1998 Report to Congress

Message from the Acting Director

"It is not the going out of port, but the coming in, that determines the success of the voyage"

- - Henry Ward Beecher

The atmosphere around OFHEO is charged with excitement as we near the completion of our risk-based capital regulation. To be a part of such unprecedented work, and to have the opportunity to work with such a talented and dedicated staff, is professionally invigorating and rewarding. Chapter 1 of this report outlines OFHEO's work on the development of this next generation of capital regulation. We will be establishing a risk-based standard that effectively captures both the credit risk and interest rate risk exposures to the Enterprises. By more closely aligning capital with risk, OFHEO's standard will be well-designed to assure that Fannie Mae and Freddie Mac can continue to fulfill their public mission while maintaining their financial safety and soundness.

Early in 1998, OFHEO reached another important regulatory milestone as we moved to a comprehensive, annual, risk-based examination program. Chapter 2 describes the details and fundamental principles of our new examination program. Chapter 3 reports the results and conclusions of our information technology and internal audit examinations of the Enterprises. These examinations provided OFHEO with the final building blocks to the essential foundation of information necessary for the evolution of our examination program.

One of OFHEO's highest priorities is working closely with the Enterprises to ensure that they successfully address their Year 2000 date change issues. Together with our partners in the federal financial regulatory community, OFHEO is working to make sure that the secondary mortgage market's transition into the new millennium is technologically successful.

A strong economy and a strong housing market proved beneficial to the operations of the Enterprises this past year. Chapter 4 analyzes developments in the primary and secondary mortgage markets as well as the performance of the Enterprises in this favorable environment.

In this period of record rates of homeownership and favorable economic conditions, strong regulation and the development of additional regulatory tools such as OFHEO's risk-based capital standard may seem like an enigma. After all, OFHEO is charged with regulating two companies that are currently healthy and enjoying record profits. However, it is our mission and responsibility to assure the financial safety and soundness of the secondary mortgage market at all times. OFHEO's regulatory activities serve to protect the American taxpayer and keep the housing finance industry safe and sound.

OFHEO's ultimate goal is that every potential homebuyer achieves their dream of owning a home. Ensuring a strong secondary mortgage market through fair and effective regulation of these two important companies can help make those dreams come true.

Mark Kinsey
June 15, 1998

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CHAPTER 1

SETTING A NEW STANDARD IN CAPITAL REGULATION

SETTING A NEW STANDARD IN CAPITAL REGULATION

The Office of Federal Housing Enterprise Oversight (OFHEO) is developing the next generation of capital regulation for the two largest housing government-sponsored enterprises - Fannie Mae and Freddie Mac (the Enterprises). Through the technique of stress testing, OFHEO will establish a risk-based capital standard that effectively captures both the credit and interest rate risk exposures of the Enterprises.

OFHEO's risk-based capital standard will represent a new standard in capital regulation because it will more closely align capital with risk than current capital standards for other federally regulated financial institutions. OFHEO's standard will be able to do this because it is being tailored to the specific risks facing the Enterprises, namely the risks associated with owning and guaranteeing conforming residential mortgages. In addition, OFHEO's risk-based capital standard will simulate the credit risk associated with mortgages along multiple risk dimensions. This allows distinctions to be made among the risks associated with different types of mortgages and mortgage products. By more closely aligning capital with risk, OFHEO's risk-based capital standard will be well-suited to permitting Fannie Mae and Freddie Mac to fulfill their public mission while ensuring their financial safety and soundness.

Risk-Based Capital Standards for Banks and Thrifts

The current capital requirements for banks and thrifts implement the principles articulated in the 1988 Basle Accord[1] and reflect an evolution in capital regulation that occurred during the 1980s. As the capital position of significant numbers of financial institutions deteriorated during this period, bank supervisory authorities adopted common standards for defining capital, and they formalized risk-based capital requirements and capital adequacy standards. The Basle Accord formalized several key ideas:

- Capital requirements must be tied to financial risk.
- Capital requirements should be tailored to the magnitude and nature of the risks (that is, the risk profile) of the individual financial institution.
- Off-balance-sheet contingent liabilities must be included in computing capital levels.

The resulting bank and thrift risk-based capital requirements were regarded as a significant improvement in capital adequacy regulation at the time that they were adopted. Previously, banks and thrifts were assessed a flat capital charge for all assets. However, distortions could arise because there was neither a penalty for risk-taking nor a benefit for risk reduction. Risk-based capital standards eliminated some of the distortions by establishing four categories of risk. The new rules also required the holding of capital against off-balance-sheet obligations, which were growing in importance and represented a potentially significant liability.

Yet the bank and thrift risk-based capital requirements are not entirely satisfactory. The implementation of the Basle Accord resulted in a risk-based capital standard that was only loosely related to the credit risks associated with a bank's or thrift's assets. The problem was that the standards had too few risk distinctions among types of assets, resulting in a failure to capture fully the risks associated with a bank's or thrift's assets.

A common criticism of the bank and thrift risk-based capital standards is that the required capital level for an institution is still more a function of asset size than of risk. That is, a large institution with very conservative investments may be required to hold more capital than a smaller institution with riskier investments. Also, as a financial institution's activities become more complex, bank and thrift risk-based capital ratios can be misleading; the ratios can give the appearance of capital adequacy because the limited number of risk categories are not adequate to capture accurately the risk associated with new types of financial instruments.

Although the bank and thrift regulators also were directed to create uniform rules that would take account of interest rate risk, that task proved to be very difficult to accomplish within the existing capital framework. Instead, banks and thrifts are currently required to determine the impact of significant shifts in interest rates, and there is no explicit link to required capital.

Risk-Based Capital Standards for Fannie Mae and Freddie Mac

The financial institution crises of the 1980s and the early 1990s not only motivated new approaches to bank and thrift supervision, they also focused attention on the potential liability to the government posed by the government-sponsored enterprises, especially the two largest ones, Fannie Mae and Freddie Mac. Though not explicitly guaranteed by the federal government, the Enterprises' financial obligations are priced in the market virtually as if they have such a guarantee. Market participants behave as though they are confident the federal government would make good on any financial obligation of an Enterprise that failed.

As the legislation that created safety and soundness oversight for Fannie Mae and Freddie Mac was being written, Congress recognized that the risk-based capital standards for banks and thrifts would be inappropriate for the Enterprises. In particular, Congress was concerned about the need to align capital closely with risk so that the taxpayers would be protected and the ability of the Enterprises to achieve the public policy goal of fostering homeownership would not be impaired. The single risk category for mortgages under the bank and thrift risk-based capital standards would not result in an accurate alignment of risk with capital because it could not distinguish between the relative risks associated with the specific types of mortgages the Enterprises purchased. Congress also recognized the need for the capital standard to capture interest rate risk associated with the Enterprises' activities.

The risk-based capital standard that Congress has mandated for the Enterprises adopts the key principles in the Basle Accord but implements them in a way that is tailored to the specific activities of the Enterprises. OFHEO is charged with developing a risk-based capital standard using a stress test methodology that measures credit and interest rate risk for the Enterprises more accurately than would a direct application of the bank and thrift capital standards.

Stress Testing

A stress test is a scenario of financial distress. It is a vehicle for estimating the losses that might occur under unforeseen circumstances. A computer model is used to simulate the cash flows from financial instruments in hypothetical severe economic conditions. The effects of the risks embedded in those instruments and the way the risks are managed are captured in the modeling of income and expense cash flows.

Stress testing is a common tool many firms use to quantify risk. Rating agencies use stress tests to simulate future performance of mortgage- and asset-backed securities. Banks use stress tests to simulate trading portfolio performance. Mortgage insurance companies use stress tests to project capital needs. The Enterprises, as well, use stress tests to simulate performance of their assets and obligations to project capital needs.

As a regulatory tool, a stress test allows the regulator to establish a capital requirement that is tailored to the specific risk profile of a financial institution. By simulating the performance of the assets and obligations held by the institution each time the stress test is conducted, the capital requirement will adjust appropriately as the institution's risk profile changes.

The basic parameters of the stress test that OFHEO will propose for the risk-based capital standard for the Enterprises are spelled out in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act). The Enterprises will be required to hold an amount of capital sufficient to remain solvent during a 10-year period of severe credit and interest rate stresses. The risk-based capital requirement will be equal to the amount of capital needed to survive the stress test, plus an additional 30 percent to cover unspecified management and operations risks.

The 1992 Act requires OFHEO to project credit losses on a national scale comparable to the worst historical mortgage default and loss experience in any region of the country.[2] Using historical Enterprise data, OFHEO found the worst regional experience for 30-year, fixed-rate mortgages to be the performance of loans originated in Arkansas, Louisiana, Mississippi, and Oklahoma in 1983 and 1984.[3] These mortgages were originated in the eastern part of the Oil Belt just before oil prices collapsed in the mid-1980s. OFHEO's research shows that 14.9 percent of these mortgages defaulted in their first 10 years, leading to dollar losses equaling 63.3 percent of the original principal balance of the defaulting loans. (These losses do not include the proceeds from mortgage insurance or other credit enhancements.) The defaults and losses associated with these mortgages serve as a benchmark for determining how all of the mortgages on the Enterprises' current books of business perform during the stress test.

The 1992 Act defined the interest rate stress in terms of sizable movements of the 10-year, constant maturity Treasury yield. The Treasury rate is assumed to increase by as much as 75 percent or decrease by as much as 50 percent during the first year of the stress test, whichever results in the greatest losses, and to remain at that level for the remaining nine years of the test. Other interest rates are assumed to move consistently with the Treasury rate and must be reasonably related to historical experience.

To subject the Enterprises to the types of credit and interest rate stresses required by the 1992 Act, OFHEO developed a sophisticated financial simulation model. The model is capable of simulating each Enterprise's financial performance for all assets, liabilities, and off-balance-sheet activities and projecting pro forma financial statements (See Box 1).

Advantages of Using a Stress Test to Determine a Risk-Based Capital Standard

There are important advantages in using a stress test to determine the risk-based capital requirements for government-sponsored enterprises like Fannie Mae and Freddie Mac. These advantages help strike a meaningful balance between the need for ensuring financial safety and soundness and the need for the Enterprises to fulfill their public mission.

The stress test will provide incentives to manage risk

A risk-based capital standard that closely aligns capital with risk provides market-like incentives to manage risk. Because capital market investors treat Enterprise debt as implicitly guaranteed by the federal government, the Enterprises' borrowing costs are little affected by changes in their leverage or general financial conditions. Since the Enterprises are not subject to the same type of market discipline as fully private firms, the market cannot be relied upon to provide the Enterprises with the proper signals to hold additional capital when the Enterprises take on additional risk. OFHEO's stress test, however, will provide such signals. For example, if the Enterprises begin to purchase higher percentages of mortgages with higher risk characteristics, their overall risk will increase. The stress test will then project higher credit losses, resulting in a higher capital requirement.

The stress test will provide the Enterprises with options to meet regulatory capital requirements

Since the stress test closely aligns capital with risk, an Enterprise will have the option of adjusting its capital position to match its risk profile, or adjusting its risk profile to match its capital position. For example, rather than hold a large amount of capital against interest rate risk, an Enterprise might choose to engage in more derivative transactions that reduce risk. The stress test will incorporate the beneficial effects of those derivatives. Similarly, instead of holding more capital against higher risk mortgages, an Enterprise might utilize third-party credit enhancements that reduce the Enterprise's exposure to the risk associated with these mortgages. OFHEO's stress test will give the Enterprises credit for high quality, third-party credit enhancements such as private mortgage insurance. Thus, the stress test will provide each Enterprise with the flexibility to pursue its own business strategy in combination with its mortgage purchase, funding, and risk management strategies, while assuring that they are adequately capitalized.

The stress test will be forward-looking

Stress tests are by nature forward-looking. A stress test approach to capital regulation allows OFHEO to project how an Enterprise, with its current book of business and management strategies, would perform in the future under stressful conditions. The stress test requires the Enterprises to hold capital today for losses that are projected to occur over the next 10 years. In addition, the use of the stress test will provide an early warning signal to OFHEO of potential problems. The stress test will incorporate the changes to the risk profile of each Enterprise every time the test is run. In contrast, existing capital standards for other federally regulated financial institutions are tied to backward-looking book values. They have predetermined risk categories for broad classes of assets that are insensitive to changes in the underlying economic factors that determine risk.

The stress test will be robust in measuring credit and interest rate risk

OFHEO's stress test captures the significant credit and interest rate risk at the Enterprises. The performance of assets, liabilities, and off-balance-sheet activities are modeled in some detail. The model recognizes that, within one broad class of asset or liability, risk varies. For example, credit risk associated with the Enterprises' mortgage portfolios is modeled along multiple risk dimensions, including borrower equity, property type, mortgage type, and interest rates. This means that a high loan-to-value (LTV) adjustable-rate mortgage will be simulated as more risky than a low LTV fixed-rate mortgage. By modeling both assets and liabilities, the stress test will measure the interaction of risk factors, such as the mitigating effect that derivatives and callable debt may have on interest rate risk. It also will measure the interaction of the risk characteristics of the Enterprises' financial instruments and the external economic conditions. For example, changes in interest rates during the stress period will have a direct effect on mortgage defaults and prepayments of the Enterprises' mortgages.

Using Minimum and Risk-Based Capital Standards to Ensure Effective Capital Regulation

The minimum capital requirement for the Enterprises, which is based on simple ratios for on- and off-balance-sheet items, represents the amount of capital that the Enterprises must always hold. The risk-based capital requirement hypothetically may be equal to, higher than, or lower than the minimum capital requirement, depending on the risk profile of each Enterprise. If the risk-based requirement is higher than the minimum, the Enterprises must hold capital equal to the risk-based requirement. If the risk-based requirement is lower, the Enterprises must hold the minimum capital requirement. There is no fixed relationship over time between the minimum capital requirement and the risk-based capital requirement, nor will the relationship between the two requirements be the same for Fannie Mae and Freddie Mac.

Enhancing OFHEO's Regulatory Oversight of the Enterprises

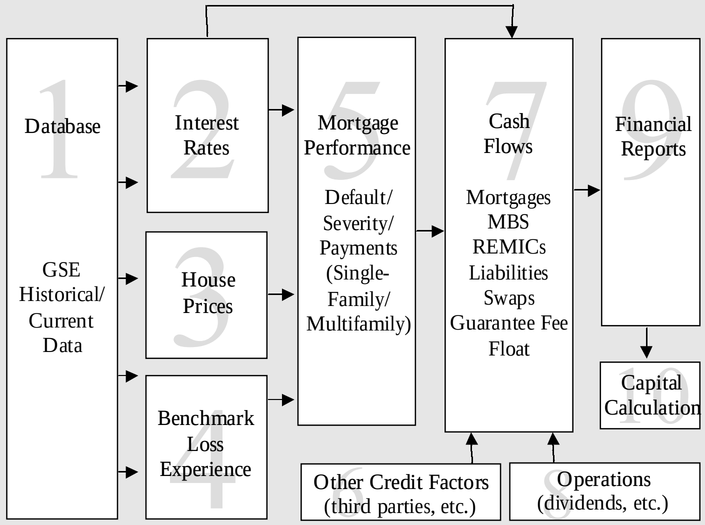
OFHEO's risk-based capital standard combined with our comprehensive, annual, risk-based examination program (discussed in Chapter 2) will provide OFHEO with powerful tools to oversee and promote the financial safety and soundness of Fannie Mae and Freddie Mac. These regulatory tools are designed to hold the Enterprises to a strong financial discipline. While the risk-based capital standard will be based on a single set of stressful conditions, the financial simulation model used to run the stress test will provide OFHEO with an unprecedented ability for a financial institution regulator to analyze the operations of the Enterprises under a wide variety of economic conditions.

Box 1

OFHEO's Financial Simulation Model

Translating the economic shocks produced by a stress test into projected company performance is no simple task. A financial simulation model was created to project the separate financial performances of Fannie Mae and Freddie Mac under the stressful conditions outlined in the 1992 Act. The model consists of several components: statistical models that project mortgage defaults, loss severities, and prepayment rates; computer programs that calculate the cash flows from assets, liabilities, and off-balance-sheet activities; and computer programs that translate these cash flows into pro forma financial statements. The diagram on the following page depicts the model and its components.

Box 1 (Continued)



1. Database: OFHEO standardizes and enters historical data obtained from the Enterprises into models to determine the appropriate relationships between mortgage risk factors and Enterprise performance. Data on the Enterprises' current books of business represent the starting positions for the stress test.

