2000
Report To Congress

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Office of Federal Housing
Enterprise Oversight

OFHEO OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3800

June 15, 2000

The Honorable Phil Gramm
Chairman
Committee on Banking, Housing, & Urban Affairs
United States Senate
Washington, D.C. 20515

The Honorable James Leach
Chairman
Committee on Banking and Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairmen:

I am pleased to transmit the 2000 Report to Congress of the Office of Federal Housing Enterprise Oversight (OFHEO). This report has been prepared to meet the statutory requirements in section 1319B of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of P.L. 102-550).

The views in this report are those of the Director and do not necessarily represent those of the President or the Secretary of Housing and Urban Development.

Sincerely,

Armando Falcon, Jr.
Director

Director's Message

On behalf of the Office of Federal Housing Enterprise Oversight (OFHEO), I am pleased to submit the 2000 Report to Congress. This is OFHEO's seventh annual report to Congress and my first as Director. I am honored to lead an agency comprised of such talented and dedicated individuals who are all committed to fulfilling a very noble mission: Safeguarding the world's best housing finance system through the regulation and oversight of Fannie Mae and Freddie Mac (the Enterprises).

We have taken many steps forward in the last year to further our mission. We issued a long-awaited proposed risk-based capital rule and expect to complete a final rule by the end of the year. We established an Office of Information Technology, led by a new Chief Information Officer, to coordinate our heavy reliance on technology. We restructured our internal organization to clarify roles and responsibilities and put an infrastructure in place to best fulfill our mission going forward. And we are increasing our staff resources to add critically needed depth.

There is still much more to do. OFHEO has matured and developed to the point where it can and must take a more comprehensive approach to fulfilling its mission. We must have a complete understanding of not just the Enterprises, but of the entire mortgage industry and the fast-paced changes underway. Few expect the mortgage industry to look the same in 10, five or even two years from now. OFHEO must understand how those changes will affect the Enterprises and the rest of the mortgage industry. The fundamental changes underway in the mortgage market will affect, across the board, our oversight of the Enterprises. Our resource allocation and skill sets must anticipate those changes and prepare accordingly, rather than simply reacting after the fact.

To do so, I have formed a new Office of Strategic Planning and Management in OFHEO. This office will be primarily responsible for developing and maintaining a long-term strategic plan that is consistent with the mission of OFHEO. In addition, we will increase our research and analysis capability in order to better understand and prepare for the changes occurring in the mortgage industry. The greater insight gained from this work will be used to continually improve our examination and capital regulation functions.

I would like to call particular attention to Chapters 1 and 2 of this report. They serve as a discussion of the changes underway in the mortgage industry and offer some insight into how the industry might evolve. These chapters illustrate the need for greater understanding through research and analysis of trends in the industry.

I look forward to another very productive year for OFHEO.

Sincerely,

Armando Falcon, Jr.
Director

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
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Dear Chairmen,

Section 1319B(a)(3) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, instructs the Director of the Office of Federal Housing Enterprise Oversight (OFHEO) to make legislative recommendations which enhance the financial safety and soundness of Fannie Mae and Freddie Mac. Pursuant to that requirement, I am forwarding the following recommendation.

As you know, although OFHEO's budget is funded entirely through assessments paid by the Enterprises it regulates, the aggregate budget level is subject to annual Congressional approval through the appropriations process. This system has been rejected by Congress for all other safety and soundness regulators and I believe should be rejected for OFHEO. Removing OFHEO from the appropriations process will provide the stable funding needed to ensure we have the resources to do our job. Also, it will provide me with the flexibility to respond rapidly to any changes in the condition of the Enterprises.

The amendment provided on the next page will achieve this goal and will provide OFHEO with the financial independence which is critical for sound management and independent regulation. While removing OFHEO from the appropriations process and apportionment, the amendment will continue to subject OFHEO to the same Congressional oversight as the other financial regulators.

Section 1316(a) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4516) is amended to read:

"(a) ANNUAL ASSESSMENTS- The Director may establish and collect from the enterprises annual assessments in an amount not exceeding the amount sufficient to provide for reasonable costs and expenses of the Office,

including the expenses of any examinations under section 1317. The initial annual assessment shall include any startup costs of the Office and any anticipated costs and expenses of the Office for the following fiscal year. Notwithstanding any other provision of law, the amounts received by the Director from any assessments under this section shall not be subject to apportionment for the purposes of Chapter 15 of Title 31 or under any other authority."

Section 1316(g)(3) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4516) is hereby repealed.

Sincerely,

Armando Falcon, Jr.

Armando Falcon, Jr.
Director

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1

Major Forces That Are Reshaping The Housing Finance System

Fannie Mae and Freddie Mac are integral components of the U.S. housing finance system. They are the largest investors in conventional mortgages—those that do not carry government insurance or guarantees. At the end of 1999, the Enterprises owned or had securitized 47 percent of outstanding conventional single-family loans. Fannie Mae and Freddie Mac set standards for originating and servicing the loans they purchase. Their credit policies influence the business practices and financial performance not only of originators and servicers but also of mortgage insurers, other providers of credit enhancements, credit bureaus, appraisal firms, and other companies that provide services to lenders. In turn, those firms affect the credit quality of the mortgages the Enterprises buy and the profitability of their mortgage guarantee business. Fannie Mae and Freddie Mac also affect indirectly the volume of activity of two Federal agencies that support mortgage lending—the Federal Housing Administration (FHA) and the Government National Mortgage Association (Ginnie Mae)—and the Federal

Home Loan Bank System, the third government-sponsored enterprise (GSE) that supports housing finance. The Enterprises combined are the largest portfolio investors in mortgage securities, the largest private issuers of debt securities, and are among the largest end users of derivatives. The funding and hedging activities of Fannie Mae and Freddie Mac are large enough to influence the activities of other large debt issuers and users of derivatives.

To regulate Fannie Mae and Freddie Mac effectively, the Office of Federal Housing Enterprise Oversight (OFHEO) must have a comprehensive and thorough understanding of the U.S. housing finance system and the roles the Enterprises play in the markets in which they participate. OFHEO must understand the major trends in housing finance and financial markets and the fundamental forces shaping those trends, in order to grasp the opportunities, challenges, and risks facing the Enterprises, anticipate future developments, and identify public policy issues. OFHEO must pay close attention not only to likely developments but to less likely ones that could cause significant problems for the functioning of mortgage markets in general and for the safety and soundness of Fannie Mae and Freddie Mac in particular.

OFHEO's understanding of housing finance markets and the financial system is the foundation of the Office's regulatory activities. That understanding informs all of OFHEO's decisions about its risk-based capital regulation and comprehensive examination program, which are two of the principal tools used to regulate Fannie Mae and Freddie Mac. OFHEO's expertise regarding housing finance markets also shapes its views about other Federal policies that may affect the safety and soundness of the Enterprises and the efficiency and stability of mortgage markets. To maintain a thorough knowledge of the housing finance system, OFHEO must conduct a broad program of economic and policy research.

OFHEO's regulation of Fannie Mae and Freddie Mac must adapt continually to the evolution of housing finance markets and the activities and risks of the Enterprises. Once the proposed risk-based capital regulation is final, OFHEO will have the opportunity to consider fully the operation of the regulation. As the Enterprises change their activities—as they introduce new loan products and use new hedging techniques, for example—OFHEO will assess how well its risk-based capital stress test measures the risk of each Enterprise. OFHEO would base any changes in the test on its understanding of developments in housing finance and the activities of Fannie Mae and Freddie Mac. Similarly, OFHEO's understanding of housing finance markets and the activities of the Enterprises is critical to its decisions about where to deploy examination resources and about the policies, procedures, and controls Fannie Mae and Freddie Mac should use to manage their businesses effectively. As markets and the activities of the Enterprises change, OFHEO must assess how its examination program should evolve in order to ensure the safety and soundness of Fannie Mae and Freddie Mac.

This chapter surveys the fundamental forces that transformed housing finance markets in the 1990s and are likely to continue to reshape those markets in the next decade. Chapter Two analyzes the implications those forces may have in the next decade for primary and secondary mortgage markets, the participation of Fannie Mae and Freddie Mac in securities markets and the global financial system, and Federal regulation of mortgage markets and the Enterprises.

IMPROVEMENTS IN INFORMATION TECHNOLOGIES

In the last two decades improvements in computer and telecommunications technologies have reduced the money and time spent in carrying out financial transactions and have made it easier to obtain and analyze information about market participants and financial instruments.[1] Lower transaction costs and greater transparency have transformed financial markets in many ways. Debt markets have become larger, with an increasing share of debt instruments becoming actively traded. Securitization, which transforms illiquid whole loans into liquid securities, has spurred the growth of debt markets. Derivatives markets have expanded, allowing firms to trade market risks more efficiently. Electronic payments technologies have grown rapidly, increasing the speed and efficiency of payments. Economies of scale in financial services have increased, spurring rapid consolidation during the 1990s, particularly in commercial banking because of the loosening of restrictions on geographic and product markets. Scoring—the process of using statistical techniques to evaluate the credit risk of specific borrowers or loans—long used to evaluate auto, credit card, and installment loans, has also become widely used to underwrite residential mortgages and small business loans. This has reduced the fixed costs associated with screening applicants for such loans and increased competition among lenders. With the emergence of the World Wide Web as a powerful communications medium, a growing share of the customers of securities firms, banks, insurance companies, and other providers of financial services are accessing information and executing transactions online.

Improvements in technology have profoundly altered the housing finance system.[2] All of the components of the single-family mortgage lending process—origination, funding, assumption of credit risk, and servicing—have become cheaper and easier to perform (Box 1 summarizes those components). Lower costs and faster execution have led to significant changes in the structure of mortgage markets and in the business practices of firms throughout the housing finance system.

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1 For a discussion of the effects of changes in technology on financial markets, see Frederick S. Mishkin and Philip E. Strahan, “What Will Technology Do to Financial Structure?” in Brookings-Wharton Papers on Financial Services 1999 (Washington, DC: The Brookings Institution, 1999), pp. 249-277.

2 The remainder of this section draws upon Michael LaCour-Little, “The Evolving Role of Technology in Mortgage Finance,” (paper presented at the Mid-Year Meeting of the American Real Estate and Urban Economics Association, Washington, DC, May 30-31, 2000).

Box 1: Components of Single-Family Mortgage Lending

Single-family mortgage lending has four components: loan origination or production, funding, assumption of credit risk, and servicing or loan administration. A financial institution may perform some or all of these functions for a particular loan.

Loan origination or production is the actual making of mortgage loans. It includes marketing to prospective borrowers, processing applications (ordering credit reports, appraisals or other property valuations, and title reports; and verifying borrower income, employment, and assets), underwriting applications, arranging for approved loans to be closed, and disbursing funds to borrowers. (Box 2 discusses the different methods used to originate single-family mortgage loans).

Funding is the provision, either temporarily or permanently, of the funds to finance mortgage loans. A depository institution that buys mortgage loans (or obtains mortgage-backed securities in exchange for whole loans) funds them on a long-term basis through checking and savings accounts, certificates of deposit, other depository products, and other borrowings. Mortgage banks, which are not deposit-taking institutions, finance closed mortgage loans temporarily, usually with a warehouse line of credit from a commercial bank. (To mortgage bankers, warehousing is the provision of temporary funding for loans.) Mortgage banks then sell the loans in the secondary market. Purchasers in the secondary market include investors who finance their purchases by issuing debt, or intermediaries between lenders and investors, often called conduits, that pool loans and sell them in the form of mortgage-backed securities. Fannie Mae and Freddie Mac function as both investors and conduits.

Assumption of credit risk is the act of bearing the risk that loans will default. Different types of financial institutions assume the credit risk of conventional single-family mortgages. Private mortgage insurers assume a portion of the risk of loans that they insure, typically those with loan-to-value (LTV) ratios greater than 80 percent, and may bear additional risk by providing supplemental coverage of pools of loans. Depository institutions bear some of the credit risk of conventional mortgages that they hold if the loans carry private mortgage insurance, and all of the risk if the loans are uninsured. Fannie Mae and Freddie Mac bear the credit risk associated with the uninsured portions of conventional mortgages that they hold in their investment portfolios or that serve as collateral for mortgage-backed securities they have guaranteed.

Servicing or loan administration is the management of the mortgage payment process for investors who are the ultimate holders of mortgage notes. Servicers collect monthly payments from borrowers, transfer principal and interest payments to investors, manage escrow accounts, and handle delinquencies and foreclosures.

Box 2: Methods of Originating Single-Family Mortgages

There are two methods of originating single-family mortgage loans — retail lending and wholesale lending. In retail lending, a mortgage lender performs all of the tasks involved in originating loans (refer to Box 1 on the previous page). Retail lenders may operate as portfolio lenders—lending institutions that hold mortgages as investments—or as mortgage banks. Retail lending may involve applicants visiting branch offices or contacting lenders by phone or over the Internet.

In wholesale lending, two or more firms are involved in the origination process. Mortgage brokers are originators who introduce prospective borrowers to lenders who operate as wholesalers. Brokers generally perform most of the application processing. Wholesalers complete any remaining processing, underwrite the applications, and generally provide funds that brokers need to close approved loans. Wholesalers may operate as portfolio lenders or mortgage banks. As compensation for their services, brokers receive the origination fees paid by borrowers and may earn additional fees from wholesalers. As with retail lenders, applicants may contact brokers in person, by phone, or by visiting a web site. Web-based mortgage consolidators such as E-loan and Lending Tree, which allow borrowers to compare loans available from and submit applications to multiple wholesalers, are online mortgage brokers.

A wholesaler may also purchase a closed loan from a correspondent lender after the latter has completed the loan origination process. A correspondent is usually a smaller lender, often a community bank or thrift, that has the funds and capacity to close loans in its own name, but cannot or does not want to service all of the loans it makes. Correspondents typically cannot manage as economically as wholesalers the interest rate risk posed by warehousing loans and selling them in the secondary market. Correspondents may commission mortgage brokers to perform some loan processing tasks. By dealing with a number of wholesalers, mortgage brokers and correspondents can assure themselves of a complete line of loan products and competitive prices at all times.

New Technologies Have Facilitated the Growth of Mortgage Securitization

Improvements in information technologies first affected housing finance markets by making securitization the preferred method of funding mortgages. The growth of securitization was stimulated in the 1970s by the advent of computers and cheap data transmission. Rapid increases in computer processor speeds facilitated the development of multi-class mortgage securities and more active markets for mortgage securities in the 1980s and 1990s. The growth of securitization greatly increased the liquidity of most single-family and multifamily mortgages and made it easier for single-family lenders to split, or “unbundle”, the components of the lending process. As a result, single-family lenders operate largely as mortgage banks, which means that they specialize in the origination and servicing components of the lending process. Today almost all large mortgage lenders are affiliates of depository institutions.

Scale Economies in Servicing Have Contributed to Industry Consolidation

Improvements in technology have allowed large lenders to achieve economies of scale in the servicing component of the lending process. Four different innovations—personal computers (PCs), local area networks (LANs) linking PCs, automated voice response technologies, and the Internet—have each reduced the costs of responding to consumer inquiries. Document imaging has allowed large servicers to retain much less paper for each individual loan and to access records quickly and cheaply. The achievement of economies of scale in servicing has been the primary force driving rapid consolidation among the largest mortgage lenders. According to Inside Mortgage Finance, between 1989 and 1999 the share of single-family loans serviced by the 25 largest servicers more than tripled to 56 percent. The market share of the 25 largest originators grew less rapidly, but still more than doubled to 57 percent.

The Origination Process Is Being Automated Rapidly

In the origination component of mortgage lending, automation has allowed single-family lenders to transmit information quickly and cheaply, allocate staff flexibly, and transform fixed costs into variable costs. One important effect of automation is that refinancing single-family mortgages is cheaper and less time-consuming, which has made borrowers more likely to refinance when mortgage rates decline and to shop among originators for the best rates and terms. Electronic commerce—the process of evaluating, negotiating, executing, and managing business transactions electronically—has been another source of savings in origination costs. The largest lenders have used Electronic Data Interchange (EDI) to exchange information and execute transactions with mortgage insurers, credit bureaus, and other business partners since the 1970s. Other firms in the industry began using EDI in the mid-1990s.

Fannie Mae and Freddie Mac accelerated the industry’s automation of the origination process and use of e-commerce by introducing their own proprietary automated underwriting systems (AUS) and electronic mortgage information networks in 1995. The industry has rapidly adopted automated underwriting and, in the process, made the use of scoring widespread in the origination process.[3] According to MORTECH 99, a leading survey of the use of technology in mortgage banking, over three-quarters of lenders had implemented AUS in 1999, up from one-quarter in 1996. The Enterprises' systems are the industry's overwhelming favorites: over 60 percent of lenders had implemented either Freddie Mac's Loan Prospector or Fannie Mae's Desktop Underwriter. By contrast, no other AUS had been implemented by more than six percent of lenders. However, the largest lenders tend to use systems they have developed themselves. Large lenders often want the flexibility to tailor a system's use of scoring and underwriting rules to suit their particular risk preferences and the requirements of a variety of investors. Nearly 90 percent of lenders are expected to have implemented automated underwriting by the end of this year. The widespread adoption of automated underwriting, and especially its availability at the point of sale, has given borrowers much better access to useful information about their credit profiles and eligibility for different types of loans.

In 1999, one-half of newly originated single-family mortgages sold to Freddie Mac (excluding those included in structured transactions) and 39 percent of such loans sold to Fannie Mae were evaluated by the respective Enterprise's AUS prior to origination. Lenders may access either Enterprise's system through its proprietary information network. Mortgage brokers may gain access to each system through the wholesale lenders with which they do business. (Box 2 on page 5 summarizes the differences between wholesale and retail single-family lending). To develop alternative channels for delivering mortgages, Fannie Mae and Freddie Mac are giving lenders and affiliated brokers access to their AUS and electronic mortgage information networks through the Internet. Thus, borrowers may access each Enterprise's AUS online by signing onto a lender's web site or by selecting a lender on the site of an online mortgage broker.

Originators' Use of the Internet Is Expected to Grow

The World Wide Web gives mortgage lenders the opportunity to reduce their costs of doing business with both consumers and their business partners. Originators increasingly use the Internet to conduct business-to-business transactions with service providers. According to MORTECH 99, over 57 percent of originators obtained services such as appraisals and mortgage insurance commitments online in 1999. Online business-to-business e-commerce by servicers is at an earlier stage of development.

Lenders see the Internet as a potentially very significant channel for originating single-family loans, and many firms have begun to use web sites to enable prospective applicants to complete some of the origination process. About 21

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[3] For an earlier discussion by OFHEO of automated underwriting, see OFHEO, 1995 Annual Report to Congress, Chapter I, "Current Issues," pp. 1-7. For a recent discussion, see John W. Straka, "A Shift in the Mortgage Landscape: The 1990s Move to Automated Credit Evaluations," (paper presented at the Mid-Year Meeting of the American Real Estate and Urban Economics Association, Washington, DC, May 30-31, 2000).

percent of lenders had their own sites in 1996, but the figure has been 47 percent since 1997, according to MORTECH 99. Some recent surveys suggest that between one-half and three-quarters of prospective applicants now use the Internet to help find a mortgage.[4] If technical and legal issues are resolved, Internet lending has the potential to eliminate as much as two-thirds of the closing costs single-family borrowers pay, which today equal about 3 percent of the amount of a typical home-purchase loan.[5]

The proportion of single-family mortgages originated online is very low at present. Wall Street analysts estimate that originations in which the borrower completed much of the transaction via the Internet accounted for less than one percent of total lending of the industry in 1999.[6] According to MORTECH 99, the Internet accounted for 3.3 percent of single-family originations by lenders who had web sites in 1999, up from 1.5 percent in 1998. Moreover, few sites let applicants complete the entire origination process online. Over 90 percent of the lenders used their sites to disseminate information to borrowers, over 50 percent used them to prequalify borrowers, and over one-quarter enabled applicants to lock in their mortgage rates, but less than 8 percent used their sites to close loans. MORTECH 99 indicates that most lenders are not investing heavily in the Internet delivery channel and are motivated primarily by a desire to hedge against online competition from firms that are investing heavily. Nonetheless, consumer use of the Internet both to submit applications for single-family mortgages and complete the origination process may grow rapidly in the next decade, despite the slow start.[7]

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4 Kenneth A. Posner and Michael D. Courtain, The Internet Mortgage Report II: Focus on Fulfillment (New York: Morgan Stanley Dean Witter, February 10, 2000), p. 4.

5 David P. Danforth, “Online Mortgage Business Puts Consumers in the Drivers Seat,” Secondary Mortgage Markets, vol. 16, no. 1 (April 1999), pp. 2-8.

6 See Michael S. Hodes, Gregory W. Hall, and Lawrence N. Rosenberg, Home Run: Taking a Closer Look at Internet Mortgage Finance (New York: Goldman Sachs, November 15, 1999), p. 12; and Kenneth A. Posner and Michael D. Courtain, The Internet Mortgage Report II: Focus on Fulfillment, p. 4.

7 Michael S. Hodes, Gregory W. Hall, and Lawrence N. Rosenberg, Home Run: Taking a Closer Look at Internet Mortgage Finance, p. 10; and Kenneth A. Posner and Michael D. Courtain, The Internet Mortgage Report II: Focus on Fulfillment, p. 4.

New Technologies Have Transformed Risk Management and Debt Financing

New technologies have also revolutionized the measurement, pricing, and allocation of risks throughout the mortgage lending process, and have facilitated the development of new financial instruments. Ever faster computer processing has steadily reduced the costs of hedging interest rate risk and of valuing whole loans, mortgage securities, and the rights to service pools of loans, thereby spurring more active trading of those assets. Scoring has led to greater quantification in underwriting of single-family loans, more competitive markets for mortgage credit risk, and more active management of delinquent loans.[8] Fannie Mae and Freddie Mac and other industry participants have benefited from new forms of credit enhancement, including pool insurance, spread accounts, and reinsurance agreements. The Enterprises are now among the largest issuers of callable debt and end-users of derivatives such as interest-rate swaps, which have allowed them to lower their funding costs and manage interest rate risk more efficiently. All those changes permit the risks associated with investing in single- and multifamily mortgages to be transferred to other firms and investors that are willing to bear them most cheaply, thereby reducing costs.

FEDERAL POLICIES

The Federal government has promoted homeownership for over fifty years by intervening in financial markets to allocate credit to housing and hold mortgage rates below their free-market level. In the last two decades, there have been major changes in the institutions and the means of conveying subsidies that the government uses to achieve those objectives. The dominant institutions are now Fannie Mae and Freddie Mac, which in the mid-1980s took the place of thrifts as the most important sources of funds for so-called conforming loans—conventional single-family mortgages with balances that make them eligible for purchase by the Enterprises.[9] Before that time the government subsidized mortgage borrowers primarily through deposit insurance and tax subsidies for thrift institutions; now it provides subsidies primarily by sponsoring the Enterprises and bearing the risk of loss if they fail.[10]

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8 For an earlier OFHEO discussion of scoring, see OFHEO, 1996 Annual Report to Congress, Chapter II, “Use of Scoring in Mortgage Lending,” pp. 21-29. For a recent discussion, see Straka, “A Shift in the Mortgage Landscape: The 1990s Move to Automated Credit Evaluations.”

9 Fannie Mae and Freddie Mac are restricted to financing single-family mortgages that have balances less than certain prescribed levels, which are adjusted annually based on changes in U.S. housing prices. In 2000 this so-called conforming limit is $252,700. This report uses the term “conforming mortgage” to refer to any single-family loan with a balance less than the limit. The Departments of Veterans Affairs and Housing and Urban Development (HUD) and Independent Agencies Appropriation Act for FY 1999 repealed the limit on the size of multifamily mortgages eligible to be financed by the Enterprises.

10 For an analysis of the process by which Fannie Mae and Freddie Mac became the most important sources of funds for single-family mortgages, see Patric H. Hendershott, “The Market for Home Mortgage Credit: Recent Changes and Future Prospects,” in R. Alton Gilbert (Ed.), The Changing Market in Financial Services (Boston: Kluwer Academic Publishers, 1992), pp. 99-123. For an analysis of how the housing finance system has changed in recent years and its current structure, see John C. Weicker, “The New Structure of the Housing Finance System,” Review (Federal Reserve Bank of St. Louis, July/August 1994), vol. 76, pp. 47-65.

The dominant position of Fannie Mae and Freddie Mac in the secondary market for conventional mortgages is a major influence on the evolution of the housing finance system. Capital and program regulation of the Enterprises and the Federal Home Loan Banks also affect mortgage markets. Federal initiatives that encourage the industry to provide more credit for affordable housing and changes that affect the demand for FHA mortgage insurance, guarantees of mortgages by the Department of Veterans Affairs (VA), and securitization by Ginnie Mae are additional influences.

The Enterprises Dominate the Secondary Market for Conventional Mortgages

Since the mid-1980s, Fannie Mae and Freddie Mac have dominated the secondary market for conforming fixed-rate mortgages (FRMs), which comprise about 60 to 70 percent of the annual dollar volume of conventional single-family originations. In 1998 and 1999, for example, the Enterprises purchased $1.1 trillion in fixed-rate loans, which amounted to over two-thirds of the volume of conforming FRMs originated in those two years. Fannie Mae and Freddie Mac are also major investors in adjustable-rate mortgages (ARMs) and multifamily loans. The Enterprises have broad discretion to determine the volume of mortgages and mortgage securities they purchase.

The dominant position of Fannie Mae and Freddie Mac in the secondary market for conforming mortgages stems largely from their special relationship to the Federal government, which has contributed to a perception among investors that the government will take any action necessary to prevent either Enterprise from defaulting on its obligations. Government sponsorship and the perception of Federal backing greatly increase the liquidity of debt issued by the Enterprises, lead investors to treat their guaranteed MBS like agency debt, permit them to operate with more leverage than non-Enterprise mortgage investors, and make them attractive derivative counterparties. Those advantages allow Fannie Mae and Freddie Mac to raise funds in the Federal agency debt market at interest rates below those paid by private firms with the highest credit ratings.

Capital regulation of Fannie Mae and Freddie Mac and depository institutions also contributes to the dominant position of the Enterprises. Banking regulation allows banks and thrifts to hold less capital against the mortgage securities and debt of Fannie Mae and Freddie Mac than against whole mortgages or mortgage securities issued by others. The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act), which established OFHEO, strengthened the Enterprises' position in the secondary mortgage market by requiring OFHEO to impose leverage ratios on them that are lower than those imposed on depositories and by prescribing specific risk-based capital requirements for Fannie Mae and Freddie Mac.

An important consequence of the dominance of Fannie Mae and Freddie Mac in the market for conforming FRMs has been a reduction in interest rates on those loans. Research has found that the yields on fixed-rate loans with balances below the conforming limit are consistently lower than those on jumbo FRMs—fixed-rate loans with balances above the limit. The differential appears to have averaged about 45 basis points between 1987 and 1991 and about 25 basis points from 1991 through early 1999. That research is often interpreted as indicating that purchases of conforming FRMs by the Enterprises have reduced the yields on such loans by the full amount of the differential.[11]

Fannie Mae and Freddie Mac are important influences on the volume of business done by the private mortgage insurance industry. Because of statutory requirements, nearly all of the single-family mortgages purchased by each Enterprise that have loan-to-value (LTV) ratios greater than 80 percent are covered by primary mortgage insurance. In addition to the volume of high-LTV loans purchased by the Enterprises, the depth of coverage they require affects the volumes of new insurance written by the industry and of primary mortgage insurance in force. In recent years Fannie Mae and Freddie Mac have purchased pools of mortgages covered by pool insurance, an additional layer of coverage that obligates the mortgage insurer to cover a portion of any losses beyond those covered by primary insurance. Such coverage has also affected the level of exposure and the revenues of the industry.

Federal Regulation of the Three Housing GSEs Affects the Industry

Federal capital regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks affects each GSE's volume of business, financing strategies, and risk. The 1992 Act directed OFHEO to establish minimum and risk-based capital requirements for Fannie Mae and Freddie Mac. The risk-based capital regulation proposed by OFHEO in June 1999, when final, will determine how much capital the Enterprises must maintain against the risks they take. In addition, the Federal Home Loan Bank System Modernization Act of 1999 changes the capital structure of the Federal Home Loan Banks and requires the Federal Housing Finance Board (FHFB), which is responsible for regulating the Banks, to impose new risk-based capital requirements on them. Because mortgage and financial markets are efficient, risks flow to the institutions that can bear them most cheaply.

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11 See Robert F. Cotterman and James E. Pearce, "The Effects of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation on Conventional Fixed-Rate Mortgage Yields," in U.S. Department of Housing and Urban Development, Studies on Privatizing Fannie Mae and Freddie Mac (Washington, DC, Office of Policy Development and Research, May 1996), pp. 97-168; and Robert S. Seiler, Jr., "Estimating the Value and Allocation of Federal Subsidies to Fannie Mae and Freddie Mac," (paper presented at an American Enterprise Institute conference on "Fannie Mae and Freddie Mac: Public Purposes and Private Interests, Washington, DC, March 1999).

Federal regulation of the programs of the three housing GSEs also affects housing finance markets. The 1992 Act directed the Secretary of Housing and Urban Development (HUD) to establish numeric goals related to purchases by the Enterprises of mortgages that finance affordable housing. The revised affordable housing goals regulation proposed by the HUD Secretary in March 2000, when final, will affect the types of mortgages the Enterprises purchase. The FHFB has approved a number of new programs under which individual Federal Home Loan Banks may acquire mortgages, bear the interest rate risk associated with financing the loans, and share the credit risk with member institutions. The programs give member institutions an alternative to selling conforming FRMs to Fannie Mae and Freddie Mac and to placing FHA-insured loans in pools backing MBS guaranteed by Ginnie Mae.

Federal Policy Encourages Mortgage Lending for Affordable Housing

In the 1990s, the government encouraged originators to engage in greater lending to low-income and minority families and other populations that typically have been underserved by the housing finance system. The Federal bank regulators promoted that objective by issuing a revised regulation to implement the Community Reinvestment Act (CRA) in 1995. The objective was also furthered by the activities and new programs that Fannie Mae and Freddie Mac initiated to comply with the affordable housing goals imposed by the initial regulation that the HUD Secretary issued in 1995 to implement the 1992 Act. The revised regulation recently proposed by the Secretary, when final, may also influence the level of affordable mortgage lending.

Changes in Policy Also Affect the Volume of Activity of FHA, VA, and Ginnie Mae

Through FHA mortgage insurance and VA guarantees, the government bears the credit risk of many single- and multifamily mortgages. Mortgage securities guaranteed by Ginnie Mae provide a low-cost means of financing FHA-insured and VA-guaranteed loans. Changes in Federal policy affect the use of FHA insurance, VA guarantees, and Ginnie Mae financing. For example, in 1998 the Congress raised the ceiling on single-family mortgages eligible for insurance by FHA. Since lenders earn higher servicing fees on FHA-insured mortgages than they do on conventional loans, the higher ceiling has tended to boost the volume of loans financed with FHA insurance.

ENTERPRISE EFFORTS TO IMPROVE FINANCIAL PERFORMANCE

Fannie Mae and Freddie Mac have increased earnings per share (EPS) at double-digit rates since 1991, and each Enterprise has made a public commitment to stockholders to sustain that rate of growth in the future. In the early 1990s, the rates of growth of the mortgage market as a whole and mortgage debt financed by the Enterprises slowed, limiting their capacity to increase earnings by expanding the volume of mortgage debt securitized. In response, Fannie Mae and Freddie Mac have engaged in a range of new activities designed to expand their market share, improve their financial performance, and sustain double-digit earnings growth.

INITIATIVES TAKE ADVANTAGE OF NEW TECHNOLOGIES

The new initiatives of Fannie Mae and Freddie Mac, which may be grouped into four broad categories, take advantage of improvements in technology to maximize the value of each Enterprise's charter. The Enterprises will continue to rely on improvements in technology to increase earnings and improve financial performance in the next decade.

Retained Portfolio Growth

Fannie Mae and Freddie Mac have increased their earnings at double-digit rates, despite less rapid growth in the mortgage market as a whole, primarily by expanding their retained mortgage portfolios, whose returns exceed those earned by securitizing loans. The Enterprises expand their portfolios primarily by buying large amounts of their own mortgage-backed securities (MBSs) and Real Estate Mortgage Investment Conduit (REMIC) securities. (Box 3 on page 39 discusses the Enterprises' purchases of mortgage securities in 1999). This activity takes advantage of the growth of the market for the Enterprises' callable debt and their preferred position as counterparties in derivatives transactions. Improvements in technology made possible the growth of derivatives markets and the development of a large, liquid market for Enterprise callable debt.

New Products and Entry into Subprime Lending

In an effort to increase the volume of mortgages they purchase, Fannie Mae and Freddie Mac have expanded the range of loans they buy. Both Enterprises have introduced new products such as low-downpayment and reverse mortgages. Fannie Mae and Freddie Mac have also purchased loans that they previously deemed to pose an unacceptable level of credit risk, including some subprime mortgages. Freddie Mac also issues multi-class mortgage securities supported by pools of subprime mortgages. Those activities take advantage of improvements in the measurement and management of mortgage credit risk made possible by automated underwriting and scoring technology.

Services to Lenders

In an effort to increase the volume of mortgages sold to them and their revenues, Fannie Mae and Freddie Mac have provided new services to lenders. Each Enterprise leases its AUS and other online services to lenders. Lenders that use the Enterprises' AUS and proprietary networks have access to credit reports, property valuations, title insurance, and other origination-related services. Each Enterprise earns money by selling foreclosed properties owned by lenders as well as foreclosed properties that it owns. Freddie Mac has taken a financial interest in HomeAdvisor Technologies, Inc. (HTI), a joint venture with Microsoft and, initially, four of the largest lenders in the industry. According to the partners in that venture, HTI will provide an integrated, web-based origination platform that consumers, real estate brokers, and mortgage lenders and brokers can use to access a broad array of origination services. Those activities take advantage of automated underwriting technology and the ability of the Enterprises to deploy their AUS at the point of sale and use electronic links to exchange information and execute transactions with lenders and other firms.

Efforts to Reduce Funding Costs

Fannie Mae and Freddie Mac have taken steps to lower the yields on their debt securities. In 1998 the Enterprises introduced benchmark debt issuance programs (called "Benchmark" securities by Fannie Mae and "Reference" securities by Freddie Mac) that provide for the regular issuance of securities in large volumes and in a range of maturities.[12] Each Enterprise's benchmark securities are designed to appeal to investors who might otherwise buy U.S. Treasury securities and are promoted as substitutes for Treasuries in investors' portfolios. The Enterprises have also issued debt denominated in foreign currencies, endeavored to expand foreign ownership of their debt and MBS, and used swaps and other new hedging tools to create synthetic securities that are attractive to investors with specific preferences. Those initiatives take advantage of improvements in information technology that have lowered the costs of informing investors about the Enterprises and the credit quality and liquidity of their securities, and the costs of measuring and managing interest rate risk.

