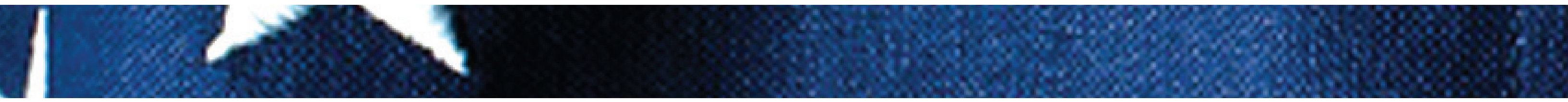
Bringing Wall Street to Main Street

Ginnie Mae

Annual Report 2004



To expand affordable housing in America
by linking global capital markets
to the nation's housing markets.

Secretary's Message

Expanding affordable housing opportunities to more families is at the heart of the mission of the Department of Housing and Urban Development (HUD). By securitizing and managing the risk of government guaranteed mortgages, Ginnie Mae has left its mark on the American landscape and played a critical role in helping low- and moderate-income families know the financial security of homeownership.

For over 35 years, Ginnie Mae has been at the heart of affordable homeownership in America. Not only did Ginnie Mae pioneer the mortgage-backed security—now one of the most widely held and traded in the world—but the $2.3 trillion in securities guaranteed by the agency has helped more than 31 million low- and moderate-income families become first-time homeowners. Ginnie Mae's efforts have resulted in enhanced returns for investors, increased liquidity for issuers, and lowered borrowing rates for homebuyers.

Ginnie Mae is integral to the success of HUD's mission, and we are proud of its accomplishments, service, and unblemished record of financial management.

Alphonso Jackson
Secretary

June 8, 2005

The Honorable Alphonso Jackson
Secretary
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Dear Mr. Secretary:

I am pleased to present to you the Fiscal Year (FY) 2004 Report to Congress and the audited financial statements of the Government National Mortgage Association (Ginnie Mae). HUD's Office of Inspector General (OIG) delivered an unqualified opinion of Ginnie Mae's financial statements and found no material weaknesses or reportable conditions.

Congress formed Ginnie Mae in 1968 to help expand the supply of affordable housing in the United States, which includes single family dwellings, apartments, nursing homes, and assisted living facilities. Ginnie Mae does this by providing an efficient, government-guaranteed vehicle—the mortgage-backed security (MBS)—to link capital markets to housing markets. Ginnie Mae's focus is on the federal affordable housing market, which includes single and multifamily dwellings with owner mortgages insured or guaranteed by four federal programs. Two are part of HUD: the Federal Housing Administration (FHA) and the Office of Public and Indian Housing (PIH). The other two are the Department of Veterans Affairs' (VA) home loan program for veterans and the Rural Housing Service (RHS) of the Department of Agriculture.

During its 36 years of existence, Ginnie Mae has helped to provide over 31 million low- and moderate-income Americans with affordable shelter by guaranteeing over $2.3 trillion of MBSs. During FY 2004, Ginnie Mae:

- Added another 1.3 million units of housing to its record of accomplishment for low- and moderate-income American families;
- Securitized 87 percent of all FHA and VA home loans;

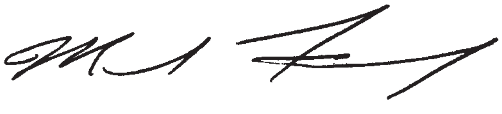
- Earned $815.5 million, of which $372.8 million was in fees, and $442.7 million was in interest income from U.S. Treasury securities; and
- Incurred operating expenses of $77.8 million. Net revenues for FY 2004 were $737.7 million.

FY 2004 saw a 5.4 percent decline in the number of single family homes and a 12.9 percent increase in the number of multifamily dwellings supported by Ginnie Mae. We believe that, to a great extent, this decline has positive causes. For example, many families that bought first homes with federally insured or guaranteed loans have built equity in their homes to the point where they qualified for conventional financing. This proves the capability of HUD and other government home loan and loan guaranty programs to help low- and moderate-income families move into the mainstream of the American economy.

Ginnie Mae's success depends on its ability to channel mortgage capital into low- and moderate-income housing. Before 1968, mortgage capital markets tended to be local or regional. Today, Ginnie Mae operates in a global market that attracts capital and excess savings from around the world into American neighborhoods. This is because Ginnie Mae securities are among the world's most secure investments. Ginnie Mae's MBSs carry the full faith and credit guaranty of the United States Government, which means that even in uncertain times, Ginnie Mae investors are guaranteed timely payment of principal and interest. Ginnie Mae is proactive and aggressive in seeking the input of MBS issuers and investors on how to make Ginnie Mae programs better, and Ginnie Mae invests in information technology that improves those programs' efficiency. Testimony before Congress by the Mortgage Bankers Association in November 2003 states that the secondary mortgage market that Ginnie Mae is proud to have helped create gives the United States "the best, cheapest, and most efficient mortgage capital delivery system in the world."

As evidenced by the constant stream of foreign officials who visit Ginnie Mae, the U.S. secondary mortgage market is envied throughout the world. Homeownership enables low- and moderate-income families to accumulate equity as the value of their homes grows. That equity is their capital, which is available for savings and investment. Today, Americans who previously lacked access to capital have the opportunity to create wealth for themselves and for the national economy.

Sincerely,



Michael J. Frenz
Executive Vice President

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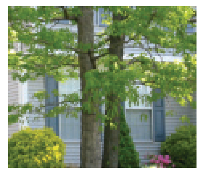
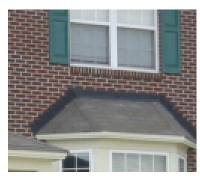




I. Overview

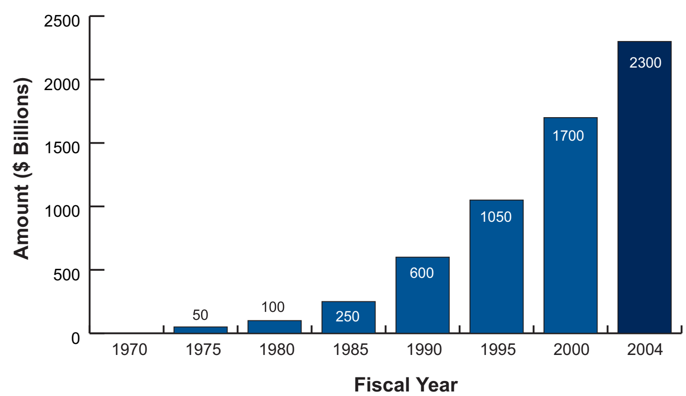
Congress formed the Government National Mortgage Association (Ginnie Mae) in 1968 to help expand the supply of affordable housing in the United States. Affordable housing includes single family dwellings, apartments, nursing homes, and assisted living facilities. Ginnie Mae links capital markets to these housing markets by providing an efficient, government-guaranteed vehicle—the mortgage-backed security (MBS). Additional information can be found on Ginnie Mae's website at *http://www.ginniemae.gov*.