2. Interest Rates: Interest rate models built by OFHEO simulate future movements of Treasury yields, related interest rates, and indexes that affect Enterprise performance.

3. House Prices: OFHEO includes past house prices and future house price projections as part of the stress test because they directly affect the likelihood of mortgage default and prepayment, and the magnitude of resulting losses. House prices are measured by indexes calculated from past house price movements.

4. Benchmark Loss Experience: OFHEO makes assumptions regarding default losses for the stress test that are based, by law, on the country's worst regional default loss experience. Models of mortgage performance must produce results that are consistent with this benchmark loss experience.

5. Mortgage Performance: Models simulate whether and when a mortgage is prepaid or defaults, as well as any resulting default losses. These three factors translate directly into Enterprise financial performance. OFHEO's models replicate the benchmark loss experience based on mortgage risk factors for both single-family and multifamily properties taken from Enterprise databases, interest rates, and house prices.

6. Other Credit Factors: Models simulate benefits of third-party credit enhancements, such as private mortgage insurance, as well as the creditworthiness of such third parties.

7. Cash Flows: Models project cash flows from all Enterprise assets, liabilities, and off-balance-sheet activities.

8. Operations: OFHEO assesses Enterprise performance, in part, by accounting for key aspects of Enterprise operations, such as dividend payouts and assumptions about operating costs, new financing, and short-term investing.

9. Financial Reports: Accounting software generates pro forma financial statements showing resulting capital levels for each period during the 10-year stress test. Results are based on cash flow model outputs and certain assumptions about Enterprise operations.

10. Capital Calculation: A computer program determines the additional amount of starting capital that an Enterprise would need to pass the risk-based capital requirement, given the results of the stress test.

[1] The Basle Accord was adopted by representatives of banking supervisory authorities and central banks from the G-10 countries: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, United Kingdom, and the United States; plus Switzerland and Luxembourg. It was designed to diminish competitive inequality among international banks and to strengthen the soundness and stability of the international banking system.

[2] The 1992 Act defines the worst regional mortgage default and loss experience to have occurred in a contiguous area of the United States containing an aggregate of not less than 5 percent of the total population of the United States that, for a period of not less than 2 years, experienced the highest rates of default and severity of loss in comparison to the rates of default and severity of loss in other such areas for any period of such duration.

[3] In June 1996, OFHEO published a notice of proposed rulemaking on risk-based capital addressing the methodology for establishing the worst regional mortgage default and loss experience of the Enterprises.

CHAPTER 2

OFHEO'S COMPREHENSIVE, ANNUAL, RISK-BASED EXAMINATION PROGRAM

OFHEO'S COMPREHENSIVE, ANNUAL, RISK-BASED EXAMINATION PROGRAM

OFHEO reached a new milestone for its safety and soundness examinations of the Enterprises in January 1998. Beginning in January, OFHEO transitioned from its initial cycle of core examinations covering discrete areas of risk at the Enterprises to its comprehensive, annual, risk-based examination program.

This chapter first describes in detail OFHEO's *comprehensive, annual,* and *risk-based* examination program. The chapter then describes the process OFHEO examiners use to conduct examinations in this program.

OFHEO's Examination Program

OFHEO's approach to examinations recognizes that the Enterprises must accept risks in order to meet their public purposes of providing a secondary mortgage market for conforming mortgages.[1] OFHEO determines whether the risks assumed by the Enterprises are warranted. As a key part of making this judgment, examiners evaluate whether the Enterprises knowingly accept risks and have the capacity to identify, measure, monitor, and control or alter risks on an ongoing basis. An Enterprise that, in OFHEO's opinion, appropriately identifies, measures, monitors, and controls or alters its risks and effectively prices those risks would be considered to operate in a safe and sound manner. If OFHEO were to conclude that an Enterprise was not operating in a safe and sound manner, OFHEO would take appropriate action to ensure the Enterprise's continued operation was not jeopardized.

Comprehensive

OFHEO's *comprehensive*, annual, risk-based examination program is designed to capture all areas of risk and risk management in the Enterprises. As described in detail later in this chapter, OFHEO has segmented the sources of risk into 10 program areas that roll up into four categories of risk and risk management. OFHEO will render the following judgments on each of the 10 program areas:

- The appropriateness of the levels of risk;
- The appropriateness of Board of Directors and Executive Management governance;
- The adequacy of the policies, procedures, and limits intended to mitigate risk;
- The appropriateness of the risk selection, measurement, and reporting mechanisms;
- The adequacy of the framework for internal controls;
- The quality of issue resolution; and
- The effectiveness of risk-taking and risk management initiatives.

Annual

OFHEO's comprehensive, *annual,* risk-based examination program is designed so that an examination cycle corresponds to one calendar year. Between January 1 and December 31, OFHEO will assess risk and risk management of both Enterprises in the 10 program areas covering all areas of risk. This will enable OFHEO to assess, every year, all areas of risk on a timely basis and communicate its findings to each Enterprise.

Risk-Based

OFHEO's examination program has always been *risk-based* and will continue to be so. Largely through its initial set of core risk examinations, OFHEO gained a thorough understanding of the risks, business strategies, organizational structures, and cultures at the two Enterprises. A risk-based examination approach promotes the effective use of OFHEO resources by focusing on areas of relatively high risk in each Enterprise. Examiners pay particular attention to those risks that represent a current or potential threat to the stable operations of an Enterprise.

As described below, OFHEO's examiners assess all areas of risk in the Enterprises. The risk-based focus allocates more OFHEO resources to the highest areas of risk in each Enterprise. This facilitates OFHEO's ability to take corrective action before issues pose a financial threat to an Enterprise, thus furthering the goal of protecting the United States taxpayer.

OFHEO's risk-based examination approach is flexible and allows OFHEO to adjust its oversight focus as conditions change in the Enterprise, industry, or economy. Finally, this approach allows examiners to evaluate Enterprise actions and initiatives against established standards and to determine whether an Enterprise engages in an activity in a safe and sound manner.

OFHEO's Examination Principles

OFHEO has adopted six examination principles to implement its comprehensive, annual, risk-based examination program. These principles add transparency to the examination process. The six principles, which are set out below, guide the implementation of OFHEO's examination program and its assessment of risk and risk management at the Enterprises.

1. Effective examination (which incorporates all examination-related activities) evaluates the existing financial condition and state of risk management and attempts to anticipate the onset of potential issues or problems that have the capacity to adversely impact the financial health of an Enterprise.
2. Effective examination requires each Enterprise's management to exercise a degree of oversight and control that is commensurate with the risks at that Enterprise.
3. Effective examination focuses examination resources on those areas where errors are pervasive, result from intentional disregard, or could impair the financial health of an Enterprise.
4. Effective examination incorporates the opportunity to share with each Enterprise the regulator's unique perspective on best practices and emerging issues, promoting operations and performance enhancements through sharing knowledge.
5. Effective examination is goal- and results-oriented and does not rigidly prescribe the means by which an Enterprise achieves the desired goals or results.
6. Effective examination uses the regulator's resources efficiently and does not impose unwarranted costs on an Enterprise.

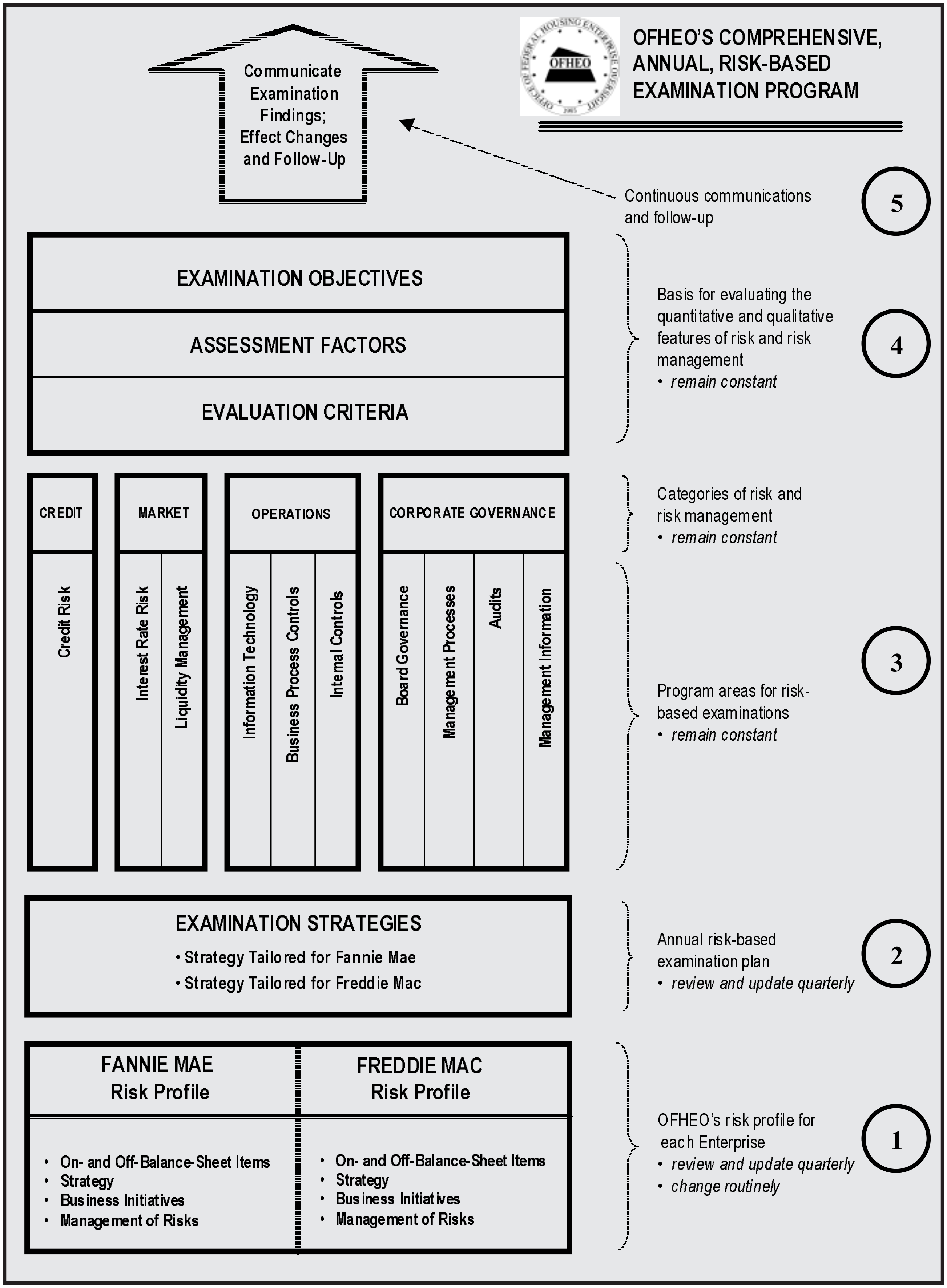
A Quality Examination Force

Achieving OFHEO's examination program goals critically depends on OFHEO's continued ability to be staffed by talented individuals who have the ability to render judgments on complex safety and soundness issues. OFHEO is committed to maintaining a high quality examination force that has the capacity to assess risks and risk management in the increasingly sophisticated Enterprises.

The Examination Process

The manner in which OFHEO conducts its comprehensive, annual, risk-based examinations is depicted on the chart on the next page and in the discussion that follows. The description starts with the bottom of the chart and concludes with the arrow at the top.

Box 2


OFHEO'S COMPREHENSIVE, ANNUAL, RISK-BASED EXAMINATION PROGRAM
Communicate Examination Findings; Effect Changes and Follow-Up
Continuous communications and follow-up
5
EXAMINATION OBJECTIVES
ASSESSMENT FACTORS
EVALUATION CRITERIA
Basis for evaluating the quantitative and qualitative features of risk and risk management
• remain constant
4
CREDIT
Credit Risk
MARKET
Interest Rate Risk
Liquidity Management
OPERATIONS
Information Technology
Business Process Controls
Internal Controls
CORPORATE GOVERNANCE
Board Governance
Management Processes
Audits
Management Information
Categories of risk and risk management
• remain constant
Program areas for risk-based examinations
• remain constant
3
EXAMINATION STRATEGIES
• Strategy Tailored for Fannie Mae
• Strategy Tailored for Freddie Mac
Annual risk-based examination plan
• review and update quarterly
2
FANNIE MAE Risk Profile
• On- and Off-Balance-Sheet Items
• Strategy
• Business Initiatives
• Management of Risks
FREDDIE MAC Risk Profile
• On- and Off-Balance-Sheet Items
• Strategy
• Business Initiatives
• Management of Risks
OFHEO's risk profile for each Enterprise
• review and update quarterly
• change routinely
1

Risk Profiles ①

OFHEO begins the examination process by assessing the quantity of risk and quality of risk management at each Enterprise. OFHEO reviews each Enterprise's risk profile at least quarterly, and revises its views if, for example, the Enterprise has planned or undertaken significant new business initiatives or the Enterprise has substantially changed the manner in which it manages risks.

Examination Strategies ②

In the next step of the examination process, OFHEO develops detailed examination strategies to provide effective, efficient oversight of each Enterprise. Written examination strategies are dynamic; they are reviewed and updated quarterly based on Enterprise, industry, and economic developments. Each strategy is tailored to the Enterprise and is based on OFHEO's knowledge of a variety of factors: the Enterprise's management, strengths, weaknesses, past performance, and markets; the applicable economic conditions and their actual or potential impact on the Enterprise; OFHEO's guidelines, standards, and priorities; and examination requirements. Each strategy is designed to evaluate the continued effectiveness of the Enterprise's risk management processes, enhancements management has made, and, if applicable, actions management has taken in response to previously identified issues. Examination activities identified in the strategy correlate to the level of risk in the Enterprise or in a particular current or proposed activity. Part of the oversight activity detailed in the strategy is the communication plan, including the means and frequency of communication with the Enterprises.

In conjunction with the strategies, OFHEO creates work plans that describe how the strategies will be achieved. The work plans outline the scope, timing, and resources needed to meet the objectives and examination activities set forth in the strategies.

Program Areas for Risk-Based Examinations and Categories of Risk and Risk Management ③

Once OFHEO has strategies and work plans in place, examiners implement strategies by completing examination work in each of the 10 program areas for risk-based examinations. These 10 program areas capture all areas of risk and risk management in the Enterprises, and each program area focuses on specific sources of risk or risk management. In order to complete examinations and allocate resources efficiently, OFHEO has grouped the 10 program areas into four categories of risk and risk management and aligned its examiner force into four teams that correspond to the categories of risk and risk management.

The 10 program areas, grouped by risk category, are:

Credit

1. Credit Risk - the risk that borrowers and counterparties will fail to meet their contractual or other obligations to an Enterprise.

Market

2. Interest Rate Risk - the risk to earnings and capital from movements in interest rates, including changes in the level of interest rates, the shape of the yield curve, the level of volatility, and the relationships or spreads among various yield curves or indices.

3. Liquidity Management - the risk to earnings and capital arising from an Enterprise's inability to meet its obligations as they come due and to transact the next incremental dollar of business cost-effectively.

Operations

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

5. Business Process Controls - the controls related to the data inputs, files, programs, and outputs of a specific computer application that ensure transactions are valid, properly authorized, and completely and accurately processed and reported.

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

Corporate Governance

7. Board Governance - the manner in which the board of an Enterprise discharges its duties and responsibilities.

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

9. Audits - the possibility that a board's or management's reliance on internal or external audits is misplaced.

10. Management Information - the possibility that management will make decisions based on ineffective, inaccurate, or incomplete information or reports.

Examination Objectives, Assessment Factors, and Evaluation Criteria

OFHEO conducts examination work in each of the 10 program areas by using examination objectives, assessment factors, and evaluation criteria. The examination objectives are broad in scope, the assessment factors are more narrowly focused, and the evaluation criteria are narrower still.