NEW ACTIVITIES AFFECT OTHER INDUSTRY PARTICIPANTS

The initiatives that Fannie Mae and Freddie Mac have undertaken to improve their financial performance and maintain earnings growth affect the relative market shares of the Enterprises and other firms in specific markets of the mortgage industry. For example, Fannie Mae and Freddie Mac have become the dominant purchasers of mortgage securities backed by newly originated loans. The reduction in the supply of such securities available for purchase by other inves-

[12] The Federal Home Loan Banks and the Farm Credit Banks have introduced benchmark debt issuance programs similar to those of Fannie Mae and Freddie Mac. The Federal Home Loan Banks introduced their "Tap Issue" program in July 1999 and the Farm Credit Banks introduced their "Designated Bonds" program in March 1999.

tors has led fewer firms to be active in that market. By initiating programs to purchase new types of mortgages, the Enterprises have encouraged more lenders to originate such loans, which has tended to increase competition in the primary market and may have lowered the interest rates paid by borrowers. By giving lenders who use their AUS the option of obtaining electronic property valuations or streamlined property appraisals, Fannie Mae and Freddie Mac may reduce the demand for traditional appraisals and alter appraisal industry practices.

ECONOMIC AND DEMOGRAPHIC TRENDS

Movements in interest rates, the stage of the business cycle, and demographic trends influence the levels of activity in housing markets and in the primary and secondary mortgage markets. In recent years solid economic growth, relatively low mortgage interest rates, the booming stock market, and strong growth in the number of households have produced record levels of housing market activity and mortgage originations and boosted the homeownership rate. (Chapter 3 discusses conditions in housing and mortgage market in 1999 in more detail.) At the same time, the vulnerability of some households to an economic downturn has increased. The median amount of debt owed by households has increased strongly since 1989, and some indicators of debt burden, such as the median ratio of debt payments to income among debtors, have also increased substantially.[13] Economic and demographic trends will continue to influence housing and mortgage market activity in the next decade.

A Less Robust Economy is Likely to Dampen Activity

The economy, the stock market, and housing market activity are expected generally to be less robust in the next few years than they were in the late 1990s. Since May 1999, the Federal Reserve has raised its Federal funds rate target by 1.5 percentage points, in an effort to dampen inflationary pressures. The Federal Reserve is widely expected to increase that target further over the rest of the year unless economic activity slows. Higher interest rates are expected to slow the growth of the economy and to dampen housing starts, home sales, and mortgage originations in 2000 and 2001. It is almost certain that there will be an economic downturn in the next decade, and any downturn might be severe. Also, home prices might rise substantially before a recession begins, at which point a downturn might produce a sharp deflation in housing markets. If the economy falls into recession, housing and mortgage market activity will decline further.

[13] Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin (Washington, DC: January 2000), pp. 1-29.

Changes in the Age Structure of the Population May Affect the Housing Market

The Joint Center for Housing Studies of Harvard University expects the number of households to increase by an average of 1.1-1.2 million annually in the next decade.[14] Immigration is expected to contribute about one-quarter of that growth. Two-thirds of the increase is expected to come from the movement of the population into age groups whose members are frequently heads of households. The entry into the housing market of the children of the baby boom generation born since 1977, the so-called "echo-boomers," will increase the number of young households.

At the same time, the parents of the baby boomers are now reaching their 70s and 80s. As those older individuals age, a substantial proportion will depart their homes for smaller or more appropriate units, or move in with others. The new, presumably younger owners of those units are likely to invest in substantial modifications or upgrades to their properties, which may boost the volume of housing activity.

[14] Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing 1999 (Cambridge, MA, June 1999), pp. 9-14.

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The Enterprises, Mortgage Markets, and The Financial System In The Next Decade

The fundamental forces that transformed the U.S. housing finance system in the 1990s will continue to reshape the industry in the next decade. There are likely to be far-reaching changes for borrowers, lenders, Fannie Mae and Freddie Mac, and other firms in the industry. This chapter reviews some of the potential implications for primary and secondary mortgage markets, securities markets, the financial system, and Federal regulation of the Enterprises. An important objective of OFHEO's comprehensive research program is to identify the potential risks and benefits of the various paths the industry may take and of possible changes in Federal policy. The chapter provides several examples of topics for economic and policy research.

IMPLICATIONS FOR THE PRIMARY MARKET

The primary mortgage market will face important challenges and is likely to change significantly in the next decade. A national economic downturn would test the ability of Fannie Mae and Freddie Mac to manage their exposure to credit risk and interest rate risk. Changes in the composition of households may affect mortgage performance. The Enterprises and traditional prime lenders will have to manage the unique risks associated with subprime lending. Automated underwriting, scoring, and the Internet will undoubtedly affect the industry, but there is uncertainty about how the new technologies may be used and how business practices may evolve in specific markets. Fannie Mae and Freddie Mac may continue to expand the services they provide to mortgage lenders.

A National Economic Downturn Will Test the Ability of the Enterprises to Manage Risk

Fannie Mae and Freddie Mac have made significant changes in their underwriting guidelines and credit risk management practices since the last national recession ended in the spring of 1991. Those changes include the introduction of new loss mitigation techniques, the use of scoring and AUS, and the use of new types of credit enhancement. Several of the changes have contributed, along with robust housing markets, to the decline in credit losses, measured as a percentage of average mortgage loans financed, achieved by the Enterprises in recent years. Fannie Mae and Freddie Mac have also introduced a number of new products, including low-downpayment mortgages, since the last national downturn.

The next national downturn will be the first major test of the changes in credit risk management and new loan products introduced by Fannie Mae and Freddie Mac in the 1990s. A recession could be accompanied by higher interest rates, stagnant household incomes, rising consumer debt burdens, higher unemployment, and a stagnant or declining stock market. Such conditions could reduce the demand for housing, dampen or reverse home price appreciation, and increase delinquency and foreclosure rates and mortgage credit losses. Each Enterprise's credit losses might increase by more than expected, reveal weaknesses in the Enterprises' underwriting, and lead to changes in their use of scoring and their AUS. On the other hand, the new loan programs and risk management practices may perform well and allow the Enterprises to keep their credit losses from increasing as much as they would have under similar conditions in the past.

A recession accompanied by higher interest rates would test the ability of Fannie Mae and Freddie Mac to manage the interest rate risk associated with their large retained mortgage portfolios. The Enterprises rely heavily on derivatives to manage that risk. A downturn could affect the performance of their derivatives counterparties and the price and availability of new derivatives in ways that could alter significantly the returns on their portfolios. In addition, as interest rates rose, the risk-based capital regulation proposed by OFHEO would increase each Enterprise's risk-based capital requirement.

Changes in the Composition of Households and Borrowers May Affect Credit Performance

The composition of households and homebuyers are projected to change in the next decade. The changing age structure of the population is expected to increase the proportion of households headed by young adults and retirees. The proportion of first-time homebuyers who are immigrants is projected to increase along with the immigrant share of the population. The share of first-time homebuyers who have made little previous use of consumer credit may also increase as the industry continues to engage in outreach efforts.

Changes in the composition of households and homebuyers may affect the performance of single- and multifamily mortgages. For example, younger households generally have less equity in their homes, which suggests that an increase in their share of the purchase market might raise single-family default rates. On the other hand, if their incomes grow at a healthy pace, their debt burdens may decline fairly quickly. Retirees are often on fixed incomes and may have difficulty making mortgage payments if unexpected expenses arise. At the same time, many retirees may supplement fixed incomes by using reverse mortgages or home equity loans to tap the wealth in their homes. Retirees on fixed incomes may be less likely to make modifications or upgrades in their properties, which might limit their resale values. However, home price appreciation in recent years may have boosted home values enough to offset the potential effect on default and loss severity rates of lower investment.

Subprime Lending Presents Opportunities and Challenges

Subprime lending—the provision of credit to mortgage borrowers who have past credit problems of varying severity—expanded dramatically in the second half of the 1990s as lenders sought to increase their origination volumes and to profit from the higher margins offered by subprime loans. In 1999, traditional prime lenders and diversified finance companies greatly increased their share of subprime originations, and Fannie Mae and Freddie Mac increased their purchases of subprime loans. (Box 3 on page 39 reviews the subprime market in 1999.) These developments suggest that the markets for prime and subprime mortgages are likely to become more integrated in the next decade, with many originators offering loans to nearly all applicants. Lack of extensive and reliable historical data on the performance of subprime mortgages has made developing accurate scoring models more difficult than for prime loans. Nonetheless, several firms in the industry have developed AUS for evaluating applications for subprime loans.

In addition to offering lenders and the Enterprises the prospect of greater volumes and higher margins, subprime mortgages pose significantly greater credit risk than prime loans. Subprime mortgages are riskier, despite the fact that borrowers have significant equity in their homes, because borrowers also generally have higher debt burdens and other financial difficulties. According to Mortgage Information Corp. (MIC), in September 1999 subprime mortgages were nearly nine times more likely to be seriously delinquent or in foreclosure than prime mortgages.[1] A 1997 study using MIC data found that the historical average foreclosure rate of subprime loans made to refinance existing mortgages was nearly eight times that of prime loans.[2] The same data indicate that subprime mortgages given a credit rating of C are seriously delinquent or default twice as frequently as subprime loans on average. Because there is a lack of historical data on the performance of subprime mortgages, those statistics may understate the additional credit risk posed by such loans.

To earn attractive returns from investing in subprime mortgages, Fannie Mae and Freddie Mac and traditional prime lenders must understand and manage the unique risks posed by such lending. Important tasks include developing and maintaining accurate scoring models for subprime mortgages, deciding which grades of subprime loans to purchase, identifying best practices in originating and servicing such loans, monitoring the performance of originators and servicers, and using credit enhancements to limit risk exposure. Failure to manage the risks associated with subprime mortgages may lead to significantly larger credit losses than on prime loans. As the safety and soundness regulator of Fannie Mae and Freddie Mac, OFHEO is and will remain well informed about all aspects of risk management of subprime loans as it evolves.

New Technologies Will Lead to Changes in Industry Business Practices

Improvements in technology will continue to reshape single-family mortgage lending over the next decade. Differences in the preferences and interests of consumers, lenders, and secondary market investors will affect how the industry uses new technologies and how business practices evolve in specific markets. In addition, public policy issues may affect the implementation of risk-based pricing and the speed at which mortgage originations move to the Internet.

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[1] Mortgage Information Corporation, Market Pulse (September 1999). In compiling statistics on the delinquency rates of prime and subprime mortgages, MIC accepts each lender's classification of the loans it originated. Subprime loans include mortgages that lenders classified as A-, B, C, and D loans.

[2] John C. Weicher, The Home Equity Lending Industry: Refinancing Mortgages for Borrowers with Impaired Credit (Indianapolis, IN: Hudson Institute, 1997), pp. 80-82.

Scoring and automated underwriting, for example, have the potential to allow the industry to vary significantly the prices charged for bearing the credit risk of single-family mortgages.[3] Such pricing would tend to reduce cross-subsidies among borrowers who pose different degrees of risk. Fannie Mae and Freddie Mac and lenders are using AUS to determine the minimum downpayments required of borrowers based on their credit scores. Subprime borrowers already pay different interest rates on the basis of their credit histories, and prices for prime loans differ for different types of loans and on the basis of some loan characteristics such as LTV ratio.

In the primary mortgage market, consumer preferences, the needs of lenders, and fair lending concerns may affect how risk-based pricing is implemented. If many households benefit from setting rates and points on the basis of specific borrower characteristics that affect credit risk, consumers may generally accept risk-based pricing. At the same time, sophisticated lenders may vary their prices for some loans less on the basis of credit risk and more on the basis of prepayment risk and the potential to cross-sell other financial services to borrowers, since those factors may have a greater effect on profitability. Implementation of "total-value" risk-based pricing might quicken the pace of consolidation among originators. The pace at which lenders implement risk-based pricing may also be affected by the potential for such pricing to have a disparate impact on applicants who are members of protected groups. It will be important for the Federal government to understand how risk-based pricing may affect the access to credit by different classes of borrowers.

Online mortgage lending has the potential to reduce the importance of production channels that rely on applicants interacting with lender staff at local branch offices. The rate of consumer migration to online mortgage origination is difficult to project, however. Wall Street analysts' estimates of the proportion of originations taking place purely online by 2005 range from 3 to 15 percent.[4] One source of uncertainty is that many regulations that apply to mortgage originations do not fit well with the speed of the Internet.[5] Another is that taking out a mortgage is an infrequent transaction, which makes many consumers both more tolerant of inefficiency and more attracted to trusted, often local, institutions. A third is that some firms that provide services used in the origination process—title record companies, for example—are not yet capable of providing

[3] The following paragraphs draw upon Richard Beidl and Craig Focardi, "The Coming of Risk-Based Pricing," Mortgage Banking (May 2000), pp. 46-53.

[4] Michael S. Hodes, Gregory W. Hall, and Lawrence N. Rosenberg, Home Run: Taking a Closer Look at Internet Mortgage Finance (New York: Goldman Sachs Investment Research, November 15, 1999), p. 10; and Kenneth A. Posner and Michael D. Courtain, The Internet Mortgage Report II: Focus on Fulfillment (New York: Morgan Stanley Dean Witter, February 10, 2000), p. 4.

[5] Craig C. Thomas, "Policy Thicket Complicates Efforts to Take Lending Online," Secondary Mortgage Markets, vol. 16, no. 1 (April 1999), pp. 9-15.

information electronically. Ultimately, online mortgage lending may not prove profitable for many lenders. The volume of loans that a lender originates online will determine whether the Internet is more or less profitable than other channels of production used by the lender.

The Enterprises' Provision of Origination-Related Services Raises Issues

As the industry has implemented the AUS of Fannie Mae and Freddie Mac, the relationships between the Enterprises and many lenders that sell single-family mortgages to them have changed. Lenders still originate all loans, but many small and medium-sized lenders are leasing technology from Fannie Mae and Freddie Mac that performs many aspects of the origination process that they themselves previously performed, including underwriting applications and obtaining credit scores, property valuations, and title insurance from third parties. The Enterprises offer lenders the ability to sell loans at the time they are closed, thereby eliminating the need for lenders to manage the interest rate risk associated with funding loans before selling them. Fannie Mae and Freddie Mac may soon be able to verify the incomes and employment status of applicants.

At some point many small and medium-sized lenders may decide to function essentially as mortgage brokers, limiting their operations to sourcing loans, processing applications and submitting them to Fannie Mae and Freddie Mac for underwriting, and processing and closing approved loans. Such changes might affect the profitability and financial health of some lenders, which might in turn pose risk for the Enterprises. Some industry participants have raised the issue of the appropriateness of GSEs providing technology that performs many of the functions previously performed by primary market lenders. Those changes may benefit borrowers by heightening competition among originators, lowering origination costs, and speeding up the origination process.

Further, if Fannie Mae and Freddie Mac became the dominant sources of origination-related services to lenders that originate conforming loans, the Enterprises might have market power in their dealings with third-party providers of those services. Fannie Mae and Freddie Mac might be able to hold down the prices they paid for credit reports, property appraisals, title insurance, and other services, while not passing those savings through to lenders, thereby increasing their profits.[6] Of course, Fannie Mae and Freddie Mac would have an incentive to protect the integrity of underwriting decisions by ensuring that credit reports and property valuations were accurate and that providers of those services were financially viable. An important task of safety and soundness regulation is to monitor the quality of the data used in the Enterprises' AUS and the effect of the actions of Fannie Mae and Freddie Mac on the financial health of mortgage lenders and service providers.

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[6] For a discussion of the risks posed when Fannie Mae and Freddie Mac enter new markets, see Robert S. Seiler, Jr., "Fannie Mae and Freddie Mac as Investor-Owned Public Utilities," Journal of Public Budgeting, Accounting & Financial Management (Spring 1999), vol. 11, no. 1, pp. 129-131.

POLICY CHANGES MAY AFFECT FHA-INSURED AND VA-GUARANTEED ORIGINATIONS

Changes in Federal policy may alter the proportion of single-family originations insured by the Federal Housing Administration (FHA) and guaranteed by the Department of Veterans Affairs (VA) in the next decade. The increase in the ceiling on single-family mortgages eligible for insurance by FHA made in 1998 may boost the volume of loans financed with FHA insurance. The Federal Home Loan Banks are acquiring FHA-insured loans, which may put downward pressure on their yields and make them more attractive to borrowers. At the same time, the relative liquidity and market value of mortgage securities guaranteed by the Government National Mortgage Association (Ginnie Mae) and those issued and guaranteed Fannie Mae and Freddie Mac fluctuates, which at times may tend to raise the yields on FHA-insured and VA-guaranteed loans and boost the market share of conventional loans. Uncertainty about the magnitudes of those potential influences make it difficult to predict what their net effect may be on the share of single-family mortgages insured by FHA and guaranteed by VA.

IMPLICATIONS FOR THE SECONDARY MARKET

Fannie Mae and Freddie Mac are likely to continue to dominate the secondary market for conforming mortgages in the next decade. Along with large lenders, the Enterprises will make significant investments in technology. It is uncertain which investments are most likely to pay off, however, because it is not clear that online originations will become routine or how e-commerce may affect the industry. As Fannie Mae and Freddie Mac offer new loan products or expand into new markets, the benefits they provide to borrowers will be influenced by existing market conditions and how vigorously they compete with each other. Changes in Federal policy may affect the volumes of activity of the Enterprises, the Federal Home Loan Banks, and Ginnie Mae. There is some risk that margin pressure and limitations on their ability to grow may prevent Fannie Mae and Freddie Mac from growing earnings as quickly as they would like, but the magnitude of that risk is unclear.

INVESTMENT IN NEW TECHNOLOGIES CREATES OPPORTUNITIES AND PRESENTS RISKS

The structure of the mortgage industry undoubtedly will be affected by increased business-to-business e-commerce and online loan originations. How the new uses of technology may affect the market shares and profitability of different players in the industry, including Fannie Mae and Freddie Mac, is uncertain, however. Ultimately, consumers will determine which applications will succeed.

Lenders are attempting to use their own Web sites or on-line mortgage brokers to attract prospective borrowers. Each approach can be used to communicate with borrowers directly, or to allow mortgage brokers or real estate professionals to help borrowers review loan terms and submit applications. Fannie Mae and Freddie Mac are using their proprietary networks and Web sites to give lenders access to their AUS and related services. Through HomeAdvisor Technologies, Inc. (HTI), a joint venture between Freddie Mac, Microsoft, and four of the largest lenders, mortgage lenders and brokers and real estate brokers will have access to the Enterprise's AUS.

At this early stage in the development of online lending, it is unclear whether any particular approach will prove to be significantly more efficient or attractive to borrowers than the others. To diversify their risk exposure, Fannie Mae and Freddie Mac and lenders are investing in as many potentially fruitful approaches as possible. Inevitably, some of those investments will not prove successful, although some may pay off handsomely.

Fannie Mae and Freddie Mac may use automated underwriting and scoring to move toward introducing much greater variation in their prices based on their estimation of risk. The Enterprises are likely to do so because they have the data and quantitative tools to quantify credit risk more precisely. In addition, failure to do so would expose each Enterprise to adverse selection if the other Enterprise and lenders moved more quickly to implement risk-based pricing. Adverse selection on a large scale would tend to reduce significantly an Enterprise's profitability and financial health and create a significant safety and soundness issue.

More refined risk-based pricing would pose several risks for Fannie Mae and Freddie Mac. Implementing new business systems always poses operational risks. In addition, automated underwriting and scoring have not been tested in a severe, nationwide economic downturn. Risk-based pricing would also heighten competition for high-quality loans, both between Fannie Mae and Freddie Mac and between each Enterprise and large lenders, which could lead to lower margins.

The Potential Benefits of Enterprise Efforts to Expand Market Share Are Uncertain

When Fannie Mae and Freddie Mac purchase a new type of loan or enter an existing loan market, borrowers may benefit by being able to obtain credit more cheaply than it is available elsewhere. Previous research has found that the differential between the yields on conforming FRMs and the yields on jumbo fixed-rate loans has averaged about one-quarter of one percentage point in recent years. It would be premature, however, to infer from this finding that the Enterprises would be likely to reduce the interest rates on other types of mortgages by that amount, for two reasons.

First, it is not clear that previous econometric studies have properly estimated the relationship between loan size and risk. Future research may conclude that some of the differential between the yields on jumbo and conforming FRMs is due to differences in default and prepayment risk between loans in the two size categories, rather than the activities of Fannie Mae and Freddie Mac.[7]

Second, the secondary market for subprime mortgages purchased by Fannie Mae and Freddie Mac may differ substantially from the market for conforming FRMs. On one hand, the market may be relatively inefficient, with a lack of standardization and liquidity and a wide variation in prices that is not justified by differences in risk. In that event, entry into the market by the Enterprises might lower interest rates by more than has occurred in the market for conforming FRMs. On the other hand, the market may already be fairly efficient, in which case Fannie Mae and Freddie Mac might use their competitive advantage to crowd out other investors without affecting the rates paid by borrowers very much. The markets for other types of single-family mortgages that the Enterprises may start to purchase in the future may also differ from the market for conforming FRMs.

DEGREE OF COMPETITION IN THE SECONDARY MARKET HAS BEEN QUESTIONED

The benefits that Fannie Mae and Freddie Mac provide to mortgage borrowers also depend on how diligently they compete with each other. Previous research has concluded that the Enterprises do not vigorously compete in the secondary market for conforming FRMs, a finding that Fannie Mae and Freddie Mac dispute.[8] There is some recent anecdotal evidence that can be cited in support of increased competition: each Enterprise has slashed the fees it charges lenders to use its AUS and other technology services, Fannie Mae and Freddie Mac competed to enter into special business arrangements with large lenders in 1999, and each Enterprise's average guarantee fee has fallen in recent years. Increased use of credit enhancements may explain much of the decline in guarantee fees, however.

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7 For discussions of the issue of the effect of loan size on mortgage rates, see General Accounting Office, Housing Enterprises: Potential Impacts of Severing Government Sponsorship (Washington, DC: July 1996), pp. 58-62; and Robert S. Seiler, Jr., "Estimating the Value and Allocation of Federal Subsidies to Fannie Mae and Freddie Mac," (paper presented at an American Enterprise Institute conference on "Fannie Mae and Freddie Mac: Public Purposes and Private Interests, Washington, DC, March 1999).

8 See John L. Goodman and S. Wayne Passmore, Market Power and the Pricing of Mortgage Securitization, (Washington, DC: Finance and Economics Discussion Series, Division of Research and Statistics, Federal Reserve Board, March 1992); Benjamin Hermalin and Dwight Jaffee, "Privatization of Fannie Mae and Freddie Mac: Implications for Mortgage Industry Structure," in Department of Housing and Urban Development, Studies on Privatizing Fannie Mae and Freddie Mac, (Washington, DC, Office of Policy Development and Research, May 1996), pp. 225-302; Fannie Mae, "Fannie Mae Review of the Hermalin-Jaffee Paper," in Department of Housing and Urban Development, Studies on Privatizing Fannie Mae and Freddie Mac, pp. 314-332; and Robert S. Seiler, Jr., "Estimating the Value and Allocation of Federal Subsidies to Fannie Mae and Freddie Mac".

Further research by OFHEO could shed light on the extent to which Fannie Mae and Freddie Mac compete to securitize conforming FRMs and buy mortgage securities. The degree of competition between the Enterprises is one of the determinants of how much of the federal subsidy they receive is transferred to borrowers through lower mortgage rates.

Changes in Federal Policy May Affect the Secondary Market

Current Federal policy and possible changes may affect the competitive positions and volumes of activity of the three housing GSEs and Ginnie Mae in the next few years. Potential sources of change include the new mortgage purchase programs of the Federal Home Loan Banks, OFHEO's proposed risk-based capital requirements for Fannie Mae and Freddie Mac, new risk-based capital requirements for the Banks required by the Federal Home Loan Bank System Modernization Act of 1999, and a proposal to allow Ginnie Mae to invest in mortgage securities it has guaranteed.

Fannie Mae and Freddie Mac compete directly with the Federal Home Loan Banks in two ways. First, the Banks compete with each Enterprise in the market for mortgage securities issued by the Enterprise. Second, the mortgage purchase programs initiated by the Banks in recent years give member institutions an alternative to selling conforming FRMs to Fannie Mae and Freddie Mac. As of year-end 1999, the Banks had acquired $2 billion in mortgages under those programs, and lenders had committed to provide an additional $6.6 billion in loans. There is uncertainty about the ability of the Banks to acquire a large volume of mortgages under the programs, in part because it is not clear that the bank regulators will continue to grant favorable capital treatment to the portion of the credit risk of the loans that member institutions retain. Further, large lenders have demonstrated a preference for selling conforming fixed-rate loans to the Enterprises. Nonetheless, the Chairman of the Federal Housing Finance Board, the regulator of the System, has recently speculated that the Banks could acquire $100 billion of mortgages by the beginning of 2003.[9]

New Federal risk-based capital requirements for the three housing GSEs will take effect in the next few years. Because OFHEO and the FHFB have not finalized their proposed risk-based capital regulations, it is not clear how the requirements may affect the competitive position of Fannie Mae and Freddie Mac relative to the Banks.

Ginnie Mae has recently proposed that it be authorized to acquire and maintain a portfolio of mortgage securities it has guaranteed. By reducing the supply of Ginnie Mae securities available to other investors, large-scale purchases by the government might increase yields on the securities and make securitization

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9 Mark Fogarty, "MPF May Zoom to $100 Billion," National Mortgage News (May 22, 2000), pp. 1, 22.

through Ginnie Mae a more attractive alternative than selling FHA-insured mortgages to the three housing GSEs. The proposal faces budgetary and policy hurdles, however, and it not clear how large a portfolio would have to be for Federal purchases to have the desired effect on the liquidity and pricing of Ginnie Mae securities.

The Enterprises' Ability to Sustain Double-Digit Earnings Growth Is Uncertain

Fannie Mae and Freddie Mac each have strong incentives to maximize the market value of its stock. The Enterprises have increased their earnings per share (EPS) at double-digit rates in recent years by increasing their retained mortgage portfolios, expanding the range of loans they buy, offering new services to lenders, and lowering their debt costs. Each Enterprise has committed to sustain that rate of earnings growth in the future. Although Fannie Mae and Freddie Mac may be able to do so, a number of factors may limit their success.

- There are limits to the ability of Fannie Mae and Freddie Mac to increase earnings by expanding their retained mortgage portfolios. In recent years each Enterprise's net interest margin has declined, as at times its purchases of its own mortgage securities have exceeded the supply of newly issued securities backed by recently originated loans. Increased hedging of interest rate risk has also compressed margins on the portfolios. To sustain earnings growth, the Enterprises have been buying non-Enterprise mortgage securities, but there are limits to that market, too. At some point the volume of outstanding conforming mortgage debt will constrain the size of the retained portfolios.
- By introducing new products and buying subprime mortgages, the Enterprises may be able to expand the volume of mortgages they purchase and increase their margins. New types of lending may pose unusual risks and may not be as profitable as expected, however.
- The Enterprises used their benchmark debt issuance programs to hold down their borrowing costs in 1998 and 1999. Recent uncertainty about the extent of the Federal government's support for their obligations have raised their funding costs, however, and it is not clear that spreads between the yields on their debt and the yields on Treasury securities will return to previous levels.
- A national recession would undoubtedly increase the credit losses incurred by Fannie Mae and Freddie Mac. The increase in credit losses might be significant.

It is important that OFHEO analyze how these factors might affect the ability of Fannie Mae and Freddie Mac to meet their earnings targets. Future earnings are critically important for each Enterprise to pass OFHEO's risk-based capital stress test and meet the Office's risk-based capital requirement.

IMPLICATIONS FOR SECURITIES MARKETS

Fannie Mae and Freddie Mac will almost certainly remain the largest investors in their own mortgage securities in the next decade. Their purchase volumes are large enough to affect the yields of those assets and close substitutes. Whether their purchases affect yields on conforming FRMs in the primary market is unclear, however. Research on that topic would help clarify the overall benefits and costs of the growth of the Enterprises' retained mortgage portfolios. Fannie Mae and Freddie Mac are also increasing their presence in securities markets through their expanded use of derivatives.

ECONOMIC EFFECTS OF RETAINED MORTGAGE PORTFOLIOS ARE UNCLEAR

As the retained mortgage portfolios of Fannie Mae and Freddie Mac grow, the interest rate risk each Enterprise must manage also increases, as does its potential exposure to losses from a failure in the systems and procedures it uses to manage that risk. Safety and soundness regulation can limit those increases in risk. To assess the overall merits of the growth of the portfolios, it is necessary to balance the additional risks against the contribution the portfolios make to Enterprise earnings and any benefits they provide to mortgage markets, in particular the market for conforming FRMs. In recent years Fannie Mae and Freddie Mac have grown their portfolios almost exclusively by buying their own mortgage securities. Thus, to assess the benefits of their portfolios, it would be useful to conduct empirical research on the effects that the Enterprises' purchases of those securities may have on the yields on conforming FRMs.

Fannie Mae and Freddie Mac finance their purchases of mortgage securities by issuing debt. Economic theory suggests that, the more integrated the markets for the Enterprises' debt and mortgage securities are, the more likely that, under normal economic conditions, simultaneous purchases of mortgage securities and issuance of debt by Fannie Mae and Freddie Mac will not change the market yields of either type of obligation or those of loans being originated in the primary market. In the short run, a reduction in the supply of mortgage securities will lower yields on those assets, while an increase in the supply of Enterprise debt will increase the yields on those obligations. Those effects may be only temporary, since investors will likely rebalance their portfolios until yields once again reflect the relative risk of the two types of assets. Temporary fluctuations in secondary market yields may not affect yields in the primary market. On the other hand, if the markets for Enterprise debt and mortgage securities are not well integrated, so that the two types of obligations are not close substitutes, the transactions could affect their relative yields over long periods. The magnitude of any changes in yields might or might not be large.

Econometric research can test which of these two conflicting hypotheses are best supported by the evidence. It may be that under most circumstances the Enterprises' purchases of mortgage securities have no effect on primary market yields, but that in crisis conditions they have a significant effect. Such research should take into account purchases by the Federal Home Loan Banks as well as Fannie Mae and Freddie Mac.

Increased Use of Credit Enhancements and Derivatives Poses Risks

Fannie Mae and Freddie Mac have dramatically increased their use of credit enhancements and derivatives in the last decade. Each Enterprise has allowed lenders to reduce the credit risk on mortgages they sell to the Enterprise by supplementing primary mortgage insurance with supplementary insurance at the pool level. Both Enterprises have made widespread use of interest rate and currency swaps. Those risk management techniques do not eliminate an Enterprise's exposure to credit or interest rate risk but transform it into counterparty default risk. As a result, the focus of risk management must include the financial strength of counterparties and the adequacy of the collateral they post. As Fannie Mae and Freddie Mac continue to grow in the next decade, their exposure to counterparty risk will increase.

As the safety and soundness regulator of Fannie Mae and Freddie Mac, OFHEO must continue to assess thoroughly the counterparty risk exposure of each Enterprise and the adequacy of its management of that risk. The increased use of pool insurance in recent years underscores the need for the Enterprises to have strong eligibility requirements for mortgage insurers and procedures for monitoring the financial strength and management of those firms. Because large banks are major swap counterparties for Fannie Mae and Freddie Mac, OFHEO also monitors how rapid consolidation in the banking industry is affecting concentration in their counterparty exposure and each Enterprise's policies and procedures for limiting that exposure.

IMPLICATIONS FOR THE FINANCIAL SYSTEM

To fund their rapidly growing retained mortgage portfolios, Fannie Mae and Freddie Mac have sharply increased their outstanding debt. The Enterprises' combined debt outstanding rose from about $195 billion at year-end 1992 to about $908 billion at year-end 1999, an average growth rate of nearly 25 percent a year. The pace at which their debt is growing and their increasingly central role in financial markets have raised concerns about the potential systemic risk that Fannie Mae and Freddie Mac pose to the financial system. In addition, if current Federal budgetary policies are unchanged, Treasury debt held by the public will fall dramatically in the next decade. As a result, debt issued by the Enterprises, perhaps with debt issued by the other GSEs and other issuers in the Federal agency debt market, could replace Treasury securities as a benchmark in financial markets.[10] If debt issued by Fannie Mae and Freddie Mac became an important benchmark, the Enterprises' issuance practices would assume increased importance, and OFHEO would increase its oversight and regulation.

GROWTH OF ENTERPRISE DEBT RAISES CONCERNS ABOUT SYSTEMIC RISK

Systemic risks are those that have the potential to cause a systemic crisis in the financial system—a disturbance that severely impairs the workings of the system and, at the extreme, causes a complete breakdown in it. There are three reasons why Fannie Mae and Freddie Mac may pose systemic risk. First, investors in the debt and mortgage securities of each Enterprise are exposed to risk of loss if the Enterprise got into financial difficulties, its securities became illiquid, or it defaulted on its obligations. Second, the debt and mortgage securities of Fannie Mae and Freddie Mac are widely held by investors across the globe, including commercial banks, pension and retirement funds, and other private investors in the U.S. and abroad; state and local governments in the U.S.; and foreign central banks. A disruption in the flow of payments to this broad range of investors could potentially cause difficulties for non-mortgage-related institutions and markets. Third, many investors hold Enterprise debt and mortgage securities in amounts that are large relative to their capital. If either Fannie Mae or Freddie Mac ever defaulted on their obligations and many investors that held their debt and mortgage securities booked significant losses and became undercapitalized, disruptions in the flow of credit, payments, or the pricing of financial of financial assets in some markets could result.

The Federal government currently limits the level of systemic risk Fannie Mae and Freddie Mac may pose to the financial system in several ways. OFHEO's proposed risk-based capital regulation, when final, will limit the potential for systemic risk by helping to ensure that the Enterprises hold adequate capital against the risks they take. OFHEO's comprehensive examination program also limits the risk of Enterprise default by assuring that each Enterprise operates in a financially safe and sound manner. The provisions of the 1992 Act that require an undercapitalized Enterprise to submit and implement a recapitalization plan are also a source of protection. In addition, the ability of Fannie Mae and Freddie Mac to retain some of their Federal subsidies makes their charters quite valuable, which gives each Enterprise an incentive to limit its risk.

Concerns about the systemic risk that Fannie Mae and Freddie Mac may pose are likely to increase if the Enterprises' outstanding debt continues to grow rapidly. Therefore, the benefits and costs of proposals intended to limit the potential systemic risk posed by Fannie Mae and Freddie Mac deserve careful analysis. Proposals advanced recently include repealing the exemption of Enterprise debt from the limit on an individual bank's credit exposure to any one entity, granting OFHEO the authority to place a severely undercapitalized Enterprise in receivership, and taking steps to increase the degree of market discipline of Fannie Mae and Freddie Mac by requiring enhanced Federal disclosure of their risk. The last option is discussed in more detail below.