During its 36 years of existence, Ginnie Mae has helped over 31 million low- and moderate-income Americans find affordable housing and has guaranteed over $2.3 trillion of MBSs (Figure 1). In Fiscal Year (FY) 2004, Ginnie Mae added another 1.3 million units of housing to its record of accomplishment. On the revenue side, in FY 2004 Ginnie Mae earned $815.5 million, collecting $372.8 million in fees and $442.7 million in interest income from U.S. Treasury securities. FY 2004 operating expenses were $77.8 million and default advances were $34.4 million, of which $28.2 million was recovered. In summation, Ginnie Mae produced net revenue in FY 2004 of $737.7 million.

Ginnie Mae's Performance in FY 2004

Ginnie Mae MBSs securitize mortgages that are insured or guaranteed by two programs of HUD: the Federal Housing Administration (FHA) and the Office of Public and Indian Housing (PIH). In addition, Ginnie Mae securitizes the Department of Veterans Affairs' (VA) home loan program for veterans and the Rural Housing Service (RHS) of the Department of Agriculture.

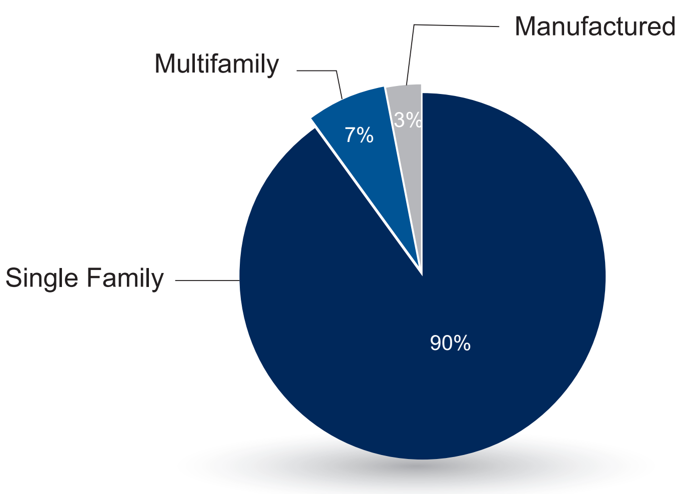
Figure 1: Cumulative Amount of Ginnie Mae Mortgage-Backed Securities, FY 1970–2004



In FY 2004, most of the mortgages Ginnie Mae securitized were from the FHA and VA programs (71.5 percent and 26.2 percent, in dollars, respectively). Ginnie Mae's FY 2004 goal was to securitize at least 85 percent of FHA and VA single family insured or guaranteed loans. Actual figures for FY 2004 indicate that 87 percent of all VA and FHA loans were placed into Ginnie Mae securities, a significant accomplishment in light of existing competition in the low- to moderate-income housing market. Ginnie Mae was able to exceed its goal by offering financial instruments with a structure that provides the best execution from a pricing standpoint.

Also important was Ginnie Mae's continued success in reducing issuers' back-end processing costs. The amount of outstanding single family securities at the end of FY 2004 was $420.4 billion, compared to $444.6 billion at the end of the previous year. This decline was primarily because repayments exceeded new issuances.

Figure 2: Types of Home Loans in Ginnie Mae Issuer Pools, FY 2004



As can be seen in Figure 2, most of Ginnie Mae's securitizations are for single family homes, followed by multifamily and manufactured homes. During a record year of growth in its multifamily portfolio, Ginnie Mae securitized 92 percent of eligible FHA multifamily mortgages. The performance in FY 2004 exceeded the goal of 80 percent market share by 12 percentage points.

Ginnie Mae has continued to streamline the multifamily program, enhancing its efficiency as a securitization vehicle, and making the program more attractive to investors. As a result, multifamily issuances increased 12.9 percent, from $9.3 billion in FY 2003 to $10.5 billion in FY 2004. The multifamily program's remaining principal balance (RPB) increased by 13.1 percent from $28.9 billion to $32.7 billion. This increase reflects the appeal of multifamily government-guaranteed loans to investors.

Figure 3: Ginnie Mae Supported Units of Housing, FY 2000–2004

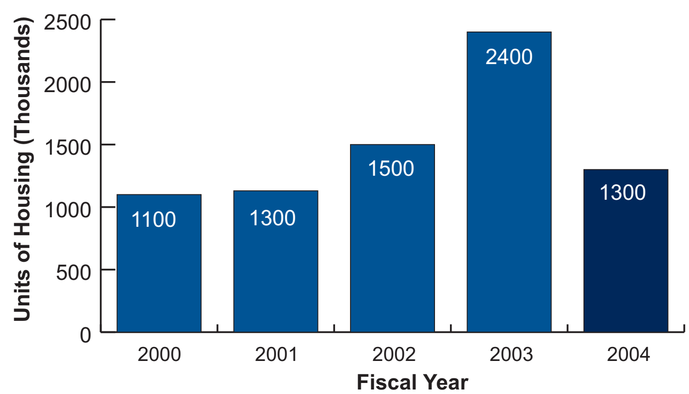
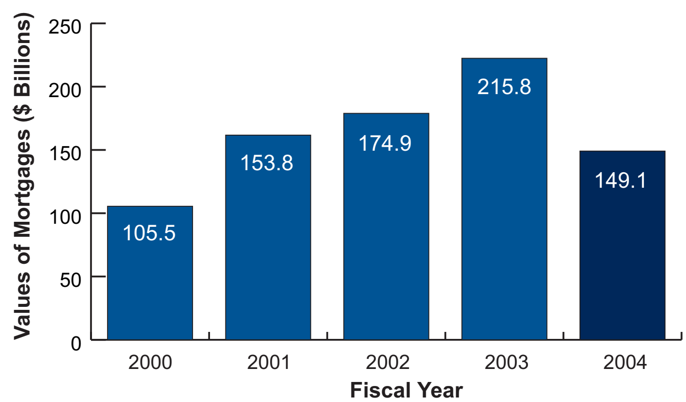


Figure 4: Value of MBS Issued by Ginnie Mae, FY 2000–2004



Since 1968, Ginnie Mae has helped more than 31 million families obtain affordable housing through lower mortgage costs. As shown by Figure 3, in FY 2004, Ginnie Mae supported 1.3 million units of housing for low- and moderate-income American families, a decline from FY 2003. The dollar value of this decline is reflected in Figure 4, showing that

Ginnie Mae issued $149.1 billion in MBSs in FY 2004.

