Stabilizing the Mortgage Market

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Urban Land Institute
Terwilliger Center Annual Forum
Washington, D.C.
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SPEECH by James B. Lockhart III

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Thank you, Brian, for that kind introduction. I am very happy to be back with you again today. I was with you in October in Miami, a little more than a month after the conservatorships of Fannie Mae and Freddie Mac began, and things have certainly changed quite a bit since the early stages of the economic crisis last fall.

This afternoon I would like to talk to you a bit about the state of the mortgage markets, where we are in our efforts to spur economic recovery and how the housing government-sponsored enterprises (GSEs) — Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks — are helping to make it happen. I also want to give you some information on the work the GSEs are doing to meet affordable housing goals and how that work plays into the multifamily housing market that I know many of you are interested in. Finally, I would like to finish up today by telling you about the Administration's modification and refinance programs, which are going to help prevent millions of foreclosures and help people stay in their homes.

Today, the biggest challenge we all face is stabilizing the housing market. Some indicators are showing the first signs that we are getting closer to market stability. Just last week, the Case-Shiller index showed that house prices fell at a slower pace in February than in January. FHFA's own house price indexes for the past two months have even shown price increases. According to the Census Bureau, the seasonally-adjusted pace of new home sales in February and March was well above the rate exhibited in January. On Monday, the National Association of Realtors announced that the seasonally adjusted index of pending sales rose 3.2 percent in March, which marked the second month of increase in a row.

So we are seeing some slight glimmers of improvement. Hopefully, we are bumping along the bottom. But we have to continue working steadily to ensure the market fully stabilizes as soon as possible.

At FHFA, we have devised a four-pronged stabilization strategy **(SLIDE 2)** for the GSEs to meet the challenge and fulfill their mission of providing liquidity, stability, and affordability to the housing market. First, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks must support the market in a safe and sound manner, with special emphasis on affordable housing. Second, we are working with our government partners to get mortgage interest rates down. Third, we are working with the Enterprises and other groups to set best practices for the whole mortgage market. I do not have to remind you how badly underwriting and other practices slipped in the 2005 to 2007 period. Finally, we are actively working with the Administration, Treasury, the Department of Housing and Urban Development (HUD), the Federal Deposit Insurance Corporation (FDIC), and the GSEs on foreclosure prevention to help homeowners in trouble.

I am going to discuss these four strategies in detail, but first, let me try to put the housing GSEs in perspective for you:

Putting the GSEs in Perspective

(SLIDE 3) The GSEs are incredibly large—their combined debt outstanding and guaranteed mortgage-backed securities (MBS) outstanding are $6.7 trillion. With the very rapid growth in Treasury issuance, the publicly held debt of the United States at $6.8 trillion, just surpassed them in March.

(SLIDE 4) Fannie Mae and Freddie Mac, also called the Enterprises, have two businesses: (1) guaranteeing residential and multifamily mortgage-backed securities (MBS)—in blue; and (2) investing in whole mortgage loans and MBS, including their own—in green. In 2006, we capped the growth of those portfolios after discovering those serious accounting and internal control problems at the Enterprises. As part of the conservatorship, the cap has been raised to $900 billion for each this year. Their MBS guarantee business will continue to grow with no restrictions to support the market.

(SLIDE 5) This slide shows the history of the mortgage market over the past 12 years with the Enterprises in gold, FHA/VA in green, and others in blue. From 1997-2003, Fannie Mae's and Freddie Mac's market share of mortgage originations—that top line—gradually grew to almost 55 percent. From 2004-2006, the private mortgage market predominated, and Fannie's and Freddie's business sank pretty dramatically, with their market share dropping below 35 percent. Then as the private market started to freeze up in 2007, Fannie's and Freddie's market share took off—up to 73 percent in 2008. However, as you will note, that is a larger share of a much smaller market. The market share of mortgages insured by FHA/VA (Federal Housing Administration/ Veterans Administration), which are generally pooled into Ginnie Mae (Government National Mortgage Association) mortgage-backed securities, has risen even more dramatically, rising from 3 percent in 2006 to 20 percent in 2008, but even more startling, to 35 percent in the fourth quarter of 2008. In the first quarter of 2009, they have fallen back to 20 percent.

(SLIDE 6) The Federal Home Loan Banks also play an important role in the mortgage market by providing secured advances to banks, credit unions, and insurance companies. Federal Home Loan Bank advances hit the trillion dollar mark in October 2008 but have dropped about 20 percent since then, down to $817 billion on March 31. Historically, we have always thought of the Federal Home Loan Banks as providing low-cost funding to small and medium-sized banks, but the top four banks represent a third of their advances. In total, the Federal Home Loan Banks have $1.24 trillion in assets. Only 5 percent is in private-label mortgage-backed securities, but these have turned out to be very high risk, even though they were originally rated triple-A.