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[10] The Federal agency debt market includes debt issued by the five GSEs and Federal agencies such as the Postal Service, the Tennessee Valley Authority, and the Export-Import Bank. In dollar volume, GSE debt makes up nearly all Federal agency debt, with Fannie Mae, Freddie Mac, and the Federal Home Loan Banks being by far the largest issuers.

Potential Benchmark Role of Enterprise Debt Raises Issues

The dramatic growth in the outstanding debt of Fannie Mae and Freddie Mac has coincided with a significant improvement in the Federal government's fiscal situation. In fiscal years 1998 and 1999, the government recorded its first consecutive budget surpluses since 1956-57. If current budgetary policies remain unchanged, the government will continue to record surpluses well into the new century. The President's Budget for Fiscal Year 2001 projects that Treasury debt held by the public will fall to $2.4 billion by the end of fiscal year 2005. If outstanding debt of Fannie Mae and Freddie Mac continues to grow at 25 percent a year and Treasury debt held by the public declines as projected, the Enterprises' debt will surpass publicly held Treasury debt during that fiscal year.

The projected growth of debt issued by Fannie Mae and Freddie Mac suggests that OFHEO may want to take steps to assure investors that there will always be adequate transparency in the pricing and distribution of the Enterprises' obligations. If investors accepted Enterprise debt as a benchmark, the process by which the securities were issued would become more important, and the market as a whole might require more thorough Federal oversight.

According to a recent study by staff of the Federal Reserve Bank of New York, several attributes of U.S. Treasury securities make them a benchmark for other financial markets.[11] Treasury securities are considered to be free of default risk. As a result, investors and analysts use the yields on Treasury securities as risk-free interest rates to forecast future economic events and analyze securities in other markets. The Treasury market is also large and liquid, with active repurchase agreement (repo) and futures market. Those features make Treasuries a popular benchmark for pricing other fixed-income securities and for hedging positions taken in other markets. If future Federal budget surpluses materialize and Treasury debt held by the public declines as projected, the market for Treasuries will become much smaller, less liquid, and less efficient. A less liquid and efficient market would be a less useful benchmark of risk-free interest rates and for pricing and hedging positions in other markets.

The study found that Federal agency debt securities have some attributes that make them attractive as a benchmark, and some that make them unattractive. On the plus side, the performance of agency securities is highly correlated with that of other fixed-income securities. The agency debt market is reasonably liquid, agencies trade in an active overnight repo market, and agencies have been relatively unaffected by issue-specific differences in liquidity. The benchmark debt issuance programs initiated by the four GSEs in 1998 and 1999 are likely to improve activity in the repo market. On the minus side, the presence of credit

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[11] The following two paragraphs draw upon Michael J. Fleming, "The Benchmark U.S. Treasury Market: Recent Performance and Possible Alternatives," Economic Policy Review (New York: Federal Reserve Bank of New York, April 2000), pp. 129-145.

risk means that there is an idiosyncratic risk component in agency securities that could become significant in the future. In addition, the agency market is not as liquid as the Treasury market, the repo market is less active, and there is a much smaller agency futures market.

The possibility of investors accepting the debt of Fannie Mae and Freddie Mac as a benchmark raises the issue of how financial markets might be affected. On one hand, if Enterprise debt outstanding continued to increase rapidly, the liquidity of the securities might increase significantly and the repo market might become more active. Moreover, if the Federal Reserve relied heavily on Enterprise debt securities to conduct open market operations, investors' perception that the government stands behind those obligations might be strengthened, perhaps significantly. Less uncertainty about the government's intentions might in turn make the debt more accepted as a benchmark for risk-free interest rates, which might lead to a larger universe of investors buying the selling the securities, which would increase their liquidity. Fannie Mae and Freddie Mac might also be able to take further steps to enhance market acceptance of their obligations. Under this scenario, outstanding Enterprise debt might crowd out Treasury debt, leading investors to require perceptibly higher yields on the latter and resulting in higher debt service costs for the Federal government.

On the other hand, if outstanding debt of Fannie Mae and Freddie Mac continued to grow rapidly, the market might become increasingly concerned about the absence of an explicit Federal guarantee and the systemic risk posed by the fact that Enterprise obligations comprised a large share of the portfolios of many investors. At some point, investors might require increasingly greater yields in order to absorb increased quantities of Enterprise debt, especially if the obligations were perceived to pose significant credit risk. In the absence of an explicit Federal commitment to back Enterprise debt, major market participants such as foreign central banks might limit their holdings. Concerns about credit quality might tend to reduce liquidity and the growth of the repo market, hamper acceptance of the debt of Fannie Mae and Freddie Mac as a benchmark for risk-free rates, and ultimately limit the growth of the Enterprises' retained mortgage portfolios.

IMPLICATIONS FOR FEDERAL REGULATION OF MORTGAGE MARKETS

Federal regulation must adapt to the rapid evolution of mortgage markets and the activities of Fannie Mae and Freddie Mac. The growing concentration of risk at the Enterprises and the potential systemic risk they pose to the financial system suggest that it would be useful to increase disclosure about their risks. Such disclosure would increase transparency and might enhance market discipline of their risk-taking and activities. It may also be appropriate for Federal regulators to pool their resources in order to conduct more comprehensive research about mortgage markets. Such research would provide policymakers and the public with new information about the U.S. housing finance system.

GREATER TRANSPARENCY OF ENTERPRISE RISK COULD ENHANCE MARKET DISCIPLINE

Market discipline of Fannie Mae and Freddie Mac is a potentially important complement to safety and soundness regulation of the Enterprises. If creditors have accurate and timely information on the financial risks of Fannie Mae and Freddie Mac and believe that they are exposed to material risk of loss if the Enterprises get into financial trouble, they will take steps to ensure that the Enterprises strike an appropriate balance between risk and return. By enhancing market discipline, greater transparency has the potential to limit the systemic risk that Fannie Mae and Freddie Mac may pose to the financial system.

Investors' perception of the risk posed by the obligations of Fannie Mae and Freddie Mac is also influenced significantly by government sponsorship of the Enterprises. Credit rating agencies routinely give the debt and mortgage securities of Fannie Mae and Freddie Mac the highest investment-grade rating because of their unique relationship to the government. Thus, the Enterprises' status as GSEs may limit the degree to which increased disclosure could enhance market discipline of their activities by creditors.

Under current law, Fannie Mae and Freddie Mac are exempt from the registration requirements of the Securities Act of 1933. The 1933 act requires all non-exempt corporations issuing stock or debt securities with maturities of more than nine months to register such offerings with the Securities and Exchange Commission (SEC), disclose uniform financial and operational information about the securities, and pay registration fees. Fannie Mae and Freddie Mac voluntarily disclose much of the information that the SEC requires. Most of the securities issued by the Enterprises' competitors to finance loans comparable to those financed by the Enterprises must be registered with the SEC. Although securities issued by banks and thrifts are exempt from the registration requirements of the 1933 act, bank and thrift holding company securities are not. More importantly, all MBS and asset-backed securities (ABS) issued by non-GSEs must be registered.

The best practices of financial institutions regarding disclosure of information about risk go beyond the SEC's requirements and are rapidly evolving as technology improves risk measures and management techniques. The Federal bank regulators recognize that transparency promotes market discipline and complements safety and soundness regulation and are developing proposals to require large banks to disclose additional, more precise information about their risks in a timely manner. The Basel Committee on Banking Supervision has recommended standards for public disclosure of trading and derivatives activities for banks. The credit rating agencies and other private market participants have also made proposals.

In light of the potentially important role of market discipline in promoting the safety and soundness of Fannie Mae and Freddie Mac, OFHEO will develop requirements for expanded disclosure of information about their financial risks. For example, it is common for private financial institutions to assess their exposure to interest rate risk by using simulation analysis to test how their market value would be affected by a variety of large, short-term changes in interest rates. Conducting such simulations and disclosing the results on a regular basis would give investors additional information about the Enterprises' interest rate risk exposure that is not conveyed by the results of OFHEO's risk-based capital stress test. Another approach would be to require each Enterprise, at a minimum, to adhere to the best disclosure practices that the Federal bank regulators require of the largest U.S. banks and bank holding companies.

More Comprehensive Federal Research About Mortgage Markets May be Appropriate

Federal policy has caused the single-family market to be demarcated into a number of segments. There is an FHA submarket, defined by the ceiling on the maximum principal balances of mortgages that FHA may insure. There is a conforming, conventional submarket, defined by the limit on the balances of loans that are eligible for purchase by Fannie Mae and Freddie Mac. Above the conforming limit is the "jumbo" submarket of the conventional market, which is served by depository institutions. And the conventional market has historically divided into two submarkets: one for mortgages that meet the Enterprises' underwriting standards (so-called prime or A loans) and mortgages that do not meet those standards (so-called subprime loans). The segmentation between those markets is not absolute, but it has focused Federal agencies on collecting and analyzing data on different submarkets rather than on the market as a whole.

The pace of change in mortgage markets and the growth of competition for borrowers who were served by FHA and subprime lenders in the past suggest that it may be appropriate for OFHEO and other Federal regulators to use data on different markets to conduct comprehensive research on the market as a whole. Such research could provide policymakers and the public with new and potentially quite useful insights about U.S. mortgage markets. For example, it would be possible to use data on sales or refinancings of single-family homes whose mortgages were insured by FHA to expand OFHEO's house price index (HPI). Another possibility would be to use data on the terms and performance of mortgages insured by FHA, purchased by the Enterprises, and financed in the jumbo and subprime markets, to do comparative research on trends in single-family mortgage markets.

3

Mortgage Markets and The Enterprises In 1999

The U.S. economy and housing markets enjoyed another very strong year in 1999 despite higher interest rates. Mortgage rates averaged 7.4 percent for the year, up from an average of 6.9 percent in 1998. Rising rates reduced the number of homeowners who refinanced, but record levels of new construction and existing home sales spurred mortgage originations. Overall, originations reached an estimated $1.3 trillion in 1999, just under the record $1.4 trillion in 1998.

The high volume of mortgage originations in 1999 facilitated the continued rapid increase in the retained mortgage portfolios of Fannie Mae and Freddie Mac. Each Enterprise expanded its mortgage assets by 26 percent. This rapid portfolio growth was the primary reason for another year of record profits at both Enterprises. Combined net income for Fannie Mae and Freddie Mac was $6.1 billion, an increase of $1 billion from 1998. Also contributing to higher profits was a further decline in each Enterprise's credit losses, due to favorable housing market conditions and increased recoveries. The combined core capital of Fannie Mae and Freddie Mac increased $4.4 billion, in line with their rapidly growing business volumes. Both Enterprises met their statutory minimum capital requirements throughout the year.

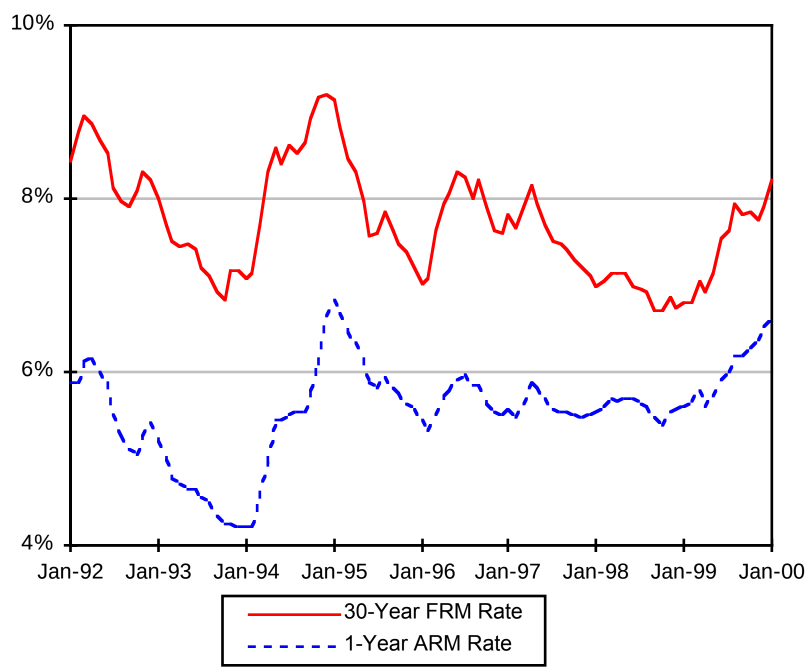
HOUSING AND PRIMARY MORTGAGE MARKET DEVELOPMENTS

STRONG ECONOMY SUSTAINS HIGH LEVELS OF ACTIVITY, HEALTHY HOME PRICE APPRECIATION

The housing market benefitted greatly in 1999 from the economy's overall strength. For the fourth consecutive year, the economy expanded by more than 4 percent, well above the average growth rate since 1973 of 3 percent. The booming stock market continued to improve household balance sheets, and the average unemployment rate fell to a 30-year low of 4.2 percent.

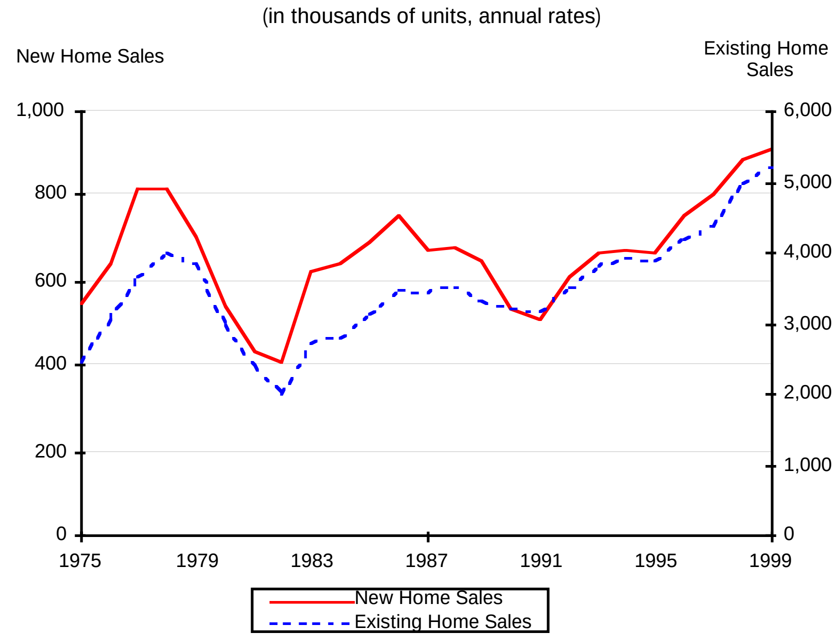
Consumer price inflation accelerated to 2.7 percent during the year from 1.6 percent in 1998. Concerns about further acceleration led the Federal Reserve to raise its federal funds rate target by three-fourths of a percentage point in the second half of 1999. Freddie Mac's Primary Mortgage Market Survey (PMMS) indicates that mortgage lenders' commitment rates on 30-year fixed-rate mortgages (FRMs) rose throughout 1999, following yields on longer-term Treasury securities (see Figure 1). In December 1999, the average FRM commitment rate was close to 8 percent, nearly 1.2 percentage points higher than in December 1998. For the year, FRM commitment rates averaged 7.4 percent, half of a percentage point higher than their 1998 average of 6.9 percent. Commitment rates on 30-year adjustable-rate mortgages (ARMs) also rose in 1999, albeit less sharply, reflecting a slight steepening of the yield curve.

Figure 1. Mortgage Interest Rates
Source: Freddie Mac Primary Mortgage Market Survey



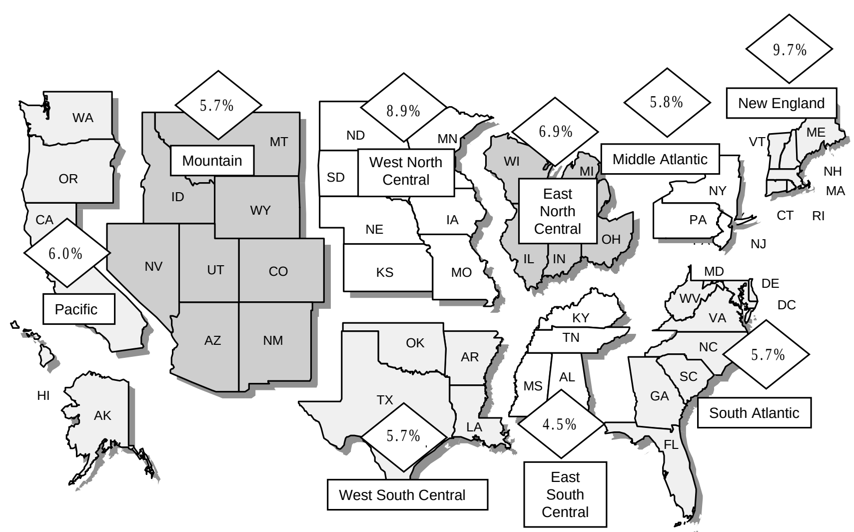
The strong economy pushed housing market activity to record levels in 1999, despite the increase in interest rates. Single-family housing starts and home sales set new records. Starts rose 5 percent from 1998, while combined new and existing home sales increased 4 percent (see Figure 2). The homeownership rate benefited from the healthy housing market in 1999. The rate increased to a record 66.8 percent in 1999, up slightly from the previous record of 66.3 percent in 1998. Multifamily markets were quite healthy as well. Although multifamily starts declined slightly, new construction increased to $21.6 billion, the highest level in a decade. Vacancy rates rose slightly to just over 8 percent.

Figure 2. New Home Sales and Existing Home Sales
Sources: U.S. Bureau of the Census and National Association of Realtors



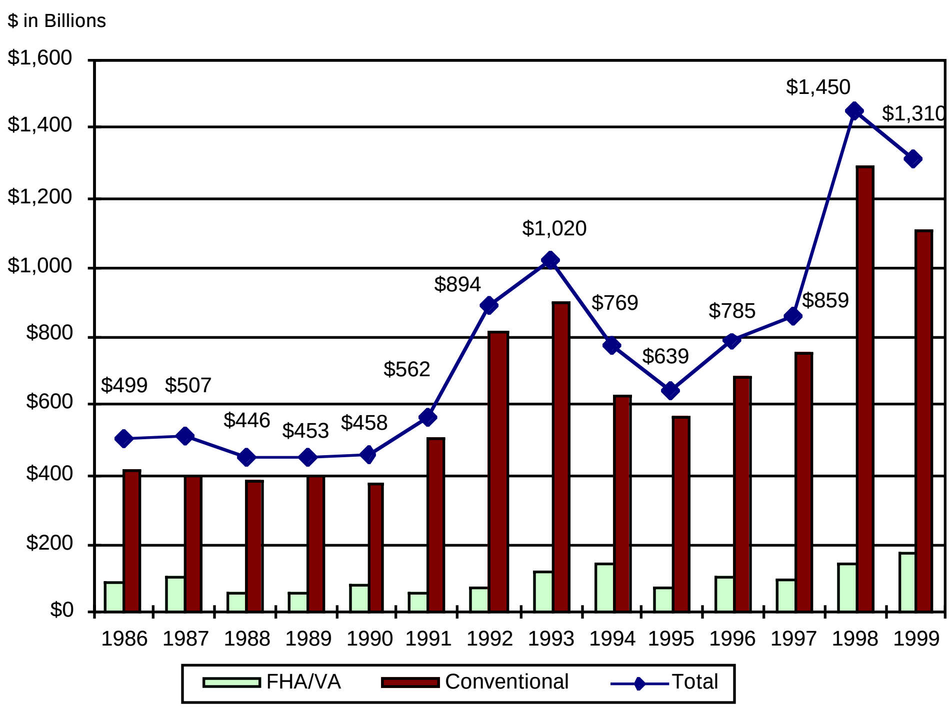
Increased housing demand produced a more rapid rise in home values in 1999 than in the previous year. Single-family house prices, as measured by OFHEO's House Price Index, increased 6.4 percent, compared with 5.4 percent in 1998. New England and the West North Central Census division were the regions with the highest house price appreciation (see Figure 3). The lowest rate of house price appreciation occurred in the East South Central division. Prices in all divisions rose at a pace well above the general inflation rate. Over the past 5 years, U.S. house prices have increased an average 26.1 percent, compared with just 8.5 percent during the previous 5 years.

Figure 3. One-Year Change in House Prices by Census Division, Fourth Quarter 1998 to Fourth Quarter 1999



Originations of single-family mortgages reached $1.3 trillion in 1999 (see Figure 4). That volume was the second highest total ever, down 10 percent from the preceding year's record. Quarterly originations declined steadily during the year, as the rising-rate environment decreased borrower incentives to refinance existing mortgages. Originations of conventional mortgages declined more than total originations, as home loans insured by the Federal Housing Administration and guaranteed by the Veterans Administration increased to record levels. FHA originations rose 19 percent in 1999, while VA production increased 16 percent. The share of mortgages with FHA or VA financing rose to 13 percent, the highest since 1994. Net new insurance of conventional loans written by private mortgage insurers increased slightly to nearly $189 billion. Originations of subprime mortgages rose 7 percent to $160 billion, 12.2 percent of the conventional market (see Box 3).

Figure 4. Originations of Single-Family Mortgages
Sources: Department of Housing and Urban Development and *Inside Mortgage Finance*



Box 3: The Subprime Market in 1999

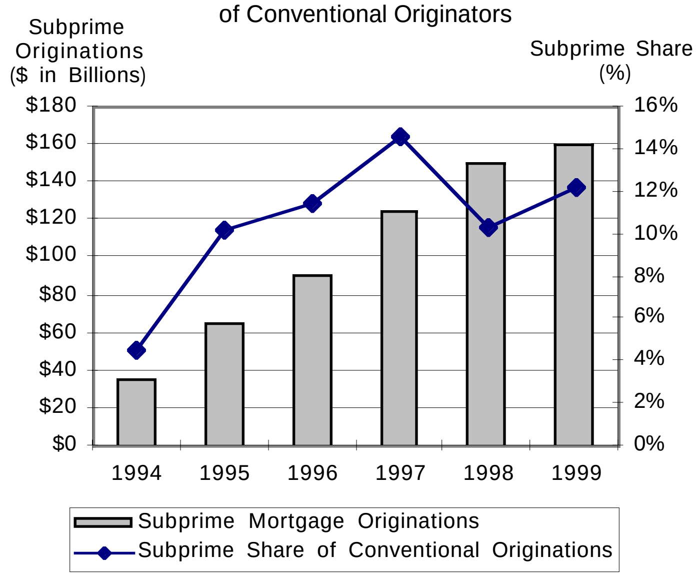
Subprime mortgage lending involves the provision of credit to borrowers who have past credit problems of varying severity. Originations of subprime mortgages (including first and second mortgages and home-equity lines of credit) totaled an estimated $160 billion in 1999, up 7 percent from $150 billion in 1998. With the decline in total conventional originations in 1999, the subprime share of the conventional market rose, climbing to 12.2 percent from 10.3 percent in 1998.

The entry into the subprime market of many traditional prime lenders and diversified financial services companies made possible the increased volume of subprime originations in 1999. The global financial crisis of late 1998 led many monoline finance companies, which had dominated the industry, to shut their doors, sharply curtail their lending, or put themselves up for sale. Low interest rates and improving borrower credit ratings led to higher-than-expected prepayments that depressed earnings and put many firms out of business. Investors' preference for Treasury securities during the financial crisis also made securitization of subprime mortgages much more difficult. Traditional prime lenders responded to those developments by entering the subprime market, often by buying monoline lenders, in search of larger volumes and the higher margins on subprime loans.

Subprime mortgages intended for sale into the secondary market receive a rating of A-, B, C, or D. Lenders and other firms in the industry often define those ratings differently. *Inside B&C Lending* classifies subprime loans solely on the basis of the borrower's credit history as measured by the credit scores that the three national credit bureaus calculate using models developed by Fair, Isaac and Company (FICO). Mortgages with a FICO score from 580 to 619 are rated A- loans, loans with a score of 560 to 579 are rated B loans, those with a score of 540 to 559 as C loans, and those with a score below 540 as D loans.

That ranking system indicates that mortgage lenders provided credit primarily to lower-risk subprime borrowers in 1999. Based on a survey of subprime originators, *Inside B&C Lending* estimates that seventy-three percent of subprime loans originated last year went to borrowers with A- credit. Thirteen percent, nine percent, and 5 percent were the shares for borrowers with B, C, and D credit, respectively. As a result of the prevalence of mainstream lenders, the industry is likely to continue to focus on lower-risk borrowers in the future, as it has in the past.

Subprime Originations and Subprime Share of Conventional Originators

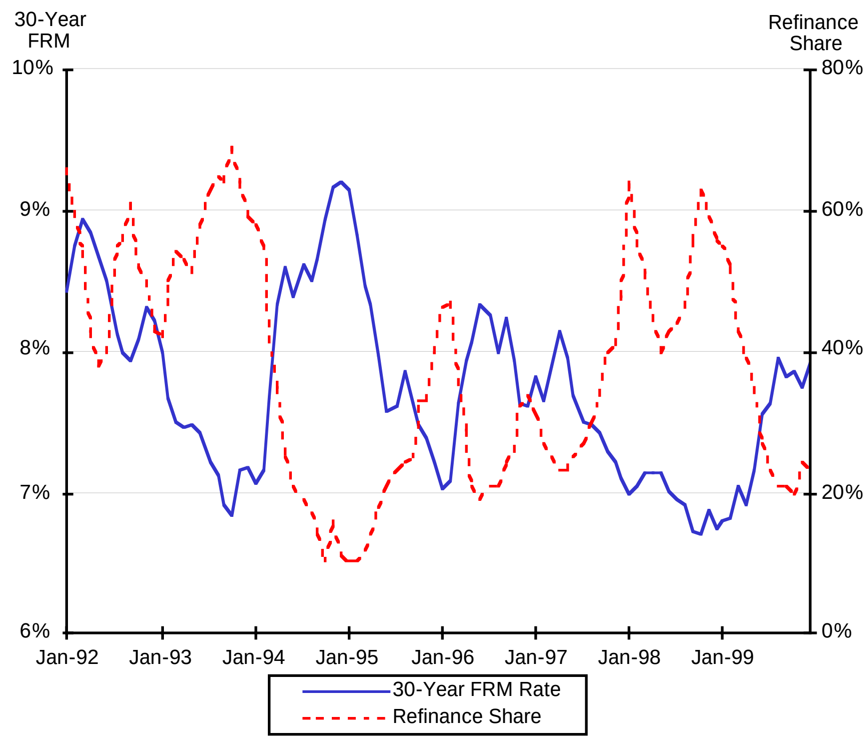


Source: *Inside B&C Lending*

Rising Rates Alter the Composition of Conventional, Single-Family Originations

Higher mortgage rates altered the characteristics of conventional, single-family mortgages originated in 1999. According to the PMMS, the average monthly share of mortgages made to refinance existing loans was 32 percent, down from 52 percent in 1998 (see Figure 5). During 1999, the refinance share fell from 50 percent in the first quarter to 22 percent in the third and fourth quarters. With rising rates, fewer homebuyers refinanced their homes to reduce their payments, and more who did so took out equity by increasing the size of their loan. For the year, 59 percent of refinancing homeowners took out a new mortgage at least 5 percent greater than the original loan, up from 48 percent in 1998. Healthy property value appreciation facilitated the trend. As in the previous year, the vast majority of refinancing borrowers chose long-term fixed-rate loans.

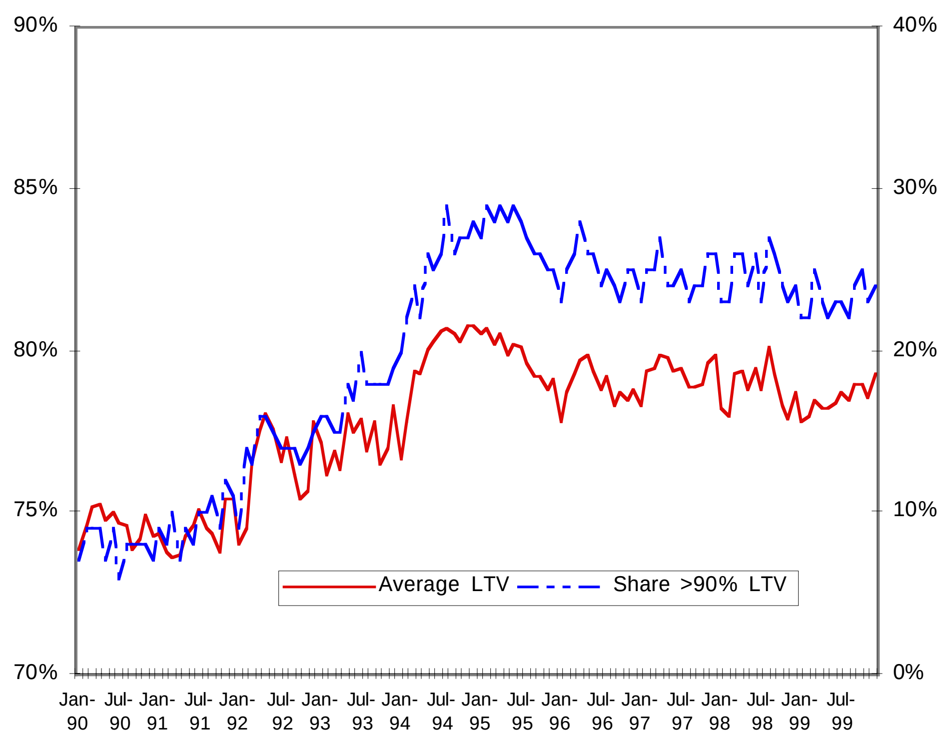
Figure 5. Interest on 30-Year Fixed-Rate Mortgages Rate Versus Refinance Share
Source: Freddie Mac Primary Mortgage Market Survey



The Federal Housing Finance Board's Mortgage Interest Rate Survey (MIRS), which tracks the terms of single-family, conventional, purchase-money originations, provides additional information on the characteristics of newly originated mortgages. The survey also permits comparison of the characteristics of purchase-money loans with balances small enough to make them eligible for purchase by Fannie Mae and Freddie Mac (conforming mortgages) and with balances too large to make them eligible for purchase by the Enterprises (jumbo loans). According to MIRS, the conforming share of total purchase-money originations, based on the number of loans, held steady at 91 percent in 1999, whereas the conforming share based on the total dollar volume of loans fell slightly from 79 percent in 1998 to 78 percent in 1999. The conforming share of the dollar volume fell because the size of the average conforming loan increased less than the size of the average jumbo loan. The average conforming mortgage increased 5.4 percent to $118,500 in 1999, whereas the average jumbo loan increased 10.6 percent to $343,600. The conforming limit in 1999 for mortgages that financed single-family properties was $240,000, a 5.7 percent increase from 1998's limit.

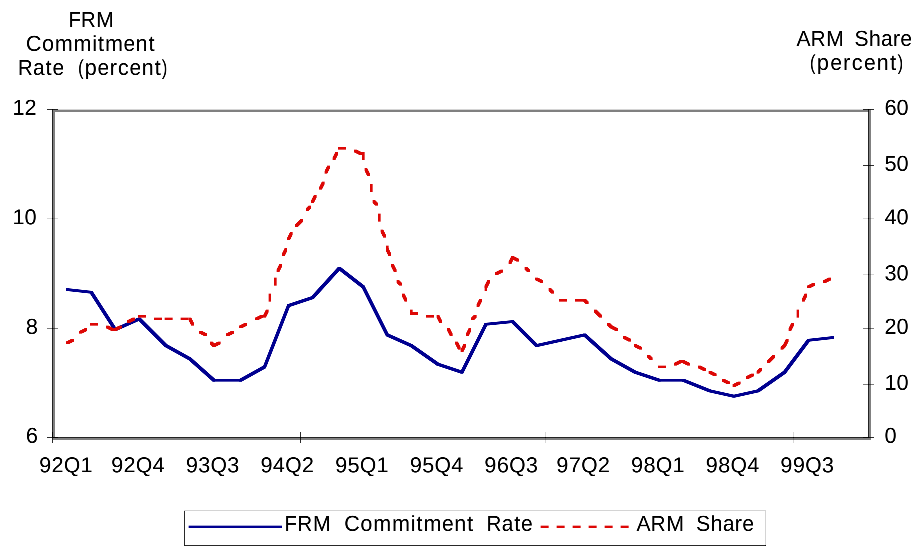
According to MIRS, the average loan-to-value (LTV) ratio of single-family, conventional, purchase-money mortgages and the proportion of such loans with high LTV ratios both fell slightly compared to 1998 (see Figure 6). A lower LTV ratio (higher borrower equity in the property) indicates that a mortgage is less likely to default, everything else being equal. Conforming and jumbo loans each had average LTV ratios of about 78 percent, and there was little difference in the average LTV ratios of FRMs and ARMs in each category. Conforming mortgages were much more likely to have high LTV ratios than jumbo loans, as in the past. Twenty-six percent of conforming FRMs had LTV ratios over 90 percent last year, compared to 7 percent of jumbo FRMs. The percentages for conforming and jumbo ARMs were 16 percent and 7 percent, respectively. The average LTV ratio of all purchase-money mortgages has not declined much from its peak in 1997 and remains much higher than in the early 1990s. The high-LTV proportion of such loans has fallen somewhat from its peak in 1995, but also remains quite high in comparison early in the decade. These trends reflect both households' desire for lower down payments on purchase-money loans and the increased availability of such loans.

Figure 6. Loan-to-Value (LTV) Ratios of Conventional Single Family Mortgages and Percentage of Originations with LTV Ratios >90
Source: Federal Housing Finance Board's Mortgage Interest Rate Survey



Rising mortgage rates also led more borrowers to choose ARMs over fixed-rate loans in 1999. The ARM share of conventional single-family originations, after reaching a low in the fourth quarter of 1998, had climbed a year later to its highest level since the third quarter of 1996 (see Figure 7). According to MIRS, the ARM share of the market on a quarterly average basis rose from 12 percent in 1998 to nearly 22 percent in 1999. The decline in FRMs was much more pronounced in the jumbo market. The fixed-rate share of jumbo loans, based on the number of mortgages, fell from 60 percent in 1998 to 41 percent in 1999. The fixed-rate share of conforming mortgages fell from 90 percent to 83 percent. Many depository institutions prefer to retain adjustable-rate loans in their portfolios rather than sell them to the secondary market, because they can earn attractive spreads with acceptable levels of interest rate risk by financing ARMs with short-term liabilities. Adjustable-rate loans are more likely to default than FRMs, everything else being equal, largely because ARM borrowers are exposed to the risk that rising interest rates will increase their monthly payments.