Recent declines in the number of housing units supported by Ginnie Mae are limited to single family dwellings. The decline can be attributed to two causes. First, families that acquired their initial homes through federal home loan programs are refinancing to obtain more favorable loan terms in order to buy better homes. This signifies that they have "graduated" from needing government help and are now in the mainstream of the housing market, thereby proving the long-term benefit of federal home loan programs. Second, organizations other than Ginnie Mae have started to securitize federal home loans. Typically, these organizations choose the least risky mortgages, whereas Ginnie Mae allows the inclusion of all eligible federal home loan MBSs regardless of risk.

Risk Management

There are two types of risks to the federal government involved in the Ginnie Mae MBS program: fraud and issuer defaults. To mitigate the risk of fraud, Ginnie Mae is continuously focused on monitoring its program participants' portfolios, including the loan origination and pooling process, to detect any deception committed by its program partners. In addition, Ginnie Mae closely monitors its issuers' records of pass-throughs of principal and interest payments to investors, as well as trends in delinquency and default among issuers and homeowners with federal home loan program mortgages. The amount paid out by Ginnie Mae to cover delinquencies and defaults was $34.4 million in FY 2004, about 4.2 percent of total revenues.

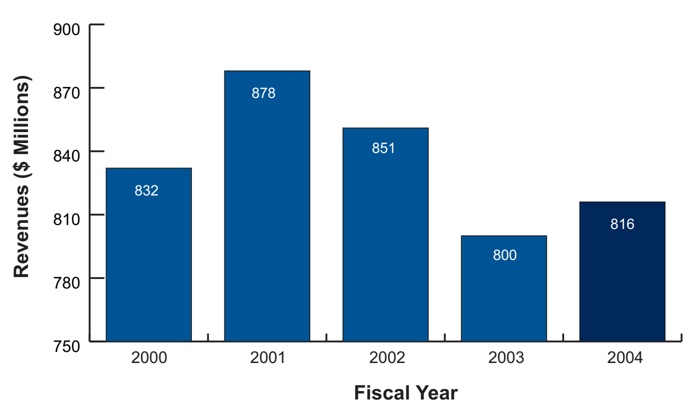
Revenues

Ginnie Mae receives no appropriations from general tax revenues. Rather, it is self-financed (through fees charged to issuers from various sources). The largest sources of funding are guaranty, multiclass, and commitment fees that provide almost 46 percent of total revenues. In FY 2004, Ginnie Mae collected $372.8 million in fees and received $442.7 million in interest revenue from U.S. Treasury securities. Figure 5 shows Ginnie Mae's annual revenues for the last 5 years.

Expenses

Ginnie Mae has a small staff of 66 government employees, most of whom are engaged in Ginnie Mae's core business of monitoring markets, programs, and issuers, developing new offerings, and working with issuers to solve problems. Almost all transactional and support work is outsourced to contractors, consuming over 81 percent of Ginnie Mae's FY 2004 operating expenses. Ginnie Mae

Figure 5: Ginnie Mae Revenues, FY 2000–2004



continues to invest in information technology that affords issuers and investors better information and service in an increasingly Internet-based environment. In this manner, Ginnie Mae's business model and approach to business reflects the President's Management Agenda Initiative for Competitive Sourcing and Expanded Electronic Government. To summarize, Ginnie Mae is a highly efficient and effective operation that pays for itself, while contributing to a housing capital market that is the envy of the world.

Ginnie Mae's Environment

Housing is one of the most vital segments of the U.S. economy. Ginnie Mae's focus is on the federal affordable housing market, which includes single family, multifamily, and manufactured dwellings with owner mortgages insured or guaranteed by FHA, VA, RHS, and PIH loan programs.

Federal housing programs such as FHA, RHS, and PIH operate in the primary mortgage market, in which lending institutions make loans to homebuyers. Lenders tend to believe that lending money to low- and moderate-income buyers is riskier than lending to higher-income borrowers (this is called "credit risk"). Higher risk results in higher interest rates and larger down payments, which low- and moderate-income would-be borrowers cannot afford. However, the FHA, RHS, and PIH loan programs provide government-supported mortgage insurance, while VA home loans come with a partial government guarantee of payment. This government support substantially lowers credit risk associated with homebuyers with limited or even slightly tarnished credit. As a result, lenders offer lower-than-market interest rates and require smaller down payments on government-guaranteed or -insured mortgages. Consequently, low- and moderate-income citizens and veterans benefit from this as does the U.S. economy.