How We Got Here

During the boom times, virtually everyone involved in home mortgage lending—builders, borrowers, brokers, Realtors®, lenders, mortgage insurers, credit rating agencies, the Enterprises, other secondary market investors, and yes, we regulators—failed to fully appreciate the

likelihood of a severe house price correction. The pricing models of Fannie Mae and Freddie Mac, for example, assumed that house prices would just continue to go up.

Well, prices did not rise forever, as this chart shows. **(SLIDE 7)** From January of 2000 through July 2006 (peak), the more volatile S&P/Case-Shiller house price index rose by 106 percent only to fall by nearly 31 percent since then. The less volatile FHFA House Price Index, which reflects Fannie Mae's and Freddie Mac's books of business, peaked later at 63 percent, and has since declined 9.5 percent from its peak. You will note that the two indices just crossed with the recent rise in the FHFA index that I mentioned.

(SLIDE 8) Over the past two years, serious delinquencies of 90-days or more have risen across the board to record levels. For subprime mortgages, serious delinquencies are 23 percent, and those subprime ARMs are 34 percent seriously delinquent. Serious delinquencies are far lower at Fannie Mae and Freddie Mac at about 2 to 3 percent, which is even lower than the prime market at 3.7 percent or the whole market at 6.3 percent. Serious delinquencies across all categories are continuing to rise rapidly.

A large proportion of subprime, Alt-A, and other nontraditional mortgages was financed with private-label MBS and increasingly complex derivative instruments. In early 2007, investors began to take notice of the statistics on rising delinquency and default rates on recently-originated subprime mortgages. People suddenly began to realize there were a lot of shaky mortgages packaged in these securities, and they stopped buying. In the second half of 2007, these factors led to a virtual collapse of the primary and secondary markets for subprime and nontraditional mortgages. Those private-label securities have continued to deteriorate rapidly since then **(SLIDE 9)**. As an example, 68 percent of Fannie's and Freddie's $178 billion of securities that were once rated triple-A are now below investment grade—junk. Only 5 percent remains triple-A and not under review for possible downgrade.

After years of seeking stronger regulatory authorities to rein in and increase the capital requirements of the Enterprises, we finally prevailed last year when the Housing and Economic Recovery Act, or HERA as we call it, was finally enacted July 30th. HERA enhanced our authorities, added new ones, and changed the composition of the agency, giving us affordable housing goals responsibility and oversight over the Federal Home Loan Banks. But it was too late. However, HERA, importantly, created the tools that made it possible for the Enterprises to operate in conservatorship.

Government Support for the GSEs

HERA gave the Treasury Department authority to support Freddie and Fannie and fund them in a variety of ways if necessary. Unfortunately, it became necessary only 38 days after passage. **(SLIDE 10)** Treasury's Senior Preferred Stock facility provides *an effective guarantee* of the Enterprises' debt and mortgage-backed securities by ensuring each Enterprise has a positive net worth. That facility was originally $100 billion each, but it has just been increased to $200 billion each. Two additional facilities were also implemented when the conservatorships began. Under the first, Treasury has purchased $124 billion of their mortgage-backed securities and has made it clear it will continue to be an active buyer. The other is an unlimited secured credit

facility that acts as a liquidity backstop for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, but it has not been needed.

Reducing Mortgage Rates

The Federal Reserve Bank announced two critically important programs in November to built upon the Treasury's support to reduce mortgage rates in addition to the liquidity facility announced in July 2008. In the first, it will purchase $500 billion or more in Fannie Mae, Freddie Mac, and Ginnie Mae MBS. Since the beginning of January, they have already purchased $404 billion. In March, the Federal Reserve announced an increase of the MBS purchases to $1.25 trillion. In the second program, they originally announced a commitment to purchase up to $100 billion in Fannie Mae, Freddie Mac, and Federal Home Loan Bank debt. That was raised to $200 billion. To date, the Federal Reserve has purchased more than $71 billion in Fannie, Freddie, and Federal Home Loan Bank notes.

When you add this all up, the U.S. government has made it critically clear to every investor that it is standing behind Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, with close to $2 trillion in commitments. That is why I call it an effective guarantee. These programs have had a very positive impact on mortgage rates, which have fallen more than 150 basis points since the conservatorship in September. **(SLIDE 11)** They have dropped below 4.8 percent for 30-year mortgages. If spreads to Treasuries return to more normal levels with a return of confidence, we could see even lower rates. **(SLIDE 12)** As a result of these lower rates, the numbers of refinancing applications have skyrocketed. March was Fannie Mae's and Freddie Mac's biggest month since the refinancing boom in 2003.

