



Office of Federal Housing Enterprise Oversight (OFHEO)

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NEWS RELEASE

FOR IMMEDIATE RELEASE

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**OFHEO ANNOUNCES FIRST QUARTER 2007
MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION
FOR FANNIE MAE and FREDDIE MAC
Reaffirms Fannie Mae Q1-4 2005 as Adequately Capitalized**

WASHINGTON, DC — James B. Lockhart III, Director of the Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie Mae and Freddie Mac, classified Fannie Mae and Freddie Mac as adequately capitalized as of March 31, 2007. Fannie Mae's classification is based on estimated numbers submitted by Fannie Mae and not financial statements released to shareholders. Freddie Mac's classification is based upon numbers consistent with their First Quarter Financial Statements and Information Statement Supplement released on June 14, 2007.

Fannie Mae had a 10.2 percent surplus above the OFHEO-directed requirement, which is 30 percent above the required minimum capital. Freddie Mac's surplus above the OFHEO-directed requirement was 5.9 percent. Both Enterprises' percentages were down from December 31, 2006.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the OFHEO Director to determine the capital level and classification of the Enterprises not less than quarterly, and to report the results to Congress. OFHEO classifies the Enterprises as adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. The Enterprises are required by federal statute to meet both minimum and risk-based capital standards to be classified as adequately capitalized.

Fannie Mae

Fannie Mae's first quarter 2007 classification of adequately capitalized remains subject to change as the company continues its ongoing accounting review and issuance of public statements. Fannie Mae's quarterly numbers carry forward its 2004 and 2005 accounting adjustments, and incorporate ongoing estimates of additional accounting changes for 2006 and 2007. This process of including ongoing adjustments in disclosures, coupled with ongoing supervisory activities, provides OFHEO additional assurance that the company is maintaining a capital surplus in excess of the OFHEO-directed requirement.

Fannie Mae's surplus as a percent of the OFHEO-directed requirement decreased slightly to 10.2 percent from 10.9 percent the prior quarter. The slight change is due mainly to growth in MBS outstanding and the resulting increase in the capital requirement. Fannie Mae continues to operate under growth restrictions for its retained portfolio and has maintained compliance with this agreement throughout the quarter. There are no restrictions on its issuance of guaranteed MBS.

Fannie Mae resubmitted capital reports to OFHEO following Fannie Mae's public disclosure of 2005 financial results and its 2005 Annual Report on May 3, 2007. After analysis of these results, Director Lockhart is reaffirming the previous capital classification of adequately capitalized for all four quarters of 2005. All capital data for these historical quarters can be found on OFHEO's website in the historical charts at [CapitalRequirements.aspx?Nav=273](http://www.ofheo.gov/CapitalRequirements.aspx?Nav=273).

Although progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the first quarter 2007, significant work remains before Fannie Mae becomes a timely financial filer and corrects its internal control and operational weaknesses.

OFHEO supports Fannie Mae's current practice of managing the surplus above the OFHEO-directed requirement to compensate for its internal control and operational weaknesses, and to account for the sensitivity of the capital surplus to potential market valuation losses arising from changes in interest rates, market volatility, and credit loss expectations.

Freddie Mac

Freddie Mac's first quarter 2007 classification of adequately capitalized is based upon results consistent with its June 14, 2007 Information Statement Supplement.

Freddie Mac's surplus as a percent of the OFHEO-directed requirement decreased to 5.9 percent from 7.7 percent the prior quarter due primarily to growth in the retained portfolio. Freddie Mac has agreed to growth restrictions on its retained portfolio as of July 1, 2006 and remains in compliance with these restrictions. There are no restrictions on its issuance of guaranteed MBS.

Although the filing of the First Quarter 2007 Financial Statements and Information Statement Supplement continues to demonstrate progress for Freddie Mac in returning to timely and accurate financial reporting, internal control and operational weaknesses remain evident. Significant work remains before Freddie Mac becomes a timely filer and SEC registrant.

OFHEO supports Freddie Mac's current practice of managing the surplus above the OFHEO-directed requirement to compensate for its internal control and operational weaknesses, and to account for the sensitivity of the capital surplus to potential market valuation losses arising from changes in interest rates, market volatility, and credit loss expectations.

