

# Ginnie Mae Report to Congress



Fiscal Year 2007

November 13, 2007





U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-9000

GOVERNMENT NATIONAL  
MORTGAGE ASSOCIATION

November 13, 2007

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

Dear Mr. Secretary:

Our mission at Ginnie Mae is to support the expansion of affordable housing in America. We promote homeownership and affordable rental housing by guaranteeing mortgage-backed securities (MBS) issued by originators of government-insured single family and multifamily mortgages. Since 1970, Ginnie Mae has guaranteed more than \$2.6 trillion in mortgage-backed securities, thereby, helping Americans achieve their dream of homeownership.

But this has been a challenging year for the housing and mortgage markets. Problems in the subprime market have contributed to broader credit problems: home prices are declining, delinquencies and foreclosures are up, and there are indications that these problems are affecting the overall economy. And yet the markets that Ginnie Mae supports have remained liquid due to the stability provided by our business partners at the Federal Housing Administration (FHA) and the Department of Veterans Affairs, as well as the full faith and credit backing of the U.S. Government for Ginnie Mae securities. Ginnie Mae has also worked closely with the FHA to support *FHASecure*, the important initiative that you announced in August to help families stay in their homes. Ginnie Mae is creating a custom security to provide an efficient source of secondary market financing for these loans.

In addition, we have focused on three other major initiatives this year: Promoting FHA modernization; developing the Home Equity Conversion Mortgage (HECM) mortgage-backed security (HMBS), and promoting foreign investment. We have worked, and will continue to work, closely with the FHA to support efforts at modernizing FHA loan programs. FHA and Ginnie Mae will be in a much better position to serve homebuyers with an FHA that has greater flexibility to continue to meet the needs of low- and moderate-income Americans.

In November, we issued the first HMBS, the first such security structure in the industry. The HECM serves the growing senior population by allowing older Americans to use the equity in their homes to meet their retirement needs. The HMBS provides an outlet for these loans and

increases the flow of cash to issuers who can increase the number of HECM loan originations. Thanks in part to the guidance and insight of former Ginnie Mae President Robert M. Couch, the HMBS product is now a viable option for lenders to securitize HECM loans backed by the full faith and credit of the U.S. Government.

International investment significantly enhances our ability to support the secondary market for government loans. Recognizing the critical role of foreign investment, Mr. Couch made an unprecedented trip to Asia to promote investment in Ginnie Mae mortgage-backed securities. Despite foreign investor concerns about the state of the U.S. subprime market, Ginnie Mae MBS remain an attractive investment option precisely because of their full faith and credit backing of the U.S. Government.

Our success in creating attractive investment vehicles and providing solutions for the nation's housing needs is evidenced by our portfolio growth this year. While much of the industry is suffering losses, Ginnie Mae's dollar volume of single family MBS increased by 7 percent, and our market share increased significantly. Through sound policies and financial practices, as well as an appreciation for the evolving needs of the American public, Ginnie Mae has demonstrated the important role it plays in helping to maintain a stable U.S. housing market.

Sincerely,

A handwritten signature in blue ink that reads "Thomas R. Weakland". The signature is written in a cursive style with a large, stylized 'T' and 'W'.

Thomas R. Weakland  
Acting Executive Vice President

# Table of Contents

<b>I. Mission and Purpose .....</b>	<b>1</b>
Expanding Affordable Housing.....	1
Providing Market Liquidity and Product Innovation .....	2
Supporting Affordable Housing .....	5
<b>II. Market Environment .....</b>	<b>6</b>
Today’s Economy .....	6
Demographic Trends .....	7
Ginnie Mae’s Role .....	7
Market Share Context.....	8
<b>III. 2007 Strategic Initiatives.....</b>	<b>9</b>
HECM Mortgage-Backed Security (HMBS) .....	9
Ginnie Mae and FHA Modernization.....	11
Ginnie Mae and FHASecure .....	12
Business Process Improvements (BPI) and System Enhancements.....	15
Human Resource Initiatives .....	16
Industry Cooperation.....	17
<b>IV. Ginnie Mae Financial Highlights and Management Discussion and Analysis.....</b>	<b>18</b>
Revenues .....	20
Expenses.....	23
Financial Models .....	25
Liquidity and Capital Adequacy.....	25
Risk Management and Systems of Internal Controls .....	27

Securitization Issuance.....28

**V. Audit Report of Ginnie Mae’s FY 2007 Financial Statements ..... 31**

**(Report Appears as a Separate Document with its Own Numbering)**

## **I. Mission and Purpose**

Ginnie Mae has been a sound and stable player in the housing finance and capital markets since its inception nearly 30 years ago. By providing investors the full faith and credit guarantee of the United States Government for timely payment of principal and interest on mortgage-backed securities (MBS), Ginnie Mae serves a vital role in expanding affordable housing, providing market liquidity and product innovation, and supporting affordable rental housing throughout the nation. Its products and programs enable qualified Americans access to affordable capital regardless of declines in the housing market, economic uncertainty, or difficulties at financial firms. Additional information can be found on Ginnie Mae's website at <http://www.ginniemae.gov/>.

### **Expanding Affordable Housing**

Ginnie Mae expands affordable housing in America by linking global capital markets to the nation's housing markets. By providing products and solutions that promote liquidity and stability in the secondary market, Ginnie Mae enables qualified mortgage lenders to sell their mortgage loans at favorable prices and attract new sources of capital. Ultimately, lenders lower costs of financing so they can in turn offer lower interest rates to qualified homebuyers and developers, thus lowering costs for homeowners and renters.

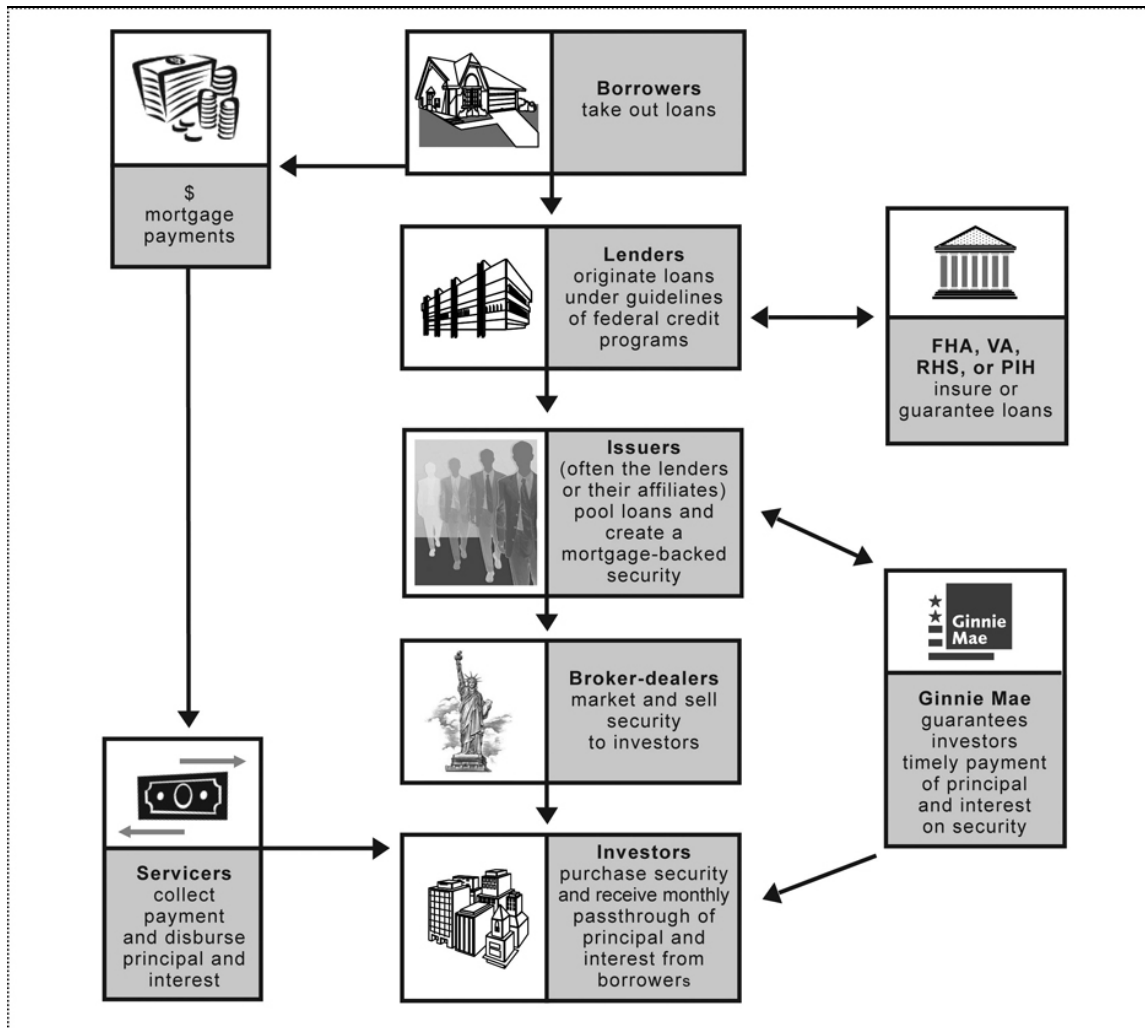
Ginnie Mae was formed by Congress in 1968 as the Government National Mortgage Association. It is a wholly owned government corporation within the U.S. Department of Housing and Urban Development (HUD), jointly administered by the Secretary of HUD and the President of Ginnie Mae. In 1970, Ginnie Mae developed and guaranteed the first MBS. Today, its primary function is to guarantee the timely payment of principal and interest on MBS. Ginnie Mae guarantees MBS that are backed by pools of mortgages issued by private mortgage institutions and insured by two Housing and Urban Development (HUD) programs: the Federal Housing Administration (FHA) and the Office of Public and Indian Housing (PIH). In addition, loans guaranteed by the Department of Veterans Affairs' (VA) Home Loan Program for Veterans and loans made by the U.S. Department of Agriculture (USDA) Rural Development Housing and Community Facilities Programs are eligible for inclusion in Ginnie Mae MBS.

Ginnie Mae does not make or purchase mortgage loans. Nor does it buy, sell, or issue securities. Subsequently, Ginnie Mae does not use derivatives to hedge or carry long term debt, or related outstanding securities liabilities, on its balance sheet. Instead, issuers, which are private lending institutions approved by Ginnie Mae, originate eligible government loans, pool them into securities, and issue the Ginnie Mae MBS.

The ability to package these loan products into securities, which are subsequently sold by broker-dealers to investors around the world, enables a lender to use the proceeds to make more mortgage

loans. Repeating this cycle increases the availability, accessibility and affordability of mortgage funds for low- to moderate-income Americans.

Figure 1 shows the process of creating Ginnie Mae securities.



**Figure 1: Ginnie Mae Securities Creation Process**

### Providing Market Liquidity and Product Innovation

Ginnie Mae securities are among the most secure investments in the global capital market and are the only MBS carrying the full faith and credit guaranty of the United States government. Even in uncertain times, investors are guaranteed payment of interest and principal, in full and on time. This, along with an expected return higher than U.S. Treasury securities, makes Ginnie Mae securities highly liquid and attractive to domestic and foreign investors, who can sell them quickly without significant risk of loss or arbitrage. Particularly in today’s turbulent mortgage industry, the faith in



Ginnie Mae is demonstrated by its anticipated 50 percent increase in market share by calendar year end despite overall market decline.<sup>1</sup>

In FY 2007, Ginnie Mae again demonstrated its industry leadership by introducing a new MBS designed specifically for securitizing Home Equity Conversion Mortgages (HECM). Ginnie Mae is the first agency to provide such a structure, which will set the standard for such securities.

Ginnie Mae has developed a variety of securities tailored to investors with diverse needs. At the core are two MBS products:

- **Ginnie Mae I MBS** require all mortgages in a pool to be of the same type, issued by the same entity, and to have the same fixed interest rate.
- **Ginnie Mae II MBS** are restricted to single family mortgages, but allow multiple-issuer pools to be assembled containing a range of coupons.

These securities drive Ginnie Mae's efforts to create a secondary market for government loans, and serve as the underlying collateral for multiclass products such as Real Estate Mortgage Investment Conduits (REMIC), Callable Trusts, Platinums, and Stripped MBS, for which Ginnie Mae also guarantees the timely payment of principal and interest. These allow the private sector to combine and restructure cash flows from Ginnie Mae MBS into securities that meet unique investor requirements in connection with yield, maturity, and call-option protection. The intent of the Multiclass Securities Program is to increase liquidity in the secondary mortgage market and to attract new sources of capital for federally insured or guaranteed residential loans.

- **REMICs** are investment vehicles that reallocate the pass-through cash flows from underlying mortgage obligations into a series of different bond classes, known as tranches.
- **Callable Trusts** allow investors the flexibility to redeem or call a security prior to its maturity date under certain conditions, to hedge against fluctuating rate environments.
- **Platinum** securities allow investors who hold multiple pools of MBS to combine them into a single Ginnie Mae Platinum Certificate.
- **Stripped Mortgage-Backed Securities (SMBS)** are custom designed securities that redirect MBS cash flows to meet investors' specific income needs around interest and principal payments.

These products are put together for offering in the public markets by designated Ginnie Mae Sponsors. These represent some of the largest domestic and international financial institutions, who have wide access to global investors. In addition, selected Co-sponsors, who are often minority and

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<sup>1</sup> "Across the Curve: in Rates and Structured Products," BEAR STEARNS, pg. 13-14, October 2, 2007.