Affordable Housing Mission and Goals

The HERA legislation for the first time moved affordable housing and mission enforcement away from HUD and added them to the responsibilities of the safety and soundness regulator. One of the other key reasons for moving quickly on conservatorship rather than waiting was that the companies' abilities to serve their mission had been impaired. The risk was that the Enterprises would have to cease new business activity and shed assets, which would have been disastrous for the housing market and the American economy.

Enforcement of the affordable housing goals used to be HUD's responsibility, but it is now up to FHFA. As this chart **(SLIDE 13)** shows, they missed most of the "stretch" goals in 2008. With all the changes in the mortgage market, we had to declare two of them infeasible.

Under HERA, the housing goals established by HUD for the Enterprises for 2008 carried over to 2009, but the law also required FHFA to review affordable housing goals against market conditions and to adjust them if needed. The previous goals, which were set by HUD in 2004, are not feasible, and so we adjusted them. For the main housing goals, we propose adjusting them to roughly the levels of 2004 to 2006. Last Friday, May 1, FHFA published the proposed goals for 2009 in the *Federal Register*, and we will take public comment for 21 days before issuing a final rule. Even as we adjust the goals for 2009, we are laying the groundwork for future changes we

know must be put in place because, beginning in 2010, HERA requires a wholesale restructuring of the affordable housing goals.

Some very basic changes in the mortgage marketplace explain why the affordable housing goals for 2009 required adjustments. The sharply restrictive standards of private mortgage insurers—who have significant capital issues—make it difficult to make high loan-to-value mortgages, instruments that often benefit low- and moderate-income borrowers. The much greater role of FHA in the marketplace also limits the ability of the GSEs to meet the housing goals, as does the near total collapse of the private-label securities market. Sharply decreased multifamily activity and a large increase in refinancing—two factors which historically have meant fewer low- and moderate-income beneficiaries—also play a role. And we also want to make sure the Enterprises receive appropriate credit for activities that benefit low- and moderate-income persons and underserved areas in today's actual mortgage marketplace. This means goals credit for loan modifications done under the Administration's new Home Affordable Modification plan, which I will tell you more about in just a moment.

(SLIDE 14) The 12 Federal Home Loan Banks also have a significant role to play in affordable housing. HERA requires FHFA to establish housing goals for the Federal Home Loan Banks' mortgage purchase programs, and we expect to have the affordable housing goals for the Federal Home Loan Banks fully implemented in 2011. Each Federal Home Loan Bank operates its own affordable housing program (AHP), which is funded by 10 percent of the bank's previous year's net earnings. These programs provide subsidies to help reduce the cost of rental and owner-occupied housing for very low-income and low- and moderate-income households. This year, we expect approximately $200 million in affordable housing program subsidies to be available nationwide.

(SLIDE 15) The Federal Home Loan Banks have traditionally been very active in the multifamily market. Since 1990, the 12 banks have funded numerous multifamily housing projects through their individual affordable housing programs. Of those, about two-thirds have been rental units, and more than 4,600 have been federal Low Income Housing Tax Credit projects. Community investment program funding has financed nearly 223,000 rental units. AHP funding has assisted more than 9,900 urban housing projects, which included more than 333,000 rental units and 88,500 homeownership units. In total, AHP funding has provided $2.2 billion in subsidies for urban housing projects.

(SLIDE 16) Fannie Mae and Freddie Mac are very important to the secondary market for multifamily loans, and multifamily lending is critical to the affordable housing mission of the Enterprises. Multifamily loans account for a very large portion of the number of low- and moderate-income units financed by the Enterprises that qualify as meeting affordable housing goals. In 2008, multifamily loans, which represented 4.5 percent of their total mortgages made, accounted for 32 percent of low- to moderate-income units, 27 percent of units in underserved areas, and 39 percent of special affordable units, which are units for very low- and low-income families in low-income areas.

I am determined to ensure both Enterprises remain dedicated to, and actively involved in, multifamily lending while they are in conservatorship. Just a few days after the Enterprises

entered conservatorship, I released a statement to this effect to assure market participants that the Enterprises would continue to be a source of underwriting and financing for multifamily loans.

It is clear, however, that the multifamily market is struggling just as much as other aspects of the overall housing market and the rest of the economy. Since last fall, we have seen the market indicators heading down. Loan defaults are accelerating because of distressed cash flows and dropping property values. Average national vacancy rates will likely reach 8 to 8.5 percent this year.

Some institutional multifamily equity investors have withdrawn from the market, and many have become net sellers of their real estate investments as they rebalance their portfolios. Perhaps most telling, both asking and effective rents have declined for the first time since the 1990s.

I am deeply concerned about the economic dislocation taking place in the multifamily market – a vital industry sector. I recognize that capital to support multifamily lending has become scarce as corporate balance sheets have come under enormous stress and the secondary market has contracted.