The Problem: Lack of Capital for Affordable Housing

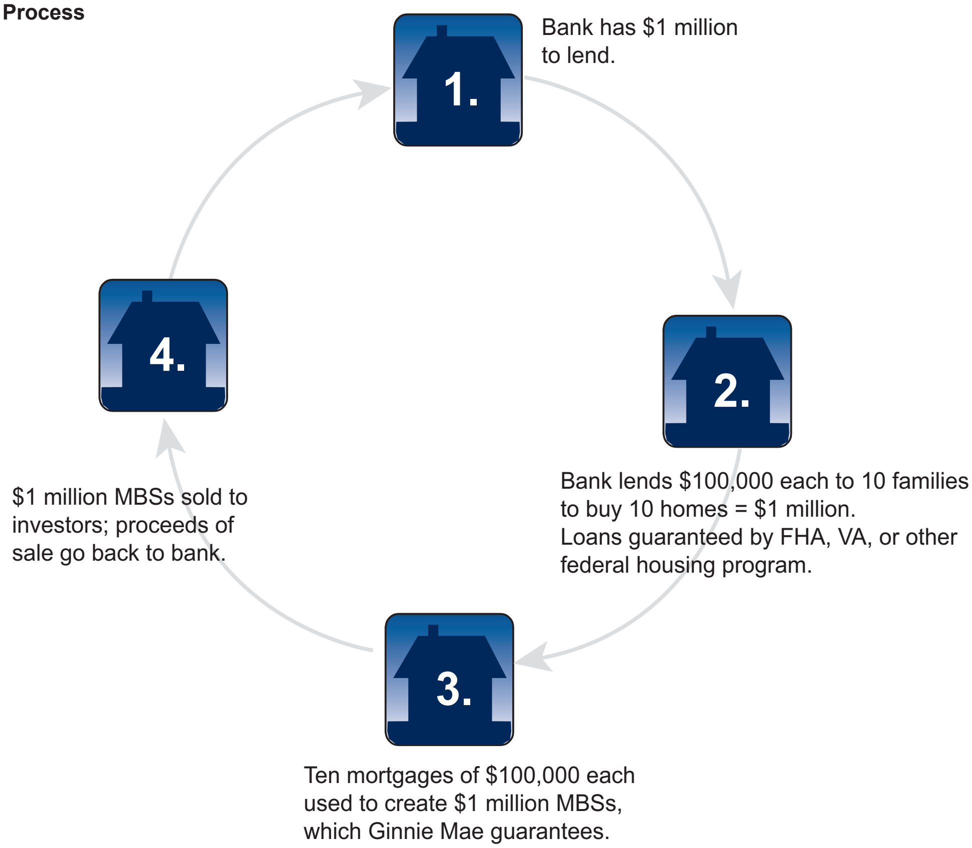
Before Congress created Ginnie Mae in 1968, lending institutions such as banks and thrifts held the home mortgage loans that they originated. Federal insurance and guarantees increased the availability of affordable housing to a certain extent; however, capital was in short supply for home loans. Investors bought some whole mortgages from lenders, but this was a complex, expensive, and somewhat risky trade, which limited the amount of capital available for housing loans to a lender's community or region. As a result, mortgage capital was abundant in richer areas, but often scarce in poorer ones. Interest rates varied from region to region, and down payments tended to be higher than they are today. Ultimately, lenders needed a way to obtain more capital and accelerate the recycling of that capital.

Congressional Action: Ginnie Mae and Mortgage-Backed Securities

In 1968, Congress established Ginnie Mae. In 1970, Ginnie Mae developed and pioneered the MBS, the most important financial vehicle in a new secondary mortgage market. An MBS passes the principal and interest payments on mortgages from lenders to investors in the form of shares in a pool of mortgages. What the federal home loan programs do in the primary mortgage market, the Ginnie Mae MBS does in the secondary market—it guarantees payment of monthly principal and interest.

Figure 6 shows the process of using a Ginnie Mae MBS to continually replenish capital markets for low- to moderate-income housing. In Step 1 in Figure 6, a bank has $1 million to lend for home mortgages. In Step 2, the bank lends $100,000 each to 10 low- to moderate-income families that qualify for FHA, VA, or other federal loan guarantees. In Step 3, the 10 $100,000 mortgages are combined into an MBS, which has its principal and interest payments guaranteed by Ginnie Mae. In Step 4, the Ginnie Mae MBS is sold to investors, and the proceeds of the sale are returned to the lending bank. This

Figure 6: The Ginnie Mae Process



makes another $1 million available for the bank to lend, and the cycle is repeated.

Lenders sell their mortgages in order to quickly recoup loaned money and lend it again. Likewise, issuers want to sell MBSs quickly for a fair price, in order to buy more mortgages to pool for more MBSs. Ginnie Mae promotes this recycling by guaranteeing that, if approved MBS issuers are delinquent or default on payments to investors, the federal government will make the payments. This guarantee, made with the *full faith and credit of the United States Government*, reduces risk to investors. The guarantee expands the amount of capital available for mortgages, which helps keep interest rates and down payments low, resulting in affordable housing for low- to moderate-income Americans.

Naturally, Ginnie Mae closely monitors issuers' financial condition and the cash flows of the mortgages that are the collateral for the MBS. Should the agency determine that an issuer is subjecting Ginnie Mae to unacceptable risk, Ginnie Mae can take over the servicing of the MBS to prevent nonpayment.

An International Mortgage Capital Market

Before 1968, mortgage capital markets tended to be local or regional. Ginnie Mae has established an international capital market, channeling capital and excess savings from around the nation and the world into American neighborhoods. Ginnie Mae MBSs, which are backed by the full faith and credit of the United States Government, appeal to investors who want expected yields higher than U.S. Treasury securities. In November 2003, the Mortgage Bankers Association testified before Congress that the secondary market gives the United States "the best, cheapest, and most efficient mortgage capital delivery system in the world."

As evidenced by the constant stream of foreign officials who visit Ginnie Mae, the nation's secondary mortgage market is envied throughout the world. Homeownership enables low- and moderate-income families to accumulate equity as the values of their homes grow. This equity is their capital that is available for savings and investment. Today, Americans who previously lacked the basic ingredient of capitalism can become capitalists who create wealth for themselves and for their national economy.

Ginnie Mae Financial Instruments

Ginnie Mae has developed a variety of financial instruments to suit investors with diverse needs. Many of these instruments are geared for specific segments of the housing capital markets, such as single family or multifamily dwellings. Ginnie Mae executives and staff are continually working on ways to improve the agency's offerings, as well as keeping up with new government requirements. Those instruments developed in FY 2004 are highlighted and discussed in Section IV.

II. Corporate Goals

Ginnie Mae's vision of making affordable housing available to more Americans is reflected within the agency's three overarching goals:

Excellence in Customer Service

To provide excellent service to its customers, including issuers, investors, and other stakeholders.

Leadership Role in the Industry

To lead the industry in increasing affordable homeownership by introducing new products and expanding affordable mortgage credit.

Integrity and Excellence in Financial Management

To manage financial risk by providing accurate and timely financial information to support management decisions, while maintaining effective stewardship and control over its funds.

Ginnie Mae believes that adhering to these goals will help it meet its mission and achieve its vision, while responding effectively to the needs of the American public and the mortgage industry.

III. Organization and Technology

Structure and Staffing

Congressional legislators anticipated Ginnie Mae's need for speed and agility when they structured it as a wholly-owned corporation housed within HUD. Almost all transactional and support work—over 81 percent—is outsourced to contractors. Because of this, in FY 2004, Ginnie Mae could maintain a relatively small staff of 66 employees while guaranteeing $149.1 billion in new securities. Most employees are engaged in core business processes involving inherently governmental activities. These include managing contractors, monitoring issuers and capital markets, and working with customers and stakeholders to develop innovative responses to changing market conditions.