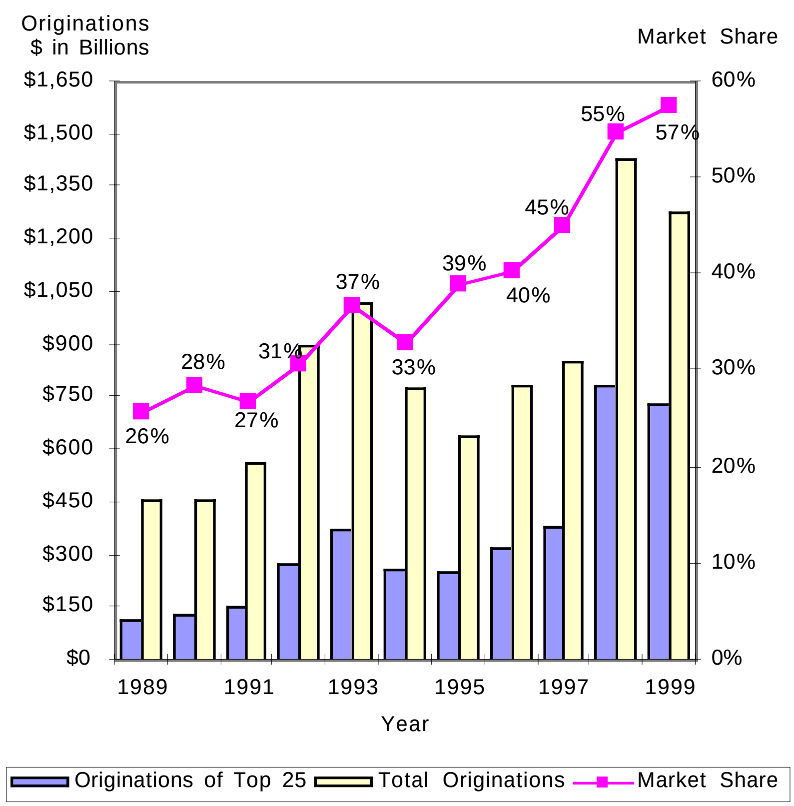
Figure 7. Percentage of Conventional Single-Family Loans with Adjustable Rates Versus Commitment Rates on 30-Year Fixed-Rate Mortgages
Source: Freddie Mac Primary Mortgage Market Survey



Consolidation Among Lenders Continues

The proportion of single-family mortgages originated by the largest lenders continued to increase in 1999, consistent with the consolidation trend in the financial services industry. The top 25 originators accounted for 57 percent of all single-family originations in 1999, up from 55 percent in 1998 and more than double their market share in the early 1990s (see Figure 8). Lenders continued to rely on multiple channels of production to originate loans. Of all single-family mortgages originated in 1999, 26 percent were acquired from brokers, 36 percent came from correspondent lenders, and 39 percent were originated through retail channels.

Figure 8. Concentration of Mortgage Originations Among the Top 25 Originators
Source: *Inside Mortgage Finance*

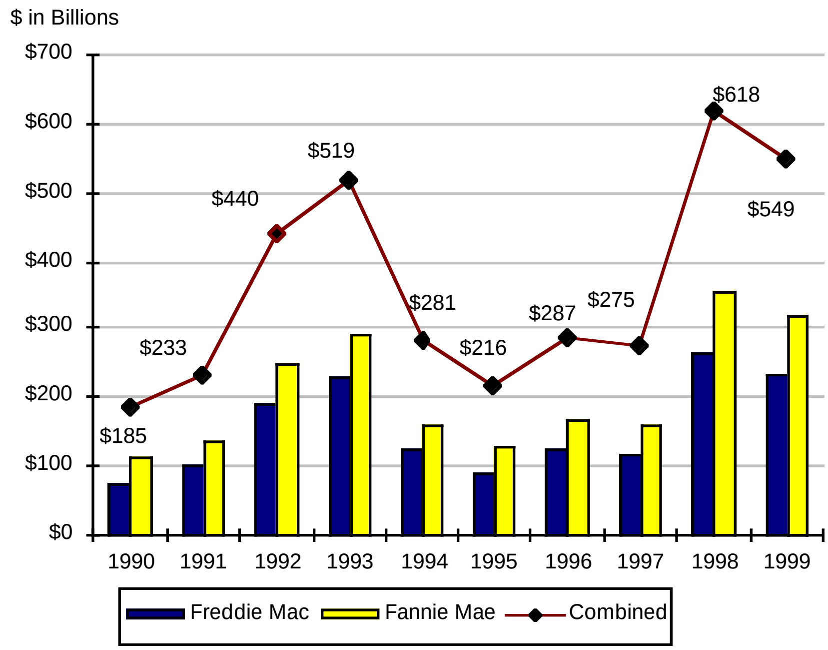


SECONDARY MARKET ACTIVITIES OF THE ENTERPRISES

SINGLE-FAMILY PURCHASES DECLINE BUT REMAIN AT HIGH LEVELS

Purchases by Fannie Mae and Freddie Mac of single-family mortgages (defined to include cash purchases from lenders and swaps of whole loans for mortgage-backed securities, or MBS) declined in 1999, as a lower volume of originations and a higher ARM share of the primary market limited opportunities to buy new loans (see Figure 9). Each Enterprise's purchases were at the second-highest level ever, however. Fannie Mae purchased $316 billion in single-family loans last year, a reduction of 11 percent from 1998. Freddie Mac bought $233 billion, a decline of 12 percent. Each Enterprise's quarterly purchases fell steadily during the year, reflecting the decline in originations. The Enterprises' share of total single-family originations declined slightly to 42 percent for the year.

Figure 9. Enterprise Single-Family Mortgage Purchases
Sources: Fannie Mae and Freddie Mac



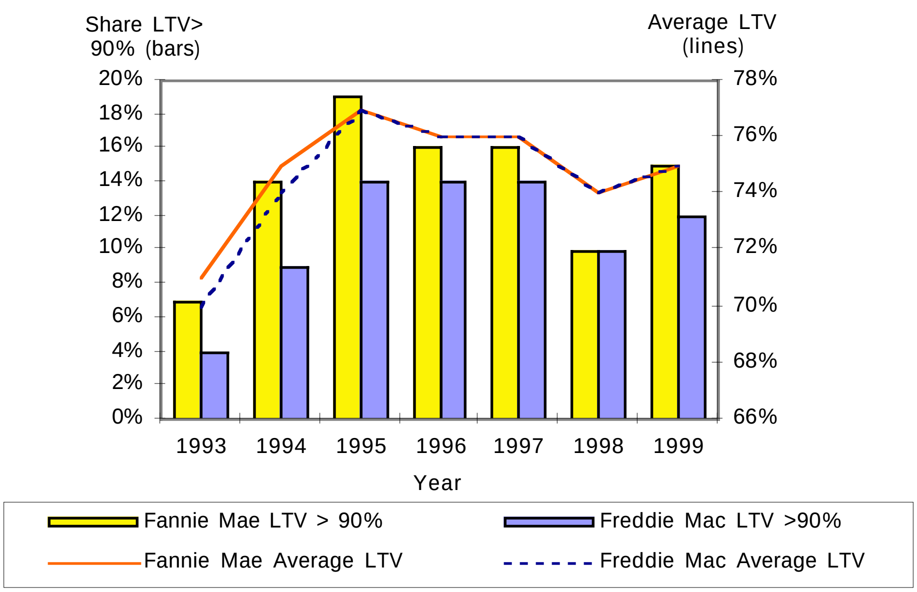
Each Enterprise entered into special business arrangements with a number of mortgage lenders in 1999. Those arrangements typically involve a commitment by the lender to sell a high proportion of its conforming mortgage originations to the respective Enterprise. Such arrangements expose an Enterprise to the risk that it will lose significant purchase volume that it may be unable to replace if, when the agreements end, one or more lenders significantly reduces the volume of mortgages it sells to the Enterprise. The arrangements had little effect on the Enterprises' respective shares of their combined single-family purchases in 1999, however. Fannie Mae's share climbed very slightly to 57.6 percent from 57.4 percent in 1998, whereas Freddie Mac's fell from 42.6 percent to 42.4 percent.

Newly Acquired Single-Family Loans Pose Slightly Greater Credit Risk

Trends in the primary market in 1999 altered the characteristics of single-family originations in ways that tended to increase slightly the credit risk posed by the mortgages purchased by each Enterprise. There were several related developments:

- ❑ The refinance share of single-family mortgages purchased by the Enterprises declined. Of the loans purchased by each Enterprise, about one-half were refinance loans, down from about two-thirds the previous year. A higher portion of refinancing borrowers withdrew equity.
- ❑ The average LTV ratio of single-family mortgages purchased by each Enterprise increased slightly (see Figure 10). That change reflects the decline in the refinance share of Enterprise purchases. Mortgages with high LTV ratios also made up a larger share of each Enterprise's single-family purchases.

Figure 10. Enterprises' Single-Family Purchases by Loan-to-Value (LTV) Ratio
Sources: Fannie Mae and Freddie Mac



- ❑ Adjustable-rate loans comprised a slightly higher share of each Enterprise's single-family purchases, consistent with the larger proportion of conforming originations with adjustable rates. The ARM share of Fannie Mae's purchases rose from 4 percent to 5 percent, whereas the ARM share of Freddie Mac's purchases increased from 3 percent to 6 percent.

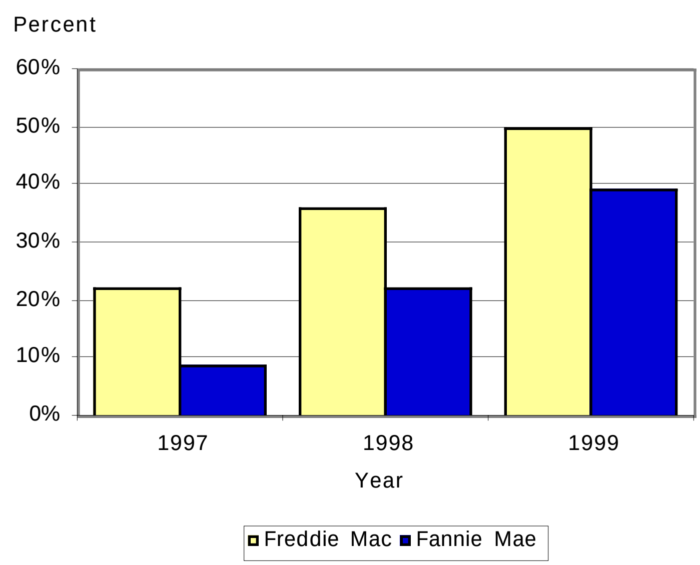
ENTERPRISES EXPAND PRESENCE IN THE SUBPRIME MARKET

After investing in the senior tranches of subprime securitizations during the illiquid market conditions of late 1998, Fannie Mae and Freddie Mac became major participants in the secondary market for subprime mortgages in 1999. Freddie Mac issued $5.3 billion in multi-class mortgage securities supported by pools of subprime loans, up from $1.4 billion in 1998. Each Enterprise initiated a program to purchase individual A- mortgages approved by its automated underwriting system (AUS), charging a somewhat higher price to cover the additional credit risk. Freddie Mac charges a delivery fee on A- loans that lenders may recoup by charging the borrower a higher rate. Fannie Mae introduced a product under which the interest rate on an A- loan is initially higher but is reduced if the borrower makes 24 consecutive months of payments on time.

ENTERPRISES CONTINUE TO MANAGE SINGLE-FAMILY CREDIT RISK ACTIVELY

Increasingly, the Enterprises are assessing the credit risk of the single-family mortgages they purchase through the use of automated underwriting. The proportion of new single-family loans purchased by Fannie Mae and Freddie Mac that was evaluated by the respective Enterprise's automated underwriting system (AUS) prior to purchase increased in 1999 (see Figure 11). Each system combines LTV ratios, credit scores, and other loan and borrower characteristics to classify loans in terms of their relative risk of default. Fifty percent of the loans sold to Freddie Mac were evaluated using that Enterprise's system, Loan Prospector, in 1999, more than double the level of two years before. Lenders used Fannie Mae's system, Desktop Underwriter, to evaluate 39 percent of new mortgages sold to that Enterprise, an increase of more than 400 percent since 1997.

Figure 11. Percent of Mortgages Evaluated by Enterprise Automated Underwriting Systems Prior to Purchase—Based on Recently Originated Mortgages Not Included in Structured Transactions
Sources: Fannie Mae and Freddie Mac

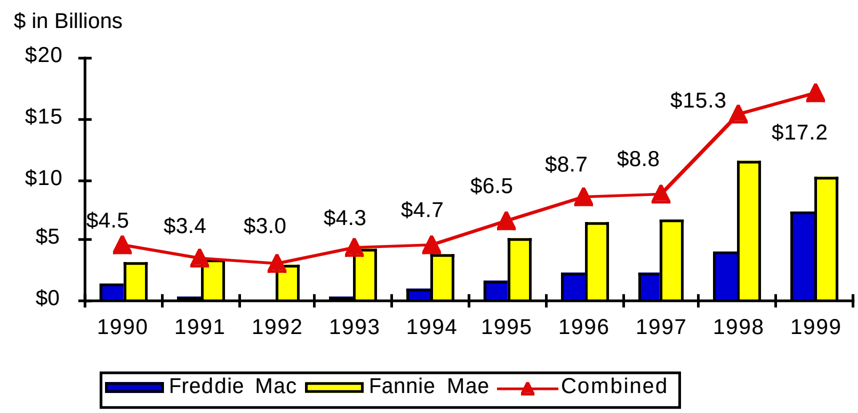


The Enterprises also reduce their exposure to mortgage credit risk by obtaining credit enhancements on higher-risk single-family loans. Credit enhancements include primary mortgage insurance on loans with original LTV ratios greater than 80 percent, and agreements in which lenders or other third parties pledge collateral or agree to accept losses on loans that default. In addition, a portion of the mortgages purchased by each Enterprise are insured by FHA or guaranteed by VA. In 1999, the share of single-family mortgages purchased by the Enterprises where lenders or other third parties bear primary risk of default declined. The proportion of single-family MBS issued by Fannie Mae where lenders bear primary risk on the collateral declined from 28 percent to 25 percent. Single-family loans on which lenders or other third-parties bear primary default risk declined from 40 percent of Freddie Mac's purchases in 1998 to 35 percent in 1999. However, each Enterprise bore primary default risk on a smaller proportion of the single-family mortgages it acquired in 1999 than on old loans that were repaid or written off during the year. As a result, the share of Fannie Mae's total mortgage portfolio where lenders or other third parties bear primary risk increased from 18 percent at year-end 1998 to 21 percent at year-end 1999. Similarly, the share of Freddie Mac's total portfolio where lenders or other third parties bear primary risk increased from 27 percent to 30 percent.

Multifamily Purchases Rise

Total Enterprise purchases of multifamily mortgages (defined to include cash purchases and securitizations) rose in 1999 (see Figure 12). The increase was due to a large jump in Freddie Mac's activity, which offset a decline in Fannie Mae's. Freddie Mac's multifamily purchases increased from $3.9 billion in 1998 to $7.2 billion last year, an increase of 84 percent. Fannie Mae's fell from $11.4 billion to $10.0 billion. Each Enterprise's purchases of multifamily loans was lower in the second half of the year.

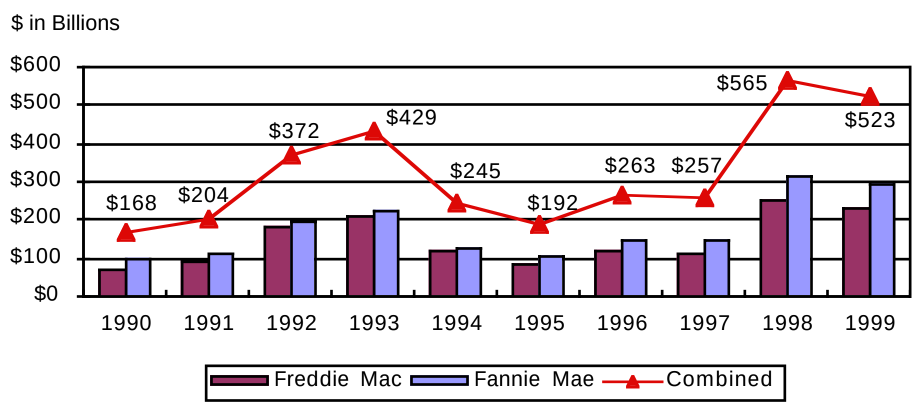
Figure 12. Enterprise Multifamily Mortgage Purchases
Sources: Fannie Mae and Freddie Mac



VOLUMES OF MBS AND REMIC ISSUANCES DECLINE

The Enterprises' securitizations of mortgages in 1999 mirrored trends in the primary market. Issuance of single-class MBS declined at both Enterprises as purchase volumes fell (see Figure 13). Fannie Mae's issuances totaled $292 billion, a decrease of 8 percent. Freddie Mac issued $231 billion in 1999, a decline of 7 percent. Each Enterprise's issuances fell in each quarter of the year, consistent with the steady downward trend in loan originations. The decrease in issuances was more than offset at both Enterprises by a decrease in mortgage liquidations brought on by the lower volume of refinance loans in 1999. As they have in recent years, the Enterprises each repurchased large volumes of their MBS issues. Despite that, outstanding MBS held by other investors increased 7 percent for Fannie Mae and 12 percent for Freddie Mac.

Figure 13. Enterprise Single-Class MBS Issuances
Sources: Fannie Mae and Freddie Mac



Issuance of multi-class mortgage securities, mostly Real Estate Mortgage Investment Conduit (REMIC) offerings, also fell at both Enterprises in 1999 (see Figure 14). Freddie Mac's new issue volume fell $15 billion to $120 billion, while Fannie Mae issues declined $29 billion to $55 billion in 1999. Freddie Mac's outstanding issues rose 21 percent, while Fannie Mae's declined by 14 percent.

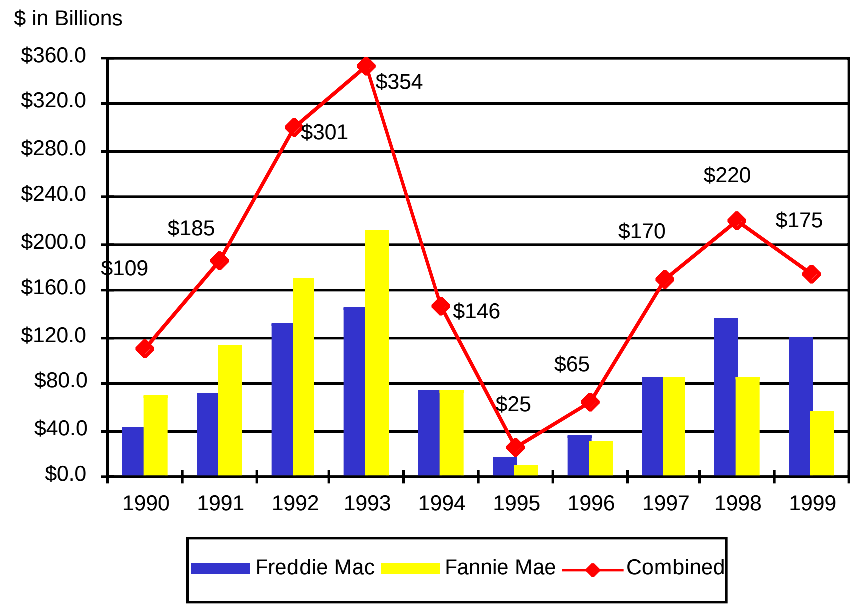


Figure 14. Enterprise REMIC Issuances
Sources: Fannie Mae and Freddie Mac

FINANCIAL CONDITION OF THE ENTERPRISES

GROWTH IN MORTGAGE INVESTMENTS PUSHES COMBINED EARNINGS OVER $6 BILLION

Fannie Mae and Freddie Mac each recorded another year of record profits in 1999, with a combined net income of $6.1 billion. Freddie Mac's net income rose 31 percent, its biggest increase in 8 years, whereas Fannie Mae's rose a more typical 14 percent (see Tables 1 and 2). Net interest income accounted for most of the increase in revenues for both Enterprises, as combined net interest income rose to $7.8 billion, up from $6.3 billion in 1998 (see Figure 15). The Enterprises' profits increased despite a further decline in the revenue yields on their two principal lines of business—portfolio investments and mortgage guarantees. Growth in mortgage investments and a decline in credit losses, as well as growth in other income at Freddie Mac, more than offset the effect of lower net interest margins and guarantee fee rates.

Table 1. Fannie Mae Financial Highlights

SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)	1999	1998	1997	1996	1995
EARNINGS PERFORMANCE:					
Net Income ($)	3.91	3.42	3.06	2.73	2.14
Net Interest Income ($)	4.89	4.11	3.95	3.59	3.05
Guarantee Fees ($)	1.28	1.23	1.27	1.20	1.09
Net Interest Margin (%)[1]	1.01	1.03	1.17	1.18	1.16
Average Guarantee Fee (basis points)[2]	19.3	20.2	22.7	22.4	22.0
Return on Common Equity (%)	25.2	25.2	24.6	24.1	20.9
Dividend Payout Ratio (%)[3]	28.8	29.5	29.4	30.4	34.6
BALANCE SHEET POSITION:					
Total Assets ($)	575.2	485.0	391.7	351.0	316.6
Outstanding Debt ($)	547.6	460.3	369.8	331.3	299.2
Mortgages:					
Retained Mortgage Portfolio ($)	522.8	415.4	316.6	286.5	252.9
MBS ($) (excludes MBS in Portfolio)	679.2	637.1	579.1	548.2	513.2
Retained as % of Total Mortgages in Portfolio and MBS	43.0	39.5	35.3	34.3	33.0
Capital:					
Equity/Assets & MBS (%)	1.41	1.38	1.42	1.42	1.32
Equity + Reserves /Assets +MBS (%)[4]	1.47	1.45	1.50	1.50	1.41

Source: Fannie Mae

1. Taxable equivalent net interest income divided by average earning assets.
2. Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.
3. Paid common dividends as a percentage of earnings available to common stockholders.
4. Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

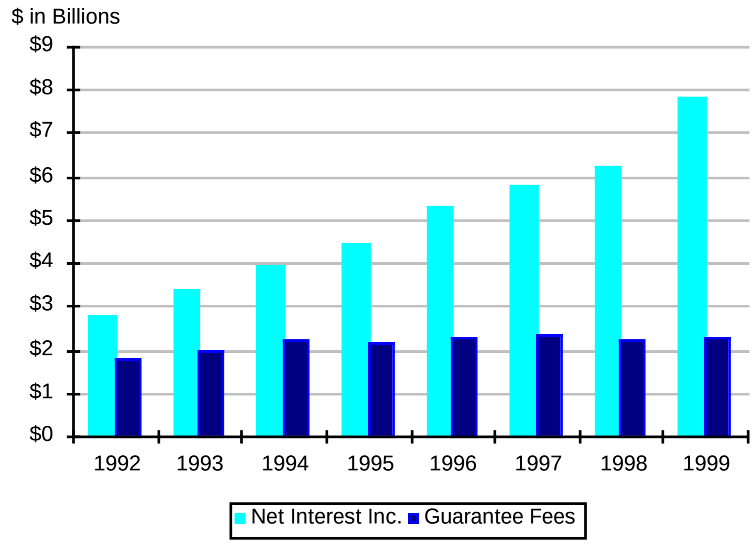
Table 2. Freddie Mac Financial Highlights

SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)					
	1999	**1998**	**1997**	**1996**	**1995**
EARNINGS PERFORMANCE:					
Net Income ($)	2.22	1.70	1.40	1.24	1.09
Net Interest Income ($)[1]	2.93	2.22	1.85	1.71	1.40
Guarantee Fees ($)[1]	1.02	1.02	1.08	1.09	1.09
Net Interest Margin (%)[1,2]	0.88	0.93	1.01	1.10	1.18
Average Guarantee Fee (basis points)[3]	19.8	21.4	22.9	23.4	23.8
Return on Common Equity (%)	25.5	22.6	23.1	22.6	22.1
Dividend Payout Ratio (%)[4]	20.1	20.7	21.1	21.3	21.1
BALANCE SHEET POSITION:					
Total Assets ($)	386.7	321.4	194.6	173.9	137.2
Outstanding Debt ($)	360.7	287.4	172.8	156.9	120.0
Mortgages:					
Retained Mortgage Portfolio ($)	322.9	255.7	164.5	137.8	107.7
MBS ($) (excludes MBS in Portfolio)	537.9	478.4	476.0	473.1	459.0
Retained as % of Total Mortgages in Portfolio and MBS	37.5	34.8	25.7	22.6	19.0
Capital:					
Equity/Assets & MBS (%)	1.25	1.35	1.12	1.04	0.98
Equity & Reserves/Assets & MBS (%)[5]	1.33	1.45	1.22	1.14	1.09

Source: Freddie Mac

1. Effective 1/1/96, Freddie Mac reports guarantee fees on retained Freddie Mac Participation Certificates or “MBS” as guarantee fee income. Previously these fees were included in net interest income. However, for comparability with Fannie Mae, guarantee fee income on retained MBS for subsequent periods has been estimated and included in net interest income rather than fee income.
2. Taxable equivalent net interest income divided by average earning assets.
3. Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.
4. Paid common dividends as a percentage of earnings available to common stockholders.
5. Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

Figure 15. Enterprise Primary Sources of Revenue
Sources: Fannie Mae and Freddie Mac

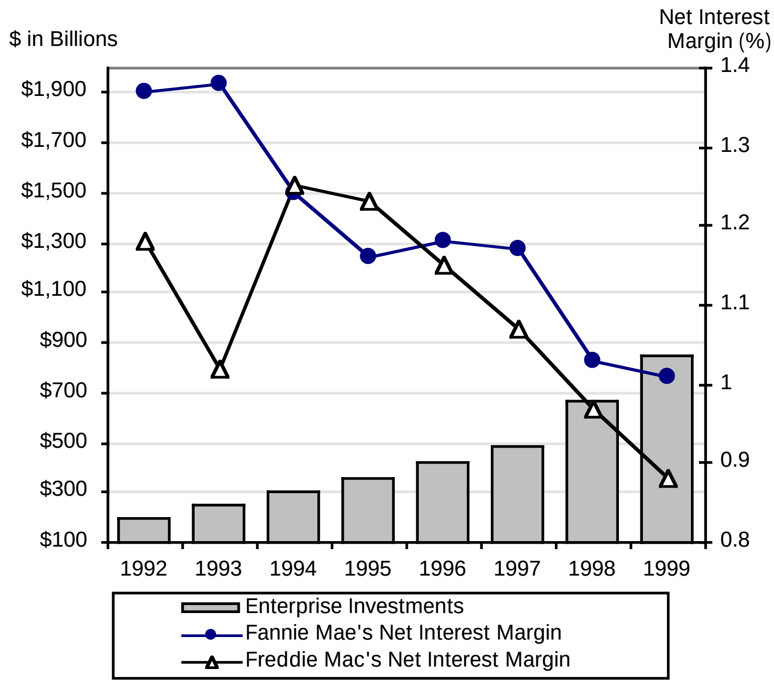


While growth of the Enterprises' mortgage investments was still very rapid, it was lower than in 1998, as rising interest rates and a decline in the refinance market reduced the supply of newly originated mortgages and newly issued mortgage securities. Fannie Mae's mortgage investments grew 26 percent in 1999, compared with 31 percent in 1998. Freddie Mac's mortgage investments also increased 26 percent in 1999, compared with 55 percent in 1998.

Revenues Continue to Rise Despite Fall in Interest Margins and Guarantee Fees

Total revenues rose $753 million at Fannie Mae and $718 million at Freddie Mac in 1999. Net interest income drove the increase in total revenues for both Enterprises, as growth in mortgage investments offset the effect of lower net interest margins. Fannie Mae's net interest margin (tax equivalent basis) declined two basis points to 1.01 percent in 1999. Freddie Mac's margin (defined to include guarantee fees on MBS in the retained portfolio) fell 5 basis points to 0.88 percent (see Figure 16). Fannie Mae's net interest margin fell largely because a large volume of mortgages with relatively high yields refinanced in the first half of the year and because the Enterprise reduced its equity-to-assets ratio, raising its interest expense. Freddie Mac's net interest margin declined for the same reasons and because the Enterprise raised the proportion of its portfolio funded with higher-cost, longer-term debt and increased its portfolio of option-based derivatives.

Figure 16. Enterprise Mortgage Investments and Net Interest Margin
Sources: Fannie Mae, Freddie Mac, and OFHEO



The combined guarantee fee income for the Enterprises rose 2 percent during 1999. Fannie Mae's average guarantee fee rate fell to 19.3 basis points in 1999, compared with 20.2 basis points in 1998. Freddie Mac's average guarantee fee rate also dropped in 1999, falling by 1.6 basis points to 19.8 basis points. The drop in average guarantee fee rates was due to the replacement of liquidated mortgages with newly originated loans that have lower fees. Lower average guarantee fees on newly financed mortgages reflects more competitive pricing, greater use of credit enhancements on MBS that reduce guarantee fees, and changes in the mix of loan products purchased.

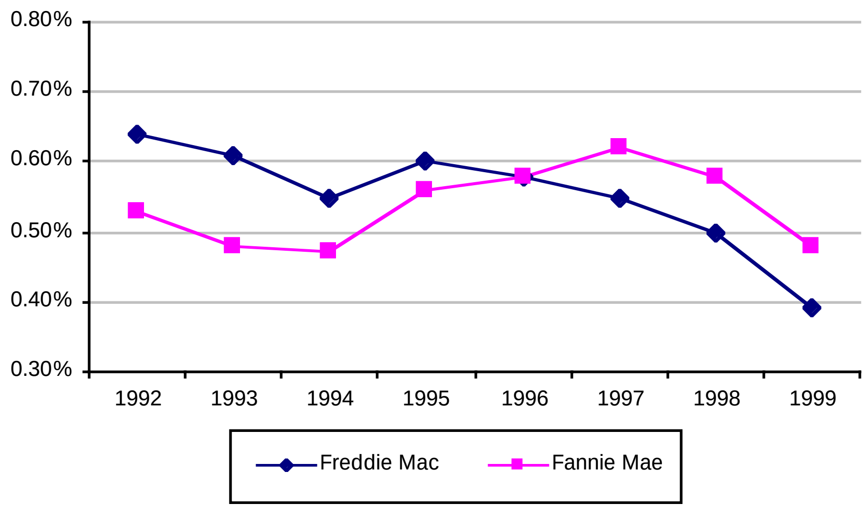
Credit Losses and Delinquencies Continue to Decline

Strong housing markets and increased recoveries from credit enhancements enabled the Enterprises to reduce their credit losses (charge-offs plus foreclosure expenses) for the third consecutive year in 1999. Credit losses for Fannie Mae fell 53 percent to $124 million, 0.011 percent of its average total mortgage portfolio. Freddie Mac's credit losses declined 42 percent to $155 million, 0.019 percent of its average total mortgage portfolio. Fannie Mae's lower loss rate reflects differences in accounting practices. Improving economic conditions nationwide reduced the number of foreclosed properties acquired by each Enterprise. In addition, strong home price appreciation and increased recoveries reduced losses on foreclosed properties.

Delinquency rates on the Enterprises' single-family mortgages (based on the number of loans on which an Enterprise bears the primary risk of loss that are delinquent 90 days or more or in foreclosure) also declined in 1999 (see

Figure 17). The increased proportion of recently originated loans in the Enterprises' retained and securitized mortgage portfolios and even more healthy economic conditions in 1999 accounted for that trend. The proportion of delinquent single-family loans at Fannie Mae declined for the second year in a row, falling from 0.58 percent at year-end 1998 to 0.48 percent at the end of 1999. Freddie Mac's single-family delinquency rate declined for the fourth year in a row, dropping from 0.50 percent at the end of 1998 to 0.39 percent at year-end 1998.

Figure 17. Single-Family Delinquency Rates
Sources: Fannie Mae and Freddie Mac



The delinquency rates on the Enterprises' multifamily mortgages (based on loans for which an Enterprise has primary or shared risk that are delinquent 60 days or more) also declined to very low levels in 1999. Fannie Mae's multifamily delinquency rate fell to 0.12 percent, down from 0.29 percent in 1998 and less than one-third of the level in 1997. Freddie Mac's multifamily delinquency rate dropped to 0.14 percent, down from 0.37 percent in 1998 and 0.96 percent in 1997. Multifamily delinquencies at both Enterprises benefited from solid economic conditions, including rising rents in many markets.

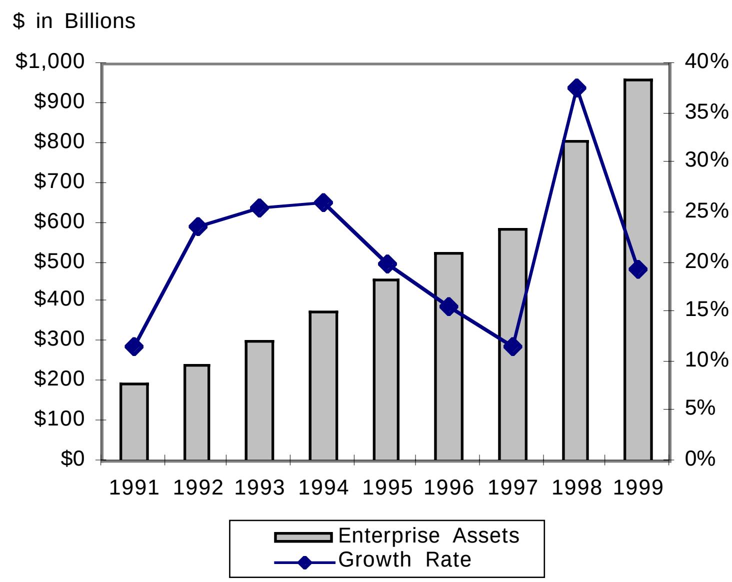
Administrative Expenses Grow Less Rapidly Than Mortgages Financed

Each Enterprise's administrative expenses increased in 1999. Fannie Mae's administrative costs rose from $0.7 billion to $0.8 billion, whereas Freddie Mac's increased from $0.6 billion to $0.7 billion. The ratio of administrative costs to total revenues remained stable at Fannie Mae and declined at Freddie Mac, however. Each Enterprise's administrative expenses also grew less rapidly than its assets and net MBS outstanding. Administrative expenses are expected to grow more slowly than revenues in 2000 with the elimination of expenses associated with the Year 2000 date change.

Assets Grow Rapidly, But More Slowly Than in 1998

Total assets for the Enterprises increased 19 percent to $962 billion during 1999, compared with 38 percent in 1998 (see Figure 18). While still rapid, asset growth slowed because the volume of single-family originations tapered off in 1999, reducing the volume of newly originated loans and newly issued mortgage securities available for purchase. Fannie Mae's retained mortgage portfolio rose $109 billion, a growth rate of 26 percent, compared with a 31 percent jump in 1998. Freddie Mac's mortgage assets rose $67 billion, also an increase of 26 percent, down from 55 percent growth in 1998. Purchases of mortgage securities accounted for all of the growth in each Enterprise's mortgage investments. Acquisitions of non-Enterprise securities accounted for two-fifths of Freddie Mac's purchases of mortgage securities and over one-quarter of Fannie Mae's (see Box 4).