In the past two years, Freddie Mac purchased $46 billion worth and Fannie Mae purchased $79 billion in nonCMBS (noncommercial MBS) multifamily loans. The Enterprises' overall multifamily loan portfolios combined total $266.3 billion. Throughout the conservatorship, I have communicated to the Enterprises that they should continue to be open for business in the multifamily sector. We want them actively engaged in the multifamily business. Both Enterprises have taken this to heart and have supported the multifamily market substantially.

In the multifamily warehouse lending arena, FHFA is working with the industry and the Enterprises to evaluate various new options, but the legislative charter issues governing both Enterprises make some of the options difficult to overcome and implement. And both Enterprises are working to provide very timely funding.

Again, I want to emphasize to you that FHFA expects all the housing GSEs to be actively involved in the multifamily market. This market sector needs consistent, unqualified support while we work to protect those in our society who are vulnerable to home loss and to help the nation's economy recover.

Foreclosure Prevention

I began today by telling you our biggest challenge is to stabilize the housing market. Keeping people in their homes has to be a cornerstone of that effort. As conservator of the Enterprises, FHFA has not only taken strong action to ensure the maximum effort by the Enterprises to modify loans to prevent foreclosures but also has taken a leading role in efforts to address the foreclosure crisis in the private-label securities market. **(SLIDE 17)** As you can see in these pie charts, while Fannie Mae and Freddie Mac own or guarantee almost 31 million single-family mortgages, about 56 percent of all single-family mortgages. The mortgages they own or guarantee only represent 20 percent of serious delinquencies. On the other hand, private-label mortgage-backed securities represent only 15 percent of the mortgages but 50 percent of the serious delinquencies.

Let me pause on these pie charts for a moment, because they represent the problem we face in foreclosure prevention. If we are going to stabilize the housing market, we have to address that PLS 50 percent. We believe Fannie Mae and Freddie Mac must be leaders in improving, promoting, and enforcing industry standards and best practices for all mortgages.

In November, I announced the streamlined modification program (SMP) developed jointly with the U.S. Treasury, HUD, Fannie Mae, Freddie Mac, and HOPE NOW's members. Building upon the streamlined program, FHFA worked directly with the White House, the Treasury Department, HUD, and the Enterprises in the development of the Homeowner Affordability and Stability Plan (HASP), including the much more aggressive Home Affordable Modification program.

Homeowner Affordability and Stability Plan

We believe the Home Affordable modification and refinance programs are a major step in reducing preventable foreclosures and stabilizing the housing market. The Treasury Department estimates it will help up to 7 million to 9 million families refinance or modify their mortgages. It also aggressively builds on FDIC's foreclosure prevention efforts. The rapid drop in mortgage rates will help.

In the Home Affordable Refinance **(SLIDE 18)** initiative, Fannie Mae and Freddie Mac will provide access to low-cost refinancing for responsible homeowners with loans the Enterprises already own or guarantee. This will help up to 4 to 5 million homeowners avoid foreclosure and reduce their monthly payments. The Enterprises are already off to a good start. This program is designed for current borrowers who want or need to refinance at a lower rate or into a safer mortgage product but who have experienced difficulties due to declining home values. Because Fannie Mae or Freddie Mac already hold the credit risk on these mortgages, no additional credit enhancements, such as mortgage insurance, will be required. Existing mortgage insurance will be rolled into the new mortgage. Borrowers will be eligible for a refinanced mortgage with a current loan-to-value of 80 percent to 105 percent. Servicers should already have most of the needed documentation. In many cases, appraisals will not be needed. The idea is to make the refinancing process quick, relatively easy, and cheaper for both the homeowner and the mortgage lender and reduce delinquencies and foreclosures. For the Enterprises, that will reduce their credit risk, and in many cases, increase their guarantee fees.

The Home Affordable Modification **(SLIDE 19)** initiative is a comprehensive $75 billion loan modification plan designed to reach up to 3 to 4 million at-risk homeowners. It will be paired with the expanded and improved FHA Hope for Homeowners plan. It will reduce a borrower's monthly housing expense to 31 percent of his/her gross income through a combination of capitalization of past due payments, interest rate reductions, term extensions, principal forbearance, and/or principal forgiveness. Servicers can lower rates to as little as 2 percent, and extend loan maturities to 40 years. After five years of reduction, payments will increase gradually—at no more than 1 percentage point per year up to the Freddie Mac rate at the time of the mortgage origination. This program includes performance incentives for borrowers, servicers, lenders, and investors to the willingness of all industry participants to engage in

aggressively modifying mortgages to assist borrowers at risk and to encourage those borrowers to keep their accounts current.