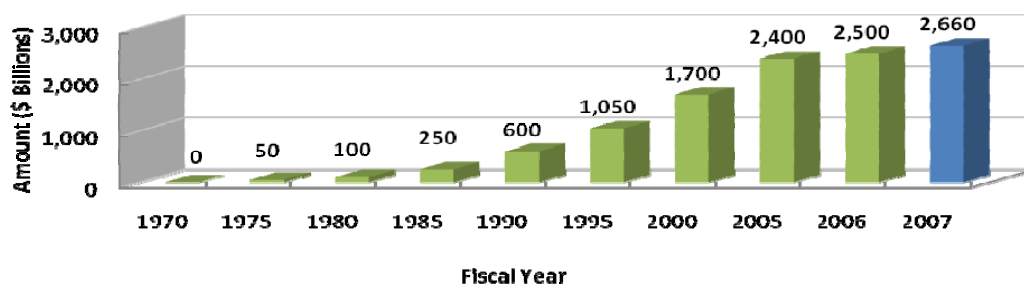
small-sized institutions with a diverse reach, support the securities' offerings. Figure 2 shows a current list of these sponsors.

GINNIE MAE REMIC SPONSORS:		
<i>Single Family</i>		
Barclays Capital	Deutsche Bank	JPMorgan
Bank of America	AC Edwards	Lehman Brothers
Bear Stearns	FTN Financial	Merrill Lynch
Citigroup Global	Goldman Sachs	Nomura Securities
Countrywide Securities	Greenwich Capital	RBC Capital Markets
Credit Suisse First Boston	HSBC Securities	UBS Warburg
<i>Multifamily</i>		<i>Ginnie Mae REMIC Co-Sponsors:</i>
Bank of America	Berean Capital	Myerberg & Company
Credit Suisse First Boston	Blaylock Capital	Ormes Capital Markets
Deutsche Bank	CastleOak Securities	Peraza Capital
Greenwich Capital	Doley Securities	Pryor, McClendon, Counts
JPMorgan	Gardner Rich	SBK Brooks Investment Corp.
Merrill Lynch	Guzman & Company	Utendahl Capital Partners
Nomura Securities	Herenton Capital Partners	The Williams Capital Group
Wachovia Capital	Loop Capital	

**Figure 2: Ginnie REMIC Sponsors and Co-sponsors**

In Fiscal Year (FY) 2007 Ginnie Mae again demonstrated its industry leadership by introducing a new MBS designed specifically for securitizing HECM loans. Ginnie Mae is the first agency to provide such a structure, which will set the standard for such securities.

Since its inception, Ginnie Mae has guaranteed more than \$2.6 trillion in MBS (see Figure 3), providing access to affordable housing for low- and moderate-income Americans and creating homeownership opportunities in every U.S. state and territory.



**Figure 3: Cumulative Amount of Ginnie Mae Mortgage-Backed Securities (1970-2007)**

## Supporting Affordable Housing

Although homeownership is a worthy and important goal, it is not a viable option for all Americans and today's housing challenges cannot be met through homeownership alone. Decent, affordable, and safe rental housing is a critical element in building economic stability for individuals and communities throughout America. In many ways, housing may be viewed as a ladder of opportunity with affordable rental housing as the "first rung." Affordable rental housing has become increasingly important as home prices have risen dramatically in recent years and now as mortgage funds are more difficult to obtain, not all Americans can, or want to, gain quick entry into homeownership.

As of the end of FY 2007, Ginnie Mae securitized 93 percent of eligible single family fixed rate FHA loans. This resulted in a 1.6 percent increase over last year's 91.4 percent securitization level. Single family securities outstanding increased to \$389.1 billion in FY 2007 from \$372 billion in FY 2006, thereby meeting the Ginnie Mae target performance goal of 93 percent share of the residential mortgage loans insured or guaranteed by the FHA.

Just as Ginnie Mae's single family products reduce finance costs for homebuyers, its multifamily products have an analogous impact on maintaining affordable rents for individuals and families. By creating multifamily pools that are sold to investors in the global capital markets, lenders help reduce mortgage interest rates paid by developers which, in turn, keep rents affordable. As of the end of FY 2007, Ginnie Mae securitized 98 percent of eligible multifamily FHA loans, 3 percentage points over the 2007 stated target. This number is a 1.1 percentage points increase over last year's result of 96.9 percent. The multifamily MBS program dollar volume increased by \$0.5 billion in FY 2007, up to \$38.3 billion from \$37.8 billion, marking the 13<sup>th</sup> year of growth in the Ginnie Mae's multifamily housing program. Since 1971, Ginnie Mae has guaranteed \$97.8 billion in multifamily MBS, helping to finance affordable multifamily housing units including apartment buildings, nursing homes and assisted-living facilities across the nation.

As of the end of FY 2007, Ginnie Mae securitized 92 percent of eligible single family fixed rate VA loans, which is 9 percentage points above the target of 83 percent. Ginnie Mae achieved this level in part by guaranteeing securities that provide the best execution from a pricing standpoint. Ginnie Mae also continued to reduce issuers' back-end processing costs and improved security disclosures.

Ginnie Mae established the Targeted Lending Initiative (TLI) program in 1996 to provide incentives for lenders to increase loan volumes in traditionally underserved areas. The TLI program offers discounts ranging from one to three basis points on Ginnie Mae's six basis point guaranty fee, depending on the percentage of TLI eligible loans within the security. The reduced fee gives lenders an incentive to originate loans in TLI areas. As of the end of FY 2007, 26 percent of all single family pools issued received TLI credit. This result is two percentage points below the target of 28 percent. In FY 2007, fewer issuers formed TLI pools than in FY 2006. This may be due, in part, to the market difficulties faced by many in the mortgage industry, particularly during the second half of the year.

## II. Market Environment

The real estate and housing finance markets faced a number of challenges in FY 2007. The meltdown of the subprime market, with the related rising delinquencies and foreclosures and lack of investor confidence across the board, has impacted the economy as a whole. At the same time, changing demographics present the need for affordable capital to a growing and changing population. Ginnie Mae has continued to play a steadfast role and will continue to develop and maintain products and programs that increase sources of capital that finance affordable housing in dynamic markets.

### Today's Economy

The Nation's economy has been strained by turmoil in housing finance and a tight credit market, and began to slow during FY 2007. The economy also was deeply impacted by sagging business confidence and weaker consumer spending as household wealth declined along with home prices.<sup>2</sup> Furthermore, in the coming year, hybrid adjustable rate mortgages (ARMs) are due to reset in dramatic numbers, with interest rates on approximately \$50 billion worth of loans ready for an interest rate increase in a single month alone.<sup>3</sup> These resets are expected to add greatly to the downward trend of the mortgage market and declining household wealth, and hence to the lack of investor confidence.

Nevada, Florida and California have been three of the hardest hit states in the country.<sup>4</sup> According to September tracking data, Nevada had one foreclosure filing for every 185 households whereas the national average is one out of every 557 households.<sup>5</sup> In September, 223,538 foreclosures and related filings were reported nationally, almost double the number reported in September 2006.<sup>6</sup> Some sources estimate that foreclosure filings will exceed two million by the end of calendar year 2007. In addition, the National Association of Realtors said home sales will fall more sharply this year than originally forecasted. The revised forecast calls for home sales to fall by 11 percent from last year.<sup>7</sup> Sales of new homes are expected to post their worst year in a decade. Prices for existing homes are expected to fall 1.3 percent by the end of 2007 to a median of \$210,200.<sup>8</sup>

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<sup>2</sup> The Conference Board, "The Conference Board Consumer Confidence Index Declines Again," September 30, 2007.

<sup>3</sup> IBID.

<sup>4</sup> RealtyTrac.com, "Foreclosure Activity Down 8 percent in September."

<sup>5</sup> IBID.

<sup>6</sup> IBID.

<sup>7</sup> MSNBC.com, "Foreclosure Rate Dips, Expected to Stay High," October 11, 2007.

<sup>8</sup> IBID.

## **Demographic Trends**

The current demographic outlook shows major shifts in population trends that will have a significant impact on the mortgage market in the coming years.<sup>9</sup> As the baby boom generation ages, today's older Americans are expected to comprise a larger share of the population, live longer, and spend more years in retirement than previous generations. As a result, they are often in need of affordable funds to supplement retirement and social security income and to meet rising health care and other living costs. In addition, minorities and immigrants will continue to gain in numbers and have a large impact on the economy, as well as demand for affordable housing.

For example, the increasing immigrant population, combined with higher than average birth rates and a population that is, on average, ten years younger than the general population, will maintain the historical and recent Hispanic population growth rates in the foreseeable future. In addition to the population growth, Hispanics are experiencing unprecedented purchasing power growth.

Regardless of their economic status, however, studies have shown that minorities and immigrants hold a strikingly high number of subprime and high cost mortgages.<sup>10</sup> As the market for these types of loans has shrunk dramatically during the past year, new sources of mortgage funding are needed to meet the housing finance needs of growing populations. FHA and Ginnie Mae are stepping in to fill the void and provide reasonable products and capital to meet these needs.

## **Ginnie Mae's Role**

In the midst of the troubles facing the U.S. housing market and the related lack of investor confidence, Ginnie Mae's unique position enables it to offer soundness and stability. As funds have diminished and investors have suffered significant losses in the wake of the subprime market meltdown, Ginnie Mae is recognized within the lending and investment community as a stalwart player. Its guarantee of the full faith and credit of the U.S. Government enables lenders to continue to access capital in order to make affordable mortgage loans and offer investors one of the most secure investment alternatives in the market.

Ginnie Mae is also well-positioned to provide solutions that help to meet the affordable financing needs of the nation's changing population segments. Section III of this report describes how Ginnie Mae guarantees mortgages insured by FHA that allow seniors to draw on the equity in their homes without having to sell them and move out. In addition, as FHA-insured mortgages become a more viable alternative to subprime loans, Ginnie Mae's ability to guarantee MBS helps to keep mortgage funds available for populations that once turned to non-prime markets.

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<sup>9</sup> Homeownership Alliance, "America's Home Forecast: The Next Decade for Housing and Mortgage Finance," (2004-2013).

<sup>10</sup> "Homeownership and Wealth Building Impeded: Continuing Lending Disparities for Minorities and Emerging Obstacles for Middle-Income and Female Borrowers of all Races," National Community Reinvestment Coalition (NCRC), The Opportunity Agenda and the Poverty and Race Research Action Council (PRRAC)

## Market Share Context

Ginnie Mae's strength and stature in the current market is also demonstrated through the increase in its securities issuance and market share, particularly as the rest of the industry experienced marked declines. The dollar volume of MBS issued in the industry is expected to decline by 9 percent from FY 2006 to FY 2007 as mortgage origination volume continues to fall.<sup>11</sup> Ginnie Mae, however, has seen a 7 percent *increase* in the original principal balance of single family issuances from a comparable period in FY 2006. In addition, Ginnie Mae's market share is expected to rise by 50 percent, from 4 percent of the MBS market at the end of calendar year 2006 to 6 percent of the MBS market by the end of calendar year 2007.<sup>12</sup> Ginnie Mae MBS, as well as the multiclass products, are very attractive and some of the most sought after securities in the market.

The increase in FHA loan volume and demand for highly secure, liquid securities has helped to boost issuance of Ginnie Mae MBS and subsequently, Ginnie Mae's outstanding portfolio. Issuance increased 6.6 percent during FY 2007 with an ending outstanding portfolio balance of \$427.6 billion, up from \$410 billion in FY 2006. As the FY 2007 came to an end, Ginnie Mae has been experiencing 18 consecutive months of portfolio growth. In addition to rising issuance, the growth in the portfolio has been due to stable liquidations. Whereas the number of foreclosures nationwide have more than doubled during the past year, Ginnie Mae's foreclosures only increased by a factor of one-third.

The number of eligible loans for Ginnie Mae securities is expected to continue to rise as originations of federally insured and guaranteed loans increases. New initiatives, such as FHASecure and FHA modernization legislation, along with a decline in subprime lending, will help this trend to continue.

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<sup>11</sup> "Across the Curve: in Rates and Structured Products," BEAR STEARNS, pg. 13-14, October 2, 2007.

<sup>12</sup> IBID.

### **III. 2007 Strategic Initiatives**

During FY 2007 Ginnie Mae embarked upon several strategic initiatives that responded to market opportunities, supported FHA programs, and addressed internal operations and resources. These included developing HECM securities, supporting FHA Modernization and FHASecure, continuing business process improvements and systems enhancements, and implementing human resource initiatives. These efforts lead to an increase in mortgage capital and/or help to lower costs of financing and thus soundly put into action Ginnie Mae's mission to expand affordable housing.

#### **HECM Mortgage-Backed Security (HMBS)**

Ginnie Mae is introducing the HMBS to securitize Home Equity Conversion Mortgages (HECM's), which are offered by lenders and backed by the FHA, and are in response to the growing affordable financing needs of the large aging population. HECM loans can be used by senior homeowners age 62 and older to convert the equity in their home into monthly streams of income today and/or a line of credit to be repaid when they no longer occupy the home. FHA's HECM product has dominated the reverse mortgage market with approximately 90 percent market share. The primary goal of Ginnie Mae's HMBS program is to provide senior citizens with more affordable reverse mortgage borrowing options to support their financial needs during their retirement years. HMBS are guaranteed by the full faith and credit of the US Government.

As a result of an overall decline in birth rates and an overwhelming increase in life expectancy, population aging is considered to be one of the most profound demographic trends of the 21<sup>st</sup> century. According to the U.S. Census Bureau, the senior population will almost double in the next 20 years, to approximately 64 million people ages 65 and older<sup>13</sup>. As the population continues to age, affordable sources of funds to supplement retirement, social security income, rising health care costs and living needs are more critical than ever.