Figure 18. Combined Enterprise Assets and Growth Rate
Sources: Fannie Mae, Freddie Mac, and OFHEO



Quarterly average non-mortgage investments declined at both Enterprises in 1999, although by very different magnitudes (see Figure 19). Fannie Mae's quarterly average non-mortgage investments fell by over $30 billion, dropping from $75 billion in the fourth quarter of 1998 to $45 billion in the fourth quarter of 1999, a decline of 40 percent. Freddie Mac's quarterly average non-mortgage investments decreased slightly, falling from just over $57 billion in the fourth quarter of 1998 to just under $57 billion a year later. Fannie Mae's ratio of annual-average non-mortgage investments to annual-average earning assets was 10 percent in 1999, down from 18 percent in 1998. Freddie Mac's ratio of annual-average non-mortgage investments to annual-average earning assets was unchanged at 17 percent. Examples of non-mortgage investments for the Enterprises include U.S. Treasury and agency securities, federal funds, reverse repurchase agreements, commercial paper, municipal bonds, corporate debt, and asset-backed securities.

Box 4: The Enterprises' Purchases of Mortgage Securities in 1999

Since 1994, Fannie Mae and Freddie Mac have increased their on-balance-sheet assets primarily by buying mortgage-backed securities (MBS) and Real Estate Mortgage Investment Conduit (REMIC) securities. When either Enterprise purchases mortgage securities that it has previously issued and guaranteed, the net effect is to add on-balance-sheet assets and subtract off-balance-sheet contingent liabilities, for no net effect on the Enterprise's overall credit risk exposure. Buying mortgage securities allows the Enterprises to increase their assets in periods when volumes of newly originated loans available for purchase are insufficient to meet their asset-growth targets.

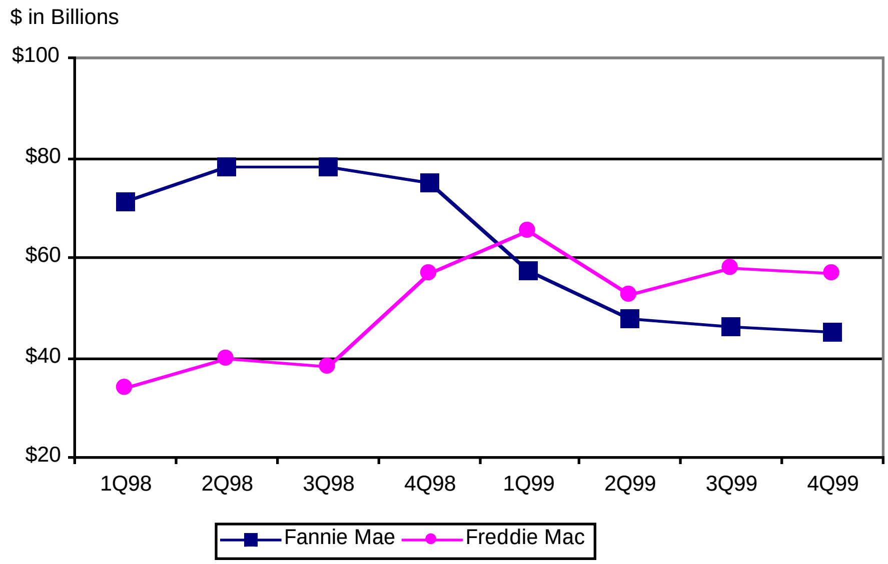
In 1999, Fannie Mae purchased $166 billion of mortgage securities, up from $144 billion in 1998. Freddie Mac bought $102 billion of mortgage securities, down from $128 billion. The Enterprises' large purchase volumes reflected the high level of mortgages securitized in the first half of the year and attractive MBS-to-debt spreads. At year-end, Fannie Mae's holdings of mortgage securities comprised 72 percent of the Enterprise's mortgage assets, up from 49 percent at the end of 1997. Whole loans in Fannie Mae's retained portfolio declined for the fifth straight year, as the Enterprise's holdings of mortgage securities increased more than its mortgage assets. Freddie Mac's mortgage securities holdings comprised 83 percent of its retained portfolio, up from 70 percent at year-end 1997. Whole loans held by Freddie Mac declined for the first time.

Fannie Mae and Freddie Mac are increasingly buying mortgage securities guaranteed by the Government National Mortgage Association (Ginnie Mae) and other government agencies or issued by private firms. Ginnie Mae and other agency securities generally pose little or no credit risk. Private-label securities pose both mortgage and institutional credit risk, which the Enterprises limit by requiring senior/subordinated structures and bond insurance and by monitoring the creditworthiness of bond insurers.

Fannie Mae purchased $41 billion of non-Enterprise mortgage securities last year, up slightly from $40 billion in 1998 and more than quadruple the 1997 level of $10 billion. Freddie Mac bought nearly $33 billion of such securities, up from just under $21 billion in 1998 and $4 billion in 1997. Non-Enterprise mortgage securities accounted for 18 percent of each Enterprise's mortgage assets at year-end, up from 8 percent at the end of 1997.

The increase in Fannie Mae's non-Enterprise mortgage securities in 1999 accounted for 29 percent of the growth of its retained portfolio, down from 36 percent in 1998. The rise in Freddie Mac's holdings of such securities represented 40 percent of the growth of its mortgage assets, more than double the 19 percent proportion in 1998. Freddie Mac's holdings included nearly $20 billion in securities guaranteed by Ginnie Mae or other agencies, nearly $14 billion in securities backed by home equity loans, and nearly $8 billion in securities backed by commercial mortgages.

Figure 19. Enterprise Average Non-Mortgage Investments
Sources: Fannie Mae and Freddie Mac

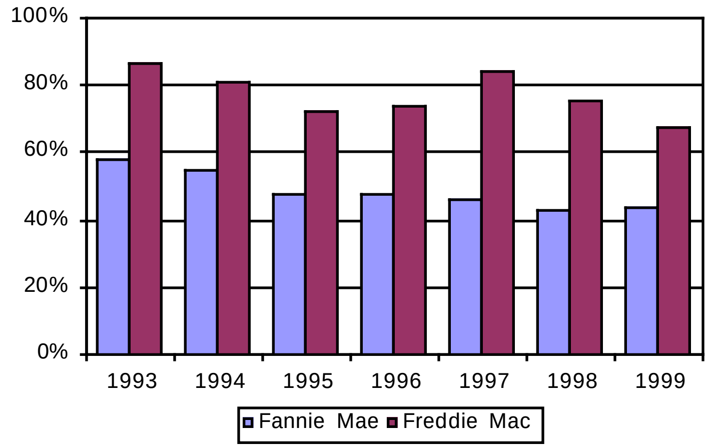


Composition of Debt Changes as Interest Rates Rise

Rising interest rates in 1999 slowed the pace at which the Enterprises exercised call options to retire debt securities before their stated maturities. As rates rose, opportunities diminished to replace callable debt with cheaper new issues. Fannie Mae called $34 billion in 1999, down from $61 billion in 1998, and Freddie Mac called $22 billion, compared to $49 billion in 1998. Roughly three-quarters of each Enterprise's 1999 calls occurred during the first half of the year.

Option-embedded debt remained attractive to Fannie Mae and Freddie Mac in 1999, however. The Enterprises issue such debt to reduce their exposure to losses from falling interest rates. When rates fall, mortgage investments roll off the balance sheet and are replaced by newly purchased assets that have lower yields. The Enterprises can offset a large portion of their losses by retiring callable debt and issuing new, lower-cost debt (or by exercising other options that effectively reduce the rates on outstanding debt), thereby matching the decline in their interest income with a reduction in interest expense. Consistent with this strategy, the majority of effective long-term debt issued by the Enterprises in 1999 had call options or downward rate-adjustment features, as has been the case in recent years. Option-embedded (mostly callable) debt comprised two-thirds of Freddie Mac's effective long-term debt at the end of the year, down from three-quarters at year-end 1998, and remained at about 43 percent of Fannie Mae's effective long-term debt (see Figure 20).

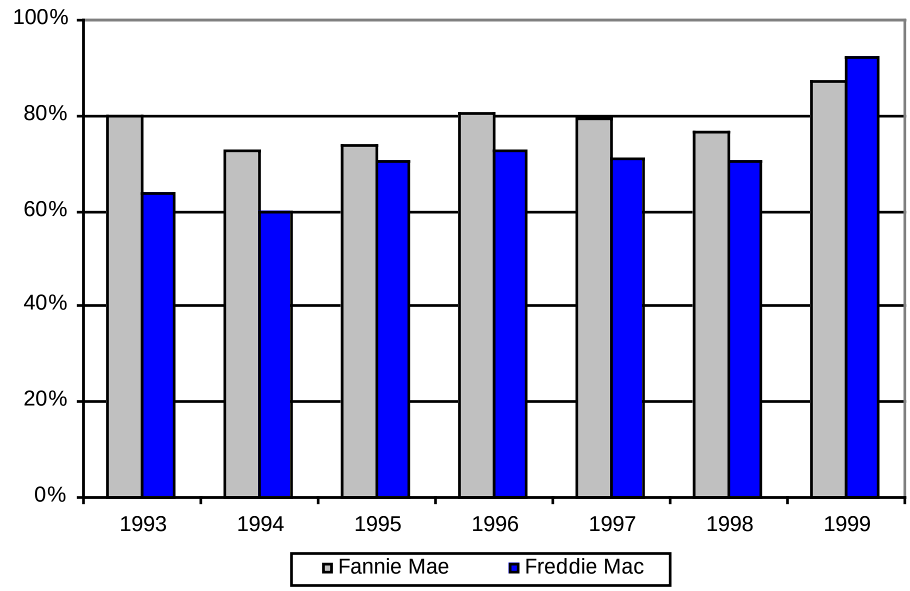
Figure 20. Callable Debt as Percentage of Total Effective Long-Term Debt
Sources: Fannie Mae and Freddie Mac



Both Enterprises increased the proportion of their debt that is effectively long-term in 1999 (see Figure 21). (Such debt includes both notes with long-term maturities and short-term debt that has been made effectively long-term through the acquisition of derivatives.) At the end of the year, 87 percent of Fannie Mae's debt was effectively long-term, up from 76 percent at year-end 1998. The proportion of Freddie Mac's debt that is effectively long-term rose from 71 percent to 92 percent. When interest rates are rising, the average expected maturity of the Enterprises' mortgage assets increases. Fannie Mae and Freddie Mac respond by increasing the proportion of their debt that is effectively long-term in order to lengthen their debt's average maturity.

The total combined outstanding debt of Fannie Mae and Freddie Mac reached $908 billion at the end of 1999, an increase of 38 percent from year-end 1998. In an effort to attract new investors to their debt and minimize their funding costs, each Enterprise expanded its program to issue new debt according to pre-announced schedules, with more standardized features. These programs mimic some techniques used by the Treasury Department in issuing debt and are designed to increase the predictability and liquidity of debt offerings. Fannie Mae issued $114 billion of such "Benchmark" securities with maturities ranging from 3 months to 30 years in 1999, compared with $42 billion with maturities ranging from 3 years to 10 years in 1998. The volume of "Reference" securities issued by Freddie Mac rose to $56 billion from $20 billion in 1998.

Figure 21. Effective Long-Term Debt as a Percentage of Total Debt
Sources: Fannie Mae and Freddie Mac



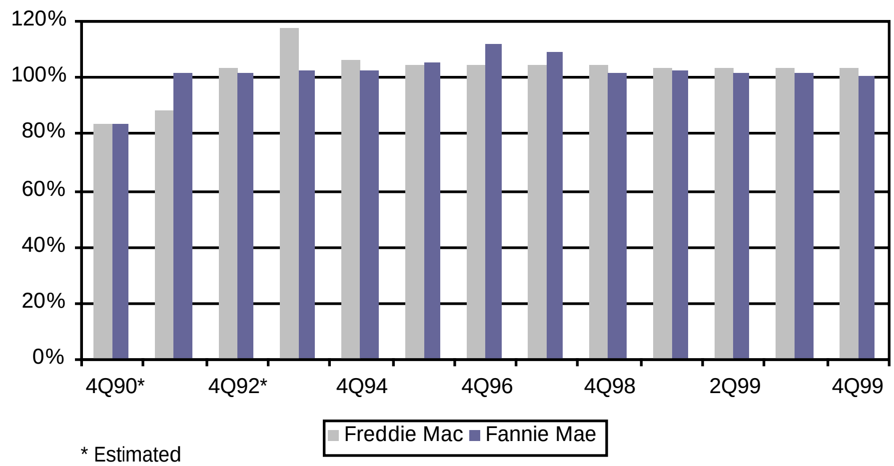
Enterprises Continue to Meet Regulatory Minimum Capital Requirements

OFHEO determined that the Enterprises continued to meet their regulatory minimum capital requirements in 1999.[1] Fannie Mae's minimum capital requirement was \$17.8 billion, and Freddie Mac's was \$12.3 billion, at year-end 1999. The Enterprises were required to hold \$4.4 billion more in core capital at year-end 1999 compared with 1998, primarily due to higher levels of assets. Core capital is the sum of the par value of outstanding common stock, the par value of outstanding noncumulative preferred stock, and paid-in capital and retained earnings. Core capital excludes net unrealized gains or losses, net of taxes, on certain investments reported at fair value, which are included in stockholders' equity. Given the Enterprises' hedging practices for interest rate risk, such unrealized gains or losses generally are offset by comparable changes in the value of outstanding debt. Excluding the gains or losses from core capital is required by statute and more accurately assesses an Enterprise's capacity to absorb potential future losses.

1 The minimum capital requirement is the sum of 2.5 percent of on-balance-sheet assets, 0.45 percent of outstanding MBS and 0.45 percent of other off-balance-sheet obligations.

Surplus capital, the margin by which Enterprise core capital exceeds minimum capital, remained small at both Enterprises in 1999, particularly Fannie Mae (see Figure 22). Fannie Mae's surplus capital dropped to $106 million at the end of the year from $131 million a year earlier. Freddie Mac's surplus capital rose from $382 million in 1998 to $405 million in 1999. Freddie Mac's surplus rose despite its recording net unrealized losses of nearly $1.3 billion on available-for-sale securities, which reduced stockholders' equity but not core capital. As a percentage of required minimum capital, Fannie Mae's surplus fell from 0.9 percent to 0.6 percent. Freddie Mac's surplus capital fell from 3.7 percent to 3.3 percent.

Figure 22. Core Capital as a Percentage of Minimum Capital Requirement
Source: OFHEO



4

Risk-Based Examination Program and Regulatory Activity

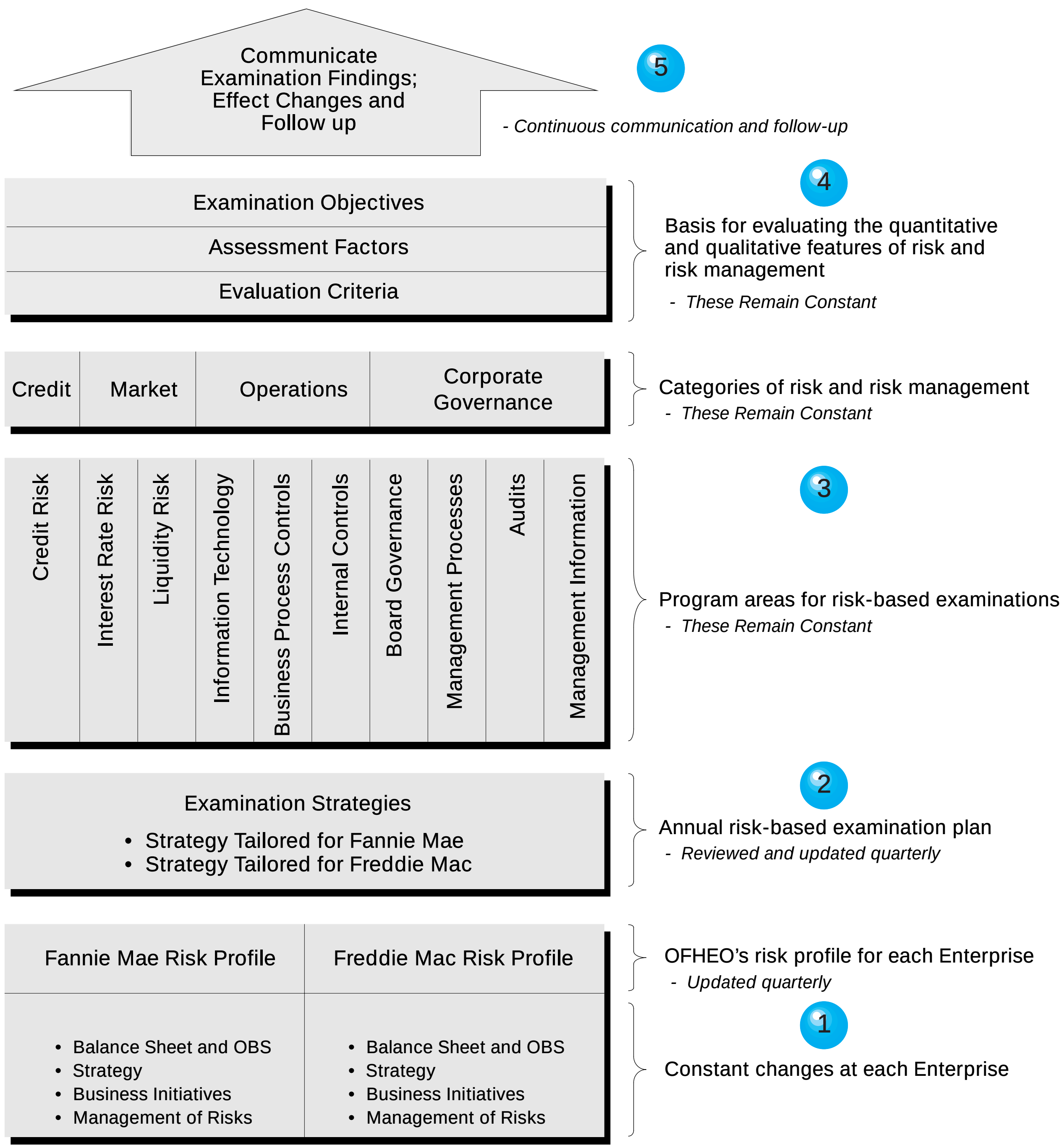
INTRODUCTION

OFHEO's annual risk-based examination program is an integral part of a system designed to ensure the ongoing safety and soundness of Fannie Mae and Freddie Mac. The examination program assesses the appropriateness and effectiveness of the Enterprises' policies and processes for selecting and managing risks, and assesses the companies' financial performance. Using a risk-based approach allows OFHEO to recognize the unique operations of each Enterprise while applying uniform safety and soundness standards throughout the year. This aspect of the examination program's design ensures that OFHEO is responsive to changes at the Enterprises while not imposing unnecessary burdens. The analysis and testing conducted during the examinations add further depth and perspective to OFHEO's oversight of Fannie Mae and Freddie Mac. The examination program, together with OFHEO's capital adequacy framework, informs the Director's judgment about the appropriateness of the balance of risk and capital at each Enterprise.

The 1999 Annual Risk-based Examinations found both Enterprises to be financially sound and well managed.

The process OFHEO employed in its comprehensive annual risk based examinations to reach these conclusions is briefly described below, and depicted on the chart set forth in Figure 23. This information is provided to give context for the summary of the examination results and conclusions for each Enterprise. The description of the examination process corresponds to the chart in Figure 23, beginning with the base of the chart and concluding at the top. Numeric references to the chart are included in the text that describes the examination process.

Figure 23. OFHEO's Comprehensive Risk-Based Examination Program



OFHEO'S EXAMINATION PROGRAM

Risk Profiles

1

Through a wealth of resources (including OFHEO knowledge, external sources and proprietary Enterprise information and data), the examination process begins by assessing the quantity of risk and quality of risk management at each Enterprise. OFHEO reviews each Enterprise's risk profile at least quarterly, and revises its views if, for example, the Enterprise has planned or undertaken substantive new business initiatives, or if the Enterprise has substantially changed its level of risk or the manner in which it manages risks.

Examination Strategies

2

Based upon OFHEO's unique position to understand the Enterprises' risk profiles, in the next step of the examination process OFHEO develops detailed examination strategies to provide effective, efficient oversight of each Enterprise. The annual written examination strategies are dynamic and represent a blueprint of the examination work to be conducted in the coming year. The examination strategies are reviewed and updated quarterly based on Enterprise, industry and economic developments. In conjunction with the strategies, OFHEO creates work plans that describe how the strategies will be achieved. The work plans outline the scope, timing, and resources needed to meet the objectives and examination activities set forth in the strategies.

3

Program Areas for Risk-Based Examinations and Categories of Risk and Risk Management

Once OFHEO has strategies and work plans in place, examiners implement the strategies by performing testing and completing exam work in each of the program areas for risk-based examinations. These are the program areas that capture the areas of risk and risk management being assessed at the Enterprises, with each program area focusing on specific sources of risk or risk management practices and tools. Later in this Chapter, OFHEO presents overall results and conclusions by program area for both Fannie Mae and Freddie Mac.

In order to enhance examinations and maximize expertise, OFHEO has grouped the program areas into four categories of risk and risk management, and aligned its examiner force expertise into five teams that correspond to the categories of risk and risk management, and provide analytical expertise and financial monitoring.

The ten program areas, grouped by category, are:

Credit

Credit Risk Program. The risk that borrowers and counterparties will fail to meet their contractual or other obligations to the Enterprise

Market

Interest Rate Risk Program. The risk from movements in interest rates, including changes in: the level of interest rates; the shape of the yield curve; the level of volatility; and the relationships or spreads among various yield curves or indices.

Liquidity Management Program. The exposure that could arise from the Enterprise's inability to efficiently meet its obligations as they come due and to transact the next incremental dollar of business cost effectively.

Operations

Information Technology Program. The infrastructure, or the general controls, needed to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations in case of unexpected interruptions.

Business Process Controls Program. Assesses the process employed to ensure business initiatives and endeavors are considered and evaluated within a complete business context with particular attention directed to risk assessment and risk management framework.

Internal Controls Program. The plan of organization, methods and procedures adopted by management to ensure that: goals and objectives are met; resource use is consistent with laws, regulations and policies; resources are safeguarded against waste, loss and misuse; and reliable data are obtained, maintained and fairly disclosed in reports.

Corporate Governance

Audit Program. The risk that the Board or management's reliance on internal or external audits is misplaced.

Management Information Program. The risk that management will make decisions based on ineffective, inaccurate or incomplete information or reports.

Management Processes Program. The processes used to drive behaviors to support the Enterprise's defined corporate goals, standards and risk tolerances.

Board Governance Program. The manner in which the Board discharges its duties and responsibilities.

Evaluation Criteria, Assessment Factors & Examination Objectives

OFHEO conducts examination work in each of the ten program areas by using evaluation criteria, assessment factors and examination objectives. The examination objectives are broad in scope, the assessment factors are more narrowly focused and the evaluative criteria are narrower still.

The approximately 700 evaluation criteria in the examination program detail both qualitative and quantitative items that examiners consider when making decisions about the assessment factors. The evaluation criteria are designed to assist the examiners and to ensure that the examination work is consistent at both Enterprises by creating transparency and understanding of the framework within which examiners make judgments.

Examiners use the information and data from the evaluation criteria to form their expert opinions about the almost 100 assessment factors which in turn link directly to one or more of the examination objectives for each of the program areas. Sources for the assessment factors included industry standards and benchmarks, best practices and examiner expertise.

For each program area there are four or five examination objectives. These are the broad statements of what OFHEO's examiners will achieve through their work in each of the ten program areas. In order to make a determination on an examination objective, OFHEO's examiners are required to support and opine on each of the underlying assessment factors. By using the evaluation criteria to reach judgments about the approximately 100 assessment factors, OFHEO achieves its examination objectives, and reaches the examination results and conclusions that are reported in this chapter.

Communicate Examination Findings

5 Throughout the course of conducting examinations, OFHEO communicates with Enterprise personnel not only to gather information, but also to share findings and discuss observations. OFHEO is committed to continuous, effective communication with the Enterprises. OFHEO has the same goal for all communications; that the free flow of information furthers the objective of ensuring the safe and sound operations of the Enterprises. Communications are tailored to the individual structure and dynamics of the Enterprise, and the timing of the communication depends on the situation being addressed. OFHEO keeps executive management and the Board appropriately informed and communicates directly with them as often as required by the Enterprise's condition and the findings from examination activities. OFHEO brings those issues that introduce an exposure to the stable operation of the Enterprise, otherwise fall under the normal duties and responsibilities of the Board, or warrant the Board's attention to the immediate attention of the Board and executive management. Technical issues and matters relating to a single line of business or activity are generally brought to the attention of operating managers with the Board and executive management kept appropriately informed.

Throughout the 1999 annual examination cycle, OFHEO's examiners had ongoing dialogues with the operating management at both Enterprises about the operations and processes covered by each of the ten examination program areas. In these discussions, the examiners shared their views about discrete opportunities the companies had to strengthen their operations and processes, including initiatives that if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring that the Enterprises' operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative process and netted results that found both companies to be well-managed and financially sound.

The different communication vehicles OFHEO uses in its examination program are highlighted on the facing page.

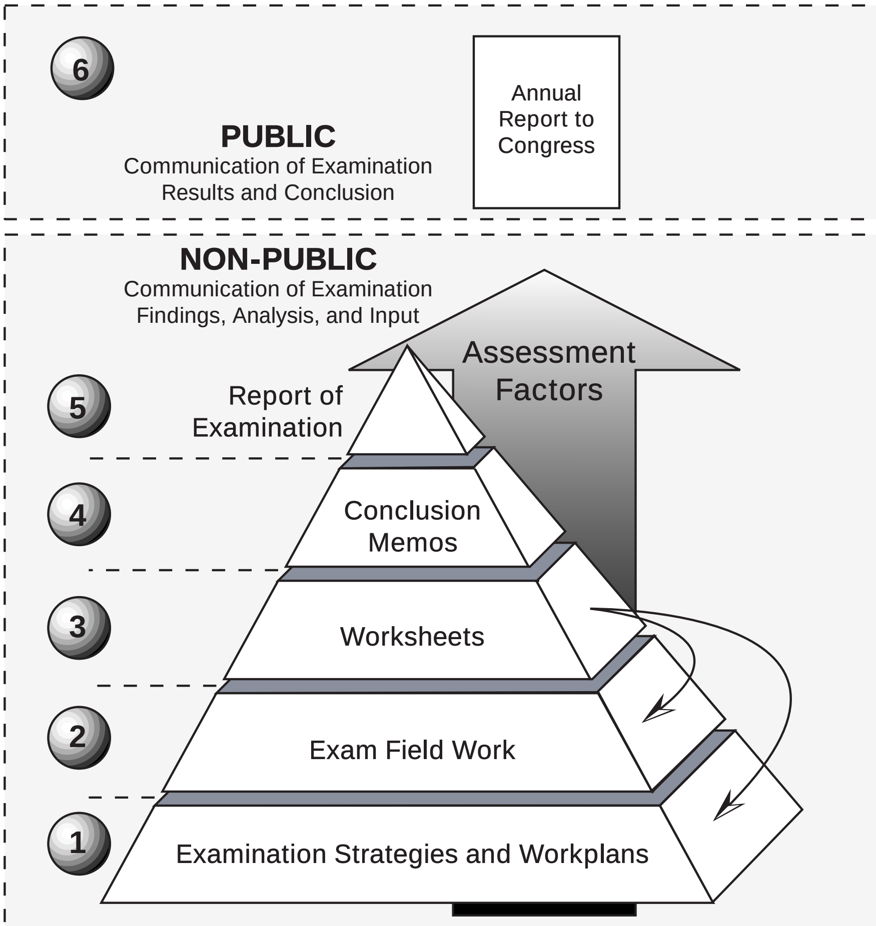
Effect Changes and Follow Up

5 A primary goal of the examination process is to influence positive changes at the Enterprises to enhance their financial safety and soundness. The intensity of the influence exerted by OFHEO relates directly to the risk presented by an issue. If, for example, in the course of an examination OFHEO identifies a significant issue in risk management systems or an undesirable risk level, OFHEO will require management to develop and execute a corrective action plan, and will ensure that the Board holds management accountable for executing the action plan. OFHEO will review the action plan to ensure that it identifies the steps or methods required to cure the root causes of significant deficiencies, and to determine whether the plan is likely to resolve the significant issues within an appropriate time frame. As part of follow up, OFHEO will verify that the action plan has been executed and evaluate its success.

OFHEO will consider the responsiveness of the Enterprise in recognizing the issue and formulating an effective solution when determining if OFHEO needs to take incremental action. If an Enterprise is unresponsive or unable to effect the resolution of meaningful issues, OFHEO will take more formal steps to ensure deficiencies are corrected.

While "effect changes and follow up" is at the top of the chart for the comprehensive annual risk-based examination process, in practice, the final step starts the examination cycle anew.

Figure 24. Examination Communications Vehicles



Full Scope Exam = Opine on All Assessment Factors at Least Annually

6. **Public** document that includes the results and conclusion by program area of the annual risk-based examination.
5. **Proprietary** report prepared at least annually for, and shared with, the Board of Directors. Informs Board about results and conclusions of examination activities.
4. **Proprietary** OFHEO documents produced at least annually. The memos contain a comprehensive summary for each assessment factor.
3. **Confidential** summary of facts, opinions and examiner judgments. Relates discrete exam work to defined program areas and identifies assessment factors relevant to field work conducted
2. **Confidential** review of GSE intellectual capital, information, and documents. Includes transaction and process testing, evaluation of tools, systems, records and personnel.
1. **Confidential** documents tailored to business proposition and risk profile of the GSE. Covers all assessment factors. Shared with GSE to make examination work transparent.

OFHEO's communications about examination activities are ongoing throughout the year. As portrayed above, the communications have a common thread of the Assessment Factors, and grow directly from strategies and workplans which direct the examination field work. As examiners complete field work, they share observations with Enterprise management, including the discrete opportunities the Enterprise has to enhance its tool and processes, through worksheets. The worksheets incorporate and document Enterprise's feedback on the examiner's observations. The worksheets also identify follow up or additional examination work which is reflected in revised strategies and workplans. At least once a year, OFHEO prepares summary memoranda on each Assessment Factor. These memoranda document that OFHEO has completed a full scope examination. The Report of Examination (ROE) informs the Enterprise's Board of Directors about the results and conclusions from OFHEO's risk-based examination activities, and documents OFHEO's expectations about the level of direct involvement by the Board of Directors in the Enterprise's affairs. The ROE is also an official mechanism for the examination group to document for OFHEO's Director its cumulative conclusions of the Enterprise's financial safety and soundness, quality of operations and controls, quality of risks, and quality of risk management and risk selection. As required by law, OFHEO's Director reports to Congress annually on the financial safety and soundness of each Enterprise, including the results and conclusions of the annual examinations.

1999 EXAMINATION RESULTS AND CONCLUSIONS FOR FANNIE MAE

In accordance with OFHEO's examination program, the results and conclusions for each program area are reported in relation to safety and soundness standards —whether they meet, exceed, or fail to meet safety and soundness standards. Throughout the annual examination cycle, OFHEO's examiners had ongoing dialogues with Fannie Mae's operating management about the company's operations and processes in all the program areas. In these discussions, the examiners shared their views about discrete opportunities the company had to strengthen its operations and processes, including initiatives that if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring that Fannie Mae's operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative process and netted favorable results. At year-end 1999, Fannie Mae exceeded safety and soundness standards in all examination program areas. These results reflect the examination work conducted from January through December 1999, and do not necessarily reflect the current condition or operations of the Enterprise.

CREDIT RISK

Fannie Mae's credit risk management and credit risk management framework exceed safety and soundness standards. The portfolio is diversified and the profile of credit risk is in compliance with the internally prescribed limits that are deemed prudent. Policies, procedures, internal controls and management reporting for the credit function are effective. Fannie Mae is adequately compensated for the credit risk it assumes. Management prudently manages counterparty exposure. New products and initiatives are appropriately researched prior to implementation. The process for determining the reserve for losses, credit risk sharing strategies, and the credit risk management tools management uses are effective. Fannie Mae effectively identifies, quantifies and tracks its credit risk exposures. Management has an effective means for following up on credit related issues. The technology and controls supporting the credit risk management function are effective. Management effectively reconciles differences between actual and expected credit portfolio performance.

INTEREST RATE RISK

Fannie Mae's interest rate risk management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to interest rate risk are effective. Management has a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk.

Fannie Mae's management effectively follows up on issues related to interest rate risk. Fannie Mae appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk, and the strategies to alter the exposures to interest rates are effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for strategy and analytics functions are appropriately separated from those for the execution functions. Derivative instruments are used prudently and in accordance with the standards used by other large financial intermediaries.

Liquidity Management

Fannie Mae's liquidity management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to liquidity management are effective. Management has an effective methodology for quantifying and monitoring liquidity, and management appropriately evaluates the impact of events and alternative environments when developing contingency plans. The planning process for liquidity management is effective. Fannie Mae appropriately considers the impact new products and initiatives may have on liquidity. Management effectively follows up on issues and initiatives that influence liquidity. Technology and controls for liquidity management are effective. The quality of tools Fannie Mae uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. Liquidity management is appropriately integrated with other management and with financial performance issues.

Information Technology

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Management has an adequate process to ensure information technology plans effectively address business unit and corporate objectives. Effective processes are in place to ensure appropriate controls are implemented. Documentation for system development and maintenance is complete. Fannie Mae has implemented effective processes to ensure data and information are processed accurately and in a timely manner. Fannie Mae's plan for identifying, renovating, testing and implementing solutions for Year 2000 issues was effective. Fannie Mae effectively coordinated its Year 2000 processing capabilities with customers, vendors and business partners.

INTERNAL CONTROLS

Fannie Mae's internal control framework and the management of that framework exceed safety and soundness standards. Management has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks assessed by management. Management has a reliable process for ensuring the timely resolution of control related issues. Internal Audit appropriately identifies and communicates control deficiencies to management and the Board of Directors. There are established policies and procedures that delineate internal control process and standards for the control environment. Management effectively ensures compliance with established internal controls.

AUDIT CONTROLS

The audit functions exceed safety and soundness standards. The Internal and External Audit functions have the appropriate independence. Auditors performing the work possess appropriate professional proficiency. The scope of audit work performed is appropriate, and the audit work is complete. The management of the Internal Audit department is effective. Executive management and the Board of Directors are appropriately involved with and follow up on identified audit issues. The auditor's risk assessment process is effective. Internal Audit is appropriately involved in new products and new initiatives.

BOARD GOVERNANCE

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. The Board is appropriately engaged in the development of a strategic direction for the company, and ensures that management appropriately defines the operating parameters and risk tolerances of the Enterprise in a manner consistent with the strategic direction; legal standards; and ethical standards. The Board has an effective process for hiring and maintaining a quality executive management team, and holds the executive management team accountable for achieving the defined goals and objectives. The Board is appropriately informed of the condition, activities and operations of the Enterprise, and has sufficient, well-organized time to carry out its responsibilities.