For each program area, there are four or five examination objectives. These are broad statements of what OFHEO's examiners will determine through their work in each of the 10 program areas. For example, one of the examination objectives for the credit risk program area is to *identify and evaluate the change in the level of credit risk and the potential impact on the Enterprise.*

The assessment factors, in conjunction with the examination objectives, form the basis for OFHEO's evaluating the qualitative and quantitative features of risk and risk management in the Enterprises. The assessment factors link directly to one or more of the examination objectives for each of the 10 program areas. There are between 10 and 15 assessment factors for each program area. Sources for the assessment factors include industry standards and benchmarks, best practices, and examiner expertise. In order to make a determination on an examination objective, OFHEO's examiners are required to opine on each of the supporting assessment factors. An example of one of the assessment factors that supports the credit risk examination objective set forth above is to *determine the degree and trend of diversification in the credit portfolio.*

The evaluation criteria detail items that examiners routinely consider when making decisions about the assessment factors. The evaluation criteria are designed to assist the examiners by ensuring that the examination work performed throughout the Enterprises is consistent. For example, when making a decision about the assessment factor on diversification in the credit portfolio, examiners would refer to evaluative criteria that directed them to consider, among other things, the following methods of diversifying a portfolio: *by product, by origination channel, by geography, and by counterparty*.

The work performed in an examination cycle that results in decisions on all assessment factors and renders judgments on the examination objectives constitutes a comprehensive examination. Consistent with the examination cycle, comprehensive examinations will be completed annually.

Communicate Examination Findings. . . ...

Throughout the course of an examination, OFHEO communicates with Enterprise personnel not only to gather information, but also to share findings and discuss observations. The types of communication run the gamut from a hallway discussion with a technical expert to clarify a point, to a letter addressed to executive management or the board. Regardless of the format, OFHEO has the same goal for all communications: that the free flow of information furthers the objective of ensuring the safe and sound operations of the Enterprises. OFHEO is committed to continuous, effective communication with the Enterprises.

Communications are tailored to the individual structure and dynamics of the Enterprise, and the timing of the communication depends on the situation being addressed. OFHEO keeps executive management and the board appropriately informed and communicates with them as often as required by the Enterprise's condition and the findings from examination activities. OFHEO brings those issues to the immediate attention of the board and executive management that either: introduce an exposure to the stable operation of the Enterprise, fall under the normal duties and responsibilities of the board, or otherwise warrant immediate attention. Technical issues and matters relating to a single line of business or activity will generally be brought to the attention of the technical and operating managers, with the board and executive management kept appropriately informed. This communication plan reinforces the risk-based examination concept and permits timely corrective action to be effected at the appropriate level.

One special form of communication that will be delivered annually to each Enterprise is the written Report of Examination (ROE). The ROEs will have an open date of January 1 and a close date of December 31. The ROEs will be delivered to the Enterprises no later than 60 days after the close date.

The ROE will describe the focus of the examination activities at each Enterprise, reflect the cumulative conclusions made throughout the yearlong examination process, and address each Enterprise's safety and soundness on an ongoing basis. Thus, while the same examination standards are applied at both Enterprises, the same issues may not be addressed in both ROEs. While all 10 program areas will be addressed, the emphasis and level of detail in the ROE will vary between Enterprises and from year to year.

. . .Effect Changes and Follow-Up

A primary goal of the examination process is to effect needed changes in the Enterprises to enhance their financial safety and soundness. Both the degree of specificity OFHEO provides to the Enterprises about items to be changed and the level of OFHEO follow-up with the Enterprises relate directly to the risk presented by an issue. If, for example, in the course of an examination, OFHEO identifies a significant issue in risk management systems or an undesirable risk level, OFHEO will require management to develop and execute a corrective action plan and will ensure that the board holds management accountable for executing the action plan. OFHEO will review the action plan to ensure that it identifies the steps or methods management expects will cure the root causes of significant deficiencies and to determine whether the plan is likely to resolve the significant issues within an appropriate timeframe. As part of the follow-up, OFHEO will verify that the action plan has been executed and evaluate its success. OFHEO will consider the responsiveness of the Enterprise in recognizing the issue and formulating an effective solution when determining if OFHEO needs to take further action. If an Enterprise is unresponsive or unable to effect resolution of significant issues, OFHEO will take more formal steps to ensure deficiencies are corrected.

The End . . . or Starting Over?

While "effect changes and follow-up" is designated as the final step in OFHEO's comprehensive, annual, risk-based examination process, that is not really the case. In practice, the final steps start the entire examination cycle anew. The examination findings, including items for follow-up, affect OFHEO's assessment of the Enterprise's risk profile. That, in turn, drives the examination strategy and begins the examination cycle once again.

[1] The sizes of mortgage loans that the Enterprises are permitted to buy are limited by their Charter Acts. These limits are usually referred to as "conforming loan limits." For example, the maximum original principal amount of a single-family mortgage that the Enterprises can currently buy is $227,150. In addition to loan size, conforming loans must also meet the Enterprises' underwriting guidelines. Non-conforming loans are loans that either exceed the conforming loan limits or do not meet the Enterprises' underwriting guidelines. Non-conforming loans that exceed the current limit of $227,150 are often called "jumbo" loans.

CHAPTER 3

OFHEO'S REGULATORY ACTIVITIES

OFHEO'S REGULATORY ACTIVITIES

OFHEO's Office of Examination and Oversight (OEO) conducts a comprehensive, annual, risk-based program of examination activities to determine the condition of Fannie Mae and Freddie Mac for the purpose of ensuring their financial safety and soundness. These activities include on-site examinations and off-site financial analysis and supervisory monitoring, as well as ongoing communication with the Board of Directors and management of each Enterprise. OEO's examination program complements OFHEO's quarterly capital classification of the Enterprises and provides comprehensive oversight of the financial safety and soundness of each Enterprise.

Preparing for Transition

OFHEO completed its initial cycle of core examinations, which focused on corporate governance, credit risk, interest rate risk, business risk, information systems and technology risk, and internal audit/operations risk. OFHEO's 1997 Annual Report explained OFHEO's strategy to complete these core examinations and proceed into a continuous examination program. Chapter 2 of this report describes OFHEO's transition into the comprehensive, annual, risk-based examination program that began in January 1998. This chapter describes the activities, which focused on information technology and internal audit/operations risk, that completed the initial cycle of examinations. In addition, this chapter describes OFHEO's ongoing examination of the Year 2000 "challenge," the Enterprises' compliance with applicable flood insurance requirements, OFHEO's capital classifications of the Enterprises and minimum capital, and OFHEO's executive compensation authority.

Through the initial cycle of examinations, OFHEO developed a knowledge base of the Enterprises' respective organizational structures, programs, processes, tools, policies, practices, and business strategies. From this knowledge base, OFHEO formulated a business and risk profile for each Enterprise, and refined examination objectives and assessment factors to be used in examining the Enterprises. As explained in the preceding chapter, the risk profiles are given form in the examination strategies OFHEO prepares each year, and on which OFHEO bases its annual examination activities. The knowledge gained during the course of the initial examinations is crucial to OFHEO's effective oversight and positions OFHEO to effectively deploy its risk-based examination program.

The Information Systems and Technology (IT) Examinations

IT Exposure

The secondary mortgage market increasingly relies on information technology. The Enterprises have been among the leaders in the development and implementation of technological innovations. In recognition of this increased reliance, OFHEO conducted examinations to assess each Enterprise's exposures to risks presented by the management and use of information technology. For purposes of the IT examinations, OFHEO defined IT risk to mean the potential that an event or action may impair an Enterprise's ability to process transactions and information in a timely and accurate manner.

Objective of the IT Examination

The primary objective of the IT examination was to assess whether management at each Enterprise effectively governs its proprietary risk management framework and tools. This included assessing management's ability to identify and resolve IT issues. Based upon these examinations, OFHEO reached a conclusion on whether management effectively oversees the IT area and the risks associated with the use of technology.

Sources of IT Exposure

When evaluating the quality of IT management and the risks associated with technology use, OFHEO must consider the numerous paths by which risk can be introduced. For example, OFHEO must consider such aspects as management's degree of reliance on IT to meet the needs of the business; management's success in integrating the IT strategies with the organization's business needs; and management's success in obtaining and retaining the expertise and staffing to implement and maintain the technology to effectively operate the business. Additional considerations include the dependence placed on external resources; the quality and reliability of vendors and service providers; the reliability and effectiveness of the Enterprise's existing technology platforms; and the quality of change management to ensure there is the capacity to evolve with the technological environment.

Examination Scope

OFHEO considered the sources of IT risk when developing the examination plan, and structured its work to assess seven control areas: (1) program management, (2) systems development, (3) program monitoring, (4) change management, (5) data security, (6) business continuity planning, and (7) facilities management. OFHEO's IT examination scope was to:

- Determine the extent of IT usage in the business processes;
- Identify the existing IT controls;
- Assess IT strengths and weaknesses;
- Evaluate the strategic thinking associated with IT;
- Evaluate the adequacy of the risk management framework as it relates to IT; and
- Conclude on the effectiveness of the overall management of IT.

Examination Results and Conclusions—Fannie Mae

Based upon our review, OFHEO concluded that Fannie Mae's risk management of the IT area is satisfactory.[1] This designation signifies that the risk management of Fannie Mae's automated environment adheres to appropriate safety and soundness standards. While some issues OFHEO identified warrant the attention of the Board of Directors and senior management, none pose safety and soundness concerns.

OFHEO identified various strengths in Fannie Mae's IT risk management framework and concluded that the use of this framework provides effective management of the risks associated with using IT. The key strengths of IT risk management include:

1. Direct, quality involvement by the Board of Directors and senior management in IT risk management;
2. Effective utilization of information technology to address the Enterprise's business needs;
3. Timely and sound IT-related decisions; and
4. Competent and capable IT staff.

There were no findings which presented OFHEO with safety and soundness concerns; however, OFHEO directed the attention of the Board of Directors and senior management to certain areas of the IT management framework. OFHEO also brought a number of other observations and suggestions to the attention of the appropriate level of operating management. OFHEO's recommendations and suggestions to the board and senior management pertained primarily to documentation enhancements for certain aspects of the risk management framework, especially end-user computing policies and procedures. Fannie Mae has addressed, or is addressing, OFHEO's recommendations, and examiners are monitoring the Enterprise's progress.

Examination Results and Conclusions—Freddie Mac

Based upon its review, OFHEO concluded that Freddie Mac's risk management of the IT area is satisfactory.[2] This designation signifies that the risk management of Freddie Mac's automated environment adheres to appropriate safety and soundness standards. While some issues warrant the attention of the Board of Directors and senior management, none pose safety and soundness concerns.

OFHEO identified various strengths in Freddie Mac's IT risk management framework and concluded that the use of this framework provides effective management of the risks associated with using IT. The key strengths of IT risk management include:

1. A comprehensive risk assessment framework;
2. Comprehensive management reporting;
3. Effective monitoring for resolution of significant issues and concerns; and
4. Competent and capable IT staff.

While there were no findings that presented safety and soundness concerns, OFHEO directed the attention of the Board of Directors and senior management to certain aspects of the IT management framework. OFHEO also brought a number of other observations and suggestions to the attention of the appropriate level of operating management. OFHEO's recommendations and suggestions to the board and senior management pertained primarily to enhancing the formal oversight of cross-cutting IT-related issues; continuing management's efforts to strengthen the control environment for data security; enhancing end-user computing standards and procedures; and enhancing business recovery testing. Freddie Mac has addressed, or is addressing, OFHEO's recommendations, and examiners are monitoring the Enterprise's progress.

The Internal Audit/Operations Risk Examinations

The Role of Internal Audit

Internal audit is a fundamental instrument for the discharge of corporate governance to ensure that operating controls are effective and appropriate to minimize risks. The primary objective of the internal audit function is to serve the Board of Directors in the effective discharge of its responsibilities. The work performed by internal auditors plays a vital role in evaluating the effectiveness of the risk management program, the sound operation of internal controls, and the reliability of records and data. A flawed internal audit program might not detect breaches in controls which are intended to mitigate financial exposure and maintain or improve an Enterprise's quality standards.

Objective of the Internal Audit/ Operations Risk Examinations

The primary objective of the examinations was to evaluate the structure, scope of authority, activities, policies, and procedures for the internal audit programs. By evaluating the work of each Enterprise's internal audit department, which focuses on, among other things, the development of and adherence to an effective internal control program, OFHEO was able to assess the degree to which the Enterprises manage their exposure to operations risk.

Examination Scope

OFHEO considers the work performed by the internal auditing departments at each Enterprise when discharging its examination authority. Leveraging off the work of internal audit contributes to OFHEO's effective use of its examination resources. OFHEO's ability to rely upon internal audit requires routine testing and evaluation of the audit programs to ensure that the work within each department meets OFHEO's standards and the appropriate professional standards. The examination activities evaluated aspects of the auditing function to re-validate the reliability of internal audit's work. Under OFHEO's risk-based examination program, OFHEO will assess more comprehensively the quality of the internal audit program on an annual basis.

OFHEO structured its work to:

1. Test a sample of audit workpapers to determine whether the work supported the department's conclusions and whether the workpapers were consistent with internal standards and applicable professional standards;
2. Review adherence to the policies and procedures;
3. Review the role of audits in management's internal control risk assessment programs;
4. Review the department's risk assessment activities; and
5. Review the tracking and reporting of control issues.

Examination Results and Conclusions—Fannie Mae

OFHEO concluded that Fannie Mae's internal audit work products are high quality and that audit activities and results generally are well documented. Particular attention was given during the examination to the Office of Auditing's transition to a continuous-presence audit approach. The continuous audit approach allows the department to maintain ongoing contact with business activities and personnel, and to rapidly adjust audit activities to address issues and concerns as they emerge.

OFHEO identified various strengths in Fannie Mae's internal audit program. These strengths include:

1. A written charter that establishes, among other things, the department's scope of authority;
2. Comprehensive written policies and procedures to guide audit personnel;
3. An internal quality control program;
4. A formal tracking and reporting system to communicate weaknesses to management and the Audit Committee of the Board of Directors;
5. A formal risk assessment process to analyze business developments and allocate resources appropriately; and
6. An active role in management's internal control self-assessment program.

OFHEO did not identify any safety and soundness concerns; however, it suggested a number of enhancements to the internal audit program. These recommendations relate to the auditing department's implementation of its quality assurance program and to documentation in certain areas impacted by the department's shift to a continuous-presence audit program. With respect to documentation, OFHEO recommended that management update internal policies and consolidate guidance related to the department's risk assessment activities, and also that it review its process for ensuring that internal control verifications are documented in a manner that complies with Enterprise policy. In addition, OFHEO encouraged the Enterprise to adopt written guidance with respect to management's internal control self-assessment program.

OFHEO has shared with senior management its suggestions and recommendations on areas which would benefit from enhancement. Fannie Mae has addressed, or is addressing, those recommendations, and examiners are monitoring the Enterprise's progress. As part of OFHEO's risk-based examination program, examiners will continue monitoring the internal audit program throughout the year, and OFHEO will produce annual conclusions on the quality of the internal audit program.

Examination Results and Conclusions—Freddie Mac

OFHEO concluded that Freddie Mac's internal audit work products are high quality and that audit activities and results are well documented. The audit program was found to meet the prescribed professional standards, and various aspects were found to substantially exceed those standards.

OFHEO identified various strengths in Freddie Mac's internal audit function. These strengths include:

1. A written charter that establishes, among other things, the department's scope of authority;
2. A key role in management's risk assessment process;
3. Sophisticated risk assessment tools to identify and prioritize risks and allocate resources;
4. A quality assurance program which exceeds prescriptive professional standards; and
5. An automated audit program which enhances management's capability to actively oversee audit scheduling, findings, status, and follow-up.

OFHEO did not identify any safety and soundness concerns, nor did it identify aspects of the internal audit program that require the board's or senior management's involvement or follow-up. As part of OFHEO's risk-based examination program, examiners will continue monitoring the internal audit program throughout the year, and OFHEO will produce annual conclusions on the quality of the internal audit program.

The Year 2000 Challenge and Examination Activities

What Is the Year 2000 Challenge?

The Year 2000 "challenge" arises because computer systems have typically used two digits, rather than four, to represent the year—for example, "98" represents the year 1998. The problem with a two-digit date field is that computer systems may identify "00" as the year 1900, rather than 2000. This error would lead to errors in performing date-sensitive tasks, including calculations to determine payment amounts, payment dates, payoff balances, interest payments, investor payouts, and other mortgage-related payment information. Failure to address this problem also may lead to errors in annual financial reporting to investors, shareholders, and federal regulatory agencies; reporting related to mortgage-backed and debt securities and derivative financial instruments; portfolio rebalancing; mortgage commitments and purchases; and the issuance of securities.

OFHEO's role as the Enterprises' financial safety and soundness regulator requires it to evaluate management's efforts to resolve the problem as it may impact the Enterprises' internal systems. OFHEO also is evaluating management's efforts to safeguard against circumstances where an Enterprise's key business partners (such as sellers, servicers, vendors, and service providers) have not corrected the problem in their own systems.