On April 28, Treasury announced the Second Lien Program component of the Making Home Affordable programs to make it possible for people with second mortgages to modify or refinance. Statistics show that about half of all at-risk mortgages have second liens—some have more than one additional lien. This new program removes the stumbling block of the second or subsequent liens that some feared would reduce the numbers of borrowers eligible for Making Home Affordable modifications or refinancing. Now when a modification is initiated on a first lien, participating servicers in the second lien program will automatically reduce the second lien's payments so that the second lien holders position will not get a free ride on the modification of the primary. They are also working on short sales and deed-in-lieu programs as the last steps before foreclosure.

As agents of the Treasury, both Fannie Mae and Freddie Mac are going to play major roles in and assume responsibilities in the implementation and ongoing oversight of the modification program. Those responsibilities include transaction processing, distribution of cash flows, payment of incentives, and program compliance oversight and on-site reviews. Given the Enterprise role in the industry as leaders in establishing best practices and standards, their involvement brings the necessary accountability as would be required for any federal program supported with taxpayer dollars.

Although the Home Affordable programs are still in their early stages, the Enterprises have reached some key milestones already. The Enterprises have signed up 13 servicers representing 75 percent of the market to participate in the programs, and they are now contacting more than 1,300 small servicers to increase participation. A special Internet portal has been set up for servicers to help them find information easily. Treasury has put a tutorial program for participating servicers on its Web site.

In the coming weeks, many more administrative milestones are pending. Freddie Mac as the contractor for the government to oversee the program will send teams out to examine loan-level transactions. By late June, a data validation process will be up and running to verify individual loan modifications have been successful in their three-month trial periods before servicers will receive the cash incentives. And by early August, Fannie Mae (on behalf of Treasury) expects to a program administrator and paying agent in place.

Before leaving the topic of mortgage modifications, I want to make one point that seems to be lost. Although these programs may have a short-term cost from an accounting standpoint to the Enterprises, foreclosures are much more costly directly and indirectly. With a $5.4 trillion mortgage book stabilizing of the mortgage is critical to the long-term profitability of Fannie Mae and Freddie Mac.

Fannie Mae and Freddie Mac have strong incentives to increase the volume of loan modifications and refinance activity, as do all mortgage holders. Increases in delinquency rates are driving higher expectations of future credit losses. In recent quarters both Enterprises have increased their provisions for losses substantially to build their loan loss reserves. Increases in

REO (real estate owned) properties are also generating higher foreclosure-related expenses and contributing to downward pressure on house prices.

As I said earlier, Fannie Mae and Freddie Mac also hold $178 billion worth of private-label securities. Continued deterioration in the credit quality of mortgages used as collateral for these securities has increased impairments and fair value losses at both Enterprises substantially in recent quarters.

Higher levels of credit-related expenses and losses are a primary driver of net losses at both Enterprises. Refinancing and modifying loans improves borrowers' ability to stay current which ultimately reduces expectations of future credit losses.

The Future of Fannie Mae and Freddie Mac

These programs depend on Fannie Mae and Freddie Mac for success, a clear sign that the Obama administration is serious in its intent that the Enterprises will continue having a key role in the nation's economy as we go forward. At this point, although our primary focus should be on the recovery of the housing market and economy, I think it is useful to look ahead. Congress and the Administration will have to determine how the Enterprises will be structured and how they will operate as they emerge from conservatorship, and there is no shortage of ideas. But before deciding among the wide variety of possible legal and ownership structures for the Enterprises, we first must establish some very basic principles that will guide our evaluation of those options and choice among them.

Before laying those four principles out, it is important to note that this is not just about Fannie Mae and Freddie Mac. Very important decisions have to be made about the future of the mortgage market and the appropriate role of the secondary mortgage market.

(SLIDE 20) The first principle is that the Enterprises should have a well-defined and internally consistent mission. Their activities should be well-tailored to achieving that mission. Current law suggests that the Enterprises should promote the stability and liquidity of the secondary mortgage market and support financing for housing that is affordable. That raises various questions: How, specifically, should the Enterprises promote market stability and liquidity? Should their business volumes be strongly countercyclical? How much risk should they bear to promote affordable mortgage lending? Should they focus their activities on supporting long-term, fixed-rate mortgage lending and on loans whose terms are simple and easy to understand?

The second principle is that there should be a clear demarcation of the respective roles of the federal government and the private sector in the secondary mortgage market. The old hybrid model of private, for-profit ownership underwritten by an implicit government guarantee allowed the Enterprises to become so leveraged that they posed a large systemic risk to the U.S. economy. The questions now are: What roles are best played by the federal government? What roles are best played by private firms? How can we best harness the strengths of market capitalism, while reducing the risks and avoiding unintended consequences? Should the existing book of business be split from new business on emergence from conservatorship—a bad bank

structure, as provided for in HERA? How can we prevent undue political influence that may increase risks to the government?