Ginnie Mae strongly supports HUD's commitment to increase contracting and subcontracting opportunities for Small, Small Disadvantaged, 8(a), Women-Owned, Veteran-Owned, Service Disabled Veteran-Owned, and HUBZone small businesses. Ginnie Mae's procurement opportunities are included in HUD's Forecast of Contracting Opportunities, which can be viewed at *http://www.hud.gov/offices/osdbu/4cast.cfm*.

Information Technology Initiatives

In FY 2004, Ginnie Mae continued to take steps to enhance its information technology infrastructure. These steps included integrating state-of-the-art solutions into its operational infrastructure and streamlining business processes, which has reduced cycle time and costs for both Ginnie Mae and its customers. In response to investor requests, Ginnie Mae increased the frequency of its data disclosure information from quarterly to monthly, and added new information to enable investors to make more informed decisions about Ginnie Mae securities. In FY 2004, Ginnie Mae made several enhancements to GinnieNET, the primary information network that Ginnie Mae uses to conduct business with its customers.

Modernization of Operating Environment

Ginnie Mae completed a Business Process Improvement (BPI) study and developed an Enterprise Architecture migration plan, which will result in a more cost-effective and streamlined operating environment. Also, Ginnie Mae developed a Concept of Operation plan for its modernization program to ensure effective implementation of the aforementioned plans. Ginnie Mae is now beginning implementation of the BPI recommendations. This action will strengthen the agency's ability to adapt quickly to market conditions and respond to the needs of investors in a timely manner. Also, this initiative is Ginnie Mae's solution for working in a dynamic secondary market where immediate access to information is paramount to success. Ultimately, both plans will establish the framework for Ginnie Mae's e-government initiatives, increasing its value to business partners.

Continuity of Operations and Disaster Recovery

During FY 2004, Ginnie Mae remained vigilant in its awareness and readiness to thwart potential threats to its financial systems and operations. The agency is committed to complying with all federal Homeland Security guidelines in support of the government's requirement to establish, maintain, and support sustainment of operations in the event of a crisis. Ginnie Mae has routinely updated and exercised its Continuity of Operations Plan (COOP) and Disaster Recovery programs. In addition, it participated in the government-wide Forward Challenge Exercise 04, the HUD departmental COOP test, training, and exercises, and in the internal Ginnie Mae Enterprise-wide COOP test, training, and exercises. The government-wide and internal exercises tested the readiness of Ginnie Mae's COOP Emergency Relocation Group, essential business partners, telecommunications tools, and alternate site building, as well as technological and staff readiness.

e-Commerce

Ginnie Mae and its business partners continue to benefit from Internet technologies. The agency has reengineered the method by which stakeholders access information, and is migrating from hard copy mailings to electronic dissemination of information. A notable enhancement has been the creation of the electronic Issuer Feedback Report, which allows issuers to use the Internet to compare their portfolio statistics with Ginnie Mae averages.

IV. Highlights and Recent Initiatives

Ginnie Mae constantly reviews its offerings and services in order to be responsive to investors and to changes in the housing finance market. The agency is keenly aware of the need to focus attention on areas of the nation that are ravaged by short-term disasters or long-term economic downturns.

Innovations

Ginnie Mae operates in capital markets that change constantly. It must be agile in order to respond quickly to interest rate fluctuations and to the health of the general economy and housing markets. In addition, Ginnie Mae must be innovative in responding to the demands of issuers and investors—otherwise, they may move their capital out of the secondary mortgage market for FHA, RHS, PIH, and VA home loans. Ginnie Mae's most significant innovations are new financial products that are derivations of the basic MBS.

Key to Ginnie Mae's innovation strategy is to maximize contacts with issuers, investors, stakeholders, and contractors. Ginnie Mae's constant question to issuers is, "What additional features or services will improve both the pricing of and your processing of Ginnie Mae securities?"

Reducing Costs to Investors to Increase Demand for Ginnie Mae MBSs

In FY 2004, Ginnie Mae reduced the fees assessed on newly issued Platinum securities. In addition, early in 2004, Ginnie Mae started requiring issuers to report loan-level information more frequently and in more detail. The resulting improvements in timeliness and disclosure give investors better information for analyzing securities.

New MBSs for New Needs

Ginnie Mae introduced the first government-guaranteed stripped MBSs (SMBSs) in FY 2004. These securities are created by separating or "stripping apart" the principal and interest payments from standard MBSs. Ginnie Mae launched the new instrument in a $2.2 billion transaction underwritten by Wall Street securities dealers.

Ginnie Mae also expanded its hybrid adjustable-rate mortgage (ARM) pooling options to give issuers the opportunity to create custom hybrid ARM pools. The underlying collateral for custom hybrid ARM pools includes FHA 3-, 5-, 7-, and 10-year, and VA 3- and 5-year hybrid ARM products. SMBSs and new hybrid ARM pooling options give issuers added flexibility and investors better ways to manage their money.

Leveraging Finance Sources

When developing low- or moderate-income housing, organizations that can leverage many capital sources are among Ginnie Mae's most valuable partners. Two examples illustrate this leverage: the Louisville YMCA and the Manhattan Park Apartments.

Louisville, Kentucky YMCA. Louisville's 91-year-old downtown YMCA building was badly dilapidated. For lack of capital for renovation, this landmark might have been a victim of the wrecker's ball. Ginnie Mae and FHA stepped in to allow developers to obtain lower interest rates for financing renovation and expansion, offering the full faith and credit of the U.S. Government as a guarantee.

Soon, new resources came from the City of Louisville, local development and housing authorities, and from historic preservation tax credits. Today, the restored structure houses an innovative private school, 56 new apartments, and ground-floor commercial space, all contributing to the revitalization of downtown Louisville—a flagship anchored by the Ginnie Mae multifamily program.

Manhattan Park Apartments. Rents in Manhattan, a borough of New York City, are among the highest in the nation, a real hardship for low-income senior citizens. In its largest-ever multifamily property project, Ginnie Mae securitized a $147.5 million refinancing of the Manhattan Park Apartments on Roosevelt Island in Manhattan. Roosevelt Island is a posh address, but over 200 apartments are for low-income elderly persons receiving housing assistance from HUD's Section 8 program. A tax-exempt bond offering issued by the New York City Housing Development Authority funds the refinancing. Because of Ginnie Mae's backing, investors are more willing to buy the bonds.

Responding to Natural Disasters

Ginnie Mae played a small but important role in the wake of Hurricanes Charley and Frances, as well as Tropical Storm Gaston. Ginnie Mae took action to help reduce the economic hardship of citizens affected by the storms. First, the agency urged MBS issuers to provide forbearance (i.e., refrain from enforcing debts when they come due) to mortgagees in those parts of South Carolina, Indiana, Florida, and Virginia declared as disaster areas by the President. Second, and more importantly, Ginnie Mae stood ready, as a last resort, to help issuers holding mortgage loans in the affected areas make their Ginnie Mae pass-through payments.