FIRST QUARTER CAPITAL RESULTS

Minimum and Critical Capital

Fannie Mae's adjusted¹ OFHEO-directed capital requirement on March 31, 2007 was \$38.4 billion and its adjusted statutory minimum capital requirement was \$29.5 billion. Fannie Mae's adjusted core capital of \$42.3 billion exceeded the adjusted OFHEO-directed capital requirement by \$3.9 billion. Fannie Mae's adjusted core capital exceeded the adjusted statutory critical capital requirement by \$27.0 billion.

Freddie Mac's reported OFHEO-directed capital requirement on March 31, 2007 was \$34.2 billion and its reported statutory minimum capital requirement was \$26.3 billion. Freddie Mac's reported core capital of \$36.2 billion exceeded the OFHEO-directed minimum capital requirement by \$2.0 billion. Freddie Mac's core capital exceeded the statutory critical capital requirement by \$22.8 billion.

Enterprise Minimum Capital Requirement (Billions of Dollars) ^(a)				
	Fannie Mae		Freddie Mac	
	31-Mar-07 <small>(b,c,d)</small>	31-Dec-06 <small>(b,c,d)</small>	31-Mar-07 <small>(c)</small>	31-Dec-06 <small>(c)</small>
Minimum Capital - Statutory Requirement	29.524	29.332	26.304	25.844
Minimum Capital - OFHEO Directed Requirement	38.381	38.131	34.196	33.597
Core Capital	42.277	42.295	36.230	36.170
Surplus (Deficit) (based on OFHEO Directed Requirement)	3.896	4.163	2.034	2.573
Surplus as a Percent of OFHEO Directed Requirement	10.2%	10.9%	5.9%	7.7%

Enterprise Critical Capital Requirement (Billions of Dollars) ^(a)				
	Fannie Mae		Freddie Mac	
	31-Mar-07 <small>(b,d)</small>	31-Dec-06 <small>(b,d)</small>	31-Mar-07	31-Dec-06
Critical Capital Level	15.247	15.134	13.484	13.237
Core Capital	42.277	42.295	36.230	36.170
Surplus (Deficit)	27.030	27.161	22.746	22.933

- a. Numbers may not add due to rounding.
- b. Subject to revision based upon results of ongoing financial restatement and audit processes.
- c. OFHEO has directed both Fannie Mae and Freddie Mac to maintain an additional 30% capital in excess of the statutory minimum capital requirement. These requirements have been an additional requirement since January 28, 2004, for Freddie Mac and since September 30, 2005, for Fannie Mae. The OFHEO-directed minimum capital requirement and capital surplus numbers stated in these charts reflect the inclusion of the additional 30% OFHEO-directed capital requirement.
- d. Fannie Mae's minimum capital, critical capital, and core capital are adjusted for accounting errors identified to date.

¹ The term "adjusted" reflects that Fannie Mae's minimum capital submissions adjust book capital based upon estimated accounting change impacts, including the roll-forward of 2004 adjustments.

During the first quarter of 2007, Fannie Mae's minimum capital surplus decreased by \$0.3 billion to \$3.9 billion, approximately 10.2 percent over the OFHEO-directed minimum capital requirement of \$38.4 billion. The OFHEO-directed minimum requirement rose \$0.3 billion primarily due to growth in MBS outstanding which contributed to the reduction in the reported capital surplus. Core capital remained at \$42.3 billion for the quarter ended March 31, 2007 as Fannie Mae's redemption of \$0.7 billion in preferred stock was offset by an equal increase in retained earnings, net of dividend payments totaling \$0.5 billion.

Freddie Mac's minimum capital surplus decreased \$0.5 billion to \$2.0 billion, approximately 5.9 percent over the OFHEO-directed minimum capital requirement of \$34.2 billion. The OFHEO-directed minimum capital requirement increased \$0.6 billion due to growth in the retained portfolio and MBS outstanding. For the quarter ended March 31, 2007, core capital remained at \$36.2 billion with preferred stock issuance of \$0.5 billion offset by a similar change in retained earnings, including losses of \$0.2 billion and dividend payments of \$0.4 billion. Net income losses were primarily the result of mark-to-market losses on the company's derivatives portfolio and on the company's single-family credit guarantee business.

Changes in critical capital mirrored changes in minimum capital for both Enterprises.

Risk-Based Capital

As of March 31, 2007, Fannie Mae's risk-based capital requirement was \$20.5 billion. Fannie Mae's total capital of \$42.6 billion on that date exceeded the requirement by \$22.1 billion.

