lean manufacturing approach to streamline operations and achieve best-in-class cost, quality and productivity
- Rebalancing customer and product groups and applying key account management to strategically important accounts
- Optimize capital across different businesses and growth opportunities

Potential opportunity to improve earnings in the range of $100-200 million over the next 2-3 years
**HOWEVER, MARKET SHARE GAINS WILL BE DIFFICULT GIVEN INTENSE COMPETITION**

<table>
<thead>
<tr>
<th><strong>Freddie Mac</strong></th>
<th><strong>Countrywide Financial</strong></th>
<th><strong>LEHMAN BROTHERS</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Aggressive pricing targeted at switching lenders (e.g., Wamu) from Fannie Mae; stated goal of achieving 50% MBS issuance market share</td>
<td>• Leveraging synergies from shared institutional relationships, production flows through the value chain, mortgage analytics, shared technology and distribution infrastructure</td>
<td>• Purchased Finance America, Aurora Loan Services, and several other small subprime originators</td>
</tr>
<tr>
<td>• Aggressively targeting IOs, recently exceeded Fannie Mae in loan purchases (since April, 2005)</td>
<td>• Developed Capital Markets BU – directing less than 1/3 of deliveries to Fannie Mae – rest to private label</td>
<td>• Sourced more that 55% of the residential securitization product from own origination platform in 2004</td>
</tr>
<tr>
<td>• Developed new customer-centric strategy and leadership team within single-family business with head of national lending to cover large accounts</td>
<td>• Growing portfolio capability – directed $15 billion of loans in Q2, 2005 to the bank vs. $8 billion in Q1, 2005</td>
<td>• Has rapidly grown its SASCO conduit through warehouse lending</td>
</tr>
<tr>
<td>• Growing portfolio business by 6-7% post re-statement</td>
<td>• 20% of revenues from new businesses (e.g., credit risk management, MBS structuring and issuance, commercial real estate, CDO lending through C-BASS JV)</td>
<td>• Geographic and product diversification by</td>
</tr>
</tbody>
</table>

- Developing origination capability in other markets e.g. Netherlands, UK
- Looking to diversify product offering rather than focusing on specific asset class e.g. Alt A, Sub-prime, reverse, conventional

- Nearly $3 billion in mortgage-related revenues and $22 billion market capitalization
  - #1 mortgage originator & servicer
  - #1 issuer of Alt A
  - #2 issuer of non-Agency MBS

- Over $2 billion in mortgage-related revenues
  - #1 underwriter of non-agency MBS
  - #4 issuer of non-agency MBS
  - #6 underwriter of Agency-backed REMICs

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$46 billion market capitalization
- #2 agency MBS issuer

$46 billion market capitalization
- #2 agency MBS issuer

$46 billion market capitalization
- #2 agency MBS issuer

Source: IMF-PUBS; Company reports; Literature Reviews, Interviews
THE PORTFOLIO BUSINESS WILL REMAIN AN OPPORTUNISTIC BUSINESS AND NOT A DRIVER OF LONG TERM GROWTH

- Portfolio buy-and-hold earnings dependent on option-adjusted spread of MBS to agency debt
  - Cyclical, and linked to supply and demand of MBS and agency debt
  - Negative today for 15-year and 30-year FRMs

- Significant earnings volatility expected from use of interest rate derivatives under GAAP accounting

- Dramatic growth in retained portfolio compared to competition likely to draw negative attention from Government and industry

"The method of GSE financing most consistent with the GSE's missions is to securitize assets and hold in their portfolios only those that are very difficult or unduly expensive to securitize"

--- Alan Greenspan

"Under the new regulatory regime we envision, Fannie and Freddie's retained portfolios will generate returns on equity of 10-12%...we expect the portfolios to remain flat, neither growing nor shrinking, as Fannie and Freddie focus on preserving their margins."

--- Morgan Stanley Equity Research

Source: Deutsche Bank U.S. Mortgage TBA Index
FANNIE MAE HAS ONLY ~10% OF THE $60 BILLION U.S. MORTGAGE PRE-TAX PROFIT POOL

$ Billion, 2005 Estimate

<table>
<thead>
<tr>
<th>Origination</th>
<th>Servicing</th>
<th>Insurance</th>
<th>Credit Risk Mgmt</th>
<th>Portfolio</th>
<th>Trading</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jumbo ~2.5</td>
<td>Jumbo ~1</td>
<td>Mortgage insurance ~2</td>
<td>Conduit/ private label* ~3</td>
<td>Banks &amp; Others ~11</td>
<td>Agency debt ~1</td>
</tr>
<tr>
<td>Sub-prime, Alt-A ~9.5</td>
<td>Sub-prime, Alt-A ~1</td>
<td>Title insurance ~2</td>
<td>Whole loans* ~4</td>
<td>Asset mgmt ~2</td>
<td>Agency MBS, CMOs ~1</td>
</tr>
<tr>
<td>Prime ~2.5</td>
<td>Prime ~3</td>
<td></td>
<td></td>
<td></td>
<td>Non-Agency MBS ~0.5</td>
</tr>
<tr>
<td>Home equity ~2</td>
<td>Home equity ~0.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total pre-tax profit