This growing population controls unprecedented levels of untapped home equity. Currently, Americans 62 years and older hold an estimated \$4.28 trillion in home equity.<sup>14</sup> As of second quarter 2007, senior home values are estimated at \$5.09 trillion.<sup>15</sup> Some projections call for as much as \$37 trillion in senior home value by 2030, from which home equity figures are derived, assuming historical appreciation and taking into account the demographic shift as baby boomers

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<sup>13</sup> "National Reverse Lenders Association Releases 2<sup>nd</sup> Quarter RMMI Results," October, 11, 2007, NRMLA and Hollister Group.

<sup>14</sup> IBID.

<sup>15</sup> IBID.

begin to turn 62. Currently, the average home equity in a senior-owned household is estimated to be over \$230,000.<sup>16</sup> Reverse Mortgages can help turn equity into cash to meet their daily living and other financing needs.

## **Securitization**

Until now, there has been a limited secondary market for reverse mortgages. With very few investors, complicated security structures, and growing consumer appetite, a robust secondary market was needed to facilitate the growth and affordability of reverse mortgages. Ginnie Mae has been at the forefront of creating a standardized security program to help facilitate the secondary market for HECM loans. A Ginnie Mae HMBS, carrying the full faith and credit of the U.S. Government now provides an attractive investment option. The quality and liquidity of a standardized Ginnie Mae HMBS security structure helps to foster a liquid, robust secondary market, which will in turn increase the availability of capital and drive down the costs of reverse mortgages for seniors.

The HMBS is a new class of Ginnie Mae security backed by FHA insured HECM loans under the umbrella of the Ginnie Mae II Custom Program. Ginnie Mae approved issuers can pool HECM loan draws, servicing fees, and mortgage insurance premium (MIP) advances, and securitize these balances into an HMBS. The HMBS is an accrual class pass-through security. As such, it does not have a payment schedule but rather accrues interest on the securitized principal until such time that payoffs are received. The HMBS is sold to investors as a stand-alone security or, beginning in FY 2008, can be used as collateral for a Ginnie Mae REMIC.

Since Ginnie Mae securities are traded actively in the global capital markets, there is strong confidence that a robust secondary market will generate significant liquidity, which will benefit the senior homeowner. Ginnie Mae's research indicates that the securitization of HECM loans can result in a savings of 50 basis points or more for the borrower. On an average HECM loan of \$118,000, this savings amounts to over \$10,000 over a 10-year period, the average life of a HECM.

Due to the lack of historical performance information on HECM loans, Ginnie Mae will offer disclosure at origination that goes beyond what is currently offered for either Ginnie Mae I or Ginnie Mae II securities. This disclosure will include (1) demographic statistics on HECM mortgagors, such as age and gender; and (2) key loan characteristics, such as the ratio of available credit remaining to the principal limit, and the ratio of the outstanding balance to the maximum claim amount.

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<sup>16</sup>NRMLA and Hollister Group Press Release, "National Reverse Mortgage Lenders Association Releases 2<sup>nd</sup> Quarter RMMI Results," October 11, 2007.



## **Next Steps**

In FY 2008, it is planned that Ginnie Mae sponsors will be able to use the HMBS as collateral for REMICs.

## **Ginnie Mae and FHA Modernization**

Supporting the Expanding Homeownership Act of 2007, also known as “FHA modernization” continues to be a top priority for Ginnie Mae. FHA modernization is designed to make government-insured loan products competitive with the private sector and make available affordable housing to more Americans than today. It will provide a safe, fair, and affordable FHA alternative to the subprime market. Given the lack of mortgage fund availability and ARM loans resets, FHA modernization will provide a welcome option to many American families. As the organization that facilitates the securitization of FHA loans, Ginnie Mae will play a critical role in ensuring continued liquidity of the government-insured mortgage market.

At the end of FY 2007, the FHA modernization legislation before Congress contains components that include the following provisions:

- Enables FHA to increase its loan limits to meet the needs of a broader cross section of consumers. Because of current limits, FHA financing is not a viable option for borrowers in high cost housing markets. Greater availability of FHA financing will limit the use of more exotic loans that often create problems for borrowers when they adjust.
- Provides FHA the flexibility to reduce the minimum 3 percent down payment requirement giving borrowers more options to control the amount of their down payment and mortgage payment based on their immediate and long-term needs.
- Eliminates the cap on the number of reverse mortgages the FHA can insure and sets a national loan limit at the GSE conforming rate so that all seniors have access to the same loan amounts.
- Permits seniors to purchase a home and obtain a HECM in one transaction.

In today’s difficult mortgage market environment Ginnie Mae and its government partners play a more and more critical role in providing affordable homeownership opportunities to Americans. With a full faith in credit backing of the U.S. government, investors can feel secure that loans guaranteed by Ginnie Mae will be a safe investment. Particularly in today’s uncertain marketplace, Ginnie Mae offers investors certainty of the timely payment of principal and interest regardless of the status of the underlying collateral. Coupled with FHA’s modernization efforts, Ginnie Mae is an attractive option for investors who have been unnerved by recent events in the U.S. housing market.

## **Securitization**

Ginnie Mae has worked closely with the FHA to support its modernization efforts and to ensure it can support capital market solutions that will provide an ongoing flow of funds.

## **Next Steps**

Ginnie Mae will continue to support FHA modernization efforts to ensure that changes to its loan programs are reflected in the securities that represent FHA loan collateral.

## **Ginnie Mae and FHA Secure**

August 31, 2007, President Bush announced that FHA will unveil a new plan called FHA Secure which will allow families with strong credit histories who have been making timely mortgage payments before their loan reset, but are now in default, to qualify for refinancing under the FHA insured mortgage program.

With its full faith and credit government guarantee, Ginnie Mae will be able to use its MBS program for new loans offered through FHA Secure. Ginnie Mae stands ready to serve a critical role in improving liquidity and addressing the current credit crisis by continuing to facilitate the flow of capital for credit-worthy borrowers who cannot obtain prime loans. Ginnie Mae is in a unique position to provide assistance to struggling American homeowners – potentially 60,000 to 80,000 according to FHA estimates -- who are unable to meet adjusting mortgage payments.

The FHA Secure program will allow homeowners who have a good credit rating, but cannot afford their current payments, to refinance into FHA-insured mortgages. Over the next 15 months, the FHA refinance option is available to borrowers who are delinquent, do not hold an FHA ARM mortgage, demonstrate six months of on-time payments prior to the reset, demonstrate a capacity to repay, reside in a single family, owner-occupied, primary residence, and are facing an interest rate reset.

The program is effective immediately and through December 31, 2008. Loan limits will match existing FHA geographical maximum mortgage limits as well as current FHA maximum loan-to-value limits. The refinance will cover existing first lien, purchase money seconds, closing costs, prepaid expenses, points, late charges, arrear charges, and other costs.

Ginnie Mae will create a new security backed by fixed-rate FHA Secure loans. The new security will be a multiple-issuer pool type under the Ginnie Mae II Mortgage-Backed Securities Program, and will be available for pool issuances beginning December 1, 2007.

## Promoting Foreign Investment

Ginnie Mae strives to lower the cost of borrowing to homeowners and multifamily providers by increasing its attractiveness to sources of capital. Foreign investors, to whom the full faith and credit guaranty is of great value, represent a significant part of the demand for Ginnie Mae securities. Relative to yields on U.S. Treasury securities, Ginnie Mae MBS are a desirable alternative investment for foreign investors seeking to maximize return with minimum credit risk

Increasing foreign demand for Ginnie Mae securities impacts security performance and pricing. As the price of Ginnie Mae securities increases, issuers can offer the underlying mortgages at lower interest rates and/or financing costs, which translate to lower costs for homebuyers and renters.

In March 2007, former Ginnie Mae President, Robert M. Couch, who led Ginnie Mae through May 2007, traveled to Asia to generate investor demand for Ginnie Mae MBS and to educate Asian investors on the new Ginnie Mae HMBS. During that period, he spoke with 29 banks, insurance companies, securities firms, and pension funds located in Hong Kong, Macao, Taipei, Beijing and Tokyo. Of the 29 organizations, 11 were central banks or national monetary authorities. During the presentations, former President Robert M. Couch, focused on:

- The history of Ginnie Mae and the U.S. Government programs that are eligible for Ginnie Mae securities
- An update on the recent performance of Ginnie Mae securities
- The effect of the subprime market problems on the performance of Ginnie Mae securities
- The usefulness of Ginnie Mae securities in managing a portfolio that is subject to the Basel II capital standards
- The reasons an investor might be willing to accept a slightly lower yield on a Ginnie Mae MBS especially during times of turmoil (full faith and credit of U.S. Government)
- A description of the new Ginnie Mae security, the HMBS

Generally, there was a lot of interest expressed in Ginnie Mae MBS and particularly, the new HMBS.

In July 2007, the Honorable Alphonso Jackson, U.S. Secretary of Housing and Urban Development (HUD), conducted a 5-day tour to Hong Kong, Macau and Beijing. The visit was part of the Strategic Economic Dialogue that began between China and the U.S. in Washington, D.C., in May 2007. Last year, President Bush and Chinese President Hu Jintao agreed to create the Strategic Economic Dialogue to provide an overarching framework for discussing ongoing and diverse economic challenges.

Secretary Jackson discussed his vision of the two countries working together to build affordable housing and affordable rental housing, and economically benefitting each other through investment in the MBS market. Secretary Jackson discussed the benefits of investing in Ginnie Mae MBS, which have the full faith and credit of the U.S. Government behind them. In 2002, the total Chinese investment in U.S. agency mortgage-backed securities was just over \$100 million. By June 2006, this number had grown to over \$107 billion -- a nearly 1,000-fold increase in less than 5 years.<sup>17</sup> The Chinese economy is benefiting from high-yielding, safe investments in U.S. mortgage-backed securities. American homeowners are benefiting from lower interest rates on mortgage loans resulting from greater Chinese demand for these securities.

## **VA Loan Limit**

Active duty military and veteran families, who are growing in number, present today's housing market with their own needs. Those who serve, and have served, our country at home and abroad are often under financial strain, particularly when they are called to duty. Many also live in high-cost housing areas, but have been shut out of being able to obtain a VA loan due to Ginnie Mae loan limits. For example, although 10 percent of the nation's veterans live in California, less than one percent of the VA loans in the Ginnie Mae securities portfolio issued during the last two years were to California veterans, because loan limits were below most house prices in the state.

To address the needs of the men and women who have or are serving our Nation, effective on September 1, 2007, Ginnie Mae eliminated the restriction on the size of mortgage loans guaranteed by the Department of Veterans Affairs (VA) that can be used as collateral for Ginnie Mae securities. Previously, Ginnie Mae limited the size of VA-guaranteed loans that can back Ginnie Mae MBS to the conforming loan limit, which is currently \$417,000 for most areas. Furthermore, by reimbursing issuers for interest in excess of 6 percent on loans made to active duty military personnel covered by the Servicemembers Civil Relief Act of 2003, Ginnie Mae provides lenders with an incentive to lend to those who serve our country. Ginnie Mae expects that these changes will expand the availability of low-cost financing and increase homeownership opportunities for America's veterans and their families, particularly in high-cost areas. Ginnie Mae will continue to require that the amount of the borrower's cash down payment, plus the amount of the available VA guaranty, be equal to at least 25 percent of the lesser of the purchase price or the Certificate of Reasonable Value.

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<sup>17</sup> HUD News Release 07-072, May 23, 2007, Statement by HUD Secretary Alphonso Jackson on His Participation in the U.S. – China Strategic Economic Dialogue.

## **Business Process Improvements (BPI) and System Enhancements**

During FY 2007, Ginnie Mae made significant strides in its information technology modernization efforts, which are designed to help it meet the needs of its issuer and investor communities.

Ginnie Mae completed the first phase of development on the Enterprise-wide Operational Data Store, a core component of its infrastructure rebuild, which will ultimately combine several internal databases into one comprehensive source for information. In addition, the organization has completed software development on the new Reporting and Feedback System (RFS). When testing is completed, RFS will be Ginnie Mae's new post settlement accounting system. RFS will collect and process loan-level data, validate pool-level data, and validate security remaining principal balances based on the loan-level data reported by issuers. RFS will improve data quality, enhance reporting and feedback functionality, support centralized data collection, support timelier disclosure of data to investors, and provide immediate status information to issuers and Ginnie Mae staff. The new system will strengthen edit parameters and enhance business rules on loan-level submission and RPB reporting, thereby improving the quality and availability of MBS information disclosed to external stakeholders and bring Ginnie Mae more in-line with current industry practice.

Ginnie Mae also introduced enhancements to existing business systems to improve communications with issuers and to establish an operating infrastructure to support other vital components of the modernization effort and to enhance other internal business processes as indicated below:

- **E-notification System:** This system was upgraded to provide operational notices and exceptions to issuers and document custodians. This system was expanded to include additional notifications.
- **Enhanced Integrated Pool Management System (IPMS):** Design work has started on enhancements to the IPMS, which, when implemented, will increase the efficiency of the platform for pool processing and management tasks such as commitment authority, new pool submissions, pool transfers, pool exception feedback, and design and development work.
- **New Web Portal:** Design work started on a new web portal, which will provide a single, secure entry point for all issuers and document custodians accessing Ginnie Mae's business applications, data, and documentation.
- **Ginnie's Financial and Accounting System (GFAS):** The Office of the Chief Financial Officer (CFO) created new reports in the system's purchase module to increase the detail provided about each contract transaction. This detail will enable Ginnie Mae to improve tracking the use of funds and thereby, more accurately forecasting future needs. The GFAS

system also now disburses funds leveraging the new interface with the US Treasury's Secure Payment System (SPS).