How Does OFHEO Evaluate the Enterprises' Efforts to Achieve Year 2000 Compliance?

Year 2000 compliance efforts were an important focus of OFHEO's examination effort during 1997 and will remain an examination priority into the new millennium. OFHEO follows the principles and framework laid out in the General Accounting Office's guide entitled *Year 2000 Computing Crisis: An Assessment Guide* to evaluate the Enterprises' efforts to address the problem. Additionally, OFHEO has been participating in the Federal Financial Institutions Examination Council's Year 2000 efforts and the Working Group on Year 2000 to ensure consistent standards and treatment with the other financial regulators.

The complexity of the effort to achieve Year 2000 compliance is not in the solution to the actual problem, but in the size and scope of the project itself. Given that this is essentially a project management issue, OFHEO has examined, and will continue to examine, the Enterprises' timely and successful management of this critical project.

The Year 2000 Evaluative Framework

The framework used to achieve Year 2000 compliance follows a five-phase approach. This five-phase approach progresses in the following sequence:

1. Awareness Phase - define the Year 2000 problem, make personnel aware of the issue, establish a Year 2000 program team, and develop an overall compliance strategy.
2. Assessment Phase - assess the Year 2000 impact on the organization, identify core business areas and processes, analyze the systems supporting the core business areas, and prioritize conversion and/or replacement of those critical systems.
3. Renovation Phase - perform the conversions, replacement, or elimination of critical platforms, applications, databases, and utilities, and modify interfaces.
4. Validation Phase - test, verify, and validate the converted or replacement platforms, applications, databases, and utilities to ensure that they meet the organization's needs.
5. Implementation Phase - implement the converted and replacement platforms, applications, databases, utilities, and interfaces while maintaining appropriate back-up.

The Enterprises' Year 2000 Efforts Are Appropriate

In addition to examining the Enterprises' efforts to achieve Year 2000 compliance with their systems, OFHEO also assesses the Enterprises' efforts to ensure that their critical business partners achieve timely Year 2000 compliance. Because technology is a cornerstone of the Enterprises' business, Year 2000 compliance is critical for business continuity.

OFHEO's Year 2000 priority with respect to the Enterprises is to safeguard the orderly operation of the secondary mortgage market by ensuring that the Enterprises are able to process transactions and information at the new millennium. OFHEO will continue to treat the Year 2000 challenge as a priority during 1998 and 1999 (and thereafter as appropriate) and will monitor the Enterprises' efforts to lead, and ultimately require, their business partners to be Year 2000 compliant.

OFHEO is able to report that each Enterprise is proceeding with an acceptable plan, and the implementation of these plans is on schedule. Year 2000 ranks among the top priorities at each Enterprise and receives the attention of senior management and substantial resource investment (both human and financial). The Enterprises recognize the significance of the Year 2000 challenge, and each organization has designated working groups to address the numerous business and technology issues. The implementation plans for correcting the problem are comprehensive, and these plans are also being enhanced as the body of knowledge for Year 2000 issues evolves. Each Enterprise has begun internal testing and is following a schedule that will allow comprehensive testing (including testing with business partners) to begin early in 1999. Overall, OFHEO continues to view each Enterprise's Year 2000 compliance plans and related timetables as reasonable.

Because OFHEO believes the Year 2000 challenge is a crucial operating issue for the Enterprises, it believes that the Board of Directors and senior management of each company should be actively involved. OFHEO has determined that the Boards of Directors are being appropriately and routinely briefed on the progress toward Year 2000 compliance, including the meeting of pertinent timetables. Senior executives at both Enterprises are actively engaged and routinely receive status updates. In addition to frequent dialogue with appropriate Enterprise representatives, OFHEO has been testing, and will continue to test and verify, each Enterprise's performance against its respective plan and evaluate its contingency plans. In the event there are adverse deviations from the plans or timetables, OFHEO will immediately determine the appropriate regulatory response.

Flood Insurance Compliance Activities

Background

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

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

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

Results of Flood Insurance Review

In 1997, OFHEO again reviewed the flood insurance procedures and controls at each Enterprise. These reviews included on-site evaluations of applicable procedures and meetings with responsible management. The reviews also included the evaluation of each Enterprise's efforts to test and validate the internal controls established to ensure compliance with applicable statutory requirements. Based on these reviews, OFHEO concluded that each Enterprise has implemented, and is adhering to, adequate flood insurance procedures.

Capital Classification and Minimum Capital

The 1992 Act requires OFHEO to determine the capital classifications of Fannie Mae and Freddie Mac for purposes of financial safety and soundness. The Act requires that these determinations be made "not less than quarterly." The classifications are "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." The Act gives the OFHEO Director "prompt corrective action" enforcement authorities if an Enterprise is classified other than adequately capitalized.

To qualify as adequately capitalized, an Enterprise must meet both minimum and risk-based capital standards. However, only the minimum capital standard applies currently. During this period, an Enterprise is considered adequately capitalized if its core capital - common stock, preferred stock, paid-in capital and retained earnings - equals or exceeds its minimum capital requirement.

The minimum capital requirement is designed to establish an essential amount of capital that an Enterprise must hold as a cushion against losses from broad business categories. It is computed on the basis of leverage ratios applied to all assets (2.50 percent) and off-balance sheet obligations (0.45 percent), with more complex rules applied to interest rate and foreign exchange contracts. OFHEO implemented the minimum capital provision of the 1992 Act by publishing a proposed minimum capital regulation for public notice and comment on June 8, 1995. After considering the comments received, OFHEO published the final regulation on July 8, 1996. Based on the minimum capital requirement, OFHEO has classified Fannie Mae and Freddie Mac adequately capitalized in each quarter since June 30, 1993.

Executive Compensation Authority

OFHEO's enabling statute and the Enterprises' Charter Acts give the Director of OFHEO oversight responsibility in the area of executive compensation. OFHEO's statute requires the Director to prohibit the Enterprises from providing excessive compensation to any executive officer. Specifically, the statute provides that compensation must be reasonable and comparable with compensation paid by other similar businesses to executives having similar duties and responsibilities. "Similar businesses" include publicly held financial institutions or major financial services companies. Additionally, the Enterprises' Charter Acts require the Enterprises to obtain the prior approval of OFHEO's Director before entering into or changing termination agreements with their executive officers. The Charter Acts provide that the Director of OFHEO may not approve any such agreement unless the Director determines that the benefits provided under the agreement are comparable to benefits provided under such agreements for officers of other public and private entities involved in financial services and housing interests who have comparable duties and responsibilities.

During the past 12 months, OFHEO has approved two termination agreements submitted by the Enterprises: one termination agreement for an executive officer and one amendment for another executive officer.

[1] OFHEO has substituted the term "satisfactory" for the term "adequate" to characterize practices that adhere to safety and soundness standards. OFHEO uses the term "strong" to characterize practices that substantially exceed safety and soundness standards.

[2] Ibid.

CHAPTER 4

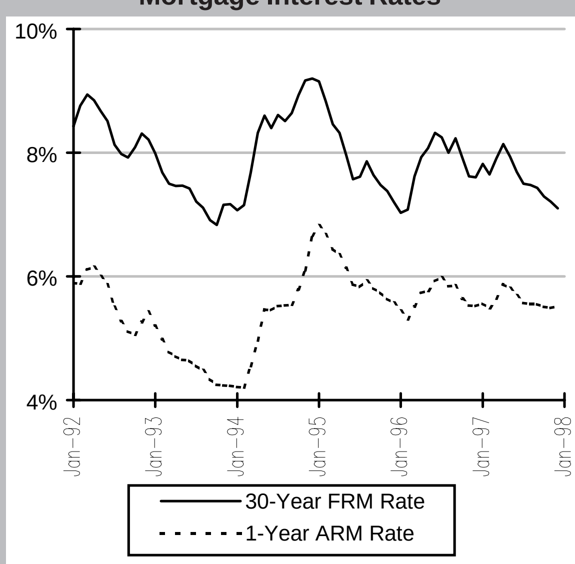
MORTGAGE MARKETS AND THE ENTERPRISES IN 1997 AND EARLY 1998

MORTGAGE MARKETS AND THE ENTERPRISES IN 1997 AND EARLY 1998

Fannie Mae and Freddie Mac continued to prosper in 1997 and early 1998 as a strong housing market and reduced credit losses resulted in record profits. The record profits were driven by net interest income from growing mortgage investments. The Enterprises also experienced declining credit losses during 1997, reflecting an improving housing market, particularly in California. In addition, the credit risk profiles of the Enterprises' 1997 and early 1998 mortgage purchases benefited from a significant increase in the use of credit enhancements, principally pool insurance, to reduce the costs of future mortgage defaults.

While the Enterprises' market share benefited from a surge in refinance volumes early this year, increased competitive pressures from private security issuers and increased holdings of mortgages by depository institutions held down Enterprise market share during 1997. In an effort to maintain business growth, the Enterprises expanded the range of their activities. In addition, the Enterprises continued to repurchase common stock shares last year rather than investing surplus funds at lower than target rates of return. Both Enterprises maintained sufficient capital to meet minimum regulatory requirements.

Figure 1
Mortgage Interest Rates



Source: Freddie Mac Primary Mortgage Market Survey

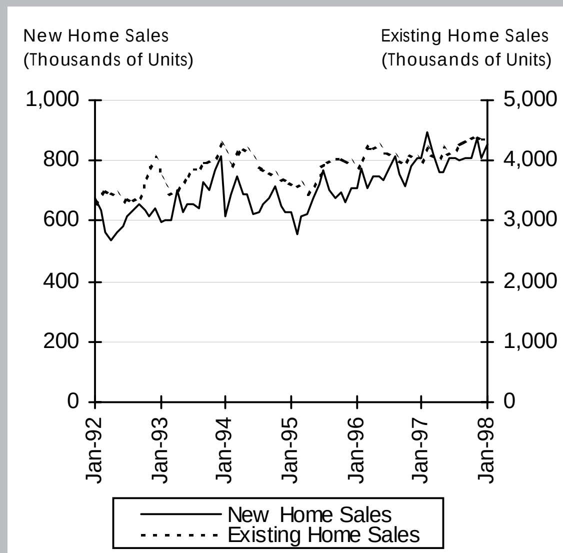
Housing and Primary Mortgage Market Developments

Record Housing and Mortgage Market Activity

Continued rapid growth in the economy coupled with low interest rates contributed to a banner year for housing and mortgage origination markets. Growth in gross domestic product was 3.6 percent in 1997, even stronger than the 3.3 percent pace in 1996. Unemployment remained low, while tame inflation and low interest rates kept consumer confidence high. Rising real wages, a strong stock market, and increases in house prices contributed to an estimated $4 trillion rise in net household wealth during 1997.

As a result of the favorable interest rate environment and unusually warm weather in many parts of the country, the primary housing activity indicators - housing starts and home sales - posted record performances in 1997. After peaking at just over 8 percent in April, the 30-year fixed mortgage rate declined to end 1997 with an average of 7.6 percent - its lowest annual level since 1993. The downward trend continued into 1998, with the 30-

Figure 2
New and Existing Single-Family Home Sales



Source: HUD

year rate at 7.1 percent by the end of the first quarter (See Figure 1). Housing starts maintained the 1996 rate of 1.5 million units in 1997, and then rose to an annual rate of 1.6 million units in the first quarter of this year.

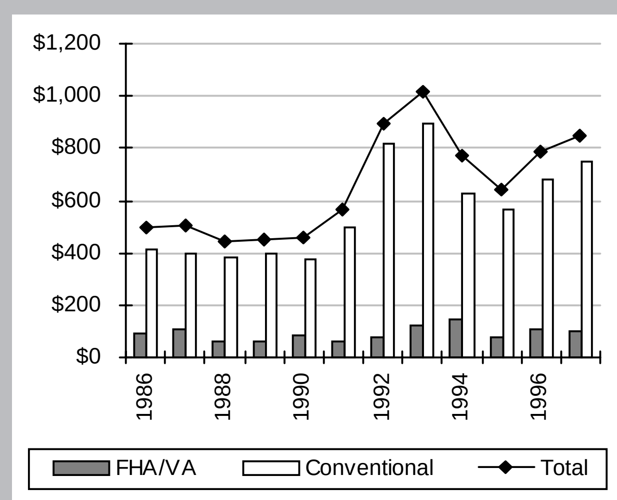
The pace of single-family home sales tracked mortgage interest rates, declining briefly in the second quarter of last year as mortgage rates peaked, and then increasing through the first quarter of 1998 (See Figure 2). New single-family home sales increased 6 percent to 0.8 million units—the highest level since 1978—while existing single-family home sales reached a record 4.2 million sold during the year.

Single-family mortgage originations increased to an estimated $834 billion in 1997 (See Figure 3), with the majority of the increase in conventional originations, while FHA and VA originations were relatively unchanged. Originations increased 6 percent from 1996 to the highest level since the refinance boom years of 1992 and 1993. Benefiting from a further decline in rates, origination volume in the first quarter of this year surged to an estimated $300 billion. This first quarter estimate exceeds the previous high of $289 billion in the fourth quarter of 1993.

Record housing activity was accompanied by an increasing homeownership rate, rising from 65.4 percent of all households at year-end 1996 to a record rate of 65.7 percent by the end of 1997. Subsequently, the surge in home sales and originations in the first quarter of 1998 pushed the rate of homeownership to a new high of 65.9 percent of total households.

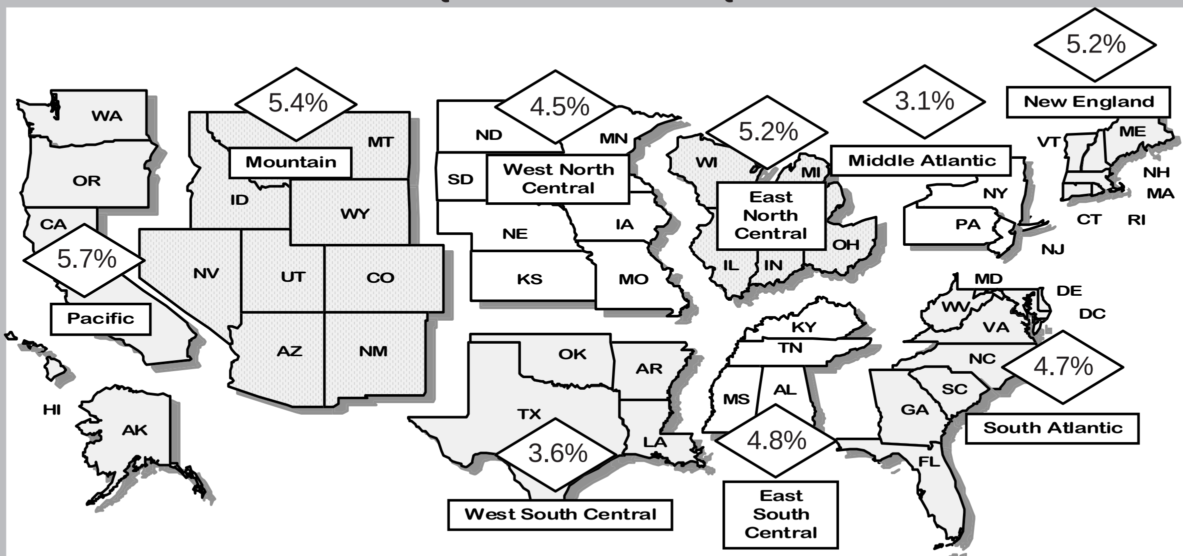
Single-family house prices, as measured by OFHEO's House Price Index (See Figure 4), increased an average of 4.7 percent in 1997, with the West Coast posting the highest gains.

Figure 3
Originations of Single-Family Mortgages
($ in Billions)



Source: HUD

Figure 4
One-Year Change in House Prices
U.S. Census Divisions
Fourth Quarter 1996 to Fourth Quarter 1997



The 5.6 percent increase in the California market is especially notable after a series of declines dating back to 1995.