MANAGEMENT INFORMATION

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive necessary reports on Fannie Mae's performance relative to established goals and objectives. Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively. Management reporting permits management to gauge the quality of their decisions. Information systems are linked to Fannie Mae's overall strategy, and are developed and refined pursuant to a strategic plan. The reports management uses for decision making are reliable. Enterprise strategy, roles and responsibility are effectively communicated. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements. Communications across the company are effective.

MANAGEMENT PROCESS

Key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. The strategic planning process is comprehensive. Business unit goals, implementation plans and programs designed to achieve the corporate plan are effective. Management is able to monitor and manage change. Key performance measures are appropriate, effective and align with strategy. The behavior management programs are effectively designed to achieve corporate goals and objectives. Fannie Mae has effective programs for career and management development, and for recruiting competent people. Fannie Mae's proprietary risk management programs and systems are effective. Management effectively conveys an appropriate message of integrity and values. Management's philosophy and operating style have a pervasive effect on the company. The organizational structure and the assignment of responsibility provide for accountability and controls.

1999 EXAMINATION RESULTS AND CONCLUSIONS FOR FREDDIE MAC

In accordance with OFHEO's examination program, the results and conclusions for each program area are reported in relation to safety and soundness standards —whether they meet, exceed, or fail to meet safety and soundness standards. Throughout the annual examination cycle, OFHEO's examiners had ongoing dialogues with Freddie Mac's operating management about the company's operations and processes in all the program areas. In these discussions, the examiners shared their views about discrete opportunities the company had to strengthen its operations and processes, including initiatives that if implemented, would enhance existing tools and processes and minimize the resulting exposure to financial risk. The goal of ensuring that Freddie Mac's operations meet or exceed financial safety and soundness standards at any given point in time is supported by this iterative process and netted favorable results. At year-end 1999, Freddie Mac exceeded safety and soundness standards in all examination program areas. These results reflect the examination work conducted from January through December 1999, and do not necessarily reflect the current condition or operations of the Enterprise.

CREDIT RISK

Freddie Mac's credit risk management and credit risk management framework exceed safety and soundness standards. The portfolio is diversified and the profile of credit risk is in compliance with the internally prescribed limits that are deemed prudent. Policies, procedures, internal controls and management reporting for the credit function are effective. Freddie Mac is adequately compensated for the credit risk it assumes. Management prudently manages counterparty exposure. New products and initiatives are appropriately researched prior to implementation. The process for determining the reserve for credit losses, credit risk sharing strategies, and the credit risk management tools management uses are effective. Freddie Mac effectively identifies, quantifies and tracks its credit risk exposures. Management has an effective means for following up on credit related issues. The technology and controls supporting the credit risk management function are effective. Management effectively reconciles differences between actual and expected credit portfolio performance.

INTEREST RATE RISK

Freddie Mac's interest rate risk management exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to interest rate risk are effective. Management has a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk. Freddie Mac's management effectively follows up on issues related to interest rate risk. Freddie Mac appropriately researches and controls the extent to which new products and initiatives may impact the interest rate risk profile. The technology and controls supporting the interest rate risk management function are effective. The tools used to model interest rate risk, and the strategies to alter the exposures to interest rates are effective. Management effectively incorporates tactical and strategic issues into the management of interest rate risk. The responsibilities for strategy and analytics functions are appropriately separated from those for the execution functions. Derivative instruments are used prudently and in accordance with the standards used by other large financial intermediaries.

LIQUIDITY MANAGEMENT

Freddie Mac's liquidity management framework exceeds safety and soundness standards. The policies, procedures, internal controls and management reporting relating to liquidity management are effective. Management has an effective methodology for quantifying and monitoring liquidity, and management appropriately evaluates the impact of events and alternative environments when developing contingency plans. The planning process for liquidity management is effective. Freddie Mac appropriately considers the impact new products and initiatives may have on liquidity. Management effectively follows up on issues and initiatives that influence liquidity. Technology and controls for liquidity management are effective. The quality of tools Freddie Mac uses to manage and monitor liquidity, and the quality of tools used to perform scenario analyses are effective. An appropriate separation of duties exists between the strategy and analytics functions and the execution function. Liquidity management is appropriately integrated with other management and with financial performance issues.

INFORMATION TECHNOLOGY

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. There are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Management has an adequate process to ensure information technology plans effectively address business unit and corporate objectives. Effective processes are in place to ensure appropriate controls are implemented. Documentation for system development and maintenance is complete. Freddie Mac has implemented effective processes to ensure data and information are processed accurately and in a timely manner. Freddie Mac's plan for identifying, renovating, testing and implementing solutions for Year 2000 issues was effective. Freddie Mac effectively coordinated its Year 2000 processing capabilities with customers, vendors and business partners.

INTERNAL CONTROLS

The internal control framework and the management of that framework exceed safety and soundness standards. Management has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Implemented controls properly address risks assessed by management. Management has a reliable process for ensuring the timely resolution of control related issues. Internal Audit appropriately identifies and communicates control deficiencies to management and the Board of Directors. There are established policies and procedures that delineate internal control process and standards for the control environment. Management effectively ensures compliance with established internal controls.

AUDIT CONTROLS

The audit functions exceed safety and soundness standards. The Internal and External Audit functions have the appropriate independence. Auditors performing the work possess appropriate professional proficiency. The scope of audit work performed is appropriate, and the audit work is complete. The management of the Internal Audit department is effective. Executive management and the Board of Directors are appropriately involved with and follow up on identified audit issues. The auditor's risk assessment process is effective. Internal Audit is appropriately involved in new products and new initiatives.

BOARD GOVERNANCE

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. The Board is appropriately engaged in the development of a strategic direction for the company. The Board ensures that management appropriately defines the operating parameters and risk tolerances of the Enterprise in a manner consistent with the strategic direction; legal standards; and ethical standards. The Board has an effective process for hiring and maintaining a quality executive management team, and holds the executive management team accountable for achieving the defined goals and objectives. The Board is appropriately informed of the condition, activities and operations of the Enterprise, and has sufficient, well-organized time to carry out its responsibilities.

MANAGEMENT INFORMATION

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Management and the Board of Directors receive necessary reports on Freddie Mac's performance relative to established goals and objectives. Management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively. Management reporting permits management to gauge the quality of their decisions. Information systems are linked to Freddie Mac's overall strategy, and are developed and refined pursuant to a strategic plan. The reports management uses for decision making are reliable. Enterprise strategy, roles and responsibility are effectively communicated. Employees have effective channels of communication to provide feedback, report suspected improprieties and suggest enhancements. Communications across the company are effective.

Management Process

Key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. The strategic planning process is appropriately comprehensive. Business unit goals, implementation plans and programs designed to achieve the corporate plan are effective. Management is able to monitor and manage change. Key performance measures are appropriate, effective and align with strategy. The behavior management programs are effectively designed to achieve corporate goals and objectives. Freddie Mac has effective programs for career and management development, and for recruiting competent people. Freddie Mac's proprietary risk management programs and systems are effective. Management effectively conveys an appropriate message of integrity and values. Management's philosophy and operating style have a pervasive effect on the company. The organizational structure and the assignment of responsibility provide for accountability and controls.

REGULATORY ACTIVITY

Rulemaking

On April 13, 1999, OFHEO published the second notice of proposed rulemaking for the risk-based capital standard. During the public comment period, which was extended until March 10, 2000, OFHEO assisted interested parties by responding to technical questions about the proposed standard. The agency also distributed supplementary technical information about the proposal throughout the comment period.

OFHEO issued two other final rules during FY 1999. One rule sets forth procedures for use by OFHEO in collecting debts owed to the Federal government, including procedures for collection of debts through salary offset, administrative offset, and tax refund offset. The second rule implements the Freedom of Information Act (FOIA) by setting forth the basic policies of OFHEO regarding information it maintains and procedures for obtaining access to such information. The second rule also establishes a schedule of fees that will be charged for the processing of document requests under FOIA and sets forth procedures with respect to legal proceedings.

Executive Compensation Authority and Activities

OFHEO's enabling statute and the Enterprises' Charter Acts give the Director of OFHEO oversight responsibility in the area of executive compensation. OFHEO's statute requires the Director to prohibit the Enterprises from providing excessive compensation to any executive officer. Specifically, the statute provides that compensation must be reasonable and comparable with compensation paid by other similar businesses to executives having similar duties and responsibilities. "Similar businesses" include publicly held financial institutions or major financial services companies.

Additionally, the Enterprises' Charter Acts require the Enterprises to obtain the prior approval of OFHEO's Director before entering into or changing termination agreements with their executive officers. The Charter Acts provide that the Director of OFHEO may not approve any such agreement unless the Director determines that the benefits provided under the agreements are comparable to benefits provided under such agreements for officers of other public and private entities involved in financial services and housing interests who have comparable duties and responsibilities.

During 1999, OFHEO approved four termination agreements submitted by the Enterprises.

Flood Insurance Compliance Activities

Background

Federal legislation requires the Enterprises to implement procedures designed to ensure that adequate flood insurance is placed over the term of loans that the Enterprises purchased after September 28, 1995, and that are secured by properties located in certain designated flood hazard areas. OFHEO is responsible for assessing whether the Enterprises have adopted, and are adhering to, such procedures and is also responsible for including that assessment in our annual reports to Congress for 1996, 1998 and 2000.

In its 1996 Annual Report, OFHEO reported that in 1995 Freddie Mac had established adequate flood insurance policies and procedures and was complying with them. OFHEO further reported that Freddie Mac had established appropriate internal controls to provide reasonable assurance of compliance with applicable flood insurance requirements and had adopted quality control procedures that would allow the Enterprise to verify sufficient flood insurance coverage on applicable loans.

OFHEO's 1996 Annual Report also reported that Fannie Mae had established an appropriate flood insurance compliance framework and adequate procedures to ensure the Enterprise's compliance with the applicable flood insurance requirements. OFHEO further reported that the Enterprise was developing internal controls to ensure adequate flood insurance is in place on applicable loans, and that OFHEO would monitor the Enterprise's implementation of the compliance program.

In its 1998 Annual Report, OFHEO reported that in 1997 it had again reviewed the flood insurance procedures and controls at each Enterprise. The reviews included on-site evaluations of applicable procedures and meetings with responsible management. The reviews also included the evaluation of each Enterprise's efforts to test and validate the internal controls established to ensure compliance with applicable statutory requirements. OFHEO reported its conclusion that both Enterprises had implemented, and was adhering to, adequate flood insurance procedures.

Results of Flood Insurance Review

In 1999, OFHEO once again reviewed the flood insurance procedures and controls at both Fannie Mae and Freddie Mac. The reviews were similar in nature and scope to the reviews conducted in 1997. The reviews included on-site evaluations of procedures, assessments of responsible management, and evaluations of internal controls. Based on the reviews, OFHEO concluded that each Enterprise has implemented, and is adhering to, adequate flood insurance procedures.

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Financing OFHEO's Operations

OFHEO'S BUDGET

OFHEO's operations are not financed by taxpayer funds. OFHEO's annual operating budget is, however, subject to the Federal appropriations process and is based on the amount appropriated by Congress and signed into law by the President. The amounts provided for by the appropriations process are collected from Fannie Mae and Freddie Mac in the form of an annual assessment paid semi-annually.

OFHEO has asked the Administration and Congress to review the law that requires OFHEO to be subject to the appropriations process. OFHEO believes that the lengthy appropriations process may not allow the flexibility necessary to address evolving, dynamic issues before those issues impact the financial safety and soundness of the Enterprises or funding for the housing market. OFHEO is requesting that it be removed from the appropriations process, and is seeking the authority to operate like most other financial regulators, such as the Office of the Comptroller of the Currency and the Office of Thrift Supervision. OFHEO's operations would remain subject to the oversight of Congress, but its budget would be free from the appropriations process.

For fiscal year 1999, OFHEO's budgetary resources totaled $16,287,000. Budgetary resources represent $16 million appropriated to OFHEO for fiscal 1999 plus a recovery of prior year funds of $287,000. The amount appropriated by Congress was less than OFHEO's request of $16,551,000. The fiscal year 1999 operating budget supported drafting of the notice of proposed rulemaking for the risk-based capital regulation for Fannie Mae and Freddie Mac, conducting comprehensive annual risk-based examinations of Fannie Mae and Freddie Mac, reviewing capital for each Enterprise quarterly and classifying the Enterprises as adequately capitalized, and performing other safety and soundness related regulatory activities.

For fiscal year 2000, OFHEO received an appropriation of $19,493,000. The fiscal year 2000 budget will support the analysis of public comments on the proposed risk-based capital regulation, continuation of comprehensive annual risk-based examinations and quarterly classification of capital for Fannie Mae and Freddie Mac, and completion of the other goals and objectives identified in OFHEO's fiscal year 2000 Performance Plan (available on OFHEO's website at www.ofheo.gov).

For fiscal year 2001, OFHEO requested a budget of $26,770,000. The increase in requested resources will bolster OFHEO's regulatory infrastructure, strengthen OFHEO's capability to perform qualitative and quantitative assessments of risk, and respond to the rapid growth and increasing complexity of the Enterprises' operations. To accomplish these objectives, OFHEO's fiscal year 2001 budget provides the necessary depth and expertise to accomplish the Office's regulatory mission by supporting 124 full-time equivalent work years. OFHEO's fiscal year 2001 budget will allow the Office to:

- ❏ Enhance the examination and oversight function;
- ❏ Strengthen economic, finance, policy analysis and systems development capacity;
- ❏ Ensure that there is no over-reliance on any single risk measure or quantitative tool by the Enterprises;
- ❏ Enhance the management, and maximize the value, of OFHEO's information technology investments; and
- ❏ Modernize financial and administrative support systems.

UNQUALIFIED AUDIT OPINION OF FY 1999 FINANCIAL STATEMENTS

In conjunction with the government's goal of improved accountability, OFHEO voluntarily prepared financial statements for fiscal year 1999 and subjected these statements and underlying processes to independent audit. The certified public accounting firm of Dembo, Jones, Healy, Pennington and Ahalt audited the statements. The firm issued an unqualified audit opinion on OFHEO's fiscal year 1999 Financial Statements. Following is a copy of the audit opinion and the associated principal financial statements and notes.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

FINANCIAL REPORT

September 30, 1999

Office of Federal Housing Enterprise Oversight

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Dembo, Jones, Healy, Pennington & Ahalt, P.C.
Certified Public Accountants and Consultants

**Independent Auditors' Opinion
on the Financial Statements**

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying balance sheets of Office of Federal Housing Enterprise Oversight as of September 30, 1999 and 1998, and the related statements of net cost, changes in net position, budgetary resources and financing for the years then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Office of Federal Housing Enterprise Oversight as of September 30, 1999 and 1998, and the results of its net costs, changes in net position, its budgetary resources and its financing for the years then ended in conformity with Federal accounting standards.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 98-08, "Audit Requirements for Federal Financial Statements." These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with Governmental Auditing Standards, we have also issued a report dated February 25, 2000, on our consideration of Office of Federal Housing Enterprise Oversight's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations.

Dembo, Jones, Healy, Pennington + Ahalt, P.C.

February 25, 2000

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Certified Public Accountants and Consultants

**Report of Independent Auditors
on Internal Control**

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Office of Federal Housing Enterprise Oversight as of and for the years ended September 30, 1999 and 1998, and have issued our report thereon dated February 25, 2000. We conducted our audits in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements." We noted no matters involving the internal control and its operation that we considered to be material as defined below.

Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. We noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

In addition, with respect to internal controls related to performance measures reported in the annual performance plan, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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In planning and performing our audit, we considered Office of Federal Housing Enterprise Oversight's internal control over financial reporting by obtaining an understanding of the agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal controls.

This report is intended for the information of the management of Office of Federal Housing Enterprise Oversight, OMB, and Congress. However, this report is a matter of public record and its distribution is not limited.

Dembo, Jones, Healy, Pennington & Ahalt, P.C.

February 25, 2000

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Dembo, Jones, Healy, Pennington & Ahalt, P.C

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

Dembo, Jones, Healy, Pennington & Ahalt, P.C.
Certified Public Accountants and Consultants

Report of Independent Auditors
on Compliance with Laws and Regulations

Mr. Armando Falcon
Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Office of Federal Housing Enterprise Oversight as of and for the years ended September 30, 1999 and 1998, and have issued our report thereon dated February 25, 2000. We conducted our audits in accordance with: generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements."

The management of Office of Federal Housing Enterprise Oversight is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 98-08, including the requirements referred as in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin 98-08. However, OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements"' defines the form and content of financial statements of the executive departments and agencies listed in the attachment to the Bulletin. The Office of Federal Housing Enterprise Oversight is not required to follow OMB Bulletin 97-01 but has voluntarily adopted the requirements with the exception of the Management Discussion and Analysis (MD&A) section.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin 98-08.

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The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended for the information of the management of Office of Federal Housing Enterprise Oversight, OMB, and Congress. However, this report is a matter of public record, and its distribution is not limited.

Dembo, Jones, Healy, Pennington & Ahalt, P.C.

February 25, 2000

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Dembo, Jones, Healy, Pennington & Ahalt, P.C.
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
BALANCE SHEETS
AS OF SEPTEMBER 30, 1999 AND 1998

		1999		1998
ASSETS				
Intragovernmental Assets				
Fund Balance with Treasury - Note 2	$	4,365,321	$	5,176,075
Accounts Receivable		-		17,511
Total Intragovernmental Assets		4,365,321		5,193,586
Accounts Receivable		1,206		-
Property, Plant and Equipment, Net - Note 3		8,765,845		5,425,211
TOTAL ASSETS	**$**	**13,132,372**	**$**	**10,618,797**
LIABILITIES				
Liabilities Covered by Budgetary Resources:				
Intragovernmental Liabilities				
Accounts Payable	$	-	$	601
Accrued Payables		58,599		151,428
Total Intragovernmental Liabilities		58,599		152,029
Other Payables and Liabilities				
Accounts Payable		1,493,434		908,270
Other Liabilities		473,666		807,570
Total Other Payables and Liabilities - Note 4		1,967,100		1,715,840
Total Liabilities Covered by Budgetary Resources		**2,025,699**		**1,867,869**
Liabilities Not Covered by Budgetary Resources:				
Governmental				
Liability for Future Worker's Compensation		430,010		406,250
Accrued Annual Leave		484,548		389,707
Total Liabilities Not Covered by Budgetary Resources		**914,558**		**795,957**
TOTAL LIABILITIES	**$**	**2,940,257**	**$**	**2,663,826**
NET POSITION				
Unexpended Appropriations	$	2,339,622	$	3,325,717
Cumulative Results of Operations		7,852,493		4,629,254
Total Net Position - Note 6		**10,192,115**		**7,954,971**
TOTAL LIABILITIES AND NET POSITION	**$**	**13,132,372**	**$**	**10,618,797**

The accompanying notes are an integral part of these statements.

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF NET COST
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 1999 AND 1998

	1999	1998
Program Costs		
Production Costs		
Public Production	$ 11,822,640	$ 11,075,929
Federal Production	2,044,421	2,008,838
Total Production Costs - Note 7	13,867,061	13,084,767
Non-production Costs		
Imputed Financing Sources - Note 8	332,384	331,497
Financing Sources Yet to be Provided - Note 9	118,601	9,491
Total Non-Production Costs	450,985	340,988
Total Program Cost	**14,318,046**	**13,425,755**
Less Earned Revenues	-	(36,479)
Net Cost of Operations	**$ 14,318,046**	**$ 13,389,276**

The accompanying notes are an integral part of these statements.

OFHEO

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF CHANGES IN NET POSITION
FOR FISCAL YEARS ENDED
SEPTEMBER 30, 1999 AND 1998

	1999	1998
Net Cost of Operations	$ (14,318,046)	$ (13,389,276)
Financing Sources		
Appropriations Used	16,960,774	16,063,521
Imputed Financing Sources - Note 8	332,384	331,497
Total Financing Sources	17,293,158	16,395,018
Net Results of Operations	2,975,112	3,005,742
Cumulative Effect of Change in Accounting Policy - Note 10	248,126	-
Net Change in Cumulative Results of Operations	3,223,238	3,005,742
Decrease in Unexpended Appropriations	(986,094)	(119,346)
Changes in Net Position	2,237,144	2,886,396
Net Position - Beginning of Period	7,954,971	5,068,575
Net Position - End of Period - Note 6	$ 10,192,115	$ 7,954,971

The accompanying notes are an integral part of these statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF BUDGETARY RESOURCES
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 1999 AND 1998

		1999		1998
Budgetary Resources				
Appropriations	$	16,000,000	$	16,000,000
Unobligated Balance Brought Forward October 1		442,751		55,593
Spending Authority for Offsetting Collections				
Collected		1,649		68,955
Receivable from Federal Source		(1,649)		(32,476)
Change in Unfilled Customer Orders Without Advances - Federal Source		-		(36,479)
Adjustments				
Recoveries of Prior Year Obligations - Note 11		286,520		582,250
Permanently not available Pursuant to Public Law 102-550		(442,751)		(55,593)
Total Budgetary Resources	**$**	**16,286,520**	**$**	**16,582,250**
Status of Budgetary Resources				
Obligations Incurred	$	16,275,742	$	16,556,930
Unobligated Balance Not Available		10,778		25,320
Total Status of Budgetary Resources	**$**	**16,286,520**		**16,582,250**
Outlays				
Obligations Incurred	$	16,275,742	$	16,556,930
Less: Spending Authority from Collections/Adjustments				
Collected		1,649		68,955
Receivable from Federal Sources		(1,649)		(32,476)
Change in Unfilled Customer Orders Without Advances - Fed Source		-		(36,479)
Actual Recoveries of Prior Year Obligations - Note 11		(286,520)		(582,250)
Total Obligations Incurred		**15,989,222**		**15,974,680**
Obligated Balance, Net - Beginning of Period		**5,150,754**		**4,947,080**
Obligation Transfer - Note 12		**(401,917)**		-
Obligated Balance, Net - End of Period				
Accounts Receivable		-		17,511
Unfilled Customer Orders Federal Sources Without Advances		-		3,060
Undelivered Orders		(2,328,842)		(3,303,456)
Accounts Payable		(2,025,699)		(1,867,869)
Total Obligated Balance, Net - End of Period		**(4,354,541)**		**(5,150,754)**
Total Outlays	**$**	**16,383,518**	**$**	**15,771,006**
Disbursements	$	16,385,167	$	15,827,201
Collections		(1,649)		(68,970)
End of Fiscal Year Adjustments		-		12,775
Total Outlays	**$**	**16,383,518**	**$**	**15,771,006**

The accompanying notes are an integral part of these statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENTS OF FINANCING
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 1999 AND 1998

	1999	1998
Obligations and Nonbudgetary Resources		
Obligations Incurred	$ 16,275,742	$ 16,556,930
Less: Spending Authority from Offsetting Collections/Adjustments		
Earned Reimbursements		
Collections	1,649	68,955
Receivables from Federal Sources	(1,649)	(32,476)
Change in Unfilled Customer Orders	-	(36,479)
Recoveries of Prior Year Obligations - Note 11	(286,520)	(582,250)
Other - Imputed Financing Sources - Note 8	332,384	331,497
Exchange Revenue Not in the Entity's Budget	(1,206)	-
Total Obligations as Adjusted and Nonbudgetary Resources	**16,320,400**	**16,306,177**
Resources That Do Not Fund Net Cost of Operations		
Change in Goods/Services/Benefits Ordered but not Provided (Increases)	974,613	127,951
Change in Unfilled Customer Orders	(3,060)	(39,109)
Costs Capitalized on the Balance Sheet (Increases)		
General Property, Plant and Equipment	(3,340,634)	(3,015,234)
Cumulative Effect in Change of Accounting Policy - Note 10	248,126	-
Total Resources That Do Not Fund Net Costs of Prior Periods	**(2,120,955)**	**(2,926,392)**
Financing Sources Yet to be Provided		
Annual Leave	94,841	28,407
Future Workers' Compensation	23,760	(18,916)
Total Financing Sources Yet to be Provided - Note 9	**118,601**	**9,491**
Net Cost of Operations	**$ 14,318,046**	**$ 13,389,276**

The accompanying notes are an integral part of these statements.

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NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- ***Reporting Entity***

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent office within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (title XIII of P.L. 102-550).

Since 1993, Congress has enacted no-year appropriations, which are available for obligation by OFHEO until expended. The appropriation is funded by an annual assessment from two government sponsored enterprises, Fannie Mae and Freddie Mac (the "Enterprises") and not with taxpayer funds. Beginning with the FY 1998 appropriation, OFHEO receives an appropriation from the U.S. Treasury General Fund each year. OFHEO fully offsets the General Fund appropriation with collections from the assessments of the Enterprises and ensures that taxpayer funds are not used for OFHEO's operations.

OFHEO's enabling statute requires that OFHEO return to the Enterprises, in the form of a credit against the next year's annual assessment, any unobligated assessment funds at the end of the fiscal year. This effectively makes OFHEO operate like a hybrid annual appropriation with no-year authority -- OFHEO's annual resources are available for obligation and expenditure without regard to any fiscal year limitation. OFHEO reduces the current year's assessment by the amount of the unobligated balance from the previous year. Consequently, there is no carry over of budget authority from one year to the next and the annual assessment is adjusted by the credit given to the Enterprises each year.

The accompanying financial statements reflect the activities of OFHEO. OFHEO has only entity activities and the financial statements reflect those activities, which include the appropriation received to conduct operations. OFHEO does not perform custodial activities on behalf of other federal agencies.

- ***Basis of Presentation***

For FY 1999 Financial Statements, OFHEO elected to eliminate Management's Discussion and Analysis (MD&A). OFHEO is not covered by the Chief Financial Officer's (CFO) Act and is not required to follow the Office of Management and Budget (OMB) Bulletin 97-01 on form and content. However, OFHEO adopted OMB's requirements for CFO Act financial statements with the exception of the MD&A. The principal statements were prepared from the official financial records and general ledger of OFHEO in accordance with Generally Accepted Accounting Principles (GAAP) as established through the Federal Accounting Standards Advisory Board (FASAB) standards.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- ***Basis of Accounting***

Transactions are recorded on both an accrual accounting basis and on a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of Federal funds. OFHEO complies with the U.S. Standard General Ledger and conforms to the hierarchy of accounting principles for the Federal Government:

> Standards established by the FASAB, approved by the Director of OMB, the Comptroller General, and the Secretary of the Treasury. The American Institute of Certified Public Accountants (AICPA) has recognized FASAB standards as Generally Accepted Accounting Principles (GAAP).
>
> Interpretations related to Standards issued by OMB in accordance with the procedures outlined in OMB Circular A-134, Financial Accounting Principles and Standards;
>
> Accounting principles published by other authoritative standard-setting bodies in the absence of guidance provided above: and
>
> Accounting policy and procedures established by OFHEO to enhance consistency or to provide guidance in the absence of government-wide standards.

- ***Funds with the U.S. Treasury***

OFHEO cash receipts and disbursements are processed by the United States Department of the Treasury (Treasury). The funds with Treasury are primarily assessment funds that are available to pay current liabilities and to finance authorized purchase commitments. OFHEO does not have monetary assets held outside OFHEO's fund balance at Treasury. OFHEO does not have an advance from Treasury to maintain an Imprest Fund and does not hold any marketable or non-marketable securities. OFHEO does not operate a direct loan or loan guarantee program.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- ***Property and Equipment***

OFHEO's property and equipment is recorded at cost and is depreciated using the straight-line method over the estimated service lives of the assets. Service lives have been established as three years. In years prior to FY 1999, OFHEO used the capitalization policy of HUD, which set the threshold at $100,000 for an individual asset. However, in FY 1999, OFHEO reviewed purchases received between October 1, 1996 and September 30, 1999. Based on this data, OFHEO determined the capitalization threshold should be $5,000 in order to conform with the materiality approach for the accounting that supports OFHEO's independent financial statements. Consequently, effective with the financial statements for the accounting period ended September 30, 1999, OFHEO implemented a change in accounting policy and lowered the threshold to $5,000 for capitalization of assets with a useful life of two or more years. The FY 1999 financial statements include the cumulative effect of this change in accounting policy. Other property items, normal repairs, and maintenance are charged to expense as incurred.

At present, internally developed software is being created at OFHEO. This asset is software under development to support the oversight of the Enterprises. The software supports the development of risk-based capital standards and will be used to implement the final risk-based capital standards. It also supports the examination of the Enterprises. The software is being developed internally, utilizing significant contractor support. The asset had not been placed in service as of September 30, 1999 and no depreciation has been recorded.

OFHEO has no capitalized leases, no real property holdings, and no heritage assets.

- ***Prepaid and Deferred Charges***

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and are recognized as expenditures/expenses when the related goods and services are received.

- ***Liabilities***

Liabilities represent the amount of moneys or other resources that are likely to be paid by OFHEO as the result of a transaction or event that has already occurred. However, no liability can be paid by OFHEO absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is no certainty that an appropriation will be enacted are classified as Liabilities Not Covered by Budgetary Resources.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- ***Liabilities (continued)***

OFHEO's Liabilities Covered by Budgetary Resources, both intragovernmental (payable to other federal entities) and governmental liabilities, consist of accounts payable and accrued liabilities. Accounts payable reflect invoices processed for payment during the fiscal year which are yet unpaid as of the end of the fiscal year due to scheduling of payments to reflect prompt payment guidelines. Accrued liabilities consist of both estimates of accounts payable for the value of services received during the fiscal year for which OFHEO had not been billed as of the end of the fiscal year and payroll accruals reflecting payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year.

OFHEO's Liabilities Not Covered by Budgetary Resources consist of annual leave balances at the end of the fiscal year and Future Workers' Compensation (FWC) benefits under the Federal Employees Compensation Act (FECA). OFHEO's current year budgetary resources do not fund these liabilities.

- ***Retirement Plans***

OFHEO participates in the retirement plans offered by the Office of Personnel Management (OPM) and does not maintain any private retirement plans or benefits. The majority of OFHEO's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). OFHEO expenses its contributions to the retirement plans of covered employees as the expenses are incurred.

OFHEO is reporting imputed financing with respect to retirement plans, health benefits and life insurance pursuant to guidance received from OPM. These costs are paid by OPM and not by OFHEO. Disclosure is intended to provide information regarding the full cost of OFHEO's program in accordance with GAAP.

- ***Net Position***

OFHEO's net position is comprised of the following components:

1. Undelivered orders and unobligated balances of OFHEO's funds.

2. Invested capital represents U.S. Government resources invested in OFHEO's property and equipment and inventory not held for sale. Increases to invested capital are recorded when assets are acquired with direct appropriations, and decreases are recorded as a result of the depreciation, disposition of capital assets, or consumption of inventory.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- ***Net Position (continued)***

3. Future funding requirements represent (a) accumulated annual leave earned but not taken as of the financial statement date and (b) Future Workers' Compensation. The expense for these accruals is not funded from current assessments, but will be funded from future assessments as the expenses are incurred.

- ***Reclassification***

Certain financial data on the financial statement for FY 1998 have been reclassified to conform to FY 1999 presentation of those amounts.

NOTE 2 - FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of the following as of September 30, 1999 and 1998:

		Unobligated			
	Obligated	Available	Unavailable	1999	1998
General Funds	$ 4,354,541	$ 10,780		$ 4,365,321	$ 5,176,075

NOTE 3 - PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment balances as of September 30, 1999 are as follows:

Asset Type	Service Life	Acquisition Cost	Accumulated Depreciation	Net Book Value
Equipment	3 yrs	$ 867,187	$ 233,805	$ 633,382
Information Technology				
Software	-	8,132,463	-	8,132,463
Total		$8,999,650	$ 233,805	$8,765,845

Property, Plant and Equipment balances as of September 30, 1998 are as follows:

Asset Type	Service Life	Acquisition Cost	Accumulated Depreciation	Net Book Value
Information Technology				
Software	-	$5,425,211	-	$5,425,211
Total		$5,425,211	$ -	$5,425,211

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NOTE 4 – OTHER PAYABLES AND LIABILITIES

	1999	1998
Accounts Payable in Process	$ 29,479	$ 3,529
Accrued Payroll and Benefits	473,666	390,139
Accrued Accounts Payable	1,463,955	904,741
Other Liabilities	-	417,431
Total Other Payables and Liabilities	$ 1,967,100	$ 1,715,840

Other Liabilities of $417,431 in 1998 consists of surplus assessment funds identified by OFHEO as part of its reconciliation of budgetary and proprietary accounts to validate account balances relating to the conversion of accounting activities from the HUD accounting system to the Department of Veteran's Affairs (VA) accounting system. The surplus cash was deducted from the FY 1999 assessment to the Enterprises, liquidating the liability reported in FY 1998

NOTE 5 – OPERATING LEASE

OFHEO has an occupancy lease that covers office space and building services which include utilities, security guards, janitorial services, mail delivery, use of the loading dock, garage parking and building operation and maintenance. The initial term of the lease was for five years beginning in 1993. OFHEO may renew the lease for three 5-year options.

OFHEO may terminate the lease agreement in whole or in part. In the event of a termination at OFHEO's discretion, OFHEO would be required to pay two months rent, at an approximate cost of $277,600 (based on FY1999 rates). OFHEO's obligation to make payments ceases on the date that the space is rented. If either party ceases to exist or merge with another entity by operation of law, either party may terminate the rental agreement. In the event of termination under this provision, neither party is liable for further costs, fees, damages or other monies due to the termination, except for payments through the date of termination.

NOTE 6 - NET POSITION

Net Position consists of the following as of September 30, 1999 and 1998:

	1999	1998
Unobligated - Available	$ 10,780	$ 25,321
Undelivered Orders	2,328,842	3,300,396
Total Unexpended Appropriations:	2,339,622	3,325,717
Invested Capital	8,765,845	5,425,211
Future Funding Requirements	(914,558)	(795,957)
Refunds - Other	1,206	-
Total Cumulative Results of Operations:	7,852,493	4,629,254
Total Net Position	$10,192,115	$ 7,954,971

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NOTE 7 - PRODUCTION COSTS

OFHEO is a single program providing financial safety and soundness oversight of Fannie Mae and Freddie Mac. OFHEO does not have any stewardship responsibilities for federal lands. Production Costs represent assessment collections. from Fannie Mae and Freddie Mac, that have been expensed for salaries and operating expenses to support OFHEO during the fiscal year ended September 30, 1999 and 1998. Operating Expenses are distributed into two categories: Public and Federal. Public costs result from contracts with the private sector for goods or services. Federal costs are a result of OFHEO contracting with other federal agencies for goods/services (e.g. purchase of supplies from the General Services Administration).

	1999	1998
Public Production Costs Paid	$10,202,114	$10,171,188
Accrued Accounts Payable Public	1,463,955	904,741
Depreciation Expense	156,571	-
Subtotal Public Production Costs	11,822,640	11,075,929
Federal Production Costs Paid	1,985,822	1,857,410
Accrued Accounts Payable Federal	58,599	151,428
Subtotal Federal Production Costs	2,044,421	2,008,838
Total Production Costs	$13,867,061	$13,084,767

NOTE 8 - IMPUTED FINANCING

Imputed Financing represents the post retirement benefits funded by OPM for OFHEO employees.