- **Policy and Financial Analysis Model (PFAM):** The Office of the CFO updated this model with the most recent economic and financial data from Global Insight, a key industry source of economic and financial data. Among other things, this model is used to predict future default rates for single and multifamily issues.
- **FEDDEBT System Integration,** the federal government system that maintains records about individuals who owe delinquent debt(s): The Office of the CFO integrated the FEDDEBT System to streamline the cash collection process and improve its ability to track delinquent debt. More than \$3 million of \$30 million of debt outstanding has been collected within the past fiscal year.
- **GinnieNET:** This business system was modified to provide web-based access for our issuers to reduce system operating costs within their infrastructures and to create paperless pools for multifamily pool processing.

Ginnie Mae's aggressive efforts to enhance existing systems, develop new systems, and eliminate legacy systems will improve the quantity and quality of information provided to stakeholders, drive down issuer costs, and launch a more flexible systems architecture that can facilitate more rapid development of new products and services.

### **Next Steps**

In early FY2008, Ginnie Mae will begin integrated testing of the new web portal and the Reporting and Feedback System, and Enterprise-wide Operational Data Store (EWODS). Development and deployment of the initial phases of IPMS are anticipated to take place in 2008.

### **Human Resource Initiatives**

Ginnie Mae continues to support government-wide initiatives to increase productivity and reduce the cost of doing business. The focus of Human Resource initiatives is on ensuring a focused and trained workforce, reducing organizational complexity and eliminating single-person dependencies. To accomplish these goals, Ginnie Mae continues to implement the following initiatives:

- **Succession Planning:** This initiative focuses on expanding employee competencies and ensuring that clear plans are in place to manage critical business needs.
- **Core Competency Training:** This training focuses on reducing skill gaps in every job category to increase productivity. Training needs are now tied to specific job requirements with the goal of attaining 100 percent productivity from every employee.

- **Enhanced Performance Management System:** This system is used by all employees and ensures that each one's performance goals and objectives are tied directly to Ginnie Mae's mission and goals.

The ongoing Human Resource initiatives ensure that Ginnie Mae continues to run smoothly and efficiently despite vacancies, reassignments and other disruptions. This is a critical component to ensuring that issuers, investors and other stakeholders always receive the best service and responsiveness from Ginnie Mae without increasing the cost to the taxpayer. A motivated, productive, and well trained workforce will add to the feeling of security investors and issuers will have in continuing to do business with Ginnie Mae. This is particularly relevant as Ginnie Mae increases its MBS volume and operations to accommodate increasing volume from FHA initiatives and the removal of the VA loan limit.

### **Next Steps**

Ginnie Mae will continue to focus on Human Resource initiatives to ensure its workforce is trained, motivated, productive, and efficient.

### **Industry Cooperation**

All of the projects initiated to date have relied heavily on the input provided by Ginnie Mae's key stakeholders. It's anticipated that next year will entail even more involvement and cooperation with issuers, document custodians, and other critical partners.

## **IV. Ginnie Mae Financial Highlights and Management Discussion and Analysis**

At Ginnie Mae, FY 2007 was marked by a decrease in revenue, a decrease in expenses, and an increase in assets. In FY 2007, revenues decreased due to a decline in interest income. Ginnie Mae achieved excess revenues over expenses of \$738.3 million in FY 2007, compared with \$789.3 million in FY 2006. Revenues decreased by 6.8 percent to \$791.3 million, down from \$849.3 million in FY 2006. Total assets increased to \$13.7 billion, up from \$12.9 billion in FY 2006.

The outstanding MBS portfolio increased by \$17.6 billion in FY 2007, which led to increased guaranty fee revenues. In FY 2007, MBS program income increased to \$308.5 million, up from \$300.3 million in FY 2006. However, interest income decreased to \$482.8 in FY 2007 from \$549 million in FY 2006. Total expenses as a percentage of total revenues decreased from 7.1 percent in FY 2006 to 6.7 percent in FY 2007.

In FY 2007, Ginnie Mae issued \$99.8 billion in commitment authority, a 56.4 percent increase from FY 2006. The \$85.1 billion of MBS issued in FY 2007 represents a 4.2 percent increase from FY 2006. The outstanding MBS balance of \$427.6 billion at the end of FY 2007, compared to \$410 billion in FY 2006, resulted from new issuances exceeding prepayments. FY 2007 production provided the capital to finance home purchases or refinances, or rental housing, for approximately 646,000 American families.

Ginnie Mae's financial performance remained stable during FY 2007. Excess revenues were invested in U.S. Treasury securities. To date, Ginnie Mae's operations have been financed by earning capital and, as a result, Ginnie Mae has not needed to obtain funds through federal appropriations.

To understand Ginnie Mae's recent financial history, see Table 1, which provides three-year financial highlights of the corporation.



**Table 1: Ginnie Mae Financial Highlights**

<b>September 30</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<i>(Dollars in Thousands)</i>			
<b>Balance Sheets Highlights and Liquidity Analysis</b>			
<b>Funds with U.S. Treasury</b>	\$ 4,432,600	\$ 4,056,500	\$ 3,711,400
<b>U.S. Government Securities</b>	\$ 8,735,900	\$ 8,358,100	\$ 7,921,000
<b>Total Assets</b>	\$ 13,710,700	\$ 12,892,700	\$ 12,134,600
<b>Total Liabilities</b>	\$ 1,090,200	\$ 1,010,500	\$ 1,041,700
<b>Investment of U.S. Government</b>	\$ 12,620,500	\$ 11,882,200	\$ 11,092,900
<b>Total RPB Outstanding (1)</b>	\$ 427,566,299	\$ 409,990,230	\$ 412,303,791
<b>LLR (2) and Investment of U.S. Government</b>	\$ 13,156,300	\$ 12,416,700	\$ 11,631,400
<b>Investment of U.S. Government as a percentage of Average Total Assets</b>	98.91%	94.95%	94.22%
<b>LLR and Investment of U.S. Government as a Percentage of RPB</b>	3.08%	3.03%	2.82%
<b>Capital Adequacy Ratio (3)</b>	2.98%	2.94%	2.74%
<b>Highlights From Statements of Revenues and Expenses &amp; Profitability Ratios Year Ended September 30</b>			
<b>MBS Program Income</b>	\$ 308,500	\$ 300,300	\$ 327,500
<b>Interest Income</b>	\$ 482,800	\$ 549,000	\$ 458,800
<b>Total Revenues</b>	\$ 791,300	\$ 849,300	\$ 786,500
<b>MBS Program Expenses</b>	\$ 41,900	\$ 47,700	\$ 58,300
<b>Administrative Expenses</b>	\$ 10,600	\$ 10,600	\$ 10,600
<b>Provision for Loss</b>	\$ -	\$ -	\$ 10,000
<b>Total Expenses</b>	\$ 53,000	\$ 60,000	\$ 71,300
<b>Excess of Revenues Over Expenses</b>	\$ 738,300	\$ 789,300	\$ 705,200
<b>Total Expense as a percentage of Average RPB</b>	0.0127%	0.0146%	0.0165%
<b>Provision for Loss as a percentage of Average RPB</b>	-	-	0.0023%

(1) Remaining Principal Balance (RPB) of Ginnie Mae MBSs, and in addition \$52.8 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

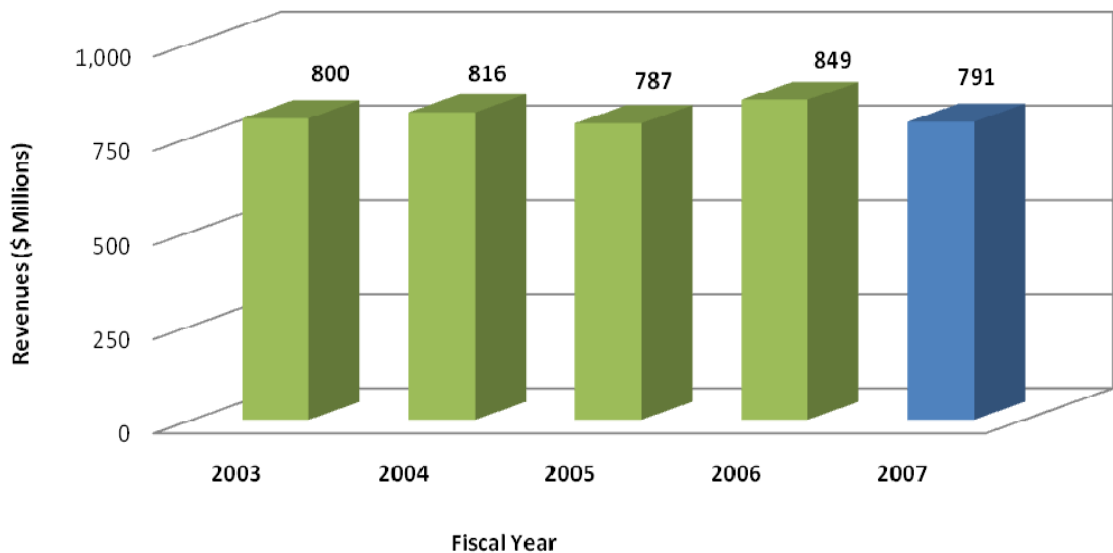
**Table 1: Ginnie Mae Financial Highlights, FY 2005-2007**

The following discussion provides information relevant to understanding Ginnie Mae’s operational results and financial condition. It should be read in conjunction with the financial statements and notes at the end of this report. These financial statements have received an unqualified audit opinion from Ginnie Mae’s independent auditor. Ginnie Mae’s operating results are subject to fluctuation each year, depending on the frequency and severity of losses resulting from general economic conditions, mortgage market conditions, and defaulting issuers.

## Revenues

Ginnie Mae receives no appropriations from general tax revenue. Operations are self-financed through a variety of fees. In FY 2007, Ginnie Mae generated total revenue of \$791.3 million. This included \$308.5 million in program income and \$482.8 million in interest income from U.S. Treasury securities. It should be noted that Ginnie Mae is required by the U.S. Treasury Department to invest any excess revenues in U.S. Treasury securities.

Figure 4 shows Ginnie Mae’s total annual revenue for the last five years.



**Figure 4: Ginnie Mae Revenues, FY 2003 – 2007**

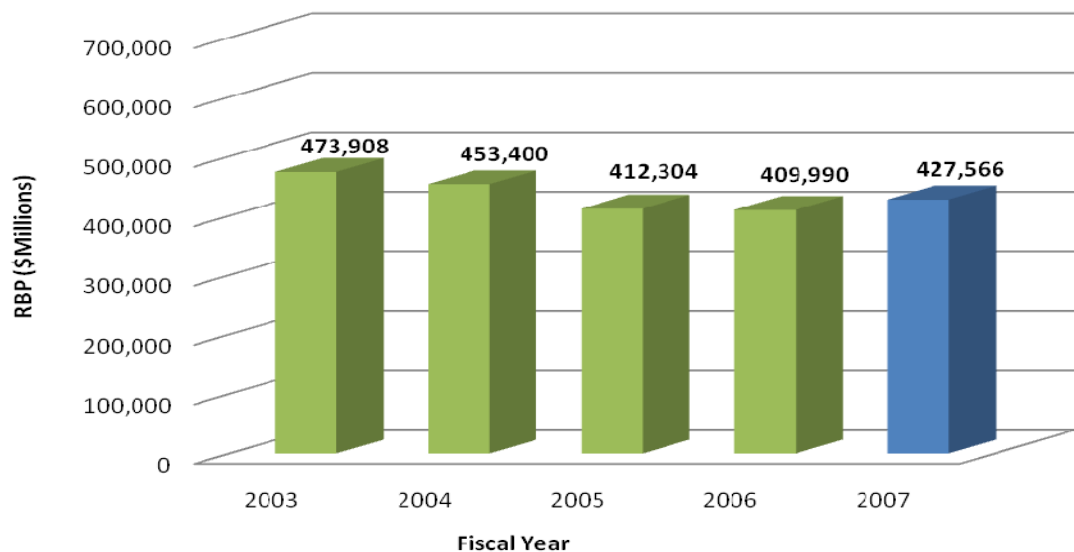
## MBS Program Income

MBS program income consists primarily of guaranty fees, commitment fees, and multiclass fees. For FY 2007, MBS program income was concentrated in guaranty fees of \$272.9 million, followed by commitment fees of \$17.4 million. Combined guaranty fees and commitment fees made up 94.2 percent of total MBS program revenues for FY 2007. Other lesser income sources include new issuer fees, handling fees, and transfer-of-servicing fees. MBS program income increased in FY 2007 due to the increase in the MBS portfolio and MBS issuances.

## Guaranty Fees

Guaranty fees are income streams earned for providing Ginnie Mae’s guarantee of the full faith and credit of the U.S. government to investors. These fees are recognized over the life of the outstanding securities.

Guaranty fees are collected on the aggregate principal balance of the guaranteed securities outstanding in the non-defaulted issuer portfolio. MBS guaranty fees grew 1.6 percent to \$272.9 million in FY 2007, from \$268.6 million in FY 2006. These higher guaranty fees reflect the increase in the MBS portfolio. The outstanding MBS balance at the end of FY 2007 was \$427.6 billion, compared with \$410 billion the previous year, as new issuances exceed repayments (see Figure 5).