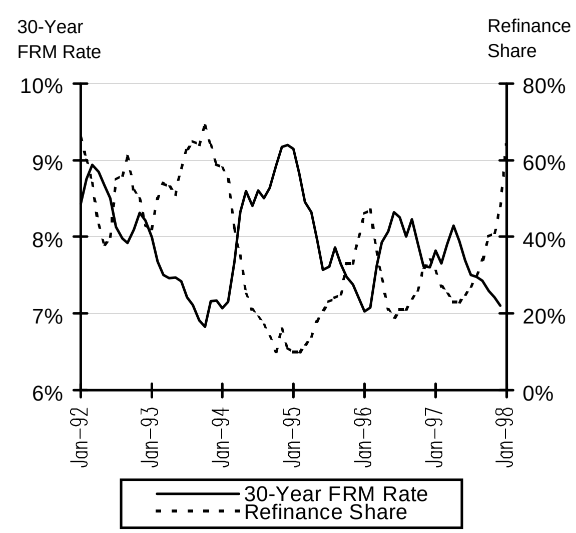
Credit Risk Profile of 1997 Originations Appears Relatively Unchanged

The relative shares of purchase money mortgages and refinanced mortgages, as well as the mix of mortgage product type, affect the credit risk profile of mortgage loans. (A purchase money mortgage is a loan for the purchase of a single-family home. A refinance mortgage is a loan that refinances an existing mortgage.)

Refinance mortgage loans represented 31 percent of total single-family originations last year, down just one percentage point from 1996, although refinancing soared in early 1998 in response to lower interest rates (See Figure 5). Refinance mortgages typically have lower loan-to-value (LTV) ratios than purchase money mortgages because borrowers who refinance typically have more equity in the underlying property from principal repayments and house price appreciation. The level of borrower equity has proven

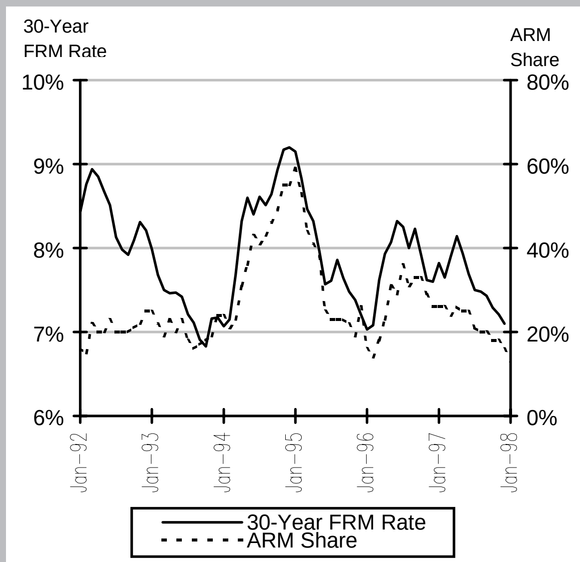
Figure 5

Refinance Share of Total Mortgage Originations vs. Commitment Rate on 30-Year FRMs



Source: Freddie Mac Primary Mortgage Market Survey

Figure 6
ARM Share of Conventional Single-Family Loans vs. Commitment Rate on 30-Year FRMs



Source: Freddie Mac and Federal Housing Finance Board

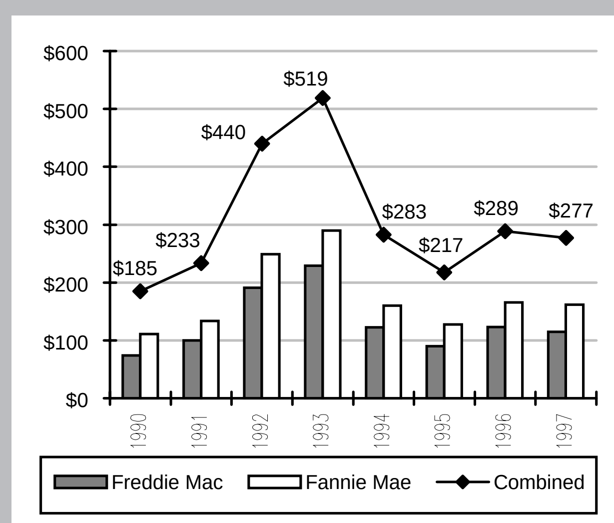
to be a key determinant in the incidence and severity of mortgage loan defaults. The average LTV ratio on conventional purchase money mortgages increased only slightly to 79.4 percent from 79.0 percent in 1996. The proportion of those loans originated with LTVs greater than 90 percent was unchanged from the prior year at 25 percent.

As mortgage rates declined throughout the second half of last year and the spread between fixed and adjustable mortgage interest rates narrowed, an increasing proportion of borrowers chose fixed-rate mortgage (FRM) loans. The adjustable-rate mortgage (ARM) share of conventional originations averaged 25 percent in the first half of the year -- slightly below the 1996 average -- then declined to a low of 13 percent early this year (See Figure 6). The decrease in the proportion of adjustable-rate loans has positive implications for the credit profile of 1997 and early 1998 originations. ARM loans typically have a higher risk of default due to potential increases in borrower payment obligations when rates increase.

Subprime Originations Surge

A surge in originations of subprime mortgage loans in 1997 was driven by a combination of easy access to capital markets for many subprime lenders and low interest rates that made debt consolidation refinancing attractive to borrowers. According to *Inside Mortgage Finance*, originations of these loans jumped to $125 billion in 1997, an increase of 39 percent from 1996, outpacing the growth in overall originations. (*Inside Mortgage Finance* defines subprime originations as mortgage loans to borrowers with credit weaknesses. These loans include A-minus through D-rated borrowers.) Subprime loans represented 15 percent of total mortgage originations, up from 12 percent in 1996 and just 5 percent of all originations in 1994.

Figure 7
Enterprise Single-Family Mortgage Purchases
($ in Billions)



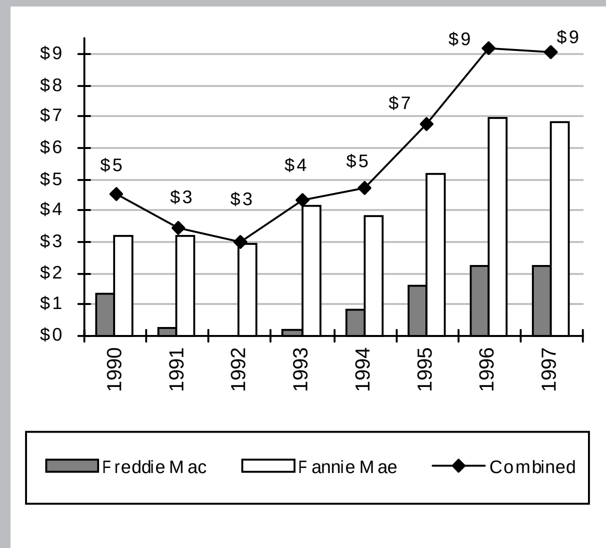
Source: Fannie Mae and Freddie Mac

Secondary Market Activities of the Enterprises

Overall Secondary Mortgage Market Activity Declined in 1997

Despite robust origination activity during 1997, increased holdings of mortgage debt by depository institutions contributed to a decline in overall secondary market activity. The drop in sales of mortgages to the secondary market combined with increased competition from private label issuers posed challenges for the volume of secondary market activities for Fannie Mae and Freddie Mac.

Figure 8
Enterprise Multifamily Mortgage Purchases
($ in Billions)

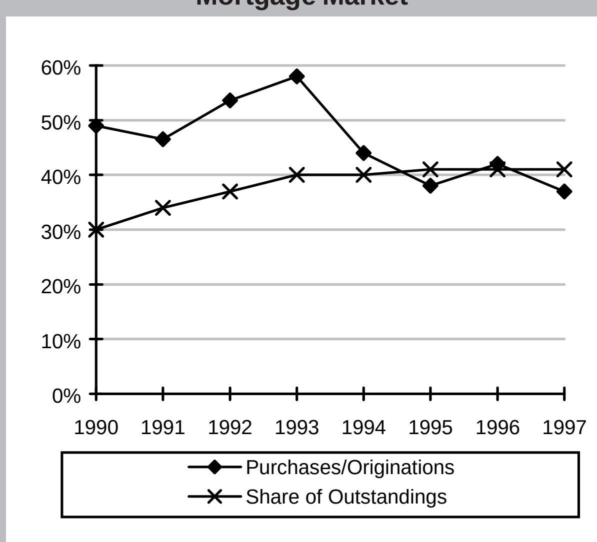


Source: Fannie Mae and Freddie Mac

Overall secondary mortgage market activity, as measured by the total rate of mortgage securitizations, declined slightly to an estimated 50 percent in 1997, and was well below the record 65 percent securitization rate for 1993. This decline occurred despite the increase in fixed-rate loans (and, conversely, the decrease in adjustable-rate loans) as a proportion of total originations. Typically, depository lending institutions prefer to securitize fixed-rate mortgage loans and hold adjustable-rate loans in their mortgage portfolios, because adjustable-rate loans better match the repricing characteristics of depository institution liabilities. However, as a result of strong capital positions and a decline in mortgage prepayment concerns, mortgage debt holdings of financial institutions increased at an annualized rate of 6 percent for the first three quarters of 1997 compared to 5 percent for 1996.

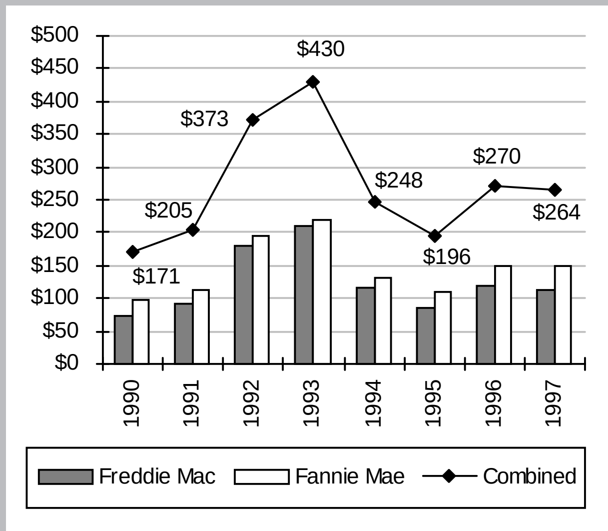
The favorable credit environment that prevailed during 1997 reduced the credit risk premium for many private label issuers. Private label mortgage-backed security (MBS) issuance was $64 billion in 1997 compared to $39 billion the prior year. Private label issuance comprised 15 percent of all MBS issuances during the year, up from just 10 percent in 1996.

Figure 9
Enterprise Share of Conventional Single-Family Mortgage Market



Source: Fannie Mae, Freddie Mac and Federal Reserve Board

Figure 10
Enterprise Single-Class MBS Issuance
($ in Billions)



Source: Fannie Mae and Freddie Mac

Enterprise Purchases and Issuances Decline

As a result of the increased competition for mortgage loans, Enterprise purchases and MBS issuances of single-family mortgage loans declined in 1997, while purchases of multifamily loans remained flat (See Figures 7 & 8). Single-family purchases comprised 37 percent of total single-family conventional originations, down from their 42 percent market share of single-family conventional originations in 1996, and well below their 58 percent share in 1993 (See Figure 9). To maintain growth in business volumes in the face of declining market share, both Fannie Mae and Freddie Mac augmented their activities with purchases of non-current coupon, seasoned MBS.

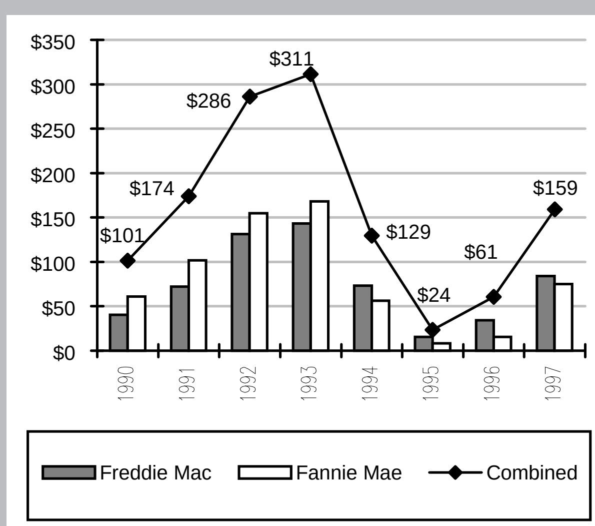
Enterprise issuances of MBS also declined slightly last year (See Figure 10). Resecuritization activity, however, driven by increased investor demand, was more than twice that of Real Estate Mortgage Investment Conduit (REMIC) issuances during 1996 (See Figure 11). In comparison, this represents a little more than half the REMIC volume posted in 1993.

Fannie Mae and Freddie Mac Expand into Wider Range of Mortgage Products

Driven by competitive pressures for attractive mortgage investment opportunities coupled with their own double-digit growth targets, Freddie Mac and Fannie Mae have begun to expand into a wider range of mortgage products. Freddie Mac announced its intention to use its automated underwriting system, *Loan Prospector*, and risk-based pricing (the practice of pricing loans on the basis of projected costs) to expand into two markets: alternative-A mortgages, which are typically loans to low-risk borrowers with either reduced documentation or relaxed LTV requirements, and A-minus mortgages, which are loans with slightly more risk than traditional Enterprise mortgages.

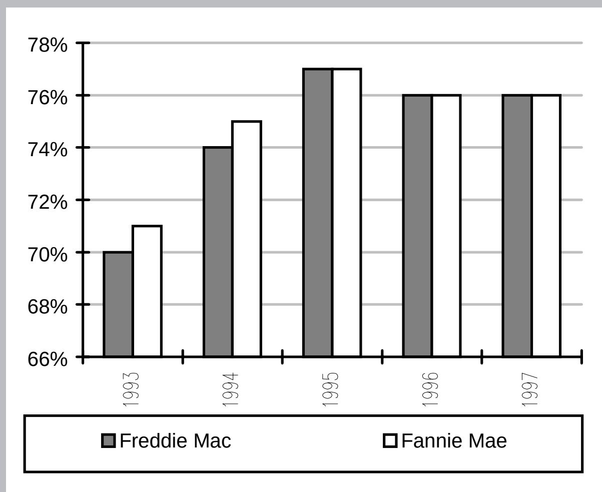
In addition, Freddie Mac has participated in a small number of highly credit-enhanced structured transactions involving still higher risk mortgages - so called "B" and "C" credit grades. Freddie Mac has indicated that participation in these transactions might lead to improve-

Figure 11
Enterprise REMIC Issuances
($ in Billions)



Source: Fannie Mae and Freddie Mac

Figure 12
Average LTV on Enterprise Purchases



Source: Fannie Mae and Freddie Mac

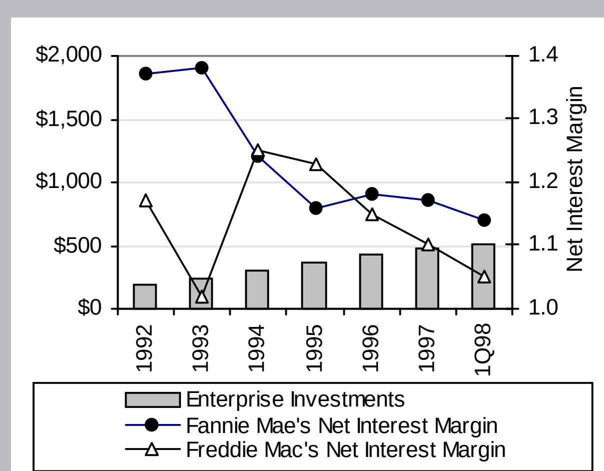
ments in underwriting and risk management systems for these types of loans. Other Freddie Mac initiatives in 1997 include pilot programs for assisted living rental housing loans, and single source loans for construction and permanent financing of selected new multifamily projects.

During the fourth quarter of 1997, Fannie Mae announced changes to its automated underwriting software, *Desktop Underwriter*, that will allow the Enterprise to become more competitive in the alternative-A mortgage market. In addition, the Enterprise initiated a pilot program that will allow purchases of higher risk loans through *Desktop Underwriter* with the placement of deeper private mortgage insurance. These loans would generally be classified as A-minus. Fannie Mae also is developing new product initiatives in the areas of manufactured housing, home improvement loans, low down payment mortgages, energy loans, and reverse mortgages.

Increased Use of Credit Enhancements Improves Credit Risk Profile of Enterprise Purchases and Guarantees

The composition of purchases and guarantees by Fannie Mae and Freddie Mac reflected, in general, the composition of primary market originations during 1997. However, while 30-year fixed-rate loans continued to account for approximately 70 percent of total Enterprise purchases and guarantees, ARM product comprised an increased proportion of purchases and guarantees from 1996. ARMs accounted for approximately 11 percent of new volumes at Fannie Mae compared to 8 percent the prior year, and 8 percent at Freddie Mac compared to 7 percent in 1996. Despite the increase in ARMs as a proportion of new volume, heavy liquidations of this product during 1997 resulted in relatively little change in ARMs as a proportion of the Enterprises' total outstanding portfolios. Consistent with activity in the primary market, the proportion of 15-year loans purchased declined at both Enterprises and represented a decreasing percentage of their outstanding portfolios.