As of March 31, 2007, Freddie Mac's risk-based capital requirement was \$13.8 billion. Freddie Mac's total capital of \$36.8 billion on that date exceeded the requirement by \$23.0 billion.

Enterprise Risk-Based Capital Requirement (Billions of Dollars) ^(a)								
Interest Rate Scenario	Fannie Mae ^(b)				Freddie Mac			
	31-Mar-07		31-Dec-06		31-Mar-07		31-Dec-06	
	Up	Down	Up	Down	Up	Down	Up	Down
Risk Based Capital Requirement	20.536	14.630	26.870	9.134	13.784	9.742	15.320	12.934
Total Capital	42.627		43.046		36.765		36.742	
Surplus (Deficit)	22.092		16.176		22.981		21.422	

a. Numbers may not add due to rounding.

b. Subject to revision based upon results of ongoing financial restatement and audit processes.

By statute, stress test interest rate levels are a function of the average 10-year Constant Maturity Treasury (CMT) over the most recent nine months. The nine-month average of the 10-year CMT fell to 4.74%, 13 basis points lower than the nine-month average at the end of the fourth quarter of 2006. As a result, 10-year CMT levels at the end of the first year in the risk-based capital stress test decreased from 8.51% to 8.29% in the up-rate stress test, and from 2.43% to 2.37% in the down-rate stress test.

While market rate levels changed little quarter over quarter, interest rates rose appreciably in the first two months before reversing course in March. Expected prepayment speeds decreased and the duration of fixed-rate mortgage assets increased intra-quarter. These outcomes caused Fannie Mae to lengthen its debt book through debt issuance and the use of derivatives in order to maintain an equal duration exposure of assets and liabilities. Freddie Mac made opportunistic purchases as Option Adjusted Spreads (OAS) widened, which caused its asset duration to lengthen slightly over the quarter. Similarly, Freddie Mac adjusted its funding and derivative portfolio to maintain an equal duration exposure of assets and liabilities.

Fannie Mae's rebalancing actions decreased exposure in the up-rate binding scenario and increased exposure in the down-rate scenario. Fannie Mae's risk-based capital requirement in the up-rate stress test fell to \$20.5 billion; \$6.3 billion lower than the fourth quarter. By contrast, the risk-based capital requirement in the down-rate stress test increased to \$14.6 billion; \$5.5 billion higher than the fourth quarter. Overall, Fannie Mae's risk-based capital surplus increased from \$16.2 billion to \$22.1 billion.

Freddie Mac's risk-based capital requirements were \$13.8 billion in the up-rate stress test and \$9.7 billion in the down-rate stress test or \$1.5 billion and \$3.2 billion lower than the fourth quarter, respectively. During the quarter, Freddie Mac's risk-based capital surplus increased from \$21.4 billion to \$23.0 billion. Lower CMT levels at the end of the first year of the stress test reduced exposures in the up-rate scenario, while rebalancing actions reduced exposures in the down-rate scenario. The up-rate stress test remained the binding scenario in the first quarter of 2007.

QUALIFICATIONS AND COMPLIANCE

Fannie Mae's capital classification is based upon Fannie Mae's best estimates of its financial condition, as certified and represented as true and correct to the best of Fannie Mae management's belief and knowledge. The first quarter 2007 capital classification remains subject to revision pending Fannie Mae's submission of audited financial statements and corresponding regulatory capital reports.

Fannie Mae remains subject to the requirements imposed by the Consent Order dated May 23, 2006 and the Capital Restoration Plan approved February 17, 2005. The Capital Restoration Plan required Fannie Mae to achieve a 30 percent capital surplus over the minimum capital requirement by September 30, 2005 (OFHEO-directed capital requirement). Fannie Mae is required to maintain a capital surplus above the OFHEO-directed requirement on an ongoing basis. Fannie Mae met the initial September 30, 2005 achievement of 30 percent surplus and it has continued to maintain the surplus through the first quarter 2007.

Freddie Mac's capital classification is based upon its financial condition, as certified and represented as true and correct by Freddie Mac's management, and consistent with the publicly disclosed Information Statement Supplement issued on June 14, 2007. OFHEO imposed a capital surcharge of 30 percent of the minimum capital requirement for Freddie Mac in January 2004 due to increased operational risk. Freddie Mac has continued to maintain its minimum capital surplus in excess of the OFHEO-directed capital requirement through the first quarter 2007.