* Pre-tax profit pool for Jumbo credit risk management = $2 bn

Source: McKinsey Analysis

Does not include international mortgage profit pool, estimated at $50 billion, and growing more rapidly in select countries.
## Strengths on Which Fannie Mae Can Build Profitable Growth

### Proprietary Assets
- Ready access to low-cost capital (for specific purposes)
- Scale
- Brand
- Technology
- Information

### Privileged Relationships
- Small and medium-sized lenders
- Investor base

### Distinctive Skills
- Credit risk management and analytics
- Hedging and interest rate risk management
- REO, loss mitigation

### Description
- Charter benefits give lower cost of capital and unrivalled access to capital markets
- Large scale provides leverage across the mortgage value chain and a unique ability to set standards
- Positive brand recognition in the mortgage and housing industry among consumers and investors
- Mortgage models and software are market standard (i.e., Desktop Underwriter 40% share) - facilitates cross sell and locks in customers
- Strong loan performance and property valuation data
  - 54 million loans dating back over 25 years
  - 500 million transaction records supporting valuation of ~70 million properties
- Small lenders prefer selling to Fannie Mae due to neutrality and trust-based relationships – this could erode over time under competition from large lenders
- Broad base of investors and counterparties familiar and comfortable with Fannie Mae products and processes
- Extensive experience in data analytics, modelling and managing credit and pre-payment risk
- Top tier pricing capability arising from superior interest rate risk management (especially for pass-throughs)
- Top tier loss mitigation and REO capability
CAPTURING NEW GROWTH OPPORTUNITIES COMBINED WITH OPTIMIZING CURRENT BUSINESSES, COULD RESULT IN AT LEAST A 50% INCREASE IN MARKET CAPITALIZATION

Assuming P/E of ~8 applied to incremental post-tax earnings of $1-1.5 billion

Assuming P/E improves from current levels to ~10-12 given stronger growth trajectory and more integrated model

Opportunity to increase market capitalization by at least ~50%

Fannie Mae's current market capitalization

57

Potential impact of:
- Legislation
- Market forces
- Resolution of acct./ legis. uncertainties

Potential value of "staying the course"

Additional value from optimizing current businesses

Value from additional business opportunities net of industry response

Potential value at current multiple

Potential increase in market capitalization value due to enhanced multiple

~80-100

~64 - 69

16-31

~6-11

Source: McKinsey analysis

PROPRIETARY AND CONFIDENTIAL - CONFIDENTIAL TREATMENT REQUESTED BY FANNIE MAE
RESHAPING PERFORMANCE CULTURE INVOLVES OVERCOMING BARRIERS TO CHANGE REPRESENTED BY DEEPLY INGRAINED EMPLOYEE MINDSETS AND BEHAVIORS

Example actions

1. Role modeling
   - Take symbolic leadership actions
   - Provide leadership opportunities
   - Foster more explicit coaching/mentoring

2. Ensuring understanding and conviction
   - Codify and cascade integrated change story
   - Gain top team alignment and commitment to making changes happen
   - Meaningfully engage employees on underlying hopes, fears, and values

3. Enabling people to succeed via skills and confidence
   - Invest in developing knowledge, skills, and external awareness
   - Expand leadership capacity and skills to drive day-to-day change
   - Upgrade talent at each level of the organization

4. Reinforcing with consistent formal mechanisms
   - Restructure the organization
   - Revise key performance metrics and target setting methodology
   - Redesign management processes
   - Align financial incentives and recognition
   - Ensure sufficient, timely MIS

Source: McKinsey Organization Practice
APPROACH TO IDENTIFY AND PRIORITIZE GROWTH OPPORTUNITIES FOR FANNIE MAE ABSENT CONSTRAINTS

Step 1 – Opportunity identification

Step 2 – Attractiveness screening

Step 3 – Prioritization

1. What is the comprehensive list of growth opportunities Fannie Mae can consider?

2. What are the attractive opportunities in the mortgage (and related) industry?
   - Materially significant (pretax earnings potential >$200 m in 3-5 years)
   - High growth/value creation potential
   - Strategic fit with current business

3. How should Fannie Mae prioritize these opportunities, given their nature and magnitude?

Proprietary and Confidential - Confidential Treatment Requested by Fannie Mae
WITHOUT TAKING CONSTRAINTS INTO ACCOUNT, FANNIE MAE HAS FIVE BROAD TYPES OF NEW GROWTH OPPORTUNITIES