Figure 13
Enterprise Mortgage Investments
($ in Billions)



Source: Fannie Mae and Freddie Mac

The average LTV ratio on Enterprise single-family purchases and guarantees was unchanged in 1997 at 76 percent for Fannie Mae and Freddie Mac. The average LTV on new business has increased since 1993 due to the shift towards purchase money mortgages with higher LTVs relative to the heavy refinance environment in 1992 and 1993 (See Figure 12), but has also been higher than the average LTV prior to the refinance years. As a result of the increase in refinancings in the first quarter of 1998, the average LTV ratio on new purchases and guarantees declined for both Enterprises.

While the average LTV on Enterprise purchases and guarantees was unchanged in 1997, the significant increase in the use of credit enhancements (which shifts the primary default risk of the mortgages to the lender or a third party) improved the credit risk profile of these mortgages. The growth in credit enhancements was driven by the favorable economic environment and increased competition among mortgage insurers, making the acquisition of pool insurance against credit losses attractive for lenders, who received lower guarantee fee rates from the Enterprises in return. Pool insurance covers a large group of loans and augments the protection provided by primary mortgage insurance on individual loans.

A significant 40 percent of Freddie Mac's 1997 purchases and guarantees were credit-enhanced, compared to 11 percent in 1996. As a result, the proportion of Freddie Mac's total outstanding portfolio that is supported by credit enhancements other than primary mortgage insurance increased to 16 percent from 10 percent in 1996. At Fannie Mae, 24 percent of guarantees were credit-enhanced compared to 9 percent in 1996. Similarly, the percentage of Fannie Mae's total portfolio outstanding that is credit-enhanced increased to 13 percent from 10 percent a year ago. While pool insurance transactions reduce the Enterprises' exposure to default losses, they do not eliminate their exposure. Pool insurance provides coverage for expected losses, but not for extraordinary losses.

Financial Condition of the Enterprises

Earnings Exceed $4 Billion in 1997, as Mortgage Investments Increase

Combined earnings for the Enterprises grew 13 percent to $4.5 billion in 1997 (See Tables A & B). Net interest income for both Enterprises rose to $5.9 billion in 1997, from $5.3 billion in 1996. Net interest income was impacted mainly by higher levels of mortgage investments, as the net interest margin of each Enterprise fell (See Figure 13). [1]

The Enterprises increased their purchases of seasoned MBS, REMICs, and other non-current coupon MBS during most of 1997, as the spreads on current coupon mortgages (recent production mortgages) remained tight. Enterprise earnings growth has become heavily dependent on volume as competition and other factors have put pressure on their net interest margins.

A comparison of the Enterprises' two principal lines of business - portfolio investments and mortgage guarantees - indicates that net interest income continues to be the primary source of income for the Enterprises (See Figure 14).

The combined mortgage guarantee fee income for the Enterprises rose slightly by 3.6 percent during 1997. Fannie Mae drove the increase in guarantee fee income, as Freddie Mac's guarantee fee income did not change from its 1996 level of approximately $1.1 billion. Fannie Mae's guarantee fee income increased to approximately $1.3 billion in 1997, compared with $1.2 billion in 1996. The increase in guarantee fee income resulted from a $27 billion increase in average net Fannie Mae MBS outstanding and an increase of 0.3 basis points in the average guarantee fee rate. Higher guarantee fee mortgages rolled off Freddie Mac's books through liquidations and were replaced by lower guarantee fee mortgages. These lower

Table A

FANNIE MAE SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)	1998Q1 Annualized	1997	1996	1995	1994
EARNINGS PERFORMANCE:					
Earnings ($)	3.30	3.06	2.72	2.14	2.13
Net Interest Income ($)	4.14	3.95	3.59	3.05	2.82
Guarantee Fees ($)	1.28	1.27	1.20	1.09	1.08
Net Interest Margin (%)[1]	1.14	1.17	1.18	1.16	1.24
Average Guarantee Fee (bp)[2]	21.9	22.7	22.4	22.0	22.5
Return on Common Equity (%)	25.0	24.6	24.1	20.9	24.3
Dividend Payout Ratio (%)[3]	32.2	30.9	31.5	34.6	30.8
BALANCE SHEET POSITION:					
Total Assets ($)	404.0	391.7	351.0	316.5	272.5
Outstanding Debt ($)	381.1	369.8	331.3	299.2	257.2
Mortgages:					
Retained Mtge. Portfolio ($)	327.2	316.6	286.5	252.9	220.8
MBS (excl. MBS in Portfolio) ($)	593.3	579.1	548.2	513.2	486.3
Retained as % of Total Mtgs. in Portfolio and MBS (%)	35.5	35.3	34.3	33.0	31.2
Capital:					
Equity/Assets & MBS (%)	1.41	1.42	1.42	1.32	1.26
Equity & Reserves/ Assets & MBS (%)[4]	1.49	1.50	1.50	1.41	1.37

Source: Fannie Mae

1. Taxable equivalent net interest income divided by average earning assets.
2. Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.
3. Common and preferred dividends divided by net income.
4. Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

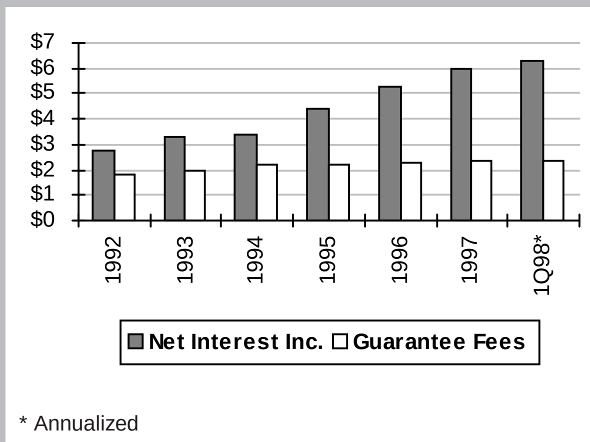
Table B

FREDDIE MAC SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)	1998Q1 Annualized	1997	1996	1995	1994
EARNINGS PERFORMANCE:					
Earnings ($)	1.57	1.40	1.24	1.09	0.98
Net Interest Income ($)[1,6]	2.18	1.99	1.71	1.40	1.11
Guarantee Fees ($)[1]	1.06	1.08	1.08	1.09	1.11
Net Interest Margin (%)[1,2,6]	1.05	1.07	1.15	1.23	1.25
Average Guarantee Fee (bp)[3]	22.4	22.9	23.4	23.8	24.4
Return on Common Equity (%)	22.7	23.1	22.6	22.1	23.3
Dividend Payout Ratio (%)[4]	27.0	26.4	26.0	25.8	25.7
BALANCE SHEET POSITION:					
Total Assets ($)	226.6	194.6	173.9	137.2	106.2
Outstanding Debt ($)	192.9	168.6	156.5	119.3	92.1
Mortgages:					
Retained Mtge. Portfolio ($)	186.0	164.5	137.8	107.7	73.2
MBS(excl. MBS in Portfolio) ($)	462.8	476.0	473.1	459.0	460.7
Retained as % of Total Mtgs. in Portfolio and MBS (%)	28.7	25.7	22.6	19.0	13.7
Capital:					
Equity/Assets & MBS (%)	1.19	1.12	1.04	0.98	0.91
Equity & Reserves/ Assets & MBS(%)[5]	1.29	1.21	1.14	1.09	1.04

Source: Freddie Mac

1. Effective 1/1/96, Freddie Mac reports guarantee fees on retained Freddie Mac MBS as guarantee fee income. Previously estimated and included in net interest income rather than fee income.
2. Taxable equivalent net interest income divided by average earning assets.
3. Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.
4. Common and preferred dividends divided by net income.
5. Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.
6. Adjusted to exclude the formation of REIT subsidiaries during 1Q97, issuances of step-down preferred stock, and associated investment activities. Dividends paid by REIT subsidiaries are reported on Freddie Mac's Consolidated Statements of Income as Minority interest in earnings of real estate investment trusts."

Figure 14
Enterprise Primary Sources of Revenue
($ in Billions)



Source: Fannie Mae and Freddie Mac

guarantee fee mortgages were the result of increased purchases of credit-enhanced mortgages by Freddie Mac.

Enterprise Credit Losses Decline, while Delinquencies Remain Low

Credit losses for the Enterprises (charge-offs plus foreclosure expenses) fell approximately 17 percent in 1997. The drop in credit losses was primarily due to an improving housing market (especially in California) that reduced foreclosure expenses for the Enterprises.

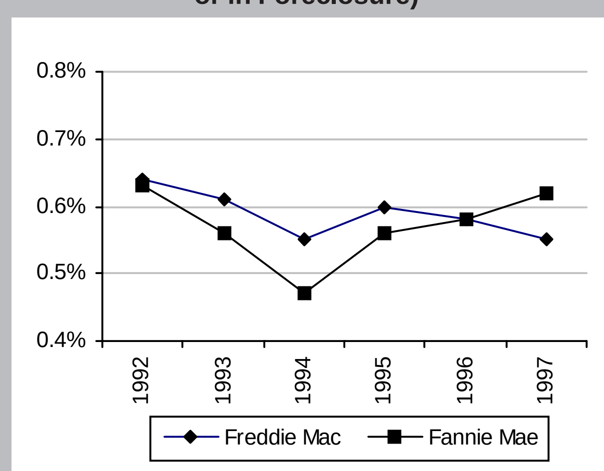
Freddie Mac's single-family delinquency rate fell to 0.55 percent during the year, while Fannie Mae's rose to 0.62 percent (See Figure 15). While this was the third consecutive annual increase for Fannie Mae, the rate was still less than half as large as it was in the mid-1980s.

Losses in future years may benefit from actions taken by the Enterprises in recent years. Three years ago, both Fannie Mae and Freddie Mac raised private mortgage insurance requirements on high LTV loans. Some of those loans will soon begin to enter their peak default years.

Also, the Enterprises continue to implement new loss mitigation initiatives that appear to have worked well in the current favorable housing market. Last year, Freddie Mac introduced a new delinquency management tool called *Early Indicator*, created through a strategic alliance with Mortgage Guaranty Insurance Corp. *Early Indicator* is designed to determine the probability of delinquent loans continuing through to foreclosure. Fannie Mae introduced its own delinquency management tool, *Risk Profiler*, in 1997. *Risk Profiler* provides servicers with monthly data on both performing and nonperforming loans to assist them in identifying and focusing on loans which have the greatest foreclosure potential.

Multifamily delinquency rates fell for both Enterprises in 1997. Freddie Mac's multifamily delinquency rate dropped to 0.96 percent in 1997, from 1.96 percent in 1996. Fannie Mae's multifamily delinquency rate declined to a very low of 0.37 percent in 1997, down from 0.68 percent in 1996. Freddie Mac continues to benefit from the reduction of poor credit quality multifamily loans purchased prior to 1991. Fannie Mae and Freddie Mac's decline in multifamily delinquency

Figure 15
Single-Family Delinquency Rates
(Loans Delinquent 90 Days or More
or in Foreclosure)



Source: Fannie Mae and Freddie Mac

rates also can be attributed to lower vacancy rates and increasing market rents in various parts of the country.

Year 2000 Costs Add to Administrative Expenses

Administrative expenses increased more rapidly than the combined Enterprises' revenue growth rate of 10 percent in 1997. Administrative expenses increased 14 percent at Fannie Mae and 13 percent at Freddie Mac. Higher administrative expenses were partly driven by increased costs associated with the Year 2000 date change issue. In particular, the Enterprises had to pay a premium to retain systems professionals due to the industry-wide shortage of skillful systems professionals to effect the Year 2000 date change.

Fannie Mae is planning to have all of its major systems Year 2000 compliant by December 31, 1998. In addition, Fannie Mae expects that all of the systems of its lenders (sellers and servicers) will be Year 2000 compliant by March 31, 1999. Freddie Mac also plans to have all of its systems ready for the Year 2000 date change by the end of 1998. Freddie Mac is requiring its seller servicers to be Year 2000 compliant by December 31, 1998.

Both Enterprises are participating in the Mortgage Bankers Association Year 2000 Inter-Industry Work Group. The group collects general Year 2000 information, identifies risks specific to the industry, shares ideas on topics such as effective testing plans and contingencies, and serves as an industry resource on Year 2000 planning.

Refinance Activity Affects First Quarter 1998 Enterprise Earnings

The Enterprises experienced double-digit earnings growth during the first quarter of 1998; Fannie Mae's earnings were $824 million, and Freddie Mac earned $393 million. Although mortgage investments increased during the quarter, growth in earnings was mainly attributable to continued declines in credit losses and gains in other income.

The decline in interest rates from September 1997 through January 1998 raised MBS investor prepayment fears during first quarter 1998. As investors began to sell their MBS, prices became more attractive to the Enterprises because they are able to hedge prepayment risks more cheaply than most other investors. Fannie Mae experienced growth in its mortgage investment portfolio at an annualized rate of 13.3 percent during the first quarter of 1998. Freddie Mac increased its retained portfolio by a record $22 billion during the quarter.

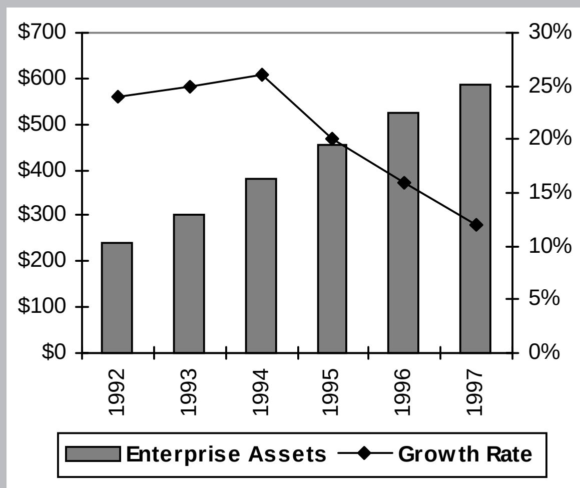
Although mortgage investments rose at the Enterprises during the quarter, net interest income increased only marginally as both Enterprises experienced compression in their net interest margins. Fannie Mae's net interest margin fell 3 basis points to 1.14 percent from fourth quarter 1997, while Freddie Mac's net interest margin dropped 5 basis points to 1.05 percent. The Enterprises' decline in net interest margins was due to incomplete hedging of prepayment risk for previously acquired mortgages and narrower spreads on new mortgage assets acquired during the first quarter of 1998.

Fannie Mae's credit losses dropped approximately 8 percent from fourth quarter 1997, while Freddie Mac's credit losses fell 15 percent. Both Enterprises experienced gains in other income (resecuritization fees, MBS-related fees, and gains or losses on the sale of securities). Fannie Mae's other income rose $26 million, while Freddie Mac's increased $8 million.

The Enterprises' Asset Growth Rate Continues to Decline

Total assets for the Enterprises increased 12 percent to $586 billion during 1997, in spite of a generally lower supply of attractive mortgage investment

Figure 16
Combined Enterprise Assets and Growth Rate
($ in Billions)



Source: Fannie Mae and Freddie Mac

opportunities. The decline in supply of attractive mortgage investments was due to tight mortgage-to-debt spreads throughout the year.

Although total Enterprise assets grew 12 percent in 1997, the rate of asset growth declined for the third consecutive year (See Figure 16). As the Enterprises continue to grow, it has become more difficult to increase asset size at previous growth rates. Asset growth has become more important for the Enterprises as they continue to experience declining margins. In an effort to address asset growth and margin pressures, the Enterprises are increasing their purchases in a wider range of mortgage products.