**Figure 5: Remaining Principal Balance (RPB) Outstanding in the MBS Portfolio**

## Commitment Fees

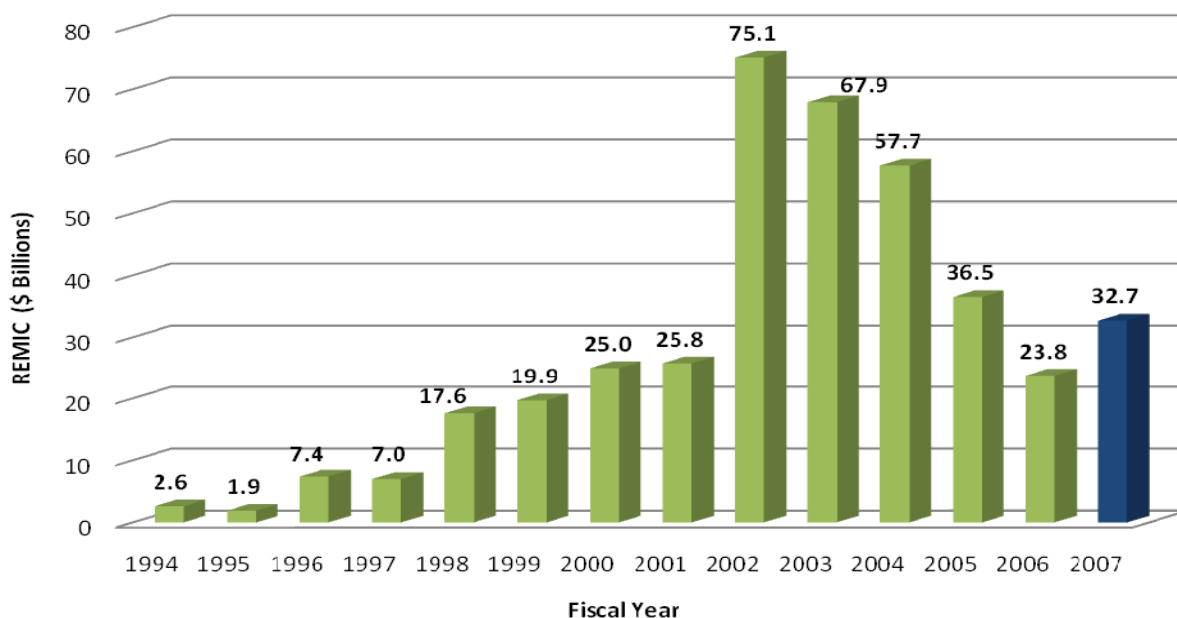
Commitment fees are income that Ginnie Mae earns for providing approved issuers with authority to pool mortgages into Ginnie Mae MBS. This authority expires 12 months from issuance for single family issuers and 24 months from issuance for multifamily issuers. Ginnie Mae receives commitment fees as issuers request commitment authority, and recognizes the commitment fees as earned when 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, 2007, total commitment fees deferred totaled \$6.9 million.

Commitment fees realized decreased to \$17.4 million in FY 2007 from \$18.1 million in FY 2006 due to an increase in MBS issuance. Ginnie Mae issued \$99.8 billion in commitment authority in FY 2007, a 56.4 percent increase from FY 2006.

### Multiclass Revenue

Multiclass revenue is part of MBS program revenue, and is composed of REMIC and Platinum program fees. Ginnie Mae issued approximately \$11.9 billion in Platinum products in FY 2007. Total cash fees for Platinum securities amounted to \$2.9 million, representing a 17.1 percent decrease in fee income from the previous year. Guaranty fees from REMIC securities totaled \$11.7 million on \$32.7 billion in issuance of REMIC products (see Figure 6). Ginnie Mae recognizes a portion of REMIC, Callable Trust, and Platinum program fees in the period they are received, with balances deferred and amortized over the remaining life of the financial investment.

In FY 2007, Ginnie Mae issued \$44.6 billion in its multiclass securities program (REMICs, Stripped MBS, and Platinums). The estimated outstanding balance of multiclass securities in the total MBS securities balance on September 30, 2007, was \$201 billion. This reflects a \$2.3 billion increase from the \$198.7 billion outstanding balance in FY 2006.



**Figure 6: Total REMIC Volume, 1994 – 2007**

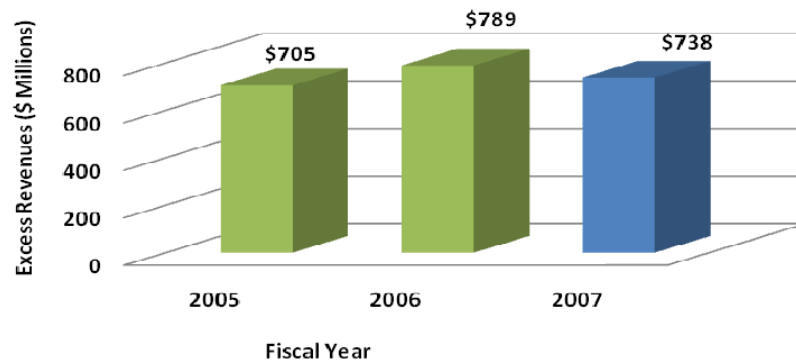
### Interest Income

Ginnie Mae invests the excess of its accumulated revenue over expenses in U.S. government securities. Ginnie Mae guaranty fee income has increased this year, however, interest income has decreased as a percentage of total revenue. In FY 2007, interest income declined by 12.1 percent to

\$482.8 million from \$549 million in FY 2006. This decrease was the result of an increased average amount of shorter term, lower interest Treasury securities held during FY 2007 as compared to FY 2006.

## Expenses

Management exercised prudent expense control during FY 2007. Operating expenses in FY 2007 decreased by 11.7 percent to \$53 million from \$60 million in FY 2006. Total expenses were 6.7 percent of total revenues in FY 2007, down from 7.1 percent in FY 2006. The increase in MBS program income and the decrease in operating expenses were not sufficient to offset the decrease in interest income, resulting in lower excess revenues over expenses of \$738.3 million for FY 2007 versus \$789.3 million for FY 2006 (see Figure 7).



**Figure 7: Excess of Revenue over Expenses**

To support U.S. military personnel called into action, Ginnie Mae reimburses the interest on loans to service members who have FHA or VA mortgages with interest rates in excess of 6 percent. This expense was minimal in FY 2007, which represents a decline over FY 2006 related expenses of \$3 million.

Table 2 represents the expenses related to program/contractors used by Ginnie Mae during the last four years. This chart demonstrates that Ginnie Mae has successfully managed its expenses over this period of time.

Program/Contractor	FY 2007	FY 2006	FY 2005	FY 2004
<i>(Dollars In Millions)</i>				
Central Paying Agent	6.8	8.5	9.3	12.9
Contract Compliance	0.9	0.2	0.8	0.2
Federal Reserve	3.2	1.9	2.8	2.1
Financial Support	0.8	0.6	0.7	0.8
IT Related & Miscellaneous	4.6	6.8	3.0	4.2
Mortgage Backed-Securities Information Systems Compliance	11.9	9.9	17.0	13.4
Multiclass	8.7	7.9	9.5	10.0
Multifamily Program	5.0	8.9	11.1	7.8
Servicemembers Civil Relief Act	0.0	3.0	4.1	11.9
	41.9	47.7	58.3	63.3

**Table 2: Program/Contractor Expenses**

### **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 adequate reserves to absorb potential losses from defaulted issuer portfolios and programs. Ginnie Mae defaulted five single family issuers during FY 2007. Ginnie Mae believes that the reserve for loss estimate is adequate to cover any noninsured loss sustained for these issuers and from unknown future losses from the occurrence of periodic defaults.

## **Financial Models**

Ginnie Mae's Policy and Financial Analysis Model (PFAM) 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 inherent operating risks with modeling that employs economic, financial, and policy variables to assess risks and overall performance.

In FY 2007, PFAM was used to estimate Ginnie Mae's credit subsidy rate based on historical loan performance data, economic measures, and program and policy assumptions. Every year, Ginnie Mae works with FHA, USDA and VA to obtain loan-level data. The data supports detailed segmentation of loans according to key risk indicators, including loan type, loan size, loan-to-value ratio, and region. Changing economic conditions related to interest rates, housing values, population demographics, consumer prices, and income levels are accommodated by updating key economic drivers within PFAM's econometric functionality. Ginnie Mae's expertise in understanding and managing risks associated with their MBS guaranty business are accommodated by adjusting management assumption drivers within the model.

Cash flows for income and expenses associated with Ginnie Mae's MBS guaranty business were estimated by simulating loan level performance for the existing book of business and forecasted new business. The simulated loan level performance was used to forecast the effects on defaulted portfolios managed by Ginnie Mae and levels of new issuer defaults. The model's cash flow output was used to estimate the net present value of Ginnie Mae's future cash flows from the outstanding guaranty portfolio at the end of FY 2007 and estimated new business for 30 years into the future.

## **Liquidity and Capital Adequacy**

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, 2007, Ginnie Mae reported \$4.4 billion in funds with the U.S. Treasury, compared to \$4.1 billion on September 30, 2006.

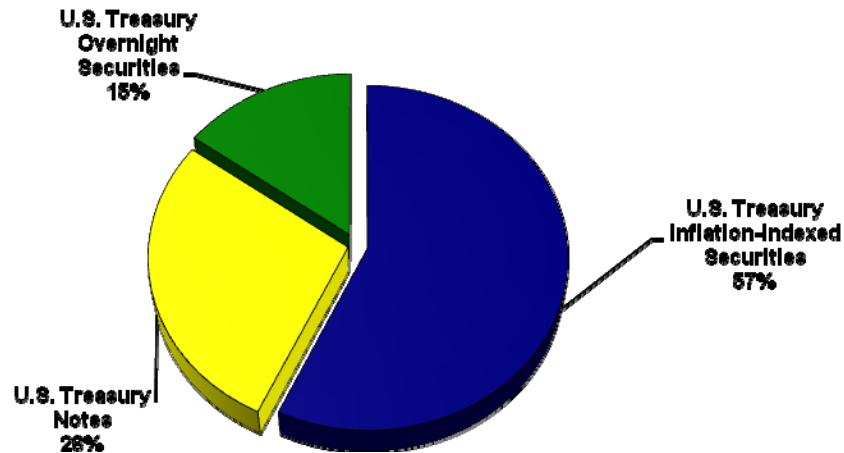
In addition to the funds with the U.S. Treasury, Ginnie Mae's investment in U.S. government securities was \$8.7 billion as of September 30, 2007. Of this amount, \$1.2 billion was held in overnight certificates. The balance of the portfolio's maturities is spread over time to ensure that Ginnie Mae has a ready source of funds to meet various liquidity needs. Emergency liquidity needs are met through short-term maturities.

Table 3 describes the fair value composition and maturity of Ginnie Mae's Treasury securities as of September 30, 2007 and 2006.

Maturity	2007	2006
Due within 1 year	32%	21%
Due in 1-5 years	43%	24%
Due in 5-10 years	25%	55%

**Table 3: Composition of Treasury Securities as of September 30 (Percentage of Total)**

Figure 8 illustrates the components of Ginnie Mae’s Investments in U.S. Government Securities as of September 30, 2007.



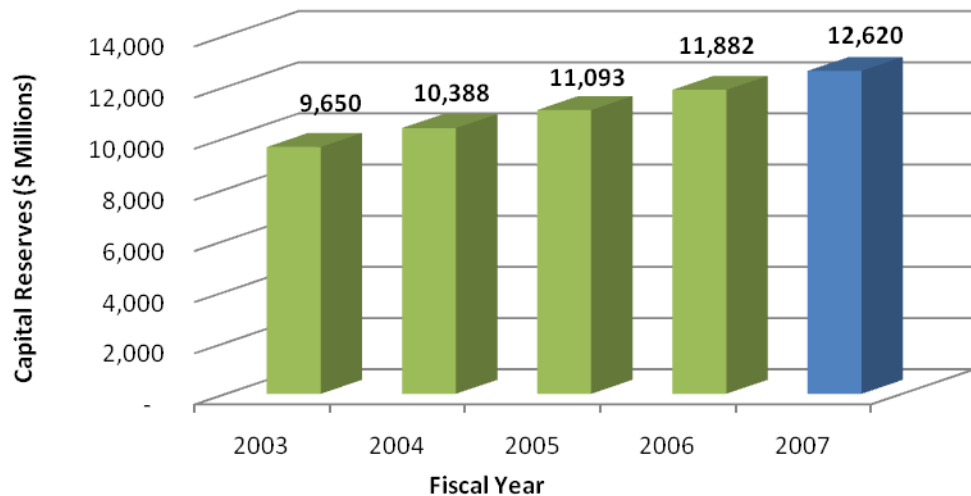
**Figure 8: Components of Investment in U.S. Government Securities, September 30, 2007**

Ginnie Mae’s MBS guaranty activities have historically operated at a profit. Ginnie Mae’s net income continues to build the agency’s capital base. Management believes the corporation maintains adequate capital reserves to withstand downturns in the housing market that could cause issuer defaults to increase.

As of September 30, 2007, the Investment of U.S. Government was \$12.6 billion after establishing reserves for losses on credit activities, compared with \$11.9 billion as of September 30, 2006. 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 remaining principal balance) to 2.98 percent in FY 2007 from 2.74 percent in FY 2006. 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 9 shows Ginnie Mae’s capital reserves (Investment of U.S. Government) as of September 30, 2007 for the last five years.



**Figure 9: Capital Reserves (Investment of U.S. Government)**

### **Risk Management and Systems of Internal Controls**

Ginnie Mae continues to enhance its automated systems and business processes to increase its operational efficiency and reduce its business risk. During FY 2007, Ginnie Mae continued periodic reviews of all master subservicers and major contractors to ensure compliance with the terms and conditions of their contracts. In addition, the audits and reviews enable Ginnie Mae to strengthen its internal controls and minimize risks. Furthermore, Ginnie Mae actively monitors its issuers to minimize fraud and default risk, which would negatively impact financial and operating results.