FIRST QUARTER QUALIFYING SUBORDINATED DEBT RESULTS

Additionally, OFHEO is releasing qualifying subordinated debt positions of Fannie Mae and Freddie Mac in accordance with the September 1, 2005 Agreements between OFHEO and the Enterprises. (See 9/2/05 release at [/newsroom.aspx?ID=237&q1=0&q2=11](http://newsroom.aspx?ID=237&q1=0&q2=11))

Fannie Mae's total capital and qualifying subordinated debt for the first quarter 2007 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Freddie Mac's total capital and qualifying subordinated debt for the first quarter 2007 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Enterprise Qualifying Subordinated Debt Disclosure(Billions of Dollars) ^(a)

	Fannie Mae		Freddie Mac	
	31-Mar-07	31-Dec-06	31-Mar-07	31-Dec-06
Total Capital & Qualifying Subordinated Debt	50.172	50.705	41.383	42.602
Capital Requirement at 4% for On-Balance Sheet Assets and at 0.45% for Net MBS / PCs Outstanding	41.940	41.798	38.093	37.576
Surplus (Deficit)	8.232	8.908	3.290	5.026

Footnote:

- a. Qualifying Subordinated Debt is defined as subordinated debt that contains the interest deferral feature. The interest deferral requires the deferral of interest payments for up to 5 years if:
- 1) The corporation's core capital falls below 125% of critical capital, or
 - 2) The corporation's core capital falls below minimum capital AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

DEFINITION OF CAPITAL STANDARDS

Core Capital is the sum of outstanding common stock, perpetual, noncumulative preferred stock, paid-in capital, and retained earnings. Core capital does not include Accumulated Other Comprehensive Income (AOCI), which is captured as part of stockholder's equity.

Total Capital is the sum of Core Capital plus the allowance for loan losses.

Minimum capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered by law adequately capitalized if core capital — common stock; perpetual noncumulative preferred stock; paid in capital; and retained earnings — equals or exceeds minimum capital. The minimum capital standard is 2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations, including guaranteed mortgage securities.

The OFHEO-directed capital requirement is the amount of capital the Enterprise needs to maintain to compensate for increased operational risks including systems, accounting, and internal control risks. The level is prescribed by the Director of OFHEO. At this time, both Enterprises are required to hold 30 percent over the statutory minimum capital requirement. This is calculated by multiplying the minimum capital requirement by 1.3 times.

OFHEO's risk-based capital requirement is the amount of total capital — core capital plus a general allowance for loan losses less specific reserves — that an Enterprise must hold to absorb projected losses flowing from future adverse interest-rate and credit-risk conditions specified by statute, plus 30 percent mandated by statute to cover management and operations risk. The risk-based capital standard is based on stress test results calculated for the two statutorily prescribed interest rate scenarios, one in which 10-year Treasury yields rise 75 percent (up-rate scenario) and another in which they fall 50 percent (down-rate scenario). Changes in both scenarios are generally capped at 600 basis points. The risk-based capital level for an Enterprise is the amount of total capital that would enable it to survive the stress test in whichever scenario is more adverse for that Enterprise, plus 30 percent of that amount to cover management and operations risk.

The **critical capital** level is the amount of core capital below which an Enterprise must be classified as critically undercapitalized and generally must be placed in conservatorship. Critical capital levels are computed consistent with the Federal Housing Enterprises Safety and Soundness Act of 1992 as follows: One-half of the portion of minimum capital requirement associated with on-balance-sheet assets plus five-ninths of the portion of the minimum capital requirement associated with off-balance-sheet obligations.

QUALIFYING SUBORDINATED DEBT

Qualifying subordinated debt is defined as subordinated debt that contains the interest deferral feature described below:

The interest deferral requires the deferral of interest payments for up to 5 years if:

- The corporation's core capital falls below 125 percent of critical capital, or
- The corporation's core capital falls below minimum AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

The September 1, 2005 agreement requires that:

Subordinated debt will be issued in a quantity such that the sum of total capital (core capital plus general allowance for losses) plus the outstanding balance of qualified subordinated debt will equal or exceed the sum of outstanding net MBS times 0.45 percent and total on-balance sheet assets times 4 percent.

Technical questions regarding these results should be directed to: rbcquestions@ofneo.gov.

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OFHEO's mission is to promote housing and a strong national finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.