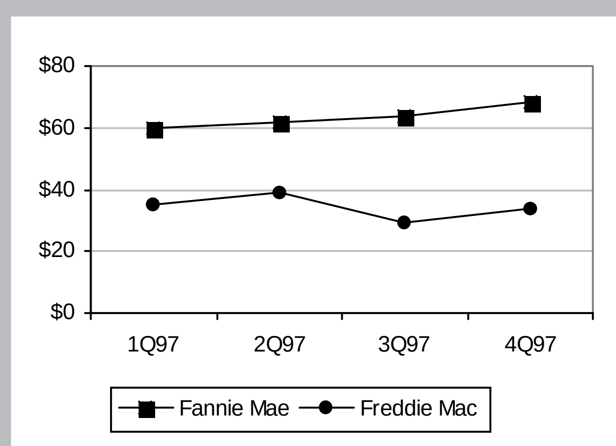
The average balance of non-mortgage investments increased steadily at Fannie Mae to $68 billion during fourth quarter 1997, up from $60 billion during the first quarter of 1997 (See Figure 17). Freddie Mac's non-mortgage investments fell $1 billion over the same period to an average balance of $34 billion during fourth quarter 1997. However, Freddie Mac's non-mortgage investment activity was more volatile than Fannie Mae's during 1997. Examples of non-mortgage investments for the Enterprises include U.S. Treasury and agency securities, federal funds, repurchase agreements, commercial paper, municipal bonds, corporate and Eurodollar securities, and asset-backed securities.[2]

As Debt Grows, Enterprises Expand Funding Sources and Seek New Types of Funding Vehicles

The Enterprises' total combined debt outstanding reached $538 billion in 1997, an increase of 10 percent from 1996. While most of the Enterprises' debt outstanding is long-term (See Figure 18), Freddie Mac's long-term debt was callable or had downward rate adjustment features in 1997. Forty-six percent of Fannie Mae's long-term debt outstanding in 1997 was callable. Callable debt is attractive to the Enterprises because it reduces the risk associated with the prepayment uncertainty of their mortgage-related assets.

Debt issuance also increased for the Enterprises in 1997. Debt issuance increased by 43 percent at Freddie Mac and 18 percent at Fannie Mae. Heavy debt issuance continued in first quarter 1998 following the exercise of call options on high-

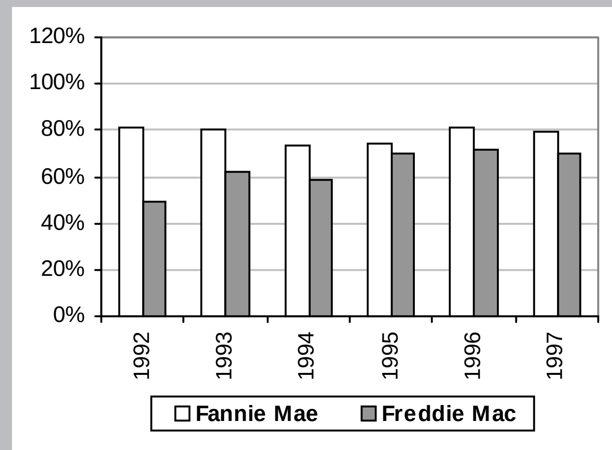
Figure 17
Enterprise Average Non-Mortgage Investments
($ in Billions)



Source: Fannie Mae and Freddie Mac

coupon debt. Fannie Mae called $20 billion during first quarter 1998, compared with $9 billion in fourth quarter 1997. Freddie Mac called $14 billion during first quarter 1998, up from the fourth quarter 1997 call amount of approximately $6 billion.

Figure 18
Effective Long-Term Debt as a Percent of Total Debt

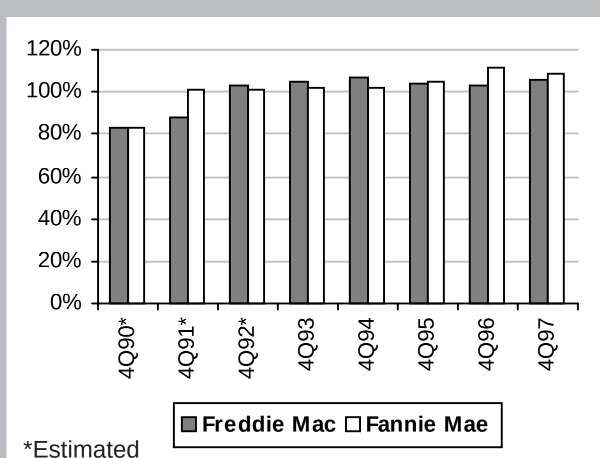


Source: Fannie Mae and Freddie Mac

The Enterprises' increasing demands for debt have caused Freddie Mac and Fannie Mae to expand their funding sources and seek new types of funding vehicles. The primary funding source for the Enterprises continues to be institutional investors. Fannie Mae's global debt outstanding increased 53 percent to $21.8 billion, while Freddie Mac issued $3.5 billion of debt in the international markets, including $700 million of debt securities denominated in foreign currencies. The expansion of funding sources improves the Enterprises' potential for lower cost funding.

In addition to expanding their sources of funds, the Enterprises are also exploring new debt programs. Fannie Mae and Freddie Mac both introduced new debt programs during first quarter 1998 (See Box 3). Fannie Mae's new debt program is called *Benchmark Notes* and Freddie Mac's is called *Reference Notes*. Both programs will be used by the Enterprises respectively to potentially reduce their funding costs by taking advantage of market opportunities created by the decline in Treasury funding demand. Treasury funding needs have tapered off due to the shift from a federal budget deficit to a surplus. The reduction in supply of new Treasury securities has opened a window of opportunity for other instruments with Treasury-like qualities such as liquidity and agency status.

Figure 19
Enterprise Core Capital as a Percent of Minimum Capital Requirements



Source: OFHEO

Enterprises Meet Regulatory Minimum Capital Requirements, while Exercising Capital Management

The Enterprises exceeded their regulatory minimum capital requirements by approximately $1.5 billion in 1997. Fannie Mae's minimum capital requirement was $12.7 billion at year-end 1997. The Enterprise held surplus capital of approximately $1.1 billion (See Figure 19). Freddie Mac held $440 million above its minimum capital requirement of nearly $7.1 billion. The Enterprises were required to hold $1.8 billion more in regulatory capital at year-end 1997 compared with 1996, due to higher levels of assets.

The Enterprises were engaged in active capital management during 1997, as attractive mortgage investment opportunities were limited. In particular, the Enterprises repurchased shares of their common stock to reduce their levels of capital in excess of internal and regulatory requirements. Freddie Mac repurchased $557 million in common stock, while Fannie Mae repurchased $1.3 million in common stock. The board of directors at each Enterprise authorized the return of capital to shareholders as an alternative to deploying capital in assets at lower than target rates of return.

The repurchasing of common stock shares has a positive impact on earnings per share (net earnings divided by average shares of common stock outstanding) because it lowers the number of shares outstanding. Both Enterprises experienced double-digit increases in their earnings per share during 1997.

During 1997, Freddie Mac redeemed a $563 million preferred stock issue and replaced it with $600 million of lower cost preferred stock. Freddie Mac's refinancing of capital at a lower dividend rate is expected to generate annual savings of $10 million. The Enterprise also issued an additional $150 million of preferred stock in 1997.

[1] Freddie Mac's figures on net interest income, guarantee fees, and net interest margin are adjusted to shift guarantee fees on portfolio holdings of its MBS from guarantee fee income as reported to net interest income. This adjustment makes the data comparable to Fannie Mae's. In addition, Freddie Mac's figures have been adjusted to exclude the formation of REIT subsidiaries established during first quarter 1997.

[2] The Department of Housing and Urban Development (HUD) published an advanced notice of proposed rulemaking in December 1997 to seek comments regarding possible regulations concerning non-mortgage investments by the Enterprises. HUD seeks to make certain that in carrying out its regulatory responsibilities with respect to the Enterprises, the Department has the necessary tools to ascertain and ensure that these non-mortgage investments are consistent with the Enterprises' charter purposes.

Box 3

Benchmark and Reference Notes

In December 1997, Fannie Mae announced a new issuance initiative called *Benchmark Notes*. The notes, issued through the Enterprise's global debt facility, are bullet instruments designed to serve as a liquidity alternative for investors at a time of reduced government borrowing.

Benchmark Notes	3-year	5-year	5-year	10-year (Reopened by $750 million on March 3)	10-year
Size	$4 billion	$4 billion	$4 billion	$4.75 billion	$3 Billion
Interest Rate	5.625%	5.25%	5.75%	5.75%	6.00%
Issue Date	Mar 6, 1998	Jan 15, 1998	Apr 6, 1998	Feb 5, 1998	May 11, 1998
Price at Issue	99.779	99.662	99.723	99.659	99.954
Maturity Date	Mar 15, 2001	Jan 15, 2003	Apr 15, 2003	Feb 15, 2008	May 15, 2008

Fannie Mae announced that as much as $40 billion of *Benchmark Notes* could be issued in 1998, which would account for approximately half of its long-term debt issuance this year. Through May, the Enterprise had issued $19.75 billion. There have been four issues of $4 billion each, one of which was reopened for an additional $750 million, and one $3 billion issue.

Fannie Mae states that the minimum new issue size for the *Benchmark Notes* is $2 billion, and the minimum size for a reopening is $500 million. The average par amount of Fannie Mae's bullet issues in 1997 was only $166.5 million. Thus, there is substantially more liquidity in the *Benchmark Notes* than in previous bullet issues.

Reference Notes	*10-year*
Size	$5 billion
Interest Rate	5.75%
Issue Date	Apr 9, 1998
Price at Issue	99.256
Maturity Date	Apr 15, 2008

On April 9, 1998, Freddie Mac issued its first *Reference Notes*, issued under terms of its global bond program, with proceeds of $5 billion. The 10-year *Reference Note* have traded within two basis points in yield to the 10-year *Benchmark Notes*. Subsequent offerings will have a minimum size of $4 billion. Freddie Mac sold approximately $15 billion of bullet debt in 1997 with maturities in the 5- to 10-year range.

For the *Benchmark* and *Reference Notes*, spreads over U.S. Treasury issues have been considerably tighter than for the Enterprises' other bullet issues. Total funding costs are also reduced by the fact that underwriting fees, as a percentage of the amount of debt issued, have been less than the fees for issuing smaller bullet bonds.

In addition to the mere size of the *Benchmark* and *Reference Notes*, liquidity for these bonds has been enhanced by the visibility of pricing. This enhanced liquidity has enabled traders to use *Benchmark* and *Reference Notes* as hedge vehicles, since these bonds can be borrowed in the security repurchase market.

HISTORICAL DATA TABLES

Table	Source	Content	Period
1	Fannie Mae	Balance Sheet / MBS	1971-1997
2	Fannie Mae	Capital / Earnings	1971-1997
3	Fannie Mae	Mortgage Asset Quality	1971-1997
4	Fannie Mae	Business Activity: Purchases / MBS	1971-1997
5	Fannie Mae	Non-Mortgage Investments	1991-1997
6	Fannie Mae	Debt / Market Share	1989-1997
7	Fannie Mae	Derivative Financial Instruments	1991-1997
8	Freddie Mac	Balance Sheet / MBS	1971-1997
9	Freddie Mac	Capital / Earnings	1971-1997
10	Freddie Mac	Mortgage Asset Quality	1971-1997
11	Freddie Mac	Business Activity: Purchases / MBS	1971-1997
12	Freddie Mac	Non-Mortgage Investments	1994-1997
13	Freddie Mac	Debt / Market share	1995-1997
14	Freddie Mac	Derivative Financial Instruments	1995-1997
15	Aggregate	Balance Sheet / MBS	1971-1997
16	Aggregate	Capital / Earnings	1971-1997
17	Aggregate	Business Activity: Purchases / MBS	1971-1997
18	Aggregate	Non-Mortgage Investments	1995-1997
19	Aggregate	Debt	1995-1997
20	Aggregate	Rates on Loans	1972-1997
21		Mortgage Interest Rates	1972-1997
22		Housing Market Activity	1971-1997
23		Weighted Repeated Sales House Price Index	1976-1997

Fannie Mae Financial Data
Table 1

	Balance Sheet/ MBS ($ in millions)				
	Total Assets	**Retained Mortgage Portfolio Outstanding 1/**	**Debt Outstanding**	**Total MBS Outstanding 2/**	**Multiclass MBS Outstanding 3/**
1Q98	403,993	327,171	381,093	593,303	397,116
4Q97	391,673	316,592	369,774	579,138	388,360
3Q97	379,225	307,037	358,003	565,697	378,476
2Q97	365,997	297,073	345,462	558,081	363,500
1Q97	357,010	291,713	336,174	554,109	351,791
Annual Data					
1997	391,673	316,592	369,774	579,138	388,360
1996	351,041	286,527	331,270	548,173	339,798
1995	316,550	252,868	299,174	513,230	353,528
1994	272,508	220,815	257,230	486,345	378,733
1993	216,979	190,169	201,112	471,306	381,865
1992	180,978	156,260	166,300	424,444	312,369
1991	147,072	126,679	133,937	355,284	224,806
1990	133,113	114,066	123,403	288,075	127,278
1989	124,315	107,981	116,064	216,512	64,826
1988	112,258	100,099	105,459	170,097	26,660
1987	103,459	93,665	97,057	135,734	11,359
1986	99,621	94,123	93,563	95,568	Not Applicable Before 1987
1985	99,076	94,609	93,985	54,552	
1984	87,798	84,135	83,719	35,738	
1983	78,383	75,247	74,594	25,121	
1982	72,981	69,356	69,614	14,450	
1981	61,578	59,629	58,551	717	
1980	57,879	55,589	54,880	Not Applicable Before 1981	
1979*	51,300	49,777	48,424		
1978*	43,506	42,103	40,985		
1977*	33,980	33,252	31,890		
1976*	32,393	31,775	30,565		
1975*	31,596	30,820	29,963		
1974*	29,671	28,666	28,168		
1973*	24,318	23,589	23,003		
1972*	20,346	19,652	19,239		
1971*	18,591	17,886	17,672		

Source: Fannie Mae
*Note: Figures are not restated for 12/87 FAS 91 change.
1/ Gross Retained Portfolio net of unamortized purchase premiums, discounts, and fees.
2/ Excludes MBS held in portfolio.
3/ Includes Multiclass MBS held in portfolio.

Fannie Mae Financial Data
Table 2

	Capital			Earnings			
	Stockholders' Equity ($ in millions)	Equity / (Assets + MBS) (%)	(Equity + Loss Reserves) / (Assets + MBS) (%) 1/	Net Income ($ in millions)	Net Interest Margin (%) 2/	Average Guarantee Fee Rate (%)	Return on Average Common Equity (%)
1Q98	14,071	1.41	1.49	824	1.14	0.219	25.0
4Q97	13,793	1.42	1.50	794	1.17	0.227	24.8
3Q97	13,358	1.41	1.50	775	1.17	0.228	24.8
2Q97	13,264	1.36	1.52	753	1.17	0.227	24.4
1Q97	13,178	1.34	1.53	734	1.17	0.227	24.0
Annual Data							
1997	13,793	1.42	1.50	3,056	1.17	0.227	24.6
1996	12,773	1.42	1.50	2,725	1.18	0.224	24.1
1995	10,959	1.32	1.41	2,144	1.16	0.220	20.9
1994	9,541	1.26	1.37	2,132	1.24	0.225	24.3
1993	8,052	1.17	1.29	1,873	1.38	0.213	25.3
1992	6,774	1.12	1.25	1,623	1.37	0.212	26.5
1991	5,547	1.10	1.24	1,363	1.42	0.210	27.7
1990	3,941	0.94	1.06	1,173	1.39	0.211	33.7
1989	2,991	0.88	1.01	807	1.16	0.213	31.1
1988	2,260	0.80	0.94	507	0.89	0.216	25.2
1987	1,811	0.76	0.90	376	1.00	0.224	23.5
1986	1,182	0.61	0.74	105	0.40	0.238	9.5
1985	1,009	0.66	0.76	(7)	0.15	0.256	(0.7)
1984	918	0.74	0.85	(71)	(0.11)	0.262	(7.4)
1983	1,000	0.97	1.10	49	(0.01)	0.263	5.1
1982	953	1.09	1.25	(192)	(0.72)	0.272	(18.9)
1981	1,080	1.73	1.90	(206)	(0.74)	0.250	(17.2)
1980*	1,457	2.49	2.73	14	0.04	Not Applicable Before 1981	0.9
1979*	1,501	2.93	3.17	162	0.70		11.3
1978*	1,362	3.13	3.36	209	0.98		16.5
1977*	1,173	3.45	3.66	165	0.95		15.3
1976*	983	3.03	3.19	127	0.82		13.8
1975*	861	2.73	2.84	115	0.73		14.1
1974*	772	2.60	2.69	107	0.70		14.7
1973*	680	2.80	2.87	126	0.98		20.3
1972*	559	2.75	2.78	96	0.84		18.8
1971*	460	2.47	2.49	61	0.40		14.4

Source: Fannie Mae
*Note: Figures are not restated for 12/87 FAS 91 change.
1/ Effective 1/1/95 reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.
2/ Taxable equivalent net interest income divided by average earning assets.