The third principle is to base any organization providing credit guarantees, or in other words, mortgage insurance, on sound insurance principles: sound management, strong underwriting, strong capital positions, risk-based pricing, and flexibility to react to changes in the market. Does the retained mortgage portfolio compound risks? Should they be purely mortgage insurers? Since they cannot reserve adequately for the bad times in the good times, should they pay an explicit, risk-based fee for the catastrophic risk that the federal government has borne?

The fourth principle is to create a regulatory and governance structure that ensures risk taking is prudent. From almost day one in my job, as did the Bush Administration well before I accepted the job three years ago, I pointed out the folly of allowing the Enterprises to legally leverage their mortgage credit by well over 100 to 1. A stronger regulatory structure for the GSEs was enacted by the Congress as part of HERA. That act afforded FHFA greater flexibility to establish capital and other prudential standards for the GSEs, and we are in the process of examining options to strengthen minimum and risk-based capital requirements and to make them more countercyclical. Beyond prudential regulation, the internal governance—board composition, management structure, compensation and incentives—should be examined and strengthened.

Using these principles, there are three key options for Fannie Mae's and Freddie Mac's futures. A first option would be to nationalize the Enterprises. One variation of that idea would be to merge them with either FHA or Ginnie Mae. I am opposed to nationalization because government insurance programs are particularly high risk and full of moral hazards. The FHA model is being tested right now.

The second and most obvious alternative would be to keep the Enterprises as GSEs building upon HERA. There are several variations on that theme that might work. They could continue with Treasury net worth protection, government reinsurance for catastrophic risk and/or a sharp reduction of retained portfolios. As former Treasury Secretary Paulson suggested in January, a public utility model could be established. A cooperative ownership model similar to that of the FHLBanks should also be considered.

A third option is to establish purely private-sector firms to supply liquidity to mortgage markets with or without government catastrophic insurance.

I will close here with a final note that all market participants, the government, and the GSEs, have to be creative and work together to help the U.S. economy and housing market recover. The fall in mortgage rates that the Treasury and Federal Reserve's purchases have triggered are very important steps in stabilizing the mortgage market. **(SLIDE 21)** I started by mentioning there some positive signs starting to emerge. A very positive note is housing affordability is fluctuating around an all-time high. That may unleash some pent-up demand. The successful implementation of the Homeowner Affordability and Stability Plan is an extremely important next step for the recovery of the housing markets and the U.S. economy.

In case there is any pent-up demand for questions, I will be happy to answer them. Thank you.

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FHFA's Four Stabilization Strategies

1. Ensure Fannie Mae, Freddie Mac, and the Federal Home Loan Banks provide liquidity, stability, and affordability to the housing market in a safe and sound manner

2. Work with government partners to reduce mortgage rates

3. Work with the Enterprises to set best practices for the mortgage market

4. Prevent foreclosures through affordable modifications and refinancings

Housing GSE Obligations vs. Public U.S. Debt

Relative Size of Enterprise Obligations (March 2009)

Sources: Fannie Mae and Freddie Mac Monthly Volume Summaries, TreasuryDirect.gov, Federal Reserve H.4.1 Release.

Fannie and Freddie Continue to Grow

Enterprises' Combined Total Book of Business
1990 - March 2009

Sources: Fannie Mae and Freddie Mac Monthly Volume Summaries and 2007 OFHEO Report to Congress.

Enterprise and FHA/VA Shares of Originations

Sources: Inside Mortgage Finance, Enterprise Monthly Volume Summaries.

Advances Drove FHLBank Asset Growth

Trillions

Portfolio Composition of the FHLBanks

At March 31, 2009

Total Assets	--	$1.24 trillion
Other Investments	--	$ 173 billion
Mortgages	--	$ 85 billion
MBS	--	$162 billion
Advances	--	$ 817 billion

$1.4
$1.2
$1.0
$0.8
$0.6
$0.4
$0.2
$0.0

12/86 12/87 12/88 12/89 12/90 12/91 12/92 12/93 12/94 12/95 12/96 12/97 12/98 12/99 12/00 12/01 12/02 12/03 12/04 12/05 12/06 12/07 12/08

Advances MBS Mortgages Other Investments

House Prices Continue to Fall

FHFA and S&P/Case-Shiller House Price Indexes
January 2000 - February 2009

Index Value (Jan. 2000=100)

220
200
180
160
140
120
100
80

+106.5% from January 2000

S&P/C-S 20-City

+63.3% from January 2000

FHFA

Fall From Peak

S&P/C-S 20-City:	-30.7%
FHFA Purchase-Only :	-9.5%

Jan-00 May-00 Sep-00 Jan-01 May-01 Sep-01 Jan-02 May-02 Sep-02 Jan-03 May-03 Sep-03 Jan-04 May-04 Sep-04 Jan-05 May-05 Sep-05 Jan-06 May-06 Sep-06 Jan-07 May-07 Sep-07 Jan-08 May-08 Sep-08 Jan-09

Year and Quarter

Note: For purposes of comparison, the FHFA purchase-only index has been re-based to January 2000=100 (the standard series is set so that January 1991=100)

Serious Delinquencies Rising Rapidly

Sources: Mortgage Bankers Association, Fannie Mae, Freddie Mac.