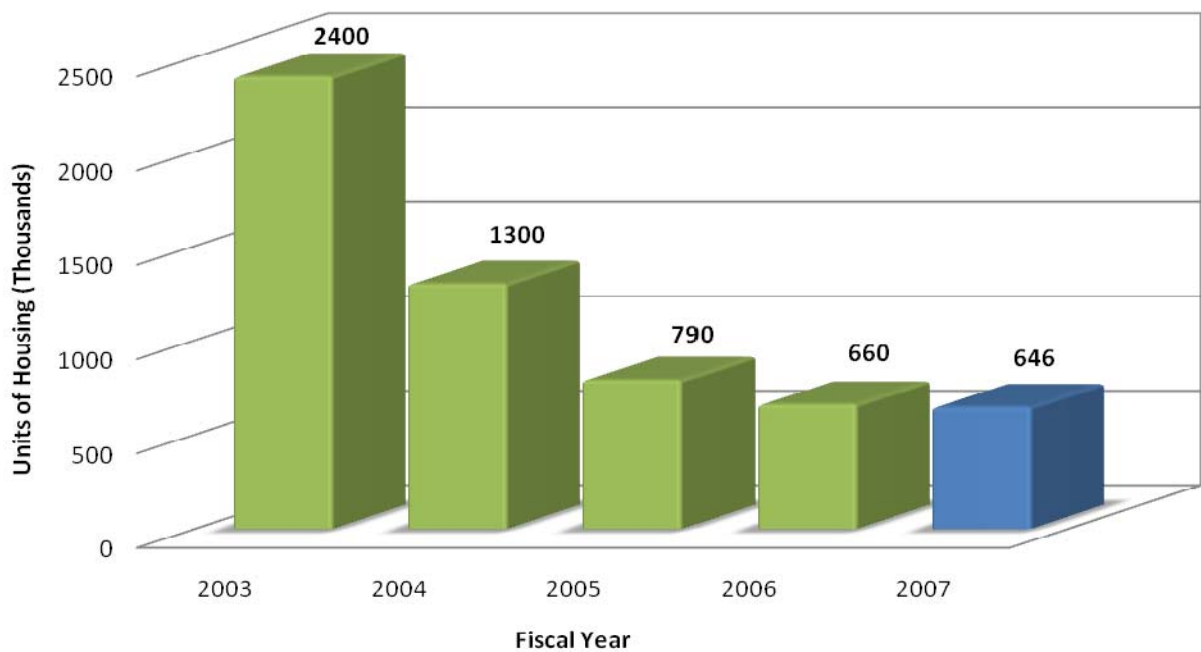
Ginnie Mae’s management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the *Federal Manager’s Financial Integrity Act* (FMFIA). Ginnie Mae is able to provide reasonable assurance that its internal controls and financial management systems meet the objectives of FMFIA.

Ginnie Mae assessed the effectiveness of internal controls over the effectiveness and efficiency of operations, and compliance with applicable laws and regulations, in accordance with Office of Management and Budget (OMB) Circular A-123. Based on the results of this evaluation, Ginnie Mae can provide reasonable assurance that its internal controls over the effectiveness and efficiency of operations is in compliance with applicable laws and regulations. As of September 30, 2007, Ginnie Mae was operating effectively and no material weaknesses were found in the design or operation of its internal controls.

In addition, Ginnie Mae assessed the effectiveness of its internal controls over financial reporting, which includes the safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. No material weaknesses were found in the design or operation of the internal controls over financial reporting. Based on these results, Ginnie Mae can provide reasonable assurance that its internal controls over financial reporting was operating effectively as of June 30, 2007.

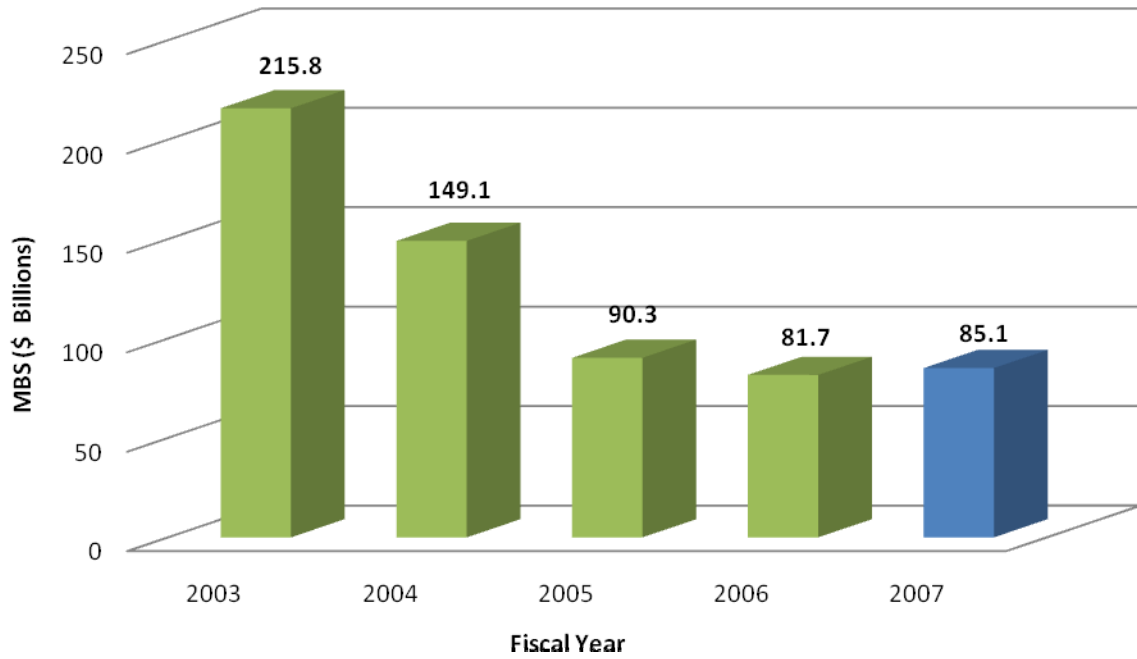
### Securitization Issuance

As shown in Figure 10, Ginnie Mae supported 646,000 units of housing for low- and moderate-income American families in FY 2007, a 2 percent decline from FY 2006.



**Figure 10: Ginnie Mae-Supported Units of Housing FY 2003-2007**

The dollar value of MBS issuance is reflected in Figure 11, which shows Ginnie Mae issued \$85.1 billion in MBS in FY 2007. Clearly, Ginnie Mae has had a dramatic impact on expanding homeowner and rental opportunities over this time.



**Figure 11: MBS Issuance of Ginnie Mae  
FY 2003-2007**



**V. Audit Report of Ginnie Mae's FY 2007 Financial Statements**





Issue Date	November 7, 2007
Audit Case Number	2008-FO-0001

**TO:** Thomas R. Weakland, Acting Executive Vice-President, Government National Mortgage Association, T

**FROM:** Robert McGriff, Director, Financial Audits Division, GAF

**SUBJECT:** Audit of the Government National Mortgage Association's (Ginnie Mae) Financial Statements for Fiscal Years 2007 and 2006

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Carmichael, Brasher, Tuvell & Company, P.C. to audit the fiscal years 2007 and 2006 financial statements of the Government National Mortgage Association (Ginnie Mae). The contract required that the audit be performed according to Generally Accepted Government Auditing Standards (GAGAS).

Carmichael, Brasher, Tuvell & Company, P.C. is responsible for the attached auditors' report dated November 6, 2007 and the conclusions expressed in the report. Accordingly, we do not express an opinion on Ginnie Mae's financial statements or conclusions on Ginnie Mae's internal controls or compliance with laws and regulations. Within 60 days of this report, Carmichael, Brasher, Tuvell and Company P.C. expects to issue a separate letter to management dated November 6, 2007 regarding other matters that came to its attention during the audit.

This report includes both the Independent Auditors' Report and Ginnie Mae's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. Ginnie Mae plans to separately publish an annual report for fiscal year 2007 that conforms to FASAB standards.

The report contains one significant deficiency in internal control. Three recommendations are new to this year's report. Based on the information provided in management's response to Carmichael, Brasher, Tuvell & Company's audit, we will record decisions in the department's Audit Resolution and Corrective Action Tracking System for these three recommendations.

We appreciate the courtesies and cooperation extended to the Carmichael, Brasher, Tuvell & Company, P.C. and OIG audit staffs during the conduct of the audit.

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## Table of Contents

OIG Transmittal Memorandum.....	1
Independent Auditors' Report.....	5
Appendix A – Significant Deficiency .....	9
Appendix B – Management's Response to Recommendations .....	11
Appendix C – Carmichael, Brasher, Tuvell & Company's Assessment of Management's Response to Recommendations .....	13
Principal Financial Statements .....	15
Balance Sheets .....	15
Statements of Revenues and Expenses and Changes In Investment of U. S. Government.....	16
Statements of Cash Flows .....	17
Notes to Financial Statements.....	18

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**INDEPENDENT AUDITORS' REPORT**

To the Acting Executive Vice President  
Government National Mortgage Association

The Government National Mortgage Association (Ginnie Mae's) financial statements are subject to the annual reporting requirements of the Chief Financial Officers Act of 1990 which requires an annual report to Congress on their financial status and any other information needed to fairly present the financial position and results of operations. Ginnie Mae is a wholly owned government corporation within the U.S. Department of Housing and Urban Development (HUD). In accordance with the Government Corporations Control Act, as amended (31 U.S.C. 9105), we audited Ginnie Mae's financial statements.

The objectives of the audit are to express an opinion on the fair presentation of Ginnie Mae's principal financial statements, obtain an understanding of Ginnie Mae's internal control, and test compliance with laws and regulations that could have a direct and material effect on the financial statements.

We have audited the accompanying balance sheets of Ginnie Mae as of September 30, 2007 and 2006, and the related statements of revenues and expenses, investments of the U. S. Government and statement of cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audit.

**OPINION ON FINANCIAL STATEMENTS**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ginnie Mae, as of September 30, 2007 and 2006; and the results of its operations and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis of Results of Operations and Financial Position is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

**REPORT ON INTERNAL CONTROL**

In planning and performing our audit, we considered Ginnie Mae's internal control over financial reporting by obtaining an understanding of the design effectiveness of its internal controls, determined whether internal controls had been placed in operation, assessed control risk, and

performed tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, but not for the purpose of expressing an opinion on the effectiveness of Ginnie Mae's internal control. Accordingly, we do not express an opinion on the effectiveness of Ginnie Mae's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Ginnie Mae's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiency to be a significant deficiency in internal control.

**Ginnie Mae should improve programs compliance and controls regarding monitoring of issuers**

- Assure more effective follow up of the automated matching process with insurer loan data
- Communicate the most current and accurate quantitative and qualitative issuers information among Ginnie Mae senior officials to ensure the potential risk for issuer default is minimized
- Segregating incompatible duties to separate MBS's monitoring process from the issuer approval and other securities revenue production process

Additional detail and the related recommendations for this significant deficiency are provided in Appendix A of this report. The full text of management's response is included in Appendix B with our assessment of management's response included at Appendix C.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Ginnie Mae's internal control.

Our consideration of internal control was for the limited purpose described above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we did identify another matter in internal control that came to our attention during our audit which we will be communicated in writing to management and those charged with governance.

**REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS**

The management of Ginnie Mae is responsible for complying with laws and regulations applicable to government corporations. As part of obtaining reasonable assurance about whether Ginnie Mae'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 No. 07-04, as applicable to government corporations. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to Ginnie Mae.

The results of our tests of compliance with the laws and regulations discussed in the preceding paragraph disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards or OMB Bulletin No. 07-04, as applicable to government corporations.

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

## **RESPONSIBILITIES**

### **Management's Responsibilities**

The Government Management Reform Act of 1994 (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, Ginnie Mae prepares annual financial statements. Ginnie Mae is a wholly owned government corporation within the U. S. Department of Housing and Urban Development (HUD).

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis; and
- Complying with laws and regulations.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

### **Auditors' Responsibilities**

Our responsibility is to express an opinion on the fiscal year 2007 and 2006 financial statements of Ginnie Mae based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to audits contained in Government Auditing Standards and OMB Bulletin No. 07-04, as applicable to government corporations. Those standards and OMB Bulletin No. 07-04 require that we plan and perform audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Our audit was not designed to test the requirements of OMB Bulletin No. 07-04 relating to the Federal Financial Management Improvement Act of 1996 (FFMIA); they are not considered applicable at the Ginnie Mae level. Our audit was also not designed to test the requirements of the Federal Credit Reform Act of 1990, because Statement of Federal Financial Accounting Standards No. 2, Accounting for Direct Loans and Loan Guarantees, has not been considered in preparing these financial statements.

An audit includes:

- Examining on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

**DISTRIBUTION**

This communication is intended solely for the information and use of the management of U. S. Department of Housing and Urban Development, Ginnie Mae, and others within the organization and OMB, the Government Accountability Office and the U. S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

CARMICHAEL, BRASHER, TUVELL & COMPANY, P.C.

*Carmichael, Brasher, Tuvell + Co., P.C.*

Atlanta, Georgia  
November 6, 2007

## APPENDIX A - SIGNIFICANT DEFICIENCY

### Ginnie Mae should improve programs compliance and controls regarding monitoring of issuers

Due to conditions in the current economic mortgage and credit environment, improvements and/or changes should be considered by Ginnie Mae's Senior Management to strengthen monitoring in the Mortgage-Backed Securities (MBS) program.

- Assure more effective follow up of the automated matching process with insurer loan data
- Communicate the most current and accurate quantitative and qualitative issuers information among Ginnie Mae senior officials to ensure the potential risk for issuer default is minimized
- Segregating incompatible duties to separate MBS's monitoring process from the issuer approval and other securities revenue production process

MBS has a matching process utilizing FHA and VA databases to assure loans within Ginnie Mae pools are insured. However, a more effective follow up of some issuers with unmatched loans within existing pools should be implemented.