	1999	1998
CSRS Imputed	$ 171,146	$ 161,615
FERS Imputed	(10,880)	-
CSRS Offset Imputed	7,783	15,399
Life Insurance Imputed	892	846
Health Insurance Imputed	163,443	153,637
Total Imputed Financing - Post Employment	$ 332,384	$ 331,497

NOTE 9 - FINANCING SOURCES YET TO BE PROVIDED

Financing Sources Yet to be Provided reflects potential future costs for accrued annual leave and future worker's compensation, which are not funded by current budgetary resources. The amounts reported are the net change from the prior year.

	1999	1998
Annual Leave Expense	$ 94,841	$ 28,407
Future Worker's Compensation	23,760	(18,916)
Total Financing Sources Yet To Be Provided	$ 118,601	$ 9,491

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NOTE 10 – CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING POLICY

The cumulative effect of change in accounting policy consisted of:

	1999
Property and Equipment Purchased in Prior Years	$ 325,361
Prior Years Accumulated Depreciation	(77,235)
Total Cumulative Effect of Change in Accounting Policy	$ 248,126

NOTE 11 - RECOVERIES OF PRIOR YEAR OBLIGATIONS

Recoveries of prior year obligations consist of the reapportionment of prior year funds by the OMB. OFHEO requested and received the authority to re-obligate these prior year funds in FY 1999 and FY 1998 for valid current year requirements.

NOTE 12 – OBLIGATION TRANSFER

Obligations transferred consist of certain transactions made during the fiscal year that relate to the prior fiscal year. This includes the surplus cash reported in FY 1998 that subsequently reduced the collection from the two Government Sponsored Enterprises' FY 1999 assessment. The transfer also reflects certain disbursement transactions pertaining to one fiscal year but received or adjusted in a different fiscal year.

	1999
Surplus Cash	$ (417,431)
Prior Year Disbursement Corrections and Credits	15,514
Total Obligation Transfer	$ (401,917)

NOTE 13 – PENSION EXPENSE

OFHEO recognizes the full cost of providing future pension benefits to eligible employees while they are working. The excess of total pension expense over the amounts contributed by OFHEO and its employees must be financed by OPM. OFHEO recognizes an imputed financing source equal to this excess amount. Pension expense in FY 1999 and 1998 consisted of the following:

	Employer Contributions	Accumulated Costs Imputed to OPM	1999 Total Pension Expense	1998 Total Pension Expense
Civil Service Retirement System	$ 188,307	$ 178,929	$ 367,236	$ 361,652
Federal Employee's Retirement System	465,653	(10,880)	454,773	449,059
Thrift Savings Plan	188,032	-	188,032	170,834
Total Pension Expense	$ 841,992	$ 168,049	$ 1,010,041	$ 981,545

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Table 1. Fannie Mae Mortgage Purchases

Business Activity ($ in Millions)				
	Purchases			
Period	Single-Family ($)	Multifamily ($)	Total [1] ($)	Mortgage Securities[2] ($)
4q99	52,105	1,903	54,008	31,706
3q99	68,632	2,479	71,111	44,188
2q99	82,789	2,769	85,558	47,963
1q99	112,610	2,861	115,471	42,574
Annual Data				
1999	316,136	10,012	326,148	166,431
1998	354,920	11,428	366,348	144,461
1997	159,921	6,534	166,455	48,848
1996	164,456	6,451	170,907	45,016
1995	126,003	4,966	130,969	34,036
1994	158,229	3,939	162,068	24,552
1993	289,826	4,135	293,961	6,275
1992	248,210	2,852	251,062	4,930
1991	133,551	3,204	136,755	2,384
1990	111,007	3,180	114,187	977
1989	80,510	4,325	84,835	Not Applicable Before 1990
1988	64,613	4,170	68,783	
1987	73,942	1,733	75,675	
1986	77,223	1,877	79,100	
1985	42,543	1,200	43,743	
1984	27,713	1,106	28,819	
1983	26,339	140	26,479	
1982	25,929	10	25,939	
1981	6,827	2	6,829	
1980	8,074	27	8,101	
1979	10,798	9	10,807	
1978	12,302	3	12,305	
1977	4,650	134	4,784	
1976	3,337	295	3,632	
1975	3,646	674	4,320	
1974	4,746	2,273	7,019	
1973	4,170	2,082	6,252	
1972	2,596	1,268	3,864	
1971	2,742	1,298	4,040	

Source: Fannie Mae

1 Cash purchases from lenders plus lender-originated securitizations; excludes non-Fannie Mae securities and repurchased Fannie Mae MBS.

2 Not included in total purchases.

Table 2. Fannie Mae MBS Issuances

Business Activity ($ in Millions)				
	MBS Issuances			
Period	Single-Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS[1] ($)
4q99	48,395	1,517	49,912	7,797
3q99	63,851	1,922	65,773	12,588
2q99	76,194	2,359	78,553	18,652
1q99	103,752	2,699	106,451	16,123
Annual Data				
1999	292,192	8,497	300,689	55,160
1998	315,120	11,028	326,148	84,147
1997	143,615	5,814	149,429	85,415
1996	144,201	5,668	149,869	30,780
1995	106,269	4,187	110,456	9,681
1994	128,385	2,237	130,622	73,365
1993	220,485	959	221,444	210,630
1992	193,187	850	194,037	170,205
1991	111,488	1,415	112,903	112,808
1990	96,006	689	96,695	68,291
1989	66,489	3,275	69,764	41,715
1988	51,120	3,758	54,878	17,005
1987	62,067	1,162	63,229	9,917
1986	60,017	549	60,566	2,400
1985	23,142	507	23,649	Not Issued Before 1986
1984	13,087	459	13,546	
1983	13,214	126	13,340	
1982	13,970	Not Issued Before 1983	13,970	
1981	717		717	
	Not Issued Before 1981		Not Issued Before 1981	

Source: Fannie Mae

[1] The majority qualify as Real Estate Mortgage Investment Conduits (REMICs) and are also known as structured securitizations.

Table 3. Fannie Mae Earnings

Period	Net Interest Income[1] ($)	Guarantee Fee Income ($)	Average Guarantee Fee Rate (basis points)	Administrative Expenses ($)	Credit-related Expenses[2] ($)	Net Income ($)	Return on Common Equity[3] (%)
Earnings ($ in Millions)							
4q99	1,306	325	19.3	206	19	1,038	25.5
3q99	1,241	320	19.2	203	21	991	25.2
2q99	1,188	320	19.4	199	40	958	24.9
1q99	1,159	317	19.4	192	47	925	24.8
Annual Data							
1999	4,894	1,282	19.3	800	127	3,912	25.2
1998	4,110	1,229	20.2	708	261	3,418	25.2
1997	3,949	1,274	22.7	636	375	3,056	24.6
1996	3,592	1,196	22.4	560	409	2,725	24.1
1995	3,047	1,086	22.0	546	335	2,144	20.9
1994	2,823	1,083	22.5	525	378	2,132	24.3
1993	2,533	961	21.3	443	305	1,873	25.3
1992	2,058	834	21.2	381	320	1,623	26.5
1991	1,778	675	21.0	319	370	1,363	27.7
1990	1,593	536	21.1	286	310	1,173	33.7
1989	1,191	408	21.3	254	310	807	31.1
1988	837	328	21.6	218	365	507	25.2
1987	890	263	22.1	197	360	376	23.5
1986	384	175	23.8	175	306	105	9.5
1985	139	112	25.6	142	206	(7)	(0.7)
1984	(90)	78	26.2	112	86	(71)	(7.4)
1983	(9)	54	26.3	81	48	49	5.1
1982	(464)	16	27.2	60	36	(192)	(18.9)
1981	(429)	0.3	25.0	49	(28)	(206)	(17.2)
1980	21	Not Applicable Before 1981	Not Applicable Before 1981	44	19	14	0.9
1979	322			46	35	162	11.3
1978	294			39	36	209	16.5
1977	251			32	28	165	15.3
1976	203			30	25	127	13.8
1975	174			27	16	115	14.1
1974	142			23	17	107	14.7
1973	180			18	12	126	20.3
1972	138			13	5	96	18.8
1971	49			15	4	61	14.4

Source: Fannie Mae

1 Interest income net of interest expense, nominal basis.
2 Credit-related expenses are mortgage loan loss provision plus real estate owned expense.
3 Average common equity used to calculate return.

Table 4. Fannie Mae Balance Sheet

Period	Balance Sheet ($ in Millions) Total Assets ($)	Retained Mortgage Portfolio ($) [1]	Non-Mortgage Investments[2] ($)	Debt Outstanding ($)	Stock-holder's Equity ($)	Mortgage Backed Securities Outstanding ($ in Millions) Total MBS Outstanding[3] ($)	Multiclass MBS Outstanding[4] ($)
4q99	575,167	522,977	39,751	547,619	17,629	679,169	335,514
3q99	551,532	504,497	36,407	524,879	17,055	670,157	338,626
2q99	526,263	473,652	42,304	499,897	16,581	661,619	342,572
1q99	501,058	440,924	49,916	475,418	16,134	660,102	346,461
Annual Data							
1999	575,167	522,977	39,751	547,619	17,629	679,169	335,514
1998	485,014	415,434	58,515	460,291	15,453	637,143	361,613
1997	391,673	316,592	64,596	369,774	13,793	579,138	388,360
1996	351,041	286,527	56,606	331,270	12,773	548,173	339,798
1995	316,550	252,868	57,273	299,174	10,959	513,230	353,528
1994	272,508	220,815	46,335	257,230	9,541	486,345	378,733
1993	216,979	190,169	21,396	201,112	8,052	471,306	381,865
1992	180,978	156,260	19,574	166,300	6,774	424,444	312,369
1991	147,072	126,679	9,836	133,937	5,547	355,284	224,806
1990	133,113	114,066	9,868	123,403	3,941	288,075	127,278
1989	124,315	107,981	8,338	116,064	2,991	216,512	64,826
1988	112,258	100,099	5,289	105,459	2,260	170,097	26,660
1987	103,459	93,665	3,468	97,057	1,811	135,734	11,359
1986	99,621	94,123	1,775	93,563	1,182	95,568	Not Available Before 1987
1985	99,076	94,609	1,466	93,985	1,009	54,552	
1984	87,798	84,135	1,840	83,719	918	35,738	
1983	78,383	75,247	1,689	74,594	1,000	25,121	
1982	72,981	69,356	2,430	69,614	953	14,450	
1981	61,578	59,629	1,047	58,551	1,080	717	
1980	57,879	55,589	1,556	54,880	1,457	Not Issued Before 1981	
1979	51,300	49,777	843	48,424	1,501		
1978	43,506	42,103	834	40,985	1,362		
1977	33,980	33,252	318	31,890	1,173		
1976	32,393	31,775	245	30,565	983		
1975	31,596	30,820	239	29,963	861		
1974	29,671	28,666	466	28,168	772		
1973	24,318	23,589	227	23,003	680		
1972	20,346	19,652	268	19,239	559		
1971	18,591	17,886	349	17,672	460		

Source: Fannie Mae

1 Gross retained portfolio net of unamortized purchase premium, discounts and deferred price adjustments.
2 Prior to 1982 balances primarily composed of U.S. government and agency securities.
3 Total MBS outstanding net of MBS in portfolio.
4 The majority qualify as REMICs and are also known as structured securitizations.

Table 5. Fannie Mae Retained Mortgage Portfolio Detail

($ in Millions)				
Period	Whole Loans ($)	Fannie Mae Securities ($)	Other Mortgage-Related Securities ($)	Total Retained Mortgage Portfolio ($)
4q99	149,105	281,714	93,122	523,941
3q99	150,984	268,327	85,627	504,938
2q99	152,897	249,816	70,602	473,315
1q99	154,973	221,713	63,453	440,139
Annual Data				
1999	149,105	281,714	93,122	523,941
1998	155,779	197,375	61,361	414,515
1997	160,102	130,444	26,132	316,678
1996	167,891	102,607	16,554	287,052
1995	171,481	69,729	12,301	253,511
1994	173,909	43,998	7,150	225,057
1993	163,149	24,219	3,493	190,861
1992	134,597	20,535	2,987	158,119
1991	109,251	16,700	3,032	128,983
1990	101,797	11,758	3,073	116,628
1989	95,729	11,720	3,272	110,721
1988	92,220	8,153	2,640	103,013
1987	89,618	4,226	2,902	96,746
1986	94,167	1,606	2,060	97,833
1985	97,421	435	793	98,649
1984	87,205	477	427	88,109
1983	77,983		273	78,256
1982	71,777		37	71,814
1981	61,411		1	61,412
1980	57,326		1	57,327
1979	51,096		1	51,097
1978	43,315			43,315
1977	34,377			34,377
1976	32,937			32,937
1975	31,916			31,916
1974	29,708			29,708
1973	24,459			24,459
1972	20,326			20,326
1971	18,515			18,515

Source: Fannie Mae

Table 6. Fannie Mae Financial Derivatives

Financial Derivatives ($ in Millions)						
Period	Interest Rate Swaps ($)	Interest Rate Caps Floors Corridors ($)	Foreign Currency ($)	Futures & Options and Forward Rate Agreements ($)	Short Sales and Other ($)	Total ($)
4q99	192,032	28,950	11,507	41,081	1,400	274,970
3q99	176,493	26,000	12,255	19,712	500	234,981
2q99	149,888	25,750	12,914	18,915	3,885	211,351
1q99	147,425	25,000	12,997	18,875	3,565	207,863
Annual Data						
1999	192,032	28,950	11,507	41,081	1,400	274,970
1998	142,846	14,500	12,995	13,481	3,735	187,557
1997	149,673	100	9,968	0	1,660	161,401
1996	158,140	300	2,429	0	350	161,219
1995	125,679	300	1,224	29	975	128,207
1994	87,470	360	1,023	0	1,465	90,317
1993	49,458	360	1,023	0	1,425	52,265
1992	24,130	0	1,177	0	1,350	26,658
1991	9,100	0	Not Available Before 1992	50	1,050	10,200
1990	4,800	0		25	1,700	6,525

Source: Fannie Mae

Table 7. Fannie Mae Non-Mortgage Investments

Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total[1] ($)
	Non-Mortgage Investments ($ in Millions)					
4q99	4,837	19,207	2,574	1,723	11,410	39,751
3q99	1,112	18,911	2,299	895	13,190	36,407
2q99	3,683	18,912	3,306	1,910	14,493	42,304
1q99	6,750	19,930	4,653	2,943	15,640	49,916
Annual Data						
1999	4,837	19,207	2,574	1,723	11,410	39,751
1998	7,928	20,993	7,556	5,155	16,885	58,515
1997	19,212	16,639	6,715	11,745	10,285	64,596
1996	21,734	14,635	4,667	6,191	9,379	56,606
1995	19,775	9,905	10,175	8,629	8,789	57,273
1994	17,593	3,796	9,006	7,719	8,221	46,335
1993	4,496	3,557	4,684	0	8,659	21,396
1992	6,587	4,124	3,189	0	5,674	19,574
1991	2,954	2,416	2,195	0	2,271	9,836
1990	5,329	1,780	951	0	1,808	9,868
1989	5,158	1,107	0	0	2,073	8,338
1988	4,125	481	0	0	683	5,289
1987	2,559	25	0	0	884	3,468
1986	1,530	0	0	0	245	1,775
1985	1,391	0	0	0	75	1,466
1984	1,575	0	0	0	265	1,840
1983	1,462	0	0	0	227	1,689
1982	1,799	0	0	0	631	2,430
1981	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	1,047
1980						1,556
1979						843
1978						834
1977						318
1976						245
1975						239
1974						466
1973						227
1972						268
1971						349

Source: Fannie Mae

1 Prior to 1982, the majority of non-mortgage investments were comprised of U.S. government securities and agency securities.

Table 8. Fannie Mae Asset - Liability Mix

Asset - Liability Ratios				
	Asset Mix		Liability Mix	
Period	Retained Portfolio / Total Assets (%)	Non-mortgage Investments/ Total Assets (%)	Callable Debt / Total Effective Long-Term Debt[1] (%)	Total Effective Long-Term Debt / Total Debt[2] (%)
4q99	90.9	6.9	43.4	87.1
3q99	91.5	6.6	44.4	86.0
2q99	90.0	8.0	46.3	84.9
1q99	88.0	10.0	46.1	82.3
Annual Data				
1999	90.9	6.9	43.4	87.1
1998	85.7	12.1	42.9	76.4
1997	80.8	16.5	46.4	79.4
1996	81.6	16.1	47.5	80.5
1995	79.9	18.1	48.0	73.9
1994	81.0	17.0	54.6	72.6
1993	87.6	9.9	58.1	80.0
1992	86.3	10.8	48.8	77.9
1991	86.1	6.7	36.0	85.5
1990	85.7	7.4	21.9	82.6
1989	86.9	6.9	10.1	80.1
1988	89.2	4.7	3.6	78.7
1987	90.5	3.4	Not Available Before 1988	Not Available Before 1988
1986	94.5	1.8		
1985	95.5	1.5		
1984	95.8	2.1		
1983	96.0	2.2		
1982	95.0	3.3		
1981	96.8	1.7		
1980	96.0	2.7		
1979	97.0	1.6		
1978	96.8	1.9		
1977	97.9	0.9		
1976	98.1	0.8		
1975	97.5	0.8		
1974	96.6	1.6		
1973	97.0	1.0		
1972	96.6	1.3		
1971	96.2	1.8		

Source: Fannie Mae

1 Callable debt includes derivative financial instruments that provide interest-rate protection similar to callable debt.

2 Total effective long-term debt represents debt with an effective repricing date greater than one year.

Table 9. Fannie Mae Mortgage Asset Quality

Mortgage Asset Quality					
Period	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2] (%)	Credit Losses / Total MBS Outstanding plus Retained Portfolio[3] (%)	REO /Total MBS Outstanding plus Retained Portfolio[4] (%)	Credit-Enhanced Outstanding /Total MBS Outstanding plus Retained Portfolio[5] (%)
4q99	0.48	0.12	0.01	0.06	20.9
3q99	0.49	0.12	0.01	0.07	20.4
2q99	0.49	0.19	0.01	0.07	19.5
1q99	0.55	0.21	0.02	0.08	18.4
Annual Data					
1999	0.48	0.12	0.01	0.06	20.9
1998	0.58	0.29	0.03	0.08	17.5
1997	0.62	0.37	0.04	0.10	12.8
1996	0.58	0.68	0.05	0.11	10.5
1995	0.56	0.81	0.05	0.08	10.6
1994	0.47	1.21	0.06	0.10	10.2
1993	0.48	2.34	0.04	0.10	10.6
1992	0.53	2.65	0.04	0.09	15.6
1991	0.64	3.62	0.04	0.07	22.0
1990	0.58	1.70	0.06	0.09	25.9
1989	0.69	3.20	0.07	0.14	Not Available Before 1990
1988	0.88	6.60	0.11	0.15	
1987	1.12	Not Available Before 1988	0.11	0.18	
1986	1.38		0.12	0.22	
1985	1.48		0.13	0.32	
1984	1.65		0.09	0.33	
1983	1.49		0.05	0.35	
1982	1.41		0.01	0.20	
1981	0.96		0.01	0.13	
1980	0.90		0.01	0.09	
1979	0.56		0.02	0.11	
1978	0.55		0.02	0.18	
1977	0.46		0.02	0.26	
1976	1.58		0.03	0.27	
1975	0.56		0.03	0.51	
1974	0.51		0.02	0.52	
1973	Not Available Before 1974		0.00	0.61	
1972			0.02	0.98	
1971			0.01	0.59	

Source: Fannie Mae

1 Includes conventional loans for which Fannie Mae has primary risk of loss that are 90 or more days delinquent or are in the process of foreclosure. Data prior to 1992 includes loans in relief or bankruptcy, even if they are less than 90 days delinquent.

2 Includes loans that are two or more months delinquent based on the dollar amount of such loans in the portfolio and underlying MBS.

3 Credit losses are charge-offs plus real estate owned expense; average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.

4 Real Estate Owned balances reflect end-of-period amounts. Beginning with 1995, data reflect adoption of SFAS 114.

5 The proportion of the retained portfolio that has additional recourse from a third party to accept some or all of the expected losses on defaulted mortgages.

Table 10. Fannie Mae Capital

Capital ($ in Millions)							
Period	Stockholders' Equity /Total MBS Outstanding plus Total Assets (%)	Stockholders' Equity plus Reserves / Total MBS Outstanding plus Total Assets[1] (%)	Core Capital[2] ($)	Minimum Regulatory Capital Requirements[3] ($)	Regulatory Capital Surplus (Deficit)[4] ($)	Market Capitalization[5] ($)	Common Share Dividend Payout Rate[6] (%)
4q99	1.41	1.47	17,876	17,770	106	63,651	27.0
3q99	1.40	1.46	17,222	17,100	122	63,982	28.5
2q99	1.40	1.46	16,690	16,465	225	69,825	29.5
1q99	1.39	1.46	16,153	15,837	316	71,109	30.6
Annual Data							
1999	1.41	1.47	17,876	17,770	106	63,651	28.8
1998	1.38	1.45	15,465	15,334	131	75,881	29.5
1997	1.42	1.50	13,793	12,703	1,090	59,167	29.4
1996	1.42	1.50	12,773	11,466	1,307	39,932	30.4
1995	1.32	1.41	10,959	10,451	508	33,812	34.6
1994	1.26	1.37	9,541	9,415	126	19,882	30.8
1993	1.17	1.29	8,052	7,064	988	21,387	26.8
1992	1.12	1.25	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	20,874	23.2
1991	1.10	1.24				18,836	21.3
1990	0.94	1.06				8,490	14.7
1989	0.88	1.01				8,092	12.8
1988	0.80	0.94				3,992	11.2
1987	0.76	0.90				2,401	11.7
1986	0.61	0.74				3,006	8.0
1985	0.66	0.76				1,904	30.1
1984	0.74	0.85				1,012	N/A
1983	0.97	1.10				1,514	13.9
1982	1.09	1.25				1,603	N/A
1981	1.73	1.90				502	N/A
1980	2.49	2.73				702	464.2
1979	2.93	3.17				Not Available Before 1980	45.7
1978	3.13	3.36					30.3
1977	3.45	3.66					31.8
1976	3.03	3.19					33.6
1975	2.73	2.84					31.8
1974	2.60	2.69					29.6
1973	2.80	2.87					18.1
1972	2.75	2.78					15.2
1971	2.47	2.49					18.7

Source: Fannie Mae

1 Effective 1995, reserves exclude specific allowances for impaired loans pursuant to SFAS 114.

2 The sum of: (Outstanding Common Stock, Noncumulative preferred stock, paid-in capital and retained earnings).

3 Minimum capital requirement in accordance with the Federal Housing Enterprise Financial Safety and Soundness Act of 1992.

4 The difference between Core Capital and Minimum Regulatory Capital Requirement.

5 Stock price multiplied by number of outstanding common shares.

6 Common dividends paid as a percentage of net income available to common shareholders.

Table 11. Freddie Mac Mortgage Purchases

Period	Business Activity ($ Millions)			
	Purchases			
	Single-Family ($)	Multifamily ($)	Total [1] ($)	Mortgage Securities[2] ($)
4q99	32,341	2,186	34,527	12,963
3q99	50,000	1,514	51,514	23,261
2q99	68,848	2,078	70,926	31,359
1q99	81,423	1,403	82,826	34,315
Annual Data				
1999	232,612	7,181	239,793	101,898
1998	263,490	3,910	267,400	128,446
1997	115,160	2,241	117,401	35,385
1996	122,850	2,229	125,079	36,824
1995	89,971	1,565	91,536	39,292
1994	122,563	847	123,410	19,817
1993	229,051	191	229,242	Not Available Before 1994
1992	191,099	27	191,126	
1991	99,729	236	99,965	
1990	74,180	1,338	75,518	
1989	76,765	1,824	78,589	
1988	42,884	1,191	44,075	
1987	74,824	2,016	76,840	
1986	99,936	3,538	103,474	
1985	42,110	1,902	44,012	
1984	Not Available Before 1985	Not Available Before 1985	21,885	
1983			22,952	
1982			23,671	
1981			3,744	
1980			3,690	
1979			5,716	
1978			6,524	
1977			4,124	
1976			1,129	
1975			1,716	
1974			2,185	
1973			1,334	
1972			1,265	
1971			778	

Source: Freddie Mac

[1] Loans purchased from Lenders; excludes non-Freddie Mac securities and repurchased Freddie Mac MBS.

[2] Not included in total purchases.

Table 12. Freddie Mac MBS Issuances

Business Activity ($ in Millions)				
MBS Issuances				
Period	Single Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS[1] ($)
4q99	31,129	1,260	32,389	15,748
3q99	48,115	341	48,456	18,635
2q99	67,350	435	67,785	28,617
1q99	84,392	9	84,401	56,565
Annual Data				
1999	230,986	2,045	233,031	119,565
1998	249,627	937	250,564	135,162
1997	113,758	500	114,258	84,366
1996	118,932	770	119,702	34,145
1995	85,522	355	85,877	15,372
1994	116,901	209	117,110	73,131
1993	208,724	0	208,724	143,336
1992	179,202	5	179,207	131,284
1991	92,479	0	92,479	72,032
1990	71,998	1,817	73,815	40,479
1989	72,931	587	73,518	39,754
1988	39,490	287	39,777	12,985
1987	72,866	2,152	75,018	0
1986	96,798	3,400	100,198	2,233
1985	37,583	1,245	38,828	2,625
1984	Not Available Before 1985	Not Available Before 1985	18,684	1,805
1983			19,691	1,685
1982			24,169	Not Issued Before 1983
1981			3,526	
1980			2,526	
1979			4,546	
1978			6,412	
1977			4,657	
1976			1,360	
1975			950	
1974			46	
1973			323	
1972			494	
1971			65	

Source: Freddie Mac

[1] The majority qualify as Real Estate Mortgage Investment Conduits (REMICs), and are also known as structured securitizations. In years 1983 - 1986, data consists of collateralized mortgage obligations (CMOs) and mortgage cash flow obligations (MCFs).

Table 13. Freddie Mac Earnings

Earnings ($ in Millions)							
Period	Net Interest Income[1, 2, 3] ($)	Guarantee Fee Income [2, 3] ($)	Average Guarantee Fee[3, 4] (basis points)	Administrative Expenses ($)	Credit-related Expenses[4] ($)	Net Income ($)	Return on Common Equity[5] (%)
4q99	767	259	19.5	167	40	594	26.7
3q99	710	256	19.6	164	36	564	26.0
2q99	734	255	19.9	161	33	552	25.6
1q99	715	249	20.3	163	50	513	23.5
Annual Data							
1999	2,926	1,019	19.8	655	159	2,223	25.5
1998	2,215	1,019	21.4	578	342	1,700	22.6
1997	1,847	1,082	22.9	495	529	1,395	23.1
1996	1,705	1,086	23.4	440	608	1,243	22.6
1995	1,396	1,087	23.8	395	541	1,091	22.1
1994	1,112	1,108	24.4	379	425	983	23.3
1993	772	1,009	23.8	361	524	786	22.3
1992	695	936	24.7	329	457	622	21.2
1991	683	792	23.7	287	419	555	23.6
1990	619	654	22.4	243	474	414	20.4
1989	517	572	23.4	217	278	437	25.0
1988	492	465	21.5	194	219	381	27.5
1987	319	472	24.2	150	175	301	28.2
1986	299	301	22.4	110	120	247	28.5
1985	312	188	22.1	81	79	208	30.0
1984	213	158	24.7	71	54	144	52.0
1983	125	132	26.2	53	46	86	44.5
1982	30	77	24.5	37	26	60	21.9
1981	34	36	19.5	30	16	31	13.1
1980	54	23	14.3	26	23	34	14.7
1979	55	18	13.2	19	20	36	16.2
1978	37	14	14.9	14	13	25	13.4
1977	31	9	18.9	12	8	21	12.4
1976	18	3	13.6	10	(1)	14	9.5
1975	31	3	24.8	10	11	16	11.6
1974	42	2	25.5	8	33	5	4
1973	31	2	32.4	7	15	12	9.9
1972	10	1	39.4	5	4	4	3.5
1971	10	1	Not Available Before 1972	Not Available Before 1972	Not Available Before 1972	6	5.5

Source: Freddie Mac

1 Interest income net of interest expense, nominal basis.

2 Effective 1/1/96, Freddie Mac reports guarantee fees on retained MBS as guarantee fee income. However, in these data, fees on retained MBS have been estimated and reclassified as interest income for comparability with Fannie Mae.

3 In 1993, Freddie Mac adopted a change in reporting of uncollectable interest on single-family mortgages. Pre-1993 amounts do not reflect this change.

4 Credit-related expenses are mortgage loan loss provision plus real estate owned expense. From 1988 to 1990, data include real estate owned disposition loss provisions instead of expense, and before 1988, only mortgage loan loss provision.

5 Average common equity used to calculate return for annual data. Quarterly data are based on averages of quarter-end equity.

Table 14. Freddie Mac Balance Sheet

Balance Sheet ($ in Millions)						Mortgage-Backed Securities Outstanding ($ in Millions)	
Period	Total Assets ($)	Retained Mortgage Portfolio[1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstandings ($)	Stock-holder's Equity ($)	Total MBS Outstanding[3] ($)	Multiclass MBS Outstanding[4] ($)
4q99	386,684	322,914	34,152	360,711	11,525	537,883	316,168
3q99	364,885	315,911	22,344	341,146	11,140	529,213	313,504
2q99	341,540	299,236	19,749	314,412	10,555	515,607	302,639
1q99	327,766	277,995	23,976	299,196	10,886	499,756	286,954
Annual Data							
1999	386,684	322,914	34,152	360,711	11,525	537,883	316,168
1998	321,421	255,670	42,160	287,396	10,835	478,351	260,504
1997	194,597	164,543	16,430	172,842	7,521	475,985	233,591
1996	173,866	137,826	22,248	156,981	6,731	473,065	237,939
1995	137,181	107,706	12,711	119,961	5,863	459,045	246,366
1994	106,199	73,171	17,808	93,279	5,162	460,656	264,152
1993	83,880	55,938	18,225	49,993	4,437	439,029	265,178
1992	59,502	33,629	12,542	29,631	3,570	407,514	218,747
1991	46,860	26,667	9,956	30,262	2,566	359,163	146,978
1990	40,579	21,520	12,124	30,941	2,136	316,359	88,124
1989	35,462	21,448	11,050	26,147	1,916	272,870	52,865
1988	34,352	16,918	14,607	26,882	1,584	226,406	15,621
1987	25,674	12,354	10,467	19,547	1,182	212,635	3,652
1986	23,229	13,093	Not Available Before 1987	15,375	953	169,186	5,333
1985	16,587	13,547		12,747	779	99,909	5,047
1984	13,778	10,018		10,999	606	70,026	3,214
1983	8,995	7,485		7,273	421	57,720	1,669
1982	5,999	4,679		4,991	296	42,952	Not Issued Before 1983
1981	6,326	5,178		5,680	250	19,897	
1980	5,478	5,006		4,886	221	16,962	
1979	4,648	4,003		4,131	238	15,316	
1978	3,697	3,038		3,216	202	12,017	
1977	3,501	3,204		3,110	177	6,765	
1976	4,832	4,175		4,523	156	2,765	
1975	5,899	4,878		5,609	142	1,643	
1974	4,901	4,469		4,684	126	780	
1973	2,873	2,521		2,696	121	791	
1972	1,772	1,726		1,639	110	444	
1971	1,038	935		915	107	64	

Source: Freddie Mac

1 Gross retained portfolio net of unamortized purchases premiums, discounts, and deferred fees.

2 Excludes mortgage-related securities held for trading purposes.

3 Total MBS outstanding net of repurchased MBS held in the retained portfolio.

4 The majority qualify as REMICs and are also known as structured securitizations. In years 1983 - 1999, data also includes original issue CMOs and MCFs, and structured securitizations and PCs with mandatory purchase obligations.

Table 15. Freddie Mac Retained Mortgage Portfolio Detail

($ in Millions)				
Period	Whole Loans[1] ($)	Fannie Mae Securities ($)	Other Mortgage-Related Securities ($)	Total Retained Mortgage Portfolio[2] ($)
4q99	55,147	211,198	56,569	322,914
3q99	54,586	209,368	51,957	315,911
2q99	53,321	202,478	43,437	299,236
1q99	53,619	187,423	36,953	277,995
Annual Data				
1999	55,147	211,198	56,569	322,914
1998	57,745	168,108	29,817	255,670
1997	48,576	103,400	12,567	164,543
1996	46,575	81,195	10,056	137,826
1995	44,035	56,006	7,665	107,706
1994	Not Separately Available Before 1995	30,670	Not Available Before 1995	73,171
1993		15,877		55,938
1992		6,394		33,629
1991		Not Available Before 1992		26,667
1990				21,520
1989				21,448
1988				16,918
1987				12,354
1986				13,093
1985				13,547
1984				10,018
1983				7,485
1982				4,679
1981				5,178
1980				5,006
1979				4,003
1978				3,038
1977				3,204
1976				4,175
1975				4,878
1974				4,469
1973				2,521
1972				1,726
1971				935

Source: Freddie Mac.

1 Includes purchase and sale premiums, discounts, and deferred fees and unrealized gain or loss on available-for-sale securities.
2 Gross retained portfolio net of amortized purchases, premiums, discounts and deferred fees.

Table 16. Freddie Mac Financial Derivatives

Period	Interest Rate Swaps[1] ($)	Interest Rate Caps Floors Corridors ($)	Treasury-Based Contracts[1,2] ($)	Foreign Currency ($)	Futures & Options and Forward Rate Agreements ($)	Total ($)
	Financial Derivatives ($ in Millions)					
4q99	126,580	19,936	8,894	1,097	267,737	424,244
3q99	107,575	20,449	14,331	1,413	221,348	365,116
2q99	77,625	21,334	17,409	1,592	247,520	365,480
1q99	61,771	20,274	14,829	1,415	176,722	275,011
Annual Data						
1999	126,580	19,936	8,894	1,097	267,737	424,244
1998	57,555	21,845	11,542	1,464	220,832	313,238
1997	54,172	21,995	12,228	1,152	6,000	95,547
1996	46,646	14,095	651	544	0	61,936
1995	45,384	13,055	24	0	0	58,463
1994	21,834	9,003	0	0	0	30,837
1993	17,888	1,500	0	0	0	19,388

Source: Freddie Mac

1 In 1999, reclassifications were made between certain financial derivatives contracts and 1998 amounts have been restated to reflect these reclassifications.