Private-Label Securities Downgrades Growing Rapidly

Total Holdings: $178 Billion
as of December 2008

Fannie Mae and Freddie Mac Private-Label Securities

Billions

$180
$160
$140
$120
$100
$80
$60
$40
$20
$0

Jul-08 Aug-08 Sep-08 Oct-08 Nov-08 Dec-08 Jan-09 Feb-09 Mar-09 Apr-09

11%
16%
68%

Downgraded Below Inv Grade
Downgraded - Remains Inv Grade
AAA on Downgrade Watch

Treasury and Fed Support Is Strong

(in Billions)

	Available	Used
Treasury:		
Senior Preferred	$400	$60
Enterprise MBS	no limit	124 *
GSE Liquidity Facility	no limit	0
Federal Reserve:		
Enterprise Credit Facility	no limit	$0
Agency MBS	$1,250	$404
GSE Debt	200	71
Total:	**$1974+**	**$659**

data as of 5/4/09

** included in available*

Mortgage Rates Falling, but Spreads Are Wide

Capital Commitment
Mar 19 08

Conservatorship
Sep 7 08

Fed Purchases

49 bp

Jul 2 07
124 bp

Mar 6 08
337 bp

May 5 09
189 bp

4.78

3.94

2.05

6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0

30 Sep 07 | 31 Dec 07 | 31 Mar 08 | 30 Jun 08 | 29 Sep 08 | 30 Dec 08 | 31 Mar 09

30-Year FRM Mortgage Commitment Rate
Freddie Mac Current Coupon 30-Year MBS Yield
5-Year CMT

Provided by Credit Suisse LOCuS

Sources: Credit Suisse, Freddie Mac, and Federal Reserve Board H15.

Applications Surge on Low Mortgage Rates

Applications for Refinance Mortgages and Long-Term Mortgage Rates
April 2008 - April 2009

Sources: Mortgage Bankers Association, Freddie Mac.

Enterprise Affordable Housing Goals

Housing Goals	Target		2008 Actual (as reported)		2009 Proposed
Goals	**2004**	**2008**	**FNM**	**FRE**	
Low and Moderate Income	50%	56%	53.6%	51.5%	51%
Underserved Areas	31%	39%	39.4%	37.7%	37%
Special Affordable	20%	27%	26.0%	23.0%	23%

FHLBanks Affordable Housing Program

- Each FHLBank operates its own AHP within FHFA regulation
- Funded by 10 percent of each FHLBank's previous year net earnings
- $200 million in AHP subsidies available this year
- FHFA will have AHP goals for FHLBanks fully implemented by 2011

FHLBanks AHP and CIP Rental Assistance

From 1990 to 2008:

- Two-thirds of units assisted by the FHLBanks' affordable housing programs have been rental
- FHLBank affordable housing programs have assisted more than 4,600 federal Low Income Housing Tax Credit projects
- Community Investment Program funding has financed 223,000 rental units
- AHP funding has provided $2.2 billion in subsidies to urban housing projects

Enterprises Growing Multifamily Portfolios

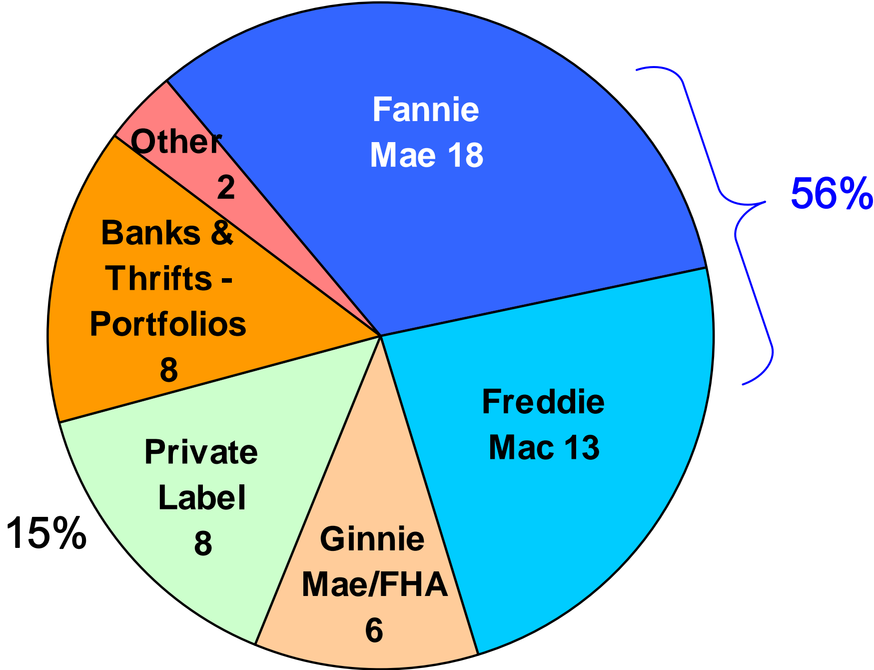
Enterprise Multifamily Portfolios
2004-2009Q1