Focusing Capital Markets on Economically Depressed Areas

Colonias are poor rural communities, almost always unincorporated, that lie in a 150-mile wide strip along the U.S.-Mexico border between Texas and California. Unable to afford mortgages, many colonia residents buy land for their homes through the third world convention of contracts-for-deed, thereby building no equity while making monthly principal and interest payments.

Responding to the President's commitment to improve housing conditions in the colonias, Ginnie Mae expanded its Targeted Lending Initiative (TLI) to cover some of the poorest and most neglected communities in the nation. Ginnie Mae started the TLI in 1996, to channel capital into HUD-designated Renewal Communities, Urban Enterprise Zones, Urban Empowerment Zones, Native American Lands, Rural Empowerment Zones, and Rural Enterprise Communities. Under the TLI program, Ginnie Mae provides an enhanced secondary market vehicle that gives lenders an incentive to originate loans in TLI areas. Through the TLI, Ginnie Mae is helping to give colonia families the opportunity to own a piece of the American Dream.

View to the Future

Looking forward, Ginnie Mae will strive to continue as a cost-effective conduit for channeling capital from around the nation and the world into homeownership for low- and moderate-income Americans. Ginnie Mae's means of protecting this pipeline will be to increase demand for its MBSs, because high demand by investors translates into lower costs for home purchases.

In the next several years, Ginnie Mae will make increased investments in information technology in order to improve services to investors and issuers, while lowering operations costs. The agency will apply its agile and cost-effective business model and the expertise of its personnel to creating the innovations that will continue to attract investors to the low- and moderate-income housing market, and that will support new congressional housing legislation.

V. Management's Discussion and Analysis of Financial Position and Results of Operations

Financial Highlights of 2004

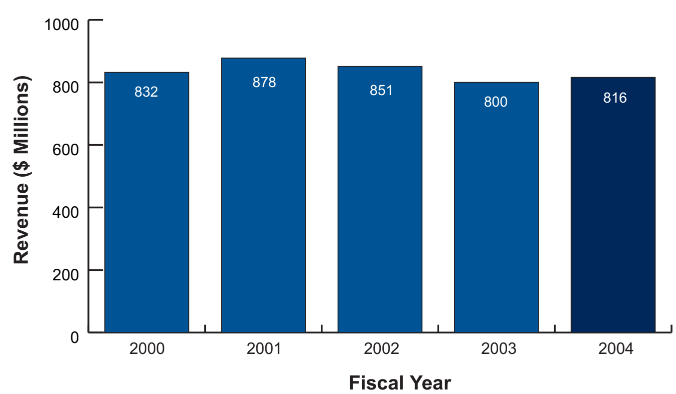
FY 2004 was marked by an increase in revenue and an increase in assets. Revenues related to interest income increased because of higher rates on U.S. Treasury overnight certificates during FY 2004. Ginnie Mae had a net income of $737.7 million in FY 2004 compared with $731.5 million in FY 2003. Revenues increased by 2 percent, to $815.5 million from $799.6 million in FY 2003, and total assets increased by 9.6 percent, to $11.4 billion from $10.4 billion in FY 2003.

The outstanding MBS portfolio decreased, which led to decreased guaranty fee revenues. In FY 2004, MBS program income declined to $372.8 million from $406.1 million in FY 2003. Total expenses as a percentage of total revenues increased from 8.5 percent in FY 2003, to 9.5 percent in FY 2004.

Ginnie Mae issued $146.1 billion in commitment authority in FY 2004, a 34.3 percent decrease from FY 2003. The outstanding MBS balance at the end of FY 2004 was $453.4 billion, compared with $473.9 billion the previous year, because repayments exceeded new issuances. FY 2004 production provided the capital to finance the purchase or refinance of homes for approximately two million American families.

Ginnie Mae's financial performance moderated during FY 2004, with a slight increase in revenue in comparison to FY 2003. Excess revenues over expenses are invested in U.S. Government securities. To date, Ginnie Mae's earnings and fund balance have provided the capital to finance its operations, so that the agency has not needed to obtain funds through federal appropriations. Figure 7 shows Ginnie Mae's revenue for each of the last 5 years.

Figure 7: Ginnie Mae Total Annual Revenues, FY 2000–2004



To assist readers in understanding Ginnie Mae's recent financial history, Table 1 on page 14 provides three-year financial highlights of the corporation.

Results of Operations

Ginnie Mae believes that the following discussion will provide the reader with information that is relevant to an assessment and understanding of Ginnie Mae's financial condition and the results of its operations. The discussion should be read in conjunction

Table 1: Ginnie Mae Financial Highlights

THREE-YEAR FINANCIAL HIGHLIGHTS			
September 30			
(Dollars in thousands)	**2004**	**2003**	**2002**
Balance Sheets Highlights and Liquidity Analysis			
Funds with U.S. Treasury	$ 3,355,100	$ 2,931,800	$ 2,509,100
U.S. Government Securities	$ 7,539,800	$ 7,215,800	$ 6,935,200
Total Assets	$ 11,411,300	$ 10,353,900	$ 9,554,600
Total Liabilities	$ 1,023,600	$ 703,900	$ 636,100
Investment of U.S. Government	$ 10,387,700	$ 9,650,000	$ 8,918,500
Total RPB Outstanding (1)	$ 453,421,816	$ 473,907,979	$ 568,351,015
LLR (2) and Investment of U.S. Government	$ 10,906,400	$ 10,169,300	$ 9,457,200
Investment of U.S. Government as a Percentage of Average Total Assets	95.45%	96.94%	97.50%
LLR and Investment of U.S. Government as a Percentage of RPB	2.41%	2.15%	1.66%
Capital Adequacy Ratio (3)	2.35%	2.10%	1.64%
Highlights From Statements of Revenues and Expenses and Profitability Ratios			
Years Ended September 30			
MBS Program Income	$ 372,800	$ 406,100	$ 446,000
Interest Income	$ 442,700	$ 389,300	$ 398,900
Total Revenues	$ 815,500	$ 799,600	$ 851,100
MBS Program Expenses	$ 63,300	$ 55,400	$ 45,600
Administrative Expenses	$ 10,600	$ 10,300	$ 9,300
Provision for Loss	$ -	$ -	$ -
Total Expenses	$ 77,800	$ 68,100	$ 56,800
Excess of Revenues Over Expenses	$ 737,700	$ 731,500	$ 794,300
Total Expense as a Percentage of Average RPB	0.0168%	0.0131%	0.0097%
Provision for Loss as a Percentage of Average RPB	-	-	-

(1) Remaining Principal Balance (RPB) of Ginnie Mae MBSs, including $96.1 million of GNMA Guaranteed Bonds

(2) Loan Loss Reserve (LLR)

(3) LLR and Investment of U.S. Government divided by the sum of Total Assets and Remaining Principal Balance

with the financial statements and notes thereto. Ginnie Mae's operating results are subject to fluctuation each year, depending on the frequency and severity of losses resulting from general economic and mortgage market conditions and termination of issuers.