MBS has policies and procedures in place that include an annual issuer review and monitoring business process that help ensure each issuer is complying with MBS financial and performance requirements. However, results from some MBS reviews were not provided and/or communicated to Ginnie Mae Senior officials in a complete and timely manner to minimize the risk of issuer default.

MBS is responsible for approval of new issuers, issuer loan commitment authority, new MBS pool issuance, issuer compliance contractor review targeting, and monitoring of issuer review compliance with MBS program performance requirements results. A potential conflict of interest or independence may exist because issuer monitoring has not been separated from the issuer approval/business expansion processes.

- OMB Circular No. A-123 *Management's Responsibility for Internal Control*, (A-123) as revised December 21, 2004, "...specifically addresses internal control over financial reporting; operational program controls and financial reporting often overlap." Additionally, Section I states that "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner." Also, within the circular's attachment, Section IV, *Assessing Internal Control*, it states, "Agency managers should continuously monitor and improve the effectiveness of internal controls associated with their programs.
- Federal as well as private sector internal control guidance requires a separation of performance monitoring and revenue producing business duties. GAO's Standards for Internal Control in Federal Government published in November 1999, Subsection "Segregation of Duties," states: "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud."

Recommendations to Ginnie Mae's Acting Executive Vice-President that address the significant deficiency described above include:

1. Institute timely and regular communications among Senior Officials or an Issuer Risk Assessment Committee regarding issuer performance and issuer review to recognize the current risk and the possibility of a potential misstatement Ginnie Mae's overall financial statements.
2. Reviewing and strengthening the completeness and timeliness of the automated pool collateral matching process as well as follow-up on unmatched loans with issuers.
3. Segregating issuer monitoring duties from MBS program functions to enhance independent management control over issuers.

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## APPENDIX B - MANAGEMENT'S RESPONSE TO RECOMMENDATIONS



GOVERNMENT NATIONAL  
MORTGAGE ASSOCIATION

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-9000

November 2, 2007

Mr. Ben W. Carmichael, Jr., CPA  
Carmichael, Brasher, Tuvell & Company  
1647 Mount Vernon Road  
Atlanta, GA 30338

Re: Response to CBTC's Fiscal Year 2007 Ginnie Mae Audit Report

Dear Mr. Carmichael:

It is my pleasure to present to you Ginnie Mae's management response to Carmichael, Brasher, Tuvell & Company's ("CBTC") audit report on Ginnie Mae's financial statements for Fiscal Year 2007.

We are pleased that CBTC has acknowledged Ginnie Mae for its financial statement presentation on its FY 2007 financial audit. Ginnie Mae is also pleased to note that there were no material weaknesses.

In CBTC's Internal Control Report, it identified one significant deficiency in the area of mortgage-backed securities ("MBS"). CBTC recommended that Ginnie Mae improve its program compliance and controls regarding the monitoring of Ginnie Mae issuers. Ginnie Mae is committed to improving its MBS monitoring process that will better assure issuer program compliance. Ginnie Mae will be taking the following steps to address CBTC's concerns:

- Ginnie Mae will institute a new reporting process where Ginnie Mae senior management will be provided information to improve communication on issuers that are not in compliance with Ginnie Mae program requirements;
- Ginnie Mae will take quicker action regarding non-compliant issuers; and
- Ginnie Mae will strengthen controls related to appropriate separation of duties.

If you have any questions regarding Ginnie Mae's response, you may contact me at 202-475-4915.

Sincerely,

A handwritten signature in black ink that reads "Thomas R. Weakland".

Thomas R. Weakland  
Acting Executive Vice President

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**APPENDIX C - CBTC'S ASSESSMENT OF MANAGEMENT'S RESPONSE TO RECOMMENDATIONS**

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CBTC has reviewed Ginnie Mae management's response to the reported significant deficiency made in connection with our audit of Ginnie Mae's 2007 Financial Statements, which is included as Appendix B. Our assessment of management's response is discussed below.

We believe management's proposed actions are responsive to our recommendations. However, this significant deficiency will remain open until after CBTC has reviewed the effectiveness of Ginnie Mae's new reporting process, the timeliness of action taken by management in regard to noncompliant issuers, and the strengthening of controls related to appropriate segregation of duties.

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## Ginnie Mae's FY 2007 Financial Statements

Balance Sheets		
September 30	2007	2006
<i>(Dollars in Thousands)</i>		
<b>Assets:</b>		
Funds with U.S. Treasury	\$ 4,432,600	\$ 4,056,500
U.S. Government securities--Note B	8,735,900	8,358,100
Mortgages held for sale, net--Note C	19,000	23,000
Properties held for sale, net--Note D	3,200	2,600
Accrued interest on U.S. Government securities	53,200	56,200
Accrued fees and other receivables	23,300	24,300
Advances against defaulted Mortgage-Backed Security pools, net--Note E	1,000	1,800
Fixed assets--software, net of accumulated amortization	16,500	6,500
Other assets--Note A	426,000	363,700
<b>Total Assets</b>	<b>\$ 13,710,700</b>	<b>\$ 12,892,700</b>
<b>Liabilities and Investment of U.S. Government</b>		
<b>Liabilities:</b>		
Reserve for loss on Mortgage-Backed Securities Program--Note F	\$ 535,800	\$ 534,500
Deferred revenue	75,600	72,800
Deferred liabilities and deposits	11,100	2,200
Accounts payable and accrued liabilities	41,700	37,300
Other liabilities--Note A	426,000	363,700
<b>Total Liabilities</b>	<b>\$ 1,090,200</b>	<b>\$ 1,010,500</b>
<b>Commitments and Contingencies--Notes G, H, and I</b>		
Investment of U.S. Government	12,620,500	11,882,200
<b>Total Liabilities and Investment of U.S. Government</b>	<b>\$ 13,710,700</b>	<b>\$ 12,892,700</b>

The accompanying notes are an integral part of these financial statements.

### Statements of Revenues and Expenses and Changes in Investment of U.S. Government

For the Years Ended September 30	2007	2006
<i>(Dollars in Thousands)</i>		
<b>Revenues:</b>		
Mortgage-Backed Securities Program income	\$ 308,500	\$ 300,300
Interest income	482,800	549,000
Other income, net	-	-
<b>Total Revenues</b>	<b>\$ 791,300</b>	<b>\$ 849,300</b>
<b>Expenses:</b>		
Mortgage-Backed Securities Program expenses	\$ 41,900	\$ 47,700
Administrative expenses	10,600	10,600
Fixed asset amortization	500	1,700
<b>Total Expenses</b>	<b>\$ 53,000</b>	<b>\$ 60,000</b>
Provision for loss on Mortgage-Backed Securities Program--Note F	-	-
<b>Excess of Revenues over Expenses</b>	<b>\$ 738,300</b>	<b>\$ 789,300</b>
<b>Investment of U.S. Government at Beginning of Year</b>	<b>11,882,200</b>	<b>11,092,900</b>
Excess of revenues over expenses	738,300	789,300
Returned to U.S. Treasury	-	-
<b>Investment of U.S. Government at End of Year</b>	<b>\$ 12,620,500</b>	<b>\$ 11,882,200</b>

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows		
For the Years Ended September 30	2007	2006
<i>(Dollars in Thousands)</i>		
<b>Cash Flow from Operating Activities:</b>		
Net excess of revenues over expenses	\$ 738,300	\$ 789,300
Adjustments to Reconcile Net Excess of Revenues Over Expenses to Net Cash from (used for) Operating Activities:		
Depreciation & amortization	500	1,700
<b>Decrease</b> / increase in accrued interest Federal investments	3,000	(6,500)
<b>Decrease</b> / increase in advances against defaulted MBS pools	800	600
<b>Increase</b> / decrease in deferred liabilities and deposits	8,900	500
<b>Increase</b> / decrease in accounts payable and accrued liabilities	4,400	(5,100)
<b>Increase</b> / decrease in deferred revenue	2,800	(3,900)
<b>Increase</b> / decrease in MBS Reserve, net of other assets relating to operating activities	5,700	11,600
<b>Total Adjustments</b>	26,100	(1,100)
<b>Net Cash from (used for) Operating Activities</b>	<b>\$ 764,400</b>	<b>\$ 788,200</b>
<b>Cash Flow from Investing Activities</b>		
Purchase of U.S. Treasury Securities, net	(377,700)	(437,100)
Purchase of software	(10,600)	(6,000)
<b>Net Cash from (used for) Investing Activities</b>	<b>\$ (388,300)</b>	<b>\$ (443,100)</b>
<b>Cash Flow from Financing Activities:</b>		
Financing activities	-	-
<b>Net Cash from (used for) Financing Activities</b>	<b>-</b>	<b>-</b>
Net increase in cash & cash equivalents	376,100	345,100
Cash & cash equivalents - beginning of period	4,056,500	3,711,400
Cash & cash equivalents - end of period	<b>\$ 4,432,600</b>	<b>\$ 4,056,500</b>

The accompanying notes are an integral part of these financial statements.

## Notes to the Financial Statements

September 30, 2007 and 2006

### Note A: Organization and Summary of Significant Accounting Policies

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act as a government corporation within the Department of Housing and Urban Development (HUD). The Mortgage-Backed Securities (MBS) program is Ginnie Mae's primary ongoing activity. Its purpose is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential mortgage loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private mortgage institutions. This guaranty is backed by the *full faith and credit of the U.S. Government*. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the Rural Housing Service (RHS) (formerly Farmer's Home Administration), the Department of Veterans Affairs (VA), or the HUD Office of Public and Indian Housing (PIH).

These MBS are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets.

**Funds with U.S. Treasury:** All of Ginnie Mae's receipts and disbursements are processed by the U.S. Treasury, which in effect maintains Ginnie Mae's bank accounts. Of the \$4.4 billion in Funds with U.S. Treasury, \$3 billion is in the Reserve Receipt Account, which is a non-interest-bearing account at the U.S. Treasury. For purposes of the Statements of Cash Flows, Funds with U.S. Treasury are considered cash.

**U.S. Government Securities:** Ginnie Mae classifies its investments in U.S. Government Securities based on its ability and intent to hold them to maturity. Therefore, Ginnie Mae's investment in U.S. Government Securities is recorded at amortized cost. Discounts and premiums are amortized, on a level yield basis, over the life of the related security.

**Mortgages Held for Sale:** Mortgages held for sale, which are purchased out of MBS pools, are carried at the lower of cost or fair value, and with any unrealized losses included in current period earnings. The related allowance for loss is established to reduce the carrying value of mortgages held for sale to their estimated fair value, which is based on the amount Ginnie Mae expects to realize in cash upon sale of the mortgages.

**Properties Held for Sale:** Foreclosed assets are recorded at the lower of cost or fair value, less estimated costs to sell. The related allowance for loss is established to reduce the property carrying value to fair value, less cost to sell. Property related expenses incurred during the holding period are included in MBS program expenses.

**Advances against Defaulted MBS Pools:** Advances against defaulted MBS pools represent payments made to fulfill Ginnie Mae's guarantee of timely principal and interest payments to MBS security holders. Such advances are reported net of an allowance for doubtful recoveries to the extent management believes they will not be recovered. The allowance for doubtful recoveries is estimated based on actual and



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expected recovery experience, and is adjusted for FHA, VA, and RHS claims that have been filed.

**Fixed Assets:** Ginnie Mae's fixed assets represent systems (software) that are used to accomplish its mission. Ginnie Mae defers significant software development project costs, and amortizes them over a three- to five-year period beginning with the project's completion.

**Reserve for Loss on MBS Program:** In the operation of its MBS programs, Ginnie Mae estimates the cost of liquidating its existing portfolio of mortgage servicing rights acquired from defaulted issuers and expected issuer defaults. Reserves are established to the extent management believes issuer defaults are probable and FHA, VA, and RHS insurance or guaranty are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenues and Expenses, and reduced by charge-offs, net of recoveries.

**Recognition of Revenues and Expenses:** Ginnie Mae receives monthly guaranty fees for each MBS mortgage pool, based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guarantee of MBS are recognized as earned. Ginnie Mae receives commitment fees as issuers request Commitment Authority, and recognizes the commitment fees as income 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. Ginnie Mae recognizes as income the major portion of fees related to the issuance of multiclass securities in the period the fees are received, with the balance deferred and amortized over the weighted average life of the underlying mortgages to match the recognition of related administrative expenses. Losses on assets acquired through liquidation and claims against FHA, VA, and RHS are recognized when they occur.

**Statements of Cash Flows:** Ginnie Mae changed the presentation of the Statements of Cash Flows for clarity purposes effective FY 2007. The statements are prepared on an indirect basis.

**FIN 45:** The Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107, and Rescission of FASB Interpretation No. 34*, in November 2002. FIN 45 clarifies the requirements of FASB Statement No. 5, *Accounting for Contingencies*, relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guarantee. We have computed the fair value of our guarantee based on the life of the mortgage-backed securities and their underlying loans. Based on this evaluation we have disclosed an asset and liability of \$425.9 million as of September 30, 2007 and \$363.7 million as of September 30, 2006 categorized as other assets and other liabilities, see Note A. There is no impact on the net financial position of Ginnie Mae due to FIN 45.

**Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets, liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Note B: U.S. Government Securities

The U.S. Government Securities portfolio is held in special market-based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book-entry form at the Bureau of Public Debt, and are made up of overnight certificates, U.S. Treasury notes, and U.S. Treasury inflation-indexed securities (reflecting inflation compensation). The coupon rates of Ginnie Mae's holdings as of September 30, 2007, range from 0.88 percent to 4.625 percent. As of September 30, 2006, they ranged from 0.88 percent to 6.50 percent.