<table>
<thead>
<tr>
<th>Materialey significant growth opportunities</th>
<th>Pre-tax profit pool, $ billion</th>
<th>Growth</th>
<th>Attractiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expand into adjacent spaces</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Credit guaranty: extend core business to subprime, home equity, Jumbo, and expansion in ARMs</td>
<td>$3 bn</td>
<td>H</td>
<td>300</td>
</tr>
<tr>
<td>2. Servicing - financial management: manage prepayment risk</td>
<td>3.5</td>
<td>M</td>
<td>350</td>
</tr>
<tr>
<td>3. Mortgage insurance</td>
<td>2</td>
<td>L</td>
<td>200</td>
</tr>
<tr>
<td>4. Title insurance</td>
<td>2</td>
<td>L</td>
<td>400</td>
</tr>
<tr>
<td>Enter asset management and alternative investing businesses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Asset management: invest third party funds in MBS</td>
<td>2</td>
<td>H</td>
<td>300</td>
</tr>
<tr>
<td>6. Commercial/ multifamily investing: significantly expand current presence to invest own/third party capital in real estate</td>
<td>5</td>
<td>H</td>
<td>400</td>
</tr>
<tr>
<td>7. Credit risk investing (own/third party capital)</td>
<td>1.5</td>
<td>H</td>
<td>300</td>
</tr>
<tr>
<td>8. Distressed assets investing (in distressed financial and physical assets)</td>
<td>1.5</td>
<td>H</td>
<td>400</td>
</tr>
<tr>
<td>9. Infrastructure bonds: invest in development infrastructure</td>
<td>3</td>
<td>H</td>
<td>500</td>
</tr>
<tr>
<td>10. Construction finance (for multifamily/ commercial assets)</td>
<td>6</td>
<td>M</td>
<td>300</td>
</tr>
<tr>
<td>Create home-value management industry</td>
<td></td>
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<tr>
<td>11. Customer benefits of home ownership beyond purchase (including transferable stock, reverse mortgages, home value insurance)</td>
<td>~5</td>
<td>H</td>
<td>500</td>
</tr>
<tr>
<td>Build service businesses</td>
<td></td>
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<tr>
<td>12. Servicing: create processing utility for industry</td>
<td>2</td>
<td>M</td>
<td>350</td>
</tr>
<tr>
<td>13. Analytics/ data-driven appraisals</td>
<td>3.5</td>
<td>M</td>
<td>200</td>
</tr>
<tr>
<td>Move Internationally</td>
<td></td>
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</tr>
<tr>
<td>14. Create MBS markets and invest in 9 major countries (UK, Canada, Netherlands, France, Germany, Japan, Brazil, China, India)</td>
<td>50</td>
<td>H</td>
<td>1000</td>
</tr>
</tbody>
</table>

Others de-prioritized due to low size/ growth, lower strategic fit
- Technology outsourcing
- Deposit taking
- Consulting
- Mortgage origination
- Technology outsourcing
- Deposit taking
- Consulting
- Mortgage origination
- Market making in MBS (dealer)

CONFIDENTIAL TREATMENT REQUESTED BY FANNIE MAE
CAPTURING ANY OF THESE OPPORTUNITIES REQUIRES ADDRESSING CURRENT CONSTRAINTS

<table>
<thead>
<tr>
<th>Growth opportunity</th>
<th>Explicit constraint (Charter limitation)</th>
<th>&quot;Implicit&quot; regulatory/constituent constraint</th>
<th>Strong negative competitive/customer response</th>
<th>Internal capability gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Credit guaranty expansion (subprime, ARM, jumbo)</td>
<td>✓ (Jumbo)</td>
<td></td>
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<tr>
<td>2. Servicing – financial management</td>
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<tr>
<td>3. Mortgage insurance (&gt; 80 LTV)</td>
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<tr>
<td>4. Title insurance (Jumbo?)</td>
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<tr>
<td>5. Asset management</td>
<td></td>
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<tr>
<td>6. Commercial/ multi-family investing (Non-multifamily)</td>
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<tr>
<td>7. Credit risk investing (Non-multifamily)</td>
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<tr>
<td>8. Distressed assets investing (SF &gt; 80 LTV)</td>
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</tr>
<tr>
<td>9. Infrastructure bonds</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>10. Construction finance</td>
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<tr>
<td>11. Home value management</td>
<td></td>
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<tr>
<td>12. Servicing – processing</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>13. Analytics/ data-driven appraisals</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. International</td>
<td></td>
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</tbody>
</table>

Constraints could be addressed by exploring a range of alternative structures – e.g., bank holding company, alliances/JV, out-licensing.

PROPRIETARY AND CONFIDENTIAL – CONFIDENTIAL TREATMENT REQUESTED BY FANNIE MAE
SUGGESTED ACTIONS FOR THE NEXT 90-120 DAYS

1. Determine specific 2005/2006 earnings improvement opportunities from optimization of existing businesses, and launch key initiatives

2. Gain alignment on aspirations for growth and valuation over the next 3-5 years

3. Drive efforts to reshape performance culture with particular emphasis on galvanizing top 250

4. Analyze in more detail highest priority growth opportunities

5. Work through implicit and explicit constraints and what it will take to capture priority growth opportunities

6. Develop detailed business cases for the short list of feasible, highest impact ideas