MBS Program Income

MBS program income includes guaranty fees, multiclass fees, new issuer fees, commitment fees, handling fees, and transfer of servicing fees. Guaranty fees and commitment fees comprise approximately 90 percent of total

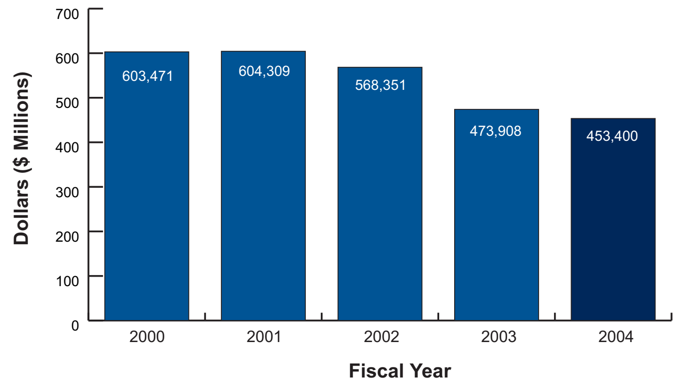
MBS program revenues. Guaranty fees are income streams earned for providing Ginnie Mae's guaranty of the full faith and credit of the U.S. Government to investors, and are so recognized over the life of the outstanding securities. Commitment fees are income that Ginnie Mae earns for providing approved issuers with authority to pool mortgages into Ginnie Mae MBSs. The authority Ginnie Mae provides expires 12 months from issuance for single family issuers, and 24 months from issuance for multifamily issuers. Ginnie Mae receives commitment fees as issuers request commitment authority, and recognizes the commitment fees as earned as issuers use their commitment authority, with the balance deferred until earned or expired, whichever occurs first. Fees from expired commitment authority are not returned to issuers. As of September 30, 2004, total commitment fees deferred equaled $8 million.

Commitment fees realized decreased to $29.3 million in FY 2004 from $44.3 million in FY 2003 because of diminished activity in MBS issuance. New commitments issued by Ginnie Mae amounted to $146.1 billion during FY 2004, a 34.3 percent decrease from FY 2003.

A decline in the MBS portfolio was responsible for the decrease in MBS program income. MBS guaranty fees decreased 9.1 percent to $306.8 million in FY 2004, from $337.5 million in FY 2003. Guaranty fees are collected on the aggregate principal balance of the guaranteed securities outstanding in the nondefaulted issuer portfolio.

Figure 8 represents the RPB of the MBS portfolio as of September 30, 2004.

Figure 8: Remaining Principal Balance Outstanding of the MBS Portfolio, FY 2000–2004



Interest Income

Ginnie Mae invests the excess of its accumulated revenues over expenses only in U.S. Government securities, as mandated by the U.S. Department of the Treasury.

For the most part, interest income has steadily increased over the years. For FY 2004, interest income increased 13.7 percent to $442.7 million from $389.3 million in FY 2003. This increase was directly related to interest rates in FY 2004 relative to FY 2003.

Multiclass Revenue

Multiclass revenue is part of the MBS program revenues, and is composed of Real Estate Mortgage Investment Conduit (REMIC) and Platinum program fees. Ginnie Mae issued approximately $23.8 billion in Platinum products in FY 2004. Total cash fees for Platinum securities amounted to $9.5 million, representing a 38 percent decrease in fee income from the previous year. Guaranty fees from REMIC securities amounted to

$20.2 million on $57.7 billion in issuance for those products. Ginnie Mae recognizes a portion of the REMIC, Callable Trust, and Platinum program fees in the period they are received, with the balance deferred and amortized over the remaining life of the financial investment.

In FY 2004, Ginnie Mae issued $81.4 billion in its multiclass securities (REMICs and Platinums) program. The estimated outstanding balance of multiclass securities included in the total MBS securities balance on September 30, 2004, was $189.1 billion. This was a 3.4 percent increase from the outstanding balance in FY 2003 of $182.9 billion.

Ginnie Mae Expenses

Ginnie Mae's program costs include contractor services, personnel, compensation, printing, and other administrative expenses. Total expenses increased by 14 percent from $68.1 million in FY 2003 to $77.8 million in FY 2004.

There was growth in the program to reimburse interest to soldiers and sailors, as well as growth in the multifamily program, which repays the 1 percent not funded in the FHA claim reimbursement. Growth in both programs resulted in significant increased expenses for Ginnie Mae.

Total expenses were 9.5 percent of total revenues in FY 2004. In addition, total expenses as a percentage of average RPB grew over the last five years from 0.0078 to 0.0168 percent.

Credit-Related Expenses

Credit-related expenses include Ginnie Mae's Provision for Loss and defaulted issuer portfolio costs. Provision for Loss is charged against income in an amount considered appropriate to maintain reserves for losses at levels that management determines are adequate to absorb potential losses from defaulted issuer portfolios and programs. Based on management's assessment of reserve adequacy, no Provision for Loss was made in Fiscal Years 2003 and 2004.

Financial Models

Ginnie Mae's Policy and Financial Analysis Model (PFAM) is a comprehensive model that allows Ginnie Mae to evaluate its financial condition in terms of cash flow, capital adequacy, and budget projections. The model does this under an array of economic and financial scenarios modified by policy or programmatic decisions. PFAM incorporates Ginnie Mae's operations-based inherent risks with modeling that employs economic, financial, and policy variables to generate output that assesses risks and overall performance.

PFAM information provides support to Ginnie Mae management for key financial decisions, such as allocating reserves against future losses. The model also helps Ginnie Mae prepare its budget, by estimating the credit subsidy rate for each Ginnie Mae program.