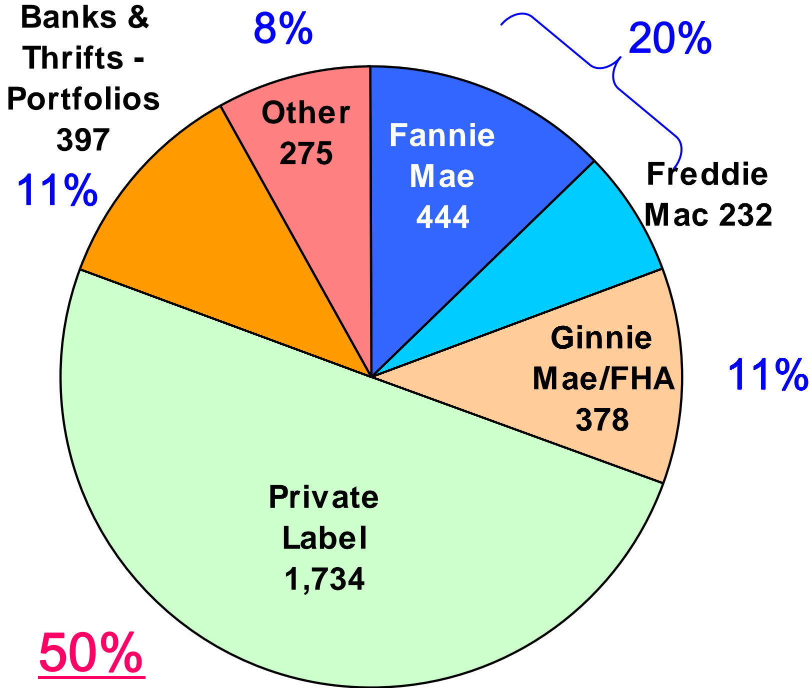
Billions

	2004	2005	2006	2007	2008	2009Q1
Freddie Mac	$55	$57	$55	$70	$89	$91
Fannie Mae	$117	$121	$121	$149	$173	$175

PLS Modifications Key to Foreclosure Prevention

Q4 2008





Total: 55 million

Total: 3.5 million

Source: Freddie Mac.

Home Affordable Refinance Program

- Low-cost refinancing on loans the Enterprises already own or guarantee
- Helps homeowners with loan-to-value ratios between 80 percent and 105 percent
- Mortgage insurance will be transferred to new mortgage; new mortgage insurance will not be required
- Positive impact on homeowners, market, and Enterprise
  - Reduces future delinquencies and foreclosures
  - Lowers mortgage payments, which reduces Enterprises' credit risk
  - Enterprises' guarantee fees will increase

Home Affordable Modification Program

- Will be paired with the expanded and improved FHA Hope for Homeowners program
- Reduces borrower's monthly housing expense to 31 percent of gross income; lender (or investor) will be reimbursed at half the cost of the borrower's monthly payment reduction from 38 percent to 31 percent
- Servicers can lower rates to as little as 2 percent, extend loan maturities to 40 years
- Pay for performance incentives for borrower, servicer, and lender/investor
- Next steps: seconds, short sales, deeds in lieu
- Reducing foreclosures will be positive for housing market and the Enterprises' $5.4 trillion book

Principles for the Future of the Enterprises

- Well-defined and consistent mission
- Clear demarcation of private and public sector roles
- Base on strong insurance principles
- Regulatory and governance structure to ensure prudent risk taking

Housing Affordability Is Recovering

National Association of Realtors' US Composite Housing Affordability Index 2000 - March 2009

185
175
165
155
145
135
125
115
105
95

Jan-00 Apr-00 Jul-00 Oct-00 Jan-01 Apr-01 Jul-01 Oct-01 Jan-02 Apr-02 Jul-02 Oct-02 Jan-03 Apr-03 Jul-03 Oct-03 Jan-04 Apr-04 Jul-04 Oct-04 Jan-05 Apr-05 Jul-05 Oct-05 Jan-06 Apr-06 Jul-06 Oct-06 Jan-07 Apr-07 Jul-07 Oct-07 Jan-08 Apr-08 Jul-08 Oct-08 Jan-09

166.7

Source: National Association of Realtors

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