2 Excludes exchange-traded derivative financial instruments, such as U.S. Treasury-based futures contracts.

Table 17. Freddie Mac Non-Mortgage Investments

Non-Mortgage Investments[1] ($ in Millions)						
Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other[1] ($)	Total ($)
4q99	10,545	10,305	4,961	3,916	4,425	34,152
3q99	1,944	9,234	3,068	4,783	3,315	22,344
2q99	875	8,925	2,143	4,275	3,531	19,749
1q99	2,024	9,371	2,191	7,571	2,819	23,976
Annual Data						
1999	10,545	10,305	4,961	3,916	4,425	34,152
1998	20,524	7,124	1,756	7,795	4,961	42,160
1997	2,750	2,200	6,982	3,203	1,295	16,430
1996	9,968	2,086	6,440	1,058	2,696	22,248
1995	110	499	9,217	1,201	1,684	12,711
1994	7,260	0	5,913	1,234	3,401	17,808
1993	9,267	0	4,198	1,438	3,322	18,225
1992	5,632	0	4,060	53	2,797	12,542
1991	2,949	0	4,437	0	2,570	9,956
1990	1,112	0	9,063	0	1,949	12,124
1989	3,527	0	5,765	0	1,758	11,050
1988	4,469	0	9,107	0	1,031	14,607
1987	3,177	0	5,859	0	1,431	10,467

Source: Freddie Mac

1 Excludes mortgage-related securities held for trading purposes.

Table 18. Freddie Mac Asset-Liability Mix

Asset-Liability Ratios				
	Asset Mix		Liability Mix	
Period	Retained Portfolio / Total Assets (%)	Non-mortgage Investments/ Total Assets (%)	Callable Debt / Total Effective Long-Term Debt[1] (%)	Total Effective Long-Term Debt / Total Debt[2] (%)
4q99	83.5	8.8	67.2	92.0
3q99	86.3	6.1	67.3	93.0
2q99	87.3	5.8	69.7	96.7
1q99	84.8	7.3	71.4	83.4
Annual Data				
1999	83.5	8.8	67.2	92.0
1998	79.5	13.1	75.6	70.6
1997	84.6	8.4	83.9	70.8
1996	79.3	12.8	73.8	72.4
1995	78.5	9.3	72.5	70.2
1994	68.9	16.8	81.0	59.8
1993	66.7	21.7	86.1	63.9
1992	56.5	21.1	Not Available Before 1993	Not Available Before 1993
1991	56.9	21.2		
1990	53.0	29.9		
1989	60.5	31.2		
1988	49.2	42.5		
1987	48.1	40.8		
1986	56.4	Not Available Before 1987		
1985	81.7			
1984	72.7			
1983	83.2			
1982	78.0			
1981	81.9			
1980	91.4			
1979	86.1			
1978	82.2			
1977	91.4			
1976	86.1			
1975	82.2			
1974	91.5			
1973	87.7			
1972	97.4			
1971	90.1			

Source: Freddie Mac

1 Callable debt includes derivative financial instruments that provide interest-rate protection similar to callable debt.

2 Total effective long-term debt represents debt with an effective repricing date greater than one year.

Table 19. Freddie Mac Mortgage Asset Quality

Period	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2,3] (%)	Credit Losses / Total MBS Outstanding plus Retained Portfolio[4] (%)	REO/Total MBS Outstanding plus Retained Portfolio[5] (%)	Credit-Enhanced / Total MBS Outstanding plus Retained Portfolio[6] (%)
Mortgage Asset Quality					
4q99	0.39	0.14	0.02	0.05	29.9
3q99	0.40	0.17	0.02	0.06	29.6
2q99	0.41	0.16	0.02	0.06	29.3
1q99	0.46	0.29	0.03	0.07	28.3
Annual Data					
1999	0.39	0.14	0.02	0.05	29.9
1998	0.50	0.37	0.04	0.08	27.3
1997	0.55	0.96	0.08	0.11	15.9
1996	0.58	1.96	0.10	0.13	10.0
1995	0.60	2.88	0.11	0.14	9.7
1994	0.55	3.79	0.08	0.18	7.2
1993	0.61	5.92	0.11	0.16	5.3
1992	0.64	6.81	0.09	0.12	Not Available Before 1993
1991	0.61	5.42	0.08	0.14	
1990	0.45	2.63	0.08	0.12	
1989	0.38	2.53	0.08	0.09	
1988	0.36	2.24	0.07	0.09	
1987	0.36	1.49	0.07	0.08	
1986	0.42	1.07	Not Available Before 1987	0.07	
1985	0.42	0.63		0.10	
1984	0.46	0.42		0.15	
1983	0.47	0.58		0.15	
1982	0.54	1.04		0.12	
1981	0.61	Not Available Before 1982		0.07	
1980	0.44			0.04	
1979	0.31			0.02	
1978	0.21			0.02	
1977	Not Available Before 1978			0.03	
1976				0.04	
1975				0.03	
1974				0.02	

Source: Freddie Mac

1 1994 - 1998 data include only loans for which Freddie Mac has assumed primary default risk (“at-risk”); includes foreclosures and in process. Pre-1994 calculations include both at-risk and non-at-risk loans.

2 1982 - 1987 data based on the number of loans delinquent 60 days or more; calculations subsequent to 1987 based on unpaid principal balance of loans 60 days or more.

3 Pre-1991 amounts do not reflect change in reporting of multi-family in-substance foreclosures pursuant to adoption of SFAS 114.

4 Credit losses are defined as charge-offs plus real estate owned expense, average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.

5 Real Estate Owned balances reflect end-of-period balances; beginning in 1992, data reflects adoption of SFAS 114.

6 Includes loans for which the lender or third-party has agreed to retain primary default risk. Also includes securities guaranteed by agencies such as GNMA, as well as asset-backed securities and commercial mortgage-backed securities.

Table 20. Freddie Mac Capital

Capital ($ in Millions)							
Period	Stockholders' Equity / Total MBS Outstanding plus Total Assets (%)	Stockholders' Equity plus Reserves / Total MBS Outstanding plus Total Assets[1] (%)	Core Capital[2] ($)	Regulatory Minimum Capital Requirements[3] ($)	Regulatory Capital Surplus (Deficit)[4] ($)	Market Capitalization[5] ($)	Common Share Dividend Payout Rate[6] (%)
4q99	1.25	1.33	12,692	12,287	405	32,713	19.0
3q99	1.25	1.33	12,048	11,659	389	36,226	19.8
2q99	1.23	1.32	11,358	11,061	297	40,367	20.2
1q99	1.32	1.41	10,940	10,595	345	39,866	21.8
Annual Data							
1999	1.25	1.33	12,692	12,287	405	32,713	20.1
1998	1.35	1.45	10,715	10,333	382	44,797	20.7
1997	1.12	1.22	7,376	7,082	294	28,461	21.1
1996	1.04	1.04	6,743	6,517	226	19,161	21.3
1995	0.98	1.09	5,829	5,584	245	14,932	21.1
1994	0.91	1.14	5,169	4,884	285	9,132	20.5
1993	0.85	0.99	4,437	3,782	655	9,005	21.6
1992	0.76	0.93	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	8,721	23.1
1991	0.63	0.81				8,247	21.6
1990	0.60	0.77				2,925	23.2
1989	0.62	0.77				4,024	24.3
1988	0.61	0.76				Not Applicable Before 1989	Not Applicable Before 1989
1987	0.50	0.64					
1986	0.50	0.64					
1985	0.67	0.85					
1984	0.73	0.93					
1983	0.63	0.83					
1982	0.60	0.82					
1981	0.95	1.25					
1980	0.98	1.27					
1979	1.19	1.44					
1978	1.29	1.50					
1977	1.72	1.93					
1976	2.05	2.22					
1975	1.88	2.03					
1974	2.22	2.34					
1973	3.30	3.47					
1972	4.95	4.96					
1971	9.71	9.80					

Source: Freddie Mac

1 Effective 1995, reserves exclude specific allowances for impaired loans pursuant to SFAS 114.
2 The sum of: (Outstanding common stock, Noncumulative preferred stock, paid-in capital and retained earnings).
3 Minimum capital requirement in accordance with the Federal Housing Enterprise Financial Safety and Soundness Act of 1992.
4 The difference between Core Capital and Minimum Regulatory Capital Requirement.
5 Stock price multiplied by number of outstanding common shares.
6 Paid common dividends as a percentage of earnings available to common shareholders.

Table 21. Aggregate Purchases

Business Activity ($ in Millions)				
	Purchases			
Period	Single-Family ($)	Multifamily ($)	Total ($)	Mortgage Securities[1] ($)
4q99	84,446	3,306	88,535	44,669
3q99	118,632	4,557	122,625	67,449
2q99	151,637	4,283	156,484	79,322
1q99	194,033	5,047	198,297	76,889
Annual Data				
1999	548,748	17,193	565,941	268,329
1998	618,410	15,338	633,748	272,907
1997	275,081	8,775	283,856	84,233
1996	287,306	8,680	295,986	81,840
1995	215,974	6,531	222,505	73,328
1994	280,792	4,786	285,478	44,369
1993	518,877	4,326	523,203	Not Available Before 1994
1992	439,309	2,879	442,188	
1991	233,280	3,440	236,720	
1990	185,187	4,518	189,705	
1989	157,275	6,149	163,424	
1988	107,497	5,361	112,858	
1987	148,766	3,749	152,515	
1986	177,159	5,415	182,574	
1985	84,653	3,102	87,755	
1984	Not Available Before 1985	Not Available Before 1985	50,704	
1983			49,431	
1982			49,610	
1981			10,573	
1980			11,791	
1979			16,523	
1978			18,829	
1977			8,908	
1976			4,761	
1975			6,036	
1974			9,204	
1973			7,586	
1972			5,129	
1971			4,818	

Sources: Fannie Mae and Freddie Mac

1 Not included in total purchases.

Table 22. Aggregate MBS Issuances

Business Activity ($ in Millions)				
	MBS Issuances			
Period	Single Family MBS ($)	Multifamily MBS ($)	Total MBS ($)	Multiclass MBS ($)
4q99	79,524	2,777	82,301	23,545
3q99	111,966	2,263	114,229	31,223
2q99	143,544	2,794	146,338	47,269
1q99	188,144	2,708	190,852	72,688
Annual Data				
1999	523,178	10,542	533,720	174,725
1998	564,747	11,965	576,712	219,309
1997	257,373	6,314	263,687	169,781
1996	263,133	6,438	269,571	64,925
1995	191,791	4,542	196,333	25,053
1994	245,286	2,446	247,732	146,496
1993	429,209	959	430,168	353,966
1992	372,389	855	373,244	301,489
1991	203,967	1,415	205,382	184,840
1990	168,004	2,506	170,510	108,770
1989	139,420	3,862	143,282	81,469
1988	90,610	4,045	94,655	29,990
1987	134,933	3,314	138,247	9,917
1986	156,815	3,949	160,764	4,633
1985	60,725	1,752	62,477	2,625
1984	Not Available Before 1985	Not Available Before 1985	32,230	1,805
1983			33,031	1,685
1982			38,139	Not Issued Before 1983
1981			4,243	
1980			2,526	
1979			4,546	
1978			6,412	
1977			4,657	
1976			1,360	
1975			950	
1974			46	
1973			323	
1972			494	
1971			65	

Sources: Fannie Mae and Freddie Mac

Table 23. Aggregate Earnings

	Earnings ($ in Millions)				
Period	Net Income ($)	Net Interest Income ($)	Guarantee Fee Income ($)	Administrative Expenses ($)	Credit-Related Expenses ($)
4q99	1,632	2,073	584	373	59
3q99	1,555	1,951	576	367	57
2q99	1,510	1,922	575	360	73
1q99	1,438	1,874	566	355	97
Annual Data					
1999	6,135	7,820	2,301	1,455	286
1998	5,118	6,325	2,248	1,286	603
1997	4,451	5,796	2,356	1,131	904
1996	3,968	5,297	2,282	1,000	1,017
1995	3,235	4,443	2,173	941	876
1994	3,115	3,935	2,191	904	803
1993	2,659	3,305	1,970	804	829
1992	2,245	2,753	1,770	710	777
1991	1,918	2,461	1,467	606	789
1990	1,587	2,212	1,190	529	784
1989	1,244	1,708	980	471	588
1988	888	1,329	793	412	584
1987	677	1,209	735	347	535
1986	352	683	476	285	426
1985	201	451	300	223	285
1984	73	123	236	183	140
1983	135	116	186	134	94
1982	(132)	(434)	93	97	62
1981	(175)	(395)	36	79	(12)
1980	48	75	23	70	42
1979	198	377	18	65	55
1978	234	331	14	53	49
1977	186	282	9	44	36
1976	141	221	3	40	24
1975	131	205	3	37	27
1974	112	184	2	31	50
1973	138	211	2	25	27
1972	100	148	1	18	9
1971	67	59	1	Not Available Before 1972	Not Available Before 1972

Sources: Fannie Mae and Freddie Mac

Table 24. Aggregate Balance Sheet

Balance Sheet Outstanding ($ in Millions)							
Period	Total Assets ($)	Retained Mortgage Portfolio [1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstanding ($)	Stockholders' Equity ($)	Total MBS Outstanding ($)	Multiclass MBS Outstanding[2] ($)
4q99	961,851	845,891	73,903	908,330	29,154	1,217,052	651,682
3q99	916,417	820,408	58,751	866,025	28,195	1,199,370	652,130
2q99	867,803	772,888	62,053	814,309	27,136	1,177,226	645,211
1q99	828,824	718,919	73,892	774,614	27,020	1,159,858	633,415
Annual Data							
1999	961,851	845,891	73,903	908,330	29,154	1,217,052	651,682
1998	806,435	671,104	100,675	747,687	26,288	1,115,494	622,117
1997	586,270	481,135	81,026	542,616	21,314	1,055,123	621,951
1996	524,907	424,353	78,854	488,251	19,504	1,021,238	577,737
1995	453,731	360,574	69,984	419,135	16,822	972,275	599,894
1994	378,707	293,986	64,143	350,509	14,703	947,001	642,885
1993	300,859	246,107	39,621	251,105	12,489	910,335	647,043
1992	240,480	189,889	32,116	195,931	10,344	831,958	531,116
1991	193,932	153,346	19,792	164,199	8,113	714,447	371,784
1990	173,692	135,586	21,992	154,344	6,077	604,434	215,402
1989	159,777	129,429	19,388	142,211	4,907	489,382	120,691
1988	146,610	117,017	19,896	132,341	3,844	396,503	42,281
1987	129,133	106,019	13,935	116,604	2,993	348,369	15,011
1986	122,850	107,216	Not Applicable Before 1987	108,938	2,135	264,754	Not Available Before 1987
1985	115,663	108,156		106,732	1,788	154,461	
1984	101,576	94,153		94,718	1,524	105,764	
1983	87,378	82,732		81,867	1,421	82,841	
1982	78,980	74,035		74,605	1,249	57,402	
1981	67,904	64,807		64,231	1,330	20,614	
1980	63,357	60,595		59,766	1,678	16,962	
1979	55,948	53,780		52,555	1,739	15,316	
1978	47,203	45,141		44,201	1,564	12,017	
1977	37,481	36,456		35,000	1,350	6,765	
1976	37,225	35,950		35,088	1,139	2,765	
1975	37,495	35,698		35,572	1,003	1,643	
1974	34,572	33,135		32,852	898	780	
1973	27,191	26,110		25,699	801	791	
1972	22,118	21,378		20,878	669	444	
1971	19,629	18,821		18,587	567	64	

Sources: Fannie Mae and Freddie Mac

1 Total MBS Outstanding net of MBS in (retained) portfolio.

2 The majority qualify as REMICS and may also be known as structured securitizations.

Table 25. Aggregate Retained Mortgage Portfolio Detail

($ in Millions)				
Period	Aggregate Whole Loans ($)	Aggregate Own-Enterprise Securities ($)	Aggregate Other Mortgage-Related Securities ($)	Aggregate Total Retained Mortgage Portfolio ($)
4q99	204,252	492,912	149,691	846,855
3q99	205,570	477,695	137,584	820,849
2q99	206,218	452,294	114,039	772,551
1q99	208,592	409,136	100,406	718,134
Annual Data				
1999	204,252	492,912	149,691	846,855
1998	213,524	365,483	91,178	670,185
1997	208,678	233,844	38,699	481,221
1996	214,466	183,802	26,610	424,878
1995	215,516	125,735	19,966	361,217
1994	Not Available Before 1995	74,668	Not Available Before 1995	298,228
1993		40,096		246,799
1992		26,929		191,748
1991		Not Available Before 1992		155,650
1990				138,148
1989				132,169
1988				119,931
1987				109,100
1986				110,926
1985				112,196
1984				98,127
1983				85,741
1982				76,493
1981				66,590
1980				62,333
1979				55,100
1978				46,353
1977				37,581
1976				37,112
1975				36,794
1974				34,177
1973				26,980
1972				22,052
1971				19,450

Sources: Fannie Mae and Freddie Mac.

Table 26. Aggregate Financial Derivatives

Financial Derivatives ($ in Millions)						
Period	Interest Rate Swaps ($)	Interest Rate Caps Floors Corridors ($)	Foreign Currency ($)	Futures & Options and Forward Rate Agreements ($)	Other ($)	Total ($)
4q99	318,612	48,886	12,604	308,818	10,294	699,214
3q99	284,068	46,449	13,668	241,060	14,851	600,097
2q99	227,513	47,084	14,506	266,435	21,294	576,831
1q99	209,196	45,274	14,412	195,597	18,394	482,874
Annual Data						
1999	318,612	48,886	12,604	308,818	10,294	699,214
1998	200,401	36,345	14,459	234,313	15,277	500,795
1997	203,845	22,095	11,120	6,000	13,888	256,948
1996	204,786	14,395	2,973	0	1,001	223,155
1995	171,063	13,355	1,224	29	999	186,670
1994	109,304	9,363	1,023	0	1,465	121,154
1993	67,346	1,860	1,023	0	1,425	71,653

Sources: Fannie Mae and Freddie Mac

Table 27. Aggregate Non-Mortgage Investments

Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total ($)
	Non-Mortgage Investments ($ in Millions)					
4q99	15,382	29,512	7,535	5,639	15,835	73,903
3q99	3,056	28,145	5,367	5,678	16,505	58,751
2q99	4,558	27,837	5,449	6,185	18,024	62,053
1q99	8,774	29,301	6,844	10,514	18,459	73,892
Annual Data						
1999	15,382	29,512	7,535	5,639	15,835	73,903
1998	28,452	28,117	9,312	12,950	21,846	100,675
1997	21,962	18,839	13,697	14,948	11,580	81,026
1996	31,702	16,721	11,107	7,249	12,075	78,854
1995	19,885	10,404	19,392	9,830	10,473	69,984
1994	24,853	3,796	14,919	8,953	11,622	64,143
1993	13,763	3,557	8,882	1,438	11,981	39,621
1992	12,219	4,124	7,249	53	8,471	32,116
1991	5,903	2,416	6,632	0	4,841	19,792
1990	6,441	1,780	10,014	0	3,757	21,992
1989	8,685	1,107	5,765	0	3,831	19,388
1988	8,594	481	9,107	0	1,714	19,896
1987	5,736	25	5,859	0	2,315	13,935

Sources: Fannie Mae and Freddie Mac

Table 28. Aggregate Capital

Capital ($ in Millions)				
Period	Core Capital ($)	Minimum Regulatory Capital Requirements ($)	Capital Surplus (Deficit) ($)	Market Capitalization ($)
4q99	30,568	30,057	511	96,364
3q99	29,270	28,759	511	100,208
2q99	28,048	27,526	522	110,192
1q99	27,093	26,432	661	110,975
Annual Data				
1999	30,568	30,057	511	96,364
1998	26,180	25,667	513	120,678
1997	21,169	19,785	1,384	87,628
1996	19,516	17,983	1,533	59,093
1995	16,788	16,035	753	48,744
1994	14,710	14,299	411	29,014
1993	12,489	10,846	1,643	30,392
1992	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	29,595
1991				27,083
1990				11,415
1989				12,116
1988				3,992
1987				2,401
1986				3,006
1985				1,904
1984				1,012
1983				1,514
1982				1,603
1981				502
1980				702

Sources: Fannie Mae and Freddie Mac

Table 29. Loan Limits

Single-Family Conforming Loan Limits[1] ($ in Millions)				
Year	**1-unit**	**2-units**	**3-units**	**4-units**
1970 - 1976	33,000	Not Available	Not Available	Not Available
1977 - 1978	60,000	Not Available	Not Available	Not Available
1979	67,500	Not Available	Not Available	Not Available
1980	93,750	120,000	145,000	180,000
1981	98,500	126,000	152,000	189,000
1982	107,000	136,800	165,100	205,300
1983	108,300	138,500	167,200	207,900
1984	114,000	145,800	176,100	218,900
1985	115,300	147,500	178,200	221,500
1986	133,250	170,450	205,950	256,000
1987	153,100	195,850	236,650	294,150
1988	168,700	215,800	260,800	324,150
1989	187,600	239,950	290,000	360,450
1990	187,450	239,750	289,750	360,150
1991	191,250	244,650	295,650	367,500
1992	202,300	258,800	312,800	388,800
1993	203,150	259,850	314,100	390,400
1994	203,150	259,850	314,100	390,400
1995	203,150	259,850	314,100	390,400
1996	207,000	264,750	320,050	397,800
1997	214,600	274,550	331,850	412,450
1998	227,150	290,650	351,300	436,000
1999	240,000	307,100	371,200	461,350
2000	252,700	323,400	390,900	485,800

Sources: Department of Housing and Urban Development (HUD), Federal Housing Finance Board, Freddie Mac

[1] Conforming Loan Limits are 50% higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands.

FHA Single-Family Insurable Limits

	1-Unit		2-units		3-units		4-units	
Year	**Low Cost Area Max**	**High Cost Area Max**	**Low Cost Area Max**	**High Cost Area Max**	**Low Cost Area Max**	**High Cost Area Max**	**Low Cost Area Max**	**High Cost Area Max**
1997	81,546	170,362	104,310	205,875	126,103	248,888	156,731	309,338
1998	109,032	197,621	139,512	252,866	168,624	305,631	209,568	379,842
1999	115,200	208,800	147,408	267,177	178,176	322,944	221,448	401,375
2000	121,296	219,849	155,232	281,358	187,632	340,083	233,184	422,646

Table 30. Mortgage Interest Rates

Period	Average Commitment Rates on Loans		Effective Rates on Closed Loans	
	Conventional		Conventional	
	30-Year Fixed Rate (%)	One-Year ARMs (%)	Fixed-Rate (%)	Adjustable Rate (%)
4q99	7.8	6.4	8.0	6.6
3q99	7.8	6.1	7.7	6.7
2q99	7.2	5.7	7.3	6.3
1q99	6.9	5.7	7.0	6.3
Annual Data				
1999	7.4	6.0	7.5	6.5
1998	6.9	5.6	7.2	6.5
1997	7.6	5.6	7.9	7.0
1996	7.8	5.7	8.0	7.2
1995	7.9	6.1	8.2	7.4
1994	8.4	5.3	8.1	6.6
1993	7.3	4.6	7.5	5.9
1992	8.4	5.6	8.5	6.9
1991	9.2	7.1	9.7	8.4
1990	10.1	8.4	10.4	9.2
1989	10.3	8.8	10.5	9.3
1988	10.3	7.9	10.4	8.5
1987	10.2	7.8	9.9	8.5
1986	10.2	8.4	10.5	9.4
1985	12.4	10.0	12.4	10.8
1984	13.9	11.5	13.2	12.1
1983	13.2	Not Available Before 1984	13.0	12.3
1982	16.1		15.2	15.4
1981	16.6		Not Available Before 1982	Not Available Before 1982
1980	13.8			
1979	11.2			
1978	9.6			
1977	8.8			
1976	8.9			
1975	9.0			
1974	9.2			
1973	8.0			
1972	7.4			
1971	Not Available Before 1971			

Average Commitment Rate Source: Freddie Mac
Effective Rates Source: Federal Housing Finance Board

Table 31. Housing Market Activity

Period	Housing Starts units in thousands			Home Sales units in thousands	
	Single-Family Housing Starts	Multifamily Housing Starts	Total Housing Starts	New Single-Family Home Sales	Existing Single-Family Homes Sales
4q99	1,403	286	1,689	866	5,057
3q99	1,344	319	1,663	899	5,253
2q99	1,324	267	1,591	925	5,418
1q99	1,420	340	1,760	897	5,187
Annual Data					
1999	1,367	300	1,667	907	5,197
1998	1,314	303	1,617	886	4,970
1997	1,179	296	1,474	804	4,382
1996	1,206	271	1,477	757	4,196
1995	1,110	244	1,354	667	3,888
1994	1,233	224	1,457	670	3,916
1993	1,155	133	1,288	666	3,786
1992	1,061	139	1,200	610	3,479
1991	876	138	1,014	509	3,186
1990	932	260	1,193	534	3,219
1989	1,059	318	1,376	650	3,325
1988	1,140	348	1,488	676	3,513
1987	1,212	409	1,621	671	3,436
1986	1,263	542	1,805	750	3,474
1985	1,166	576	1,742	688	3,134
1984	1,206	544	1,750	639	2,829
1983	1,181	522	1,703	623	2,697
1982	743	320	1,062	412	1,991
1981	796	288	1,084	436	2,419
1980	962	331	1,292	545	2,973
1979	1,316	429	1,745	709	3,827
1978	1,558	462	2,020	817	3,986
1977	1,573	414	1,987	819	3,650
1976	1,248	289	1,538	646	3,064
1975	956	204	1,160	549	2,476
1974	956	382	1,338	519	2,272
1973	1,250	795	2,045	634	2,334
1972	1,451	906	2,357	718	2,252
1971	1,271	781	2,052	656	2,019

Components may not add to totals due to rounding. *Adjusted Annual Rates.
Housing Starts Source and New Single-Family Home Sales Source: Bureau of the Census.
Existing Single-Family Home Sales Source: National Association of Realtors

Table 32. Weighted Repeat Sales House Price Index

Weighted Repeat Sales House Price Index (Annual Data)[1]										
% Change	USA	New England	Mid-Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific
1Q00	6.5%	10.2%	6.5%	5.7%	6.3%	7.8%	3.9%	5.3%	5.9%	7.1%
4Q99	6.7%	10.2%	6.5%	5.7%	7.1%	8.9%	4.7%	5.8%	5.8%	6.5%
3Q99	6.2%	9.5%	6.2%	5.3%	6.3%	8.2%	4.5%	5.7%	5.3%	5.8%
2Q99	5.8%	8.5%	4.9%	5.0%	5.6%	7.0%	4.5%	5.4%	5.3%	6.7%
1Q99	5.2%	7.4%	4.1%	4.3%	5.2%	5.3%	4.8%	4.3%	4.6%	6.9%
Annual Data										
1999	6.7%	10.2%	6.5%	5.7%	7.1%	8.9%	4.7%	5.8%	5.8%	6.5%
1998	5.4%	7.0%	4.7%	4.8%	4.4%	4.9%	5.1%	5.5%	4.6%	8.0%
1997	4.8%	4.9%	3.4%	4.7%	5.3%	5.0%	5.1%	3.9%	5.1%	5.5%
1996	2.7%	1.9%	0.4%	2.3%	5.1%	4.1%	4.0%	2.2%	4.5%	1.1%
1995	4.5%	4.1%	3.2%	4.4%	5.9%	5.2%	5.6%	4.0%	7.4%	2.9%
1994	1.2%	-2.7%	-2.8%	0.5%	5.4%	5.8%	5.1%	1.8%	9.5%	-3.2%
1993	2.1%	0.5%	1.5%	2.0%	3.6%	3.9%	4.1%	4.1%	8.0%	-1.8%
1992	1.9%	-1.0%	1.7%	2.2%	3.9%	3.1%	3.4%	3.5%	5.4%	-1.2%
1991	2.6%	-2.0%	1.6%	3.1%	4.5%	3.8%	4.1%	3.7%	4.8%	1.5%
1990	0.3%	-7.6%	-2.5%	0.4%	3.8%	0.6%	0.7%	0.6%	1.8%	2.8%
1989	6.1%	0.9%	2.5%	5.1%	6.2%	3.3%	3.4%	2.9%	2.8%	19.3%
1988	6.3%	3.9%	6.3%	7.1%	6.7%	2.7%	3.0%	-2.1%	0.4%	17.2%
1987	8.0%	13.5%	17.6%	8.0%	8.8%	4.4%	5.2%	-7.7%	0.0%	10.1%
1986	10.0%	21.2%	20.3%	9.0%	8.4%	5.9%	9.1%	1.2%	4.5%	7.7%
1985	6.8%	24.6%	12.3%	7.4%	4.5%	3.5%	12.1%	-2.2%	0.7%	4.7%
1984	3.6%	17.8%	12.8%	-0.3%	2.4%	4.3%	-4.4%	-1.3%	0.5%	4.8%
1983	4.3%	15.9%	10.3%	4.2%	3.8%	4.3%	5.8%	0.8%	-2.6%	1.1%
1982	2.6%	5.0%	4.4%	4.4%	-3.4%	-0.2%	5.3%	5.8%	6.8%	1.1%
1981	3.4%	5.8%	-1.0%	4.0%	0.5%	0.0%	-3.1%	11.7%	6.3%	5.8%
1980	6.4%	5.2%	9.0%	8.5%	1.2%	2.7%	4.9%	6.9%	6.2%	11.5%
1979	11.8%	11.6%	14.5%	11.8%	9.0%	9.7%	5.8%	12.5%	15.6%	16.3%
1978	13.1%	16.4%	6.6%	10.4%	14.6%	11.9%	10.6%	17.5%	16.8%	16.6%
1977	13.5%	10.7%	11.3%	8.2%	13.1%	14.5%	12.7%	11.6%	18.8%	25.6%
1976	8.0%	1.8%	7.2%	5.9%	9.3%	7.6%	3.1%	10.4%	11.2%	20.3%

Regional Divisions:
New England: CT, MA, ME, NH, RI, VT
Mid-Atlantic: NJ, NY, PA
South Atlantic: DC, DE, FL, GA, MD, NC, SC, VA, WV
East North Central: IL, IN, MI, OH, WI, ND, SD, NE
East South Central: AL, KY, MS, TN
West South Central: AR, LA, OK, TX
Mountain: AZ, CO, ID, MT, NM, NV, UT, WY
Pacific: AK, CA, HI, OR, WA

[1] All data is measured based on percentage change over the previous four quarters. Data from 1976 - 1999 is measured based on fourth quarter to fourth quarter percentage change.

Appendix

FEDERAL HOUSING ENTERPRISES FINANCIAL SAFETY AND SOUNDNESS ACT OF 1992

(TITLE 13 OF PUBLIC LAW 102-550)

Section 1313. DUTY AND AUTHORITY OF DIRECTOR.

(a) DUTY.- The duty of the Director shall be to ensure that the enterprises are adequately capitalized and operating safely, in accordance with this title.

(b) AUTHORITY EXCLUSIVE OF SECRETARY.- The Director is authorized, without the review or approval of the Secretary, to make such determinations, take such actions, and perform such functions as the Director determines necessary regarding -

(1) the issuance of regulations to carry out this part, subtitle B, and subtitle C (including the establishment of capital standards pursuant to subtitle B);

(2) examinations of the enterprises under section 1317;

(3) determining the capital levels of the enterprises and classification of the enterprises within capital classifications established under subtitle B;

(4) decisions to appoint conservators for the enterprises;

(5) administrative and enforcement actions under subtitle B, actions taken under subtitle C with respect to enforcement of subtitle B, and other matters relating to safety and soundness;

(6) approval of payments of capital distributions by the enterprises under section 303(c)(2) of the Federal National Mortgage Association Charter Act and section 303(b)(2) of the Federal Home Loan Mortgage Corporation Act;

(7) requiring the enterprises to submit reports under section 1314 of this title, section 309(k) of the Federal National Mortgage Association Charter Act, and section 307(c) of the Federal Home Loan Mortgage Corporation Act;

(8) prohibiting the payment of excessive compensation by the enterprises to any executive officer of the enterprises under section 1318;

(9) the management of the Office, including the establishment and implementation of annual budgets, the hiring of, and compensation levels for, personnel of the Office, and annual assessments for the costs of the Office;

(10) conducting research and financial analysis;

(11) the submission of reports required by the Director under this title.

(c) AUTHORITY SUBJECT TO APPROVAL OF SECRETARY.- Any determinations, actions, and functions of the Director not referred to in subsection (b) shall be subject to the review and approval of the Secretary.

(d) DELEGATION OF AUTHORITY.- The Director may delegate to officers and employees of the Office any of the functions, powers, and duties of the Director, as the Director considers appropriate.

(e) INDEPENDENCE IN PROVIDING INFORMATION TO CONGRESS.- The Director shall not be required to obtain the prior approval, comment, or review of any officer or agency of the United States before submitting to the Congress, or any committee or subcommittee thereof, any reports, recommendations, testimony, or comments if such submissions include a statement indicating that the views expressed therein are those of the Director and do not necessarily represent the views of the Secretary or the President.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent entity within the Department of Housing and Urban Development by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of P.L. 102-550). The Office is headed by a Director appointed by the President for a five-year term.

OFHEO's primary mission is ensuring the capital adequacy and financial safety and soundness of two government-sponsored enterprises (GSEs) — the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Fannie Mae and Freddie Mac are the nation's largest housing finance institutions. They buy mortgages from commercial banks, thrift institutions, mortgage banks, and other primary lenders, and either hold these mortgages in their own portfolios or package them into mortgage-backed securities for resale to investors. These secondary mortgage market operations play a major role in creating a ready supply of mortgage funds for American homebuyers. Combined assets and off-balance sheet obligations of Fannie Mae and Freddie Mac were more than $2 trillion at the end of 1999.

Fannie Mae and Freddie Mac are Congressionally-chartered, publicly-owned corporations whose shares are listed on the New York Stock Exchange. Under terms of their GSE charters, they are exempt from state and local taxation and from registration requirements of the Securities and Exchange Commission. Each firm has a back-up credit line with the U.S. Treasury.

OFHEO's oversight responsibility includes:

- Conducting broad-based examinations of Fannie Mae and Freddie Mac;
- Developing risk-based capital standards using a "stress test" that simulates stressful interest rate and credit risk scenarios;
- Making quarterly findings of capital adequacy based on minimum capital standards until a risk-based standard is completed;
- Prohibiting excessive executive compensation;
- Issuing regulations concerning capital and enforcement standards; and
- Taking necessary enforcement actions.

OFHEO is funded through assessments of Fannie Mae and Freddie Mac. OFHEO's operations represent no direct cost to the taxpayer.

In its safety and soundness mission, OFHEO has regulatory authority similar to such other federal financial regulators as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Reserve System.

(*The legislation that established OFHEO also requires Fannie Mae and Freddie Mac to meet certain affordable housing goals set annually by the Secretary of Housing and Urban Development. These goals specify the share of mortgages that the two GSEs are required to purchase annually from low-income, moderate-income and central-city homebuyers.)*