PFAM includes a well-designed, self-documenting database that supports the model and streamlines the process of updating data, while reducing turnaround time. Its relational database is a vital feature because it enables expanded reporting capabilities, such as drill-down graphs and charts, and it gives the user meaningful access to the wealth of data available in the model.

In FY 2004, Ginnie Mae started developing PFAM Lite, an offline version of the model, which can perform ad hoc analyses in a shorter period that can reasonably approximate the types of results produced by the more robust processes in PFAM. PFAM Lite allows quick analyses of the impact of changes in a few key variables, such as prepayment, default, commitment fee, and guarantee fee rates, origination and issuer default volumes, servicing fee income, and subservicer fee expense estimates.

Every year Ginnie Mae works with FHA and VA to obtain the most current and comprehensive loan-level data. The data support detailed segmentation of loans according to key risk indicators—including loan type, loan size, loan-to-value ratio, and region—and enable Ginnie Mae to map the current risk profile of the collateral supporting its guaranteed MBSs.

Liquidity

Ginnie Mae's primary sources of cash are MBS and Multiclass Guaranty Fee Income, Commitment Fee Income, and Interest Income. After accounting for expenses and other factors, on September 30, 2004, Ginnie Mae reported Funds with the U.S. Treasury of $3.4 billion, compared with $2.9 billion on September 30, 2003.

In addition to the Funds with the U.S. Treasury, Ginnie Mae's Investment in U.S. Government securities was $7.5 billion as of September 30, 2004. Of this amount, $1.3 billion was held in overnight certificates on September 30, 2004. The balance of the portfolio's maturities is spread over time to ensure that Ginnie Mae has a ready source of funds to meet various liquidity needs. Emergency liquidity needs are met through short-term maturities.

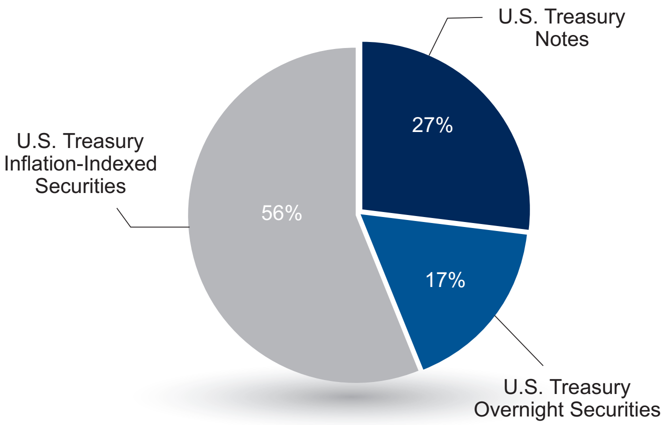
Table 2 describes the fair value composition and maturity of Ginnie Mae's Treasury securities as of September 30, 2003, and 2004.

Table 2: Composition of Treasury Securities as of September 30 (Percentage of Total)

Maturity	2004	2003
Due within 1 year	27%	30%
Due in 1–5 years	16%	28%
Due in 5–10 years	57%	42%

Figure 9 illustrates the components of Ginnie Mae's investments in U.S. Government securities as of September 30, 2004.

Figure 9: Components of Investment in U.S. Government Securities, September 30, 2004



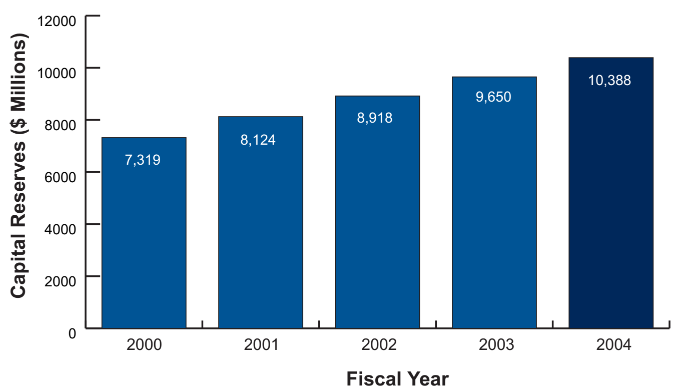
Capital Adequacy

Ginnie Mae's activities involving the guaranty of MBSs have historically operated at a profit. The agency has never had to exercise its authority to borrow funds from the U.S. Treasury to finance its operations. Ginnie Mae's net income continues to build and strengthen the agency's capital base and programs. Ginnie Mae believes it maintains adequate capital reserves to withstand downturns in the housing market that could cause severe issuer defaults. This capital is backed by the full faith and credit guaranty of the U.S. Government.

As of September 30, 2004, the Investment of U.S. Government securities was $10.4 billion after establishing reserves for losses on credit activities, compared with $9.7 billion as of September 30, 2003. Over the past three years, Ginnie Mae has increased its capital adequacy ratio (investment in U.S. Government securities, plus loan loss reserve as a percentage of total assets and RPB) from 1.4 percent to 2.4 percent. To assess the strength of its capital position, Ginnie Mae uses a "stress test" methodology that measures the agency's ability to withstand severe economic conditions.

Figure 10 shows Ginnie Mae's capital reserves (Investment of U.S. Government securities) as of September 30, 2004, for the last five years.

Figure 10: Capital Reserves (Investment of U.S. Government Securities)



Risk Management

Ginnie Mae continues to enhance its automated systems and business processes to increase the efficiency of its operations and to reduce its business risk. During FY 2004, Ginnie Mae continued periodic reviews of all master subservicers and major contractors, to ensure compliance with the terms and conditions of their contracts with Ginnie Mae. In addition, the audits and reviews enable Ginnie Mae to strengthen its internal controls and minimize risks.

Management Comments on Systems of Internal Controls

Ginnie Mae management maintains and depends on a system of internal administrative and accounting controls that, in the agency's opinion, provides reasonable assurance that transactions are properly authorized and recorded, permits preparation of financial statements in conformity with generally accepted accounting principles, and ensures that Ginnie Mae's assets are safeguarded. The system of internal and accounting controls includes policies and procedures for the execution, documentation, and recording of transactions, and an organizational structure that provides for effective segregation of duties and responsibilities.

Ginnie Mae management believes that this internal assessment meets the intent of the U.S. Office of Management and Budget (OMB) internal control review requirements outlined in OMB Circular A-123, Management Accountability and Control, and OMB Circular A-127, Financial Management Systems. In addition, management believes that Ginnie Mae complies with the reasonable assurance standards of sections 2 and 4 of the Federal Managers' Financial Integrity Act of 1982.