The amortized cost and fair values as of September 30, 2007, were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in Thousands)</i>				
U.S. Treasury Overnight Certificates	\$ 1,214,100	\$ -	\$ -	\$ 1,214,100
U.S. Treasury Notes	2,294,900	8,600	(2,900)	2,300,600
U.S. Treasury inflation-Indexed Securities	5,226,900	-	(589,800)	4,637,100
<b>Total</b>	<b>\$ 8,735,900</b>	<b>\$ 8,600</b>	<b>\$ (592,700)</b>	<b>\$ 8,151,800</b>

The amortized cost and fair values as of September 30, 2006, were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in Thousands)</i>				
U.S. Treasury Overnight Certificates	\$ 1,262,400	\$ -	\$ -	\$ 1,262,400
U.S. Treasury Notes	1,994,100	2,900	(14,000)	1,983,000
U.S. Treasury inflation-Indexed Securities	5,101,600	108,800	(67,800)	5,142,600
<b>Total</b>	<b>\$ 8,358,100</b>	<b>\$ 111,700</b>	<b>\$ (81,800)</b>	<b>\$ 8,388,000</b>

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government Securities at September 30, 2007, by contractual maturity date, were as follows:

<i>(Dollars in Thousands)</i>	Amortized Cost	Fair Value	Weighted Average Interest Ratio
Due within one year	\$ 2,612,100	\$ 2,616,100	3.12%
Due after one year through five years	3,768,800	3,468,100	2.62%
Due after five years through ten years	2,355,000	2,067,600	2.20%
<b>Total</b>	<b>\$ 8,735,900</b>	<b>\$ 8,151,800</b>	<b>2.98%</b>

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2006, by contractual maturity date, were as follows:

<i>(Dollars in Thousands)</i>	Amortized Cost	Fair Value	Weighted Average Interest Ratio
Due within one year	\$ 1,762,300	\$ 1,763,500	5.11%
Due after one year through five years	2,026,000	1,990,500	4.13%
Due after five years through ten years	4,569,800	4,634,000	2.33%
<b>Total</b>	<b>\$ 8,358,100</b>	<b>\$ 8,388,000</b>	<b>3.34%</b>

### Note C: Mortgages Held for Sale, Net

Ginnie Mae acquires certain mortgages from defaulted issuers' portfolios to bring the pools into conformity with MBS program requirements. Ginnie Mae acquires mortgages ineligible to remain in pools when servicing rights are sold. Mortgages held for sale were as follows:

<i>(Dollars in Thousands)</i>	September 30	
	2007	2006
Unpaid principal balance	\$ 23,600	\$ 29,100
Allowance for losses	(4,600)	(6,100)
<b>Mortgages held for sale, net</b>	<b>\$ 19,000</b>	<b>\$ 23,000</b>

### Note D: Properties Held for Sale, Net

Ginnie Mae acquires residential properties by foreclosure out of the defaulted issuer portfolios to comply with MBS program requirements. Balances and activity in properties held for sale were as follows:

	September 30	
	2007	2006
<i>(Dollars in Thousands)</i>		
Cost of properties, beginning of year	\$ 11,300	\$ 10,400
Additions	7,200	6,000
Dispositions and Losses	(4,600)	(5,100)
Cost of properties, end of year	\$ 13,900	\$ 11,300
Allowance for losses and costs to sell	(10,700)	(8,700)
<b>Properties held for sale, net</b>	<b>\$ 3,200</b>	<b>\$ 2,600</b>

### Note E: Advances against Defaulted Mortgage-Backed Security Pools, Net

Under its MBS guaranty, Ginnie Mae advanced \$30.4 million in FY 2007, and \$30 million in FY 2006 against defaulted MBS pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guaranty proceeds, were \$31.1 million in FY 2007 and \$30.4 million in FY 2006. There were no advances written off in FY 2007 and FY 2006. There were no advances associated with RHS in FY 2007 or FY 2006.

	September 30	
	2007	2006
<i>(Dollars in Thousands)</i>		
Advances against defaulted pools	\$ 15,900	\$ 13,100
Allowance for losses	(14,900)	(11,300)
<b>Advances against defaulted pools</b>	<b>\$ 1,000</b>	<b>\$ 1,800</b>

### Note F: Reserve for Losses on MBS Program

Ginnie Mae establishes a reserve for losses through a provision charged to operations, when, in management's judgment, defaults of MBS issuers become probable. The reserve for losses is based on an analysis of the MBS portfolio outstanding. In estimating losses, management utilizes a statistically based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience.

Management also considers uncertainties related to estimates in the reserve setting process. The reserve is relieved as losses are realized from the disposal of the defaulted

issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights. As Ginnie Mae's defaulted issuer portfolio decreases, original estimates are compared with actual results over time, and the reserve's adequacy is assessed, and if necessary, the reserve is adjusted. Management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed MBS. During fiscal year 2007, Ginnie Mae reallocated the distribution of the reserves between each of the programs. Changes in the reserve for the years ended September 30, 2007, and 2006 were as follows:

<i>(Dollars in Thousands)</i>	Single Family	Multifamily	Manufactured Housing	Total
<i>September 30, 2005 Reserve for Loss</i>	\$ 238,300	\$ 58,600	\$ 241,600	\$ 538,500
Recoveries	4,800	250	7,100	12,150
Realized Losses	(5,200)	-	(11,000)	(16,200)
Provision	-	-	-	-
<i>September 30, 2006 Reserve for Loss</i>	\$ 237,900	\$ 58,850	\$ 237,700	\$ 534,450
<i>Reallocation between programs</i>	\$ 187,800	\$ (100)	\$ (187,700)	\$ -
Recoveries	7,900	100	6,700	14,700
Realized Losses	(7,200)	(50)	(6,100)	(13,350)
Provision	-	-	-	-
<i>September 30, 2007 Reserve for Loss</i>	\$ 426,400	\$ 58,800	\$ 50,600	\$ 535,800

Ginnie Mae incurs losses when FHA, VA, and RHS insurance and guaranty do not cover expenses that result from issuer defaults. Such expenses include: (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guaranties; (2) ineligible mortgages included in defaulted Ginnie Mae pools; (3) improper use of proceeds by an issuer; and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

Five single family issuers defaulted during FY 2007. Ginnie Mae believes that the reserve for loss estimate is adequate to cover any noninsured loss sustained for these issuers and from unknown future losses from the occurrence of periodic defaults.

### **Note G: Financial Instruments with Off-Balance Sheet Risk**

Ginnie Mae is subject to credit risk for financial instruments not reflected in its balance sheet in the normal course of operations. These financial instruments include guarantees of MBS and commitments to guarantee MBS. The Ginnie Mae guaranteed security is a pass-through security, whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the security's structure, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's

exposure to credit loss is contingent on the nonperformance by other parties to the financial instruments. Other than those issuers considered in the reserve for loss on the MBS program (see Note F), Ginnie Mae does not anticipate nonperformance by the counter parties.

Ginnie Mae guarantees the timely payment of principal and interest to MBS holders should the issuers fail to do so. The securities are backed by pools of insured or guaranteed FHA, RHS, or VA mortgage loans. On September 30, 2007, the amount of securities outstanding, which is guaranteed by Ginnie Mae, was \$427.6 billion, including \$52.8 million of Ginnie Mae guaranteed bonds. However, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral, and the FHA, RHS, and VA insurance or guaranty indemnifies Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guarantee MBS. The commitment ends when the securities are issued, or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities, due in part to Ginnie Mae's ability to limit Commitment Authority granted to individual MBS issuers.

Outstanding MBS and commitments were as follows:

	September 30	
	2007	2006
<i>(Dollars in Billions)</i>		
Outstanding MBS	\$ 427.6	\$ 410.0
Outstanding MBS Commitments	\$ 35.8	\$ 22.8

#### Note H: Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counter parties (e.g., issuers and borrowers) engage in similar activities, or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers as noted below, as of September 30, 2007:

	Single Family		Multifamily		Manufactured Housing	
	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance
<i>(Dollars in Billions)</i>						
Largest performing issuers	20	\$358.0	10	\$26.5	1	\$0.1
Other performing issuers	125	\$ 30.9	49	\$11.8	2	-
Defaulted issuers	11	\$ 0.2	3	-	8	-

As of September 30, 2007, Ginnie Mae's single family, multifamily, and manufactured housing defaulted portfolio had remaining principal balances of \$ 196.1 million, \$ 33.4 million, and \$ 13.8 million, respectively.

In FY 2007, Ginnie Mae issued a total of \$ 44.6 billion in its multiclass securities program. The estimated outstanding balance of multiclass securities included in the total MBS securities balance in Note G as of September 30, 2007, was \$201 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

### **Note I: Commitments, Contingencies and Uncertainties**

As of September 30, 2007, Ginnie Mae has no legal actions pending. However, Ginnie Mae's management recognizes the uncertainties that could occur in regard to potential default issuers and other indirect guarantees. (See Note A, Note F, and Note M.)

### **Note J: Related Parties**

Ginnie Mae is subject to controls established by government corporation control laws (31 U.S.C. Chapter 91), and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). These controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

Ginnie Mae reimbursed HUD \$10.6 million in FY 2007, and \$10.6 million in FY 2006, for administrative expenses (office space, etc.), including payroll and payroll-related costs. Payroll-related costs reimbursed to HUD included matching contributions to the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). Although Ginnie Mae funds a portion of pension benefits under these programs, it has no liability for future payments to employees under them. Ginnie Mae does not account for the assets of CSRS or FERS, nor does it have actuarial data with respect to accumulated plan benefits, or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM), and are allocated to HUD. OPM also accounts for the health and life insurance programs for

federal employees and retirees, and funds the nonemployee portion of these programs' costs.

Cash receipts, disbursements, and investment activities are processed by the U.S. Treasury. Funds with U.S. Treasury represent cash currently available to finance purchase commitments and pay current liabilities. Ginnie Mae has authority to borrow from the U.S. Treasury to finance operations in lieu of appropriations, if necessary.

### Note K: Fair Value of Financial Instruments

The following table shows the fair value of financial instruments to which Ginnie Mae has a contractual obligation to deliver cash to, or a contractual right to receive cash from, another entity as of September 30, 2007, and 2006:

	September 30, 2007		September 30, 2006	
	Cost	Fair Value	Cost	Fair Value
<i>(Dollars in Thousands)</i>				
Funds with U.S. Treasury	\$ 4,432,600	\$ 4,432,600	\$ 4,056,500	\$ 4,056,500
U.S. Government Securities	8,735,900	8,151,800	8,358,100	8,388,000
Advances against Defaulted MBS Pools	1,000	1,000	1,800	1,800
Other assets	98,700	98,700	106,100	106,100
Unrecognized financial instruments	-	1,643,000	-	1,306,000
Other liabilities	128,400	128,400	112,300	112,300

The fair value of Ginnie Mae's largest asset, U.S. Government securities, is estimated based on quoted market prices for securities of similar maturity. The fair values of Funds with U.S. Treasury, advances against MBS pools, other assets, and other liabilities are not materially different from their carrying values.

Unrecognized financial instruments comprise the net fair value of the fee Ginnie Mae receives for the guarantee of timely payment of principal and interest. The value was derived by discounting the estimated future net cash flows relating to Ginnie Mae guaranteed MBS outstanding. The assumptions and estimates used in calculating the fair values of unrecognized financial instruments are based on management's evaluation of economic conditions, and, therefore, are not subject to precise quantification.

These discounted cash flows consist of estimated future guaranty fees, taking into account estimated prepayments, in excess of: (1) projected losses relating to the MBS program, including projected losses on defaulted pools of MBS; and (2) projected administrative expenses. The discount rate approximates an interest rate for risk-free instruments of a type and duration similar to the Ginnie Mae guaranty. The fair value of Ginnie Mae's guaranty recognizes the present value of future fees, which are not recognized under accounting principles generally accepted in the U.S., since to do so



would record revenue prior to realization. The fair value of unrecognized financial instruments increased from FY 2006 to FY 2007, and is primarily attributable to the impact of interest rate volatility.

Ginnie Mae's standing as a federal government corporation whose guaranty carries the full faith and credit of the U.S. government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Accordingly, the amount Ginnie Mae would realize upon sale of its financial instruments could differ, perhaps materially, from the amounts shown above.

### **Note L: Credit Reform**

The Federal Credit Reform Act of 1990, which became effective on October 1, 1991, was enacted to more accurately measure the cost of federal credit programs, and to place the cost of these credit programs on a basis equivalent with other federal spending. Credit reform focuses on credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to the U.S. Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations. As of September 30, 2007, Ginnie Mae had reserves of \$12.6 billion held in the U.S. Treasury. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management, and HUD's general counsel, Ginnie Mae is not subject to the Federal Credit Reform Act.

### **Note M: Subsequent Events**

On October 25, 2007, Ginnie Mae defaulted a single family issuer with a portfolio of \$235 million. Estimated losses on this default are not readily determinable and management believes that the reserve for loss estimate of \$535.8 million (Note F) is adequate to cover any losses incurred by Ginnie Mae due to this default.

On August 1, 2007, Ginnie Mae defaulted a single family issuer. On September 20, 2007, the U.S. Bankruptcy Court approved the agreement to allow until October 9, 2007, for this defaulted issuer to find a buyer agreeable to Ginnie Mae to transfer the portfolio. The defaulted issuer found a buyer on October 9, 2007. Per the agreement, the defaulted issuer will reimburse Ginnie Mae for all costs associated with the default. On November 2, 2007, the transfer of the portfolio to the buyer occurred.