Fannie Mae Financial Data
Table 3

	Mortgage Asset Quality			
	Single-Family Delinquency Rate (%) 1/	Multifamily Delinquency Rate (%)	Charge-Offs / (Portfolio + MBS) (%) 2/	REO / (Portfolio + MBS) (%) 3/
1Q98	0.61	0.36	0.03	0.10
4Q97	0.62	0.37	0.04	0.10
3Q97	0.59	0.43	0.04	0.11
2Q97	0.58	0.47	0.05	0.11
1Q97	0.59	0.58	0.05	0.11
Annual Data				
1997	0.62	0.37	0.04	0.10
1996	0.58	0.68	0.05	0.11
1995	0.56	0.81	0.05	0.08
1994	0.47	1.21	0.06	0.10
1993	0.48	2.34	0.04	0.10
1992	0.53	2.65	0.04	0.09
1991	0.64	3.62	0.04	0.07
1990	0.58	1.70	0.06	0.09
1989	0.69	3.20	0.07	0.14
1988	0.88	6.60	0.11	0.15
1987	1.12	Not Available Before 1988	0.11	0.18
1986#	1.38		0.12	0.22
1985#	1.48		0.13	0.32
1984#	1.65		0.09	0.33
1983#	1.49		0.05	0.35
1982#	1.41		0.01	0.20
1981#	0.96		0.01	0.13
1980#	0.90		0.01	0.09
1979*	0.56		0.02	0.11
1978*	0.55		0.02	0.18
1977*	0.46		0.02	0.26
1976*	1.58		0.03	0.27
1975*	0.56		0.03	0.51
1974*	0.51		0.02	0.52
1973*	Not Available Before 1988		0.00	0.61
1972*			0.02	0.98
1971*			0.01	0.59

Source: Fannie Mae
*Note: Asset Quality figures are not restated for 12/87 FAS 91 change.
#Note: Charge-off ratio has not been restated for change in Loss Accounting methodology for the years 1971 through 1986
1/ Single-family delinquency rate has been restated for periods prior to 12/31/95, to include loans three or more months delinquent or in foreclosure.
2/ Average Balances for Portfolio and MBS used to calculate ratios subsequent to 1994; includes REO expenses.
3/ REO balances reflect end-of-period amounts. Begnning 1Q95, data includes adoption of SFAS 114.

Fannie Mae Financial Data
Table 4

	Business Activity ($ in millions)							
	Purchases						MBS	
	Single-Family Mortgage Purchases	Multifamily Mortgage Purchases	Total Mortgage Purchases	Mortgage Securities Purchased 1/	Single-Family MBS Issued	Multifamily MBS Issued	Total MBS Issued	Multiclass MBS Issued
1Q98	66,070	1,711	67,781	18,850	56,784	1,475	58,259	22,382
4Q97	52,374	2,171	54,545	15,332	45,539	1,861	47,400	26,025
3Q97	44,065	1,788	45,853	15,416	39,058	1,644	40,702	19,462
2Q97	33,765	1,367	35,132	9,739	29,264	1,182	30,446	20,369
1Q97	34,230	1,286	35,516	8,361	29,754	1,127	30,881	19,559
Annual Data								
1997	164,434	6,612	171,046	48,848	143,615	5,814	149,429	85,415
1996	166,965	6,942	173,907	45,016	144,201	5,668	149,869	30,780
1995	127,988	5,030	133,018	34,036	106,269	4,187	110,456	9,681
1994	164,619	3,840	168,459	24,552	128,385	2,237	130,622	73,365
1993	303,071	4,135	307,206	6,275	220,485	959	221,444	210,630
1992	262,055	2,956	265,011	4,930	193,187	850	194,037	170,205
1991	144,517	3,204	147,721	2,384	111,488	1,415	112,903	112,808
1990	116,496	3,181	119,677	977	96,006	689	96,695	68,291
1989	87,446	4,836	92,282	Not Applicable Before 1990	66,489	3,275	69,764	41,715
1988	73,808	4,180	77,988		51,120	3,758	54,878	17,005
1987	82,277	1,483	83,760		62,067	1,162	63,229	9,917
1986	89,515	1,877	91,392		60,017	549	60,566	2,400
1985	43,959	1,200	45,159		23,142	507	23,649	Not Applicable Before 1986
1984	29,161	1,106	30,267		13,087	459	13,546	
1983	30,757	140	30,897		13,214	126	13,340	
1982	29,077	9	29,086		13,970	Not Applicable Before 1983	13,970	
1981	6,828	2	6,830		717		717	
1980	8,074	27	8,101		Not Applicable Before 1981		Not Applicable Before 1981	
1979	10,798	9	10,807					
1978	12,302	3	12,305					
1977	4,650	134	4,784					
1976	3,337	295	3,632					
1975	3,646	674	4,320					
1974	4,746	2,273	7,019					
1973	4,170	2,082	6,252					
1972	2,596	1,268	3,864					
1971	2,742	1,298	4,040					

Source: Fannie Mae
1/ Not included in mortgage purchases.

Fannie Mae Financial Data
Table 5

	Non-Mortgage Investments ($ in millions)					
	Federal Funds & Eurodollars	**Asset-Backed Securities**	**Repurchase Agreements**	**Commercial Paper & Corporate Debt**	**Other**	**Total**
1Q98	16,939	16,832	6,503	11,888	15,045	67,207
4Q97	19,212	16,639	6,715	11,745	10,285	64,596
3Q97	20,906	11,835	6,611	7,857	16,144	63,353
2Q97	23,171	12,207	5,214	6,619	12,072	59,283
1Q97	21,534	12,168	3,869	6,241	13,305	57,117
Annual Data						
1997	19,212	16,639	6,715	11,745	10,285	64,596
1996	21,734	14,635	4,667	6,191	9,379	56,606
1995	19,775	9,905	10,175	8,629	8,789	57,273
1994	17,593	3,796	9,006	7,719	8,221	46,335
1993	4,496	3,557	4,684	0	8,659	21,396
1992	6,587	4,124	3,189	0	5,674	19,574
1991	2,954	2,416	2,195	0	2,271	9,836
1990	Not Available Before 1991	Not Available Before 1991	Not Available Before 1991	Not Available Before 1991	Not Available Before 1991	Not Available Before 1991
1989						

Source: Fannie Mae

Fannie Mae Financial Data
Table 6

	Debt $ in millions			Market share /1
	Callable	Effective Long-Term /2	Callable %	Overall %
1Q98	139,948	304,066	46%	58%
4Q97	136,276	293,636	46%	57%
3Q97	133,882	284,040	47%	61%
2Q97	131,329	273,105	48%	57%
1Q97	130,218	271,092	48%	58%
Annual Data				
1997	136,276	293,636	46%	58%
1996	126,818	266,816	48%	57%
1995	106,079	221,176	48%	58%
1994	101,873	186,687	47%	57%
1993	93,533	160,848	58%	56%
1992	63,237	129,523	49%	Not Available Before 1993
1991	41,196	114,545	36%	
1990	22,301	101,896	22%	
1989	9,428	92,977	10%	
1988	Not Available Before 1989	Not Available Before 1989	Not Available Before 1989	
1987				

Source: Fannie Mae

1/ Fannie Mae share of combined enterprise purchases

2/ Included the effect of off-balance sheet transactions that convert short funding to long-term.

Fannie Mae Financial Data
Table 7

Derivative Financial Instruments 1/ ($ in millions)					
	Interest Rate	**Debt-linked**	**Asset-linked**	**Other 2/**	**Total Outstandings**
1Q98	89,200	53,900	1,000	13,100	157,200
4Q97	96,100	52,700	1,000	11,500	161,300
3Q97	95,200	50,900	1,900	10,100	158,100
2Q97	96,100	57,000	2,000	9,800	164,900
1Q97	98,500	59,700	2,300	8,300	168,800
Annual Data					
1997	96,100	52,700	1,000	11,500	161,300
1996	97,900	57,900	2,600	8,300	166,700
1995	74,800	48,400	2,800	5,900	131,900
1994	54,300	32,100	1,500	3,800	91,700
1993	31,600	17,200	1,000	3,200	53,000
1992	14,300	9,300	600	2,700	26,900
1991	4,700	4,300	1,000	1,100	11,100
1990	Not Available Before 1990	Not Available Before 1990	Not Available Before 1990	Not Available Before 1990	Not Available Before 1990
1989					

Source: Fannie Mae
1/ notional balances or contract amounts
2/ Includes short-sales of Treasury securities

Freddie Mac Financial Data
Table 8

	Balance Sheet / MBS ($ in millions)				
	Total Assets	Retained Mortgage Portfolio Outstanding 1/	Debt Outstanding 2/	Total MBS Outstanding 3/	Multiclass MBS Outstanding
1Q98	226,571	185,928	192,868	462,765	214,330
4Q97	194,597	164,543	168,574	475,985	233,591
3Q97	184,275	157,263	159,538	470,015	236,517
2Q97	184,003	149,397	161,396	474,195	236,517
1Q97	174,442	144,672	153,124	473,405	246,723
Annual Data					
1997	194,597	164,543	168,574	475,985	233,591
1996	173,866	137,826	156,491	473,065	231,539
1995	137,181	107,706	119,328	459,045	246,969
1994	106,199	73,171	92,053	460,656	263,662
1993	83,880	55,938	48,510	439,029	264,122
1992	59,502	33,629	28,173	407,514	217,030
1991	46,860	26,667	28,300	359,163	142,960
1990	40,579	21,520	28,375	316,359	83,437
1989	35,462	21,448	24,102	272,870	47,573
1988	34,352	16,918	24,846	226,406	10,877
1987	25,674	12,354	17,461	212,635	Not Applicable Before 1988
1986	23,229	13,093	13,378	169,186	
1985	16,299	13,547	11,754	99,908	
1984	13,175	10,018	10,186	70,025	
1983	8,954	7,485	6,782	57,720	
1982	6,029	4,679	4,521	42,952	
1981	6,326	5,178	5,480	19,897	
1980	5,478	5,006	4,686	16,962	
1979	4,648	4,003	3,981	15,316	
1978	3,697	3,038	3,066	12,017	
1977	3,501	3,204	3,110	6,765	
1976	4,832	4,175	3,351	2,765	
1975	5,899	4,878	4,050	1,643	
1974	4,901	4,469	3,989	780	
1973	2,873	2,521	2,696	791	
1972	1,778	1,726	1,639	444	
1971	1,038	935	915	64	

Source: Freddie Mac

1/ Gross Retained Portfolio net of unamortized purchase premiums, discounts, and fees. Beginning 1/1/95, the data reflects adoption of SFAS 114. Data for prior periods have not been restated.

2/ Does not include subordinated borrowings.

3/ Excludes MBS held in portfolio.

Freddie Mac Financial Data
Table 9

	Capital			Earnings			
	Stockholders' Equity ($ in millions)	Equity / (Assets + MBS) (%)	(Equity + Loss Reserves) / (Assets + MBS) (%) 1/	Net Income 2/ ($ in millions)	Net Interest Margin (%) 2/ 3/ 4/ 5/	Average Guarantee Fee Rate (%) 3/	Return on Average Common Equity (%)
1Q98	8,204	1.19	1.29	393	1.05	0.224	24.2
4Q97	7,521	1.12	1.21	372	1.09	0.228	23.9
3Q97	7,148	1.09	1.19	354	1.08	0.229	23.7
2Q97	7,507	1.14	1.23	340	1.04	0.230	23.0
1Q97	6,811	1.05	1.15	329	1.08	0.230	22.7
Annual Data							
1997	7,521	1.12	1.21	1,395	1.07	0.229	23.1
1996	6,731	1.04	1.15	1,243	1.15	0.234	22.6
1995	5,863	0.98	1.10	1,091	1.23	0.238	22.1
1994	5,162	0.91	1.04	983	1.25	0.244	23.3
1993	4,437	0.85	0.99	786	1.02	0.238	22.3
1992	3,570	0.76	0.93	622	1.17	0.241	21.2
1991	2,566	0.63	0.81	555	1.66	0.237	23.6
1990	2,136	0.60	0.77	414	1.76	0.224	20.4
1989	1,916	0.62	0.77	437	1.62	0.234	25.0
1988	1,584	0.61	0.76	381	1.95	0.215	27.5
1987	1,182	0.50	0.64	301	1.50	0.242	28.2
1986	953	0.50	0.64	247	1.66	0.224	28.5
1985	779	0.67	0.86	208	2.31	0.221	30.0
1984	606	0.73	0.95	144	2.08	0.247	52.0
1983	421	0.63	0.85	160	1.83	0.262	44.5
1982	296	0.60	0.84	60	0.53	0.245	21.9
1981	250	0.95	1.30	31	0.63	0.195	13.1
1980	221	0.98	1.31	34	1.17	0.143	14.7
1979	238	1.19	1.49	36	1.45	0.132	16.2
1978	202	1.29	1.56	25	1.11	0.149	13.4
1977	177	1.72	2.02	21	0.77	0.189	12.4
1976	156	2.05	2.34	14	0.34	0.136	9.5
1975	142	1.88	2.24	16	0.58	0.248	11.6
1974	126	2.22	2.52	5	1.09	0.255	4.0
1973	121	3.30	3.71	12	1.35	0.324	9.9
1972	110	4.95	5.18	4	Not Available Before 1973	0.394	3.5
1971	107	9.71	Not Available Before 1972	6		Not Available Before 1972	5.5

Source: Freddie Mac

1/ Effective 1/1/95 reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

2/ Effective 1/1/96 Freddie Mac reports guarantee fees on retained MBS as guarantee fee income. Previously these fees were included in net interest income.
However, for comparability with Fannie Mae, guarantee fee income on retained MBS has been estimated and included in the net interest income.

3/ 1993 and 1992 pro forma, to reflect reporting change of uncollectible interest on Single Family mortgages implemented in 1 94.

4/ Average balances used in pre-1987 calculations based on the simple average of the year-end balance of the reported period and the prior year-end balance.
Subsequent calculations use average daily balances.

5/ Beginning with 1993 data, net interest margin is calculated on a taxable equivalent basis, excludes the effects of a REIT formed in

Freddie Mac Financial Data
Table 10

	Mortgage Asset Quality			
	Single-Family Delinquency Rate (%)	Multifamily Delinquency Rate (%) 1/	Charge-Offs / (Portfolio + MBS) (%) 2/	REO / (Portfolio + MBS) (%) 3/
1Q98	0.55	0.96	0.06	0.11
4Q97	0.55	0.96	0.07	0.11
3Q97	0.55	1.33	0.08	0.12
2Q97	0.55	1.71	0.09	0.12
1Q97	0.59	2.00	0.09	0.13
Annual Data				
1997	0.55	0.96	0.08	0.11
1996	0.58	1.96	0.10	0.13
1995	0.60	2.88	0.11	0.14
1994	0.55	3.79	0.08	0.18
1993	0.61	3.45	0.05	0.20
1992	0.64	4.45	0.06	0.17
1991	0.61	3.40	0.08	0.14
1990	0.45	2.63	0.08	0.12
1989	0.38	2.53	0.06	0.09
1988	0.36	2.24	0.06	0.09
1987	0.36	1.49	0.06	0.08
1986	0.42	1.07	0.04	0.07
1985	0.42	0.63	0.04	0.10
1984	0.46	0.42	0.02	0.15
1983	0.47	0.58	0.02	0.13
1982	0.54	1.04	0.01	0.12
1981	0.61	Not Available Before 1982		0.07
1980	0.44		0.04	0.04
1979	0.31		0.02	0.02
1978	0.21			0.02
1977	Not Available Before 1978			0.03
1976			0.03	0.04
1975			0.05	0.03
1974			0.70	0.02
1973			0.36	
1972			Not Available Before 1973	Not Available Before 1973
1971				

Source: Freddie Mac

1/ 1982-1987 Multifamily delinquencies were based on the number of loans delinquent 60 days or more. 1988-1994 Multifamily delinquencies based upon unpaid principal balances.

2/ Average balances for Portfolio and MBS used to calculate ratios subsequent to 1994; includes REO Expenses.

3/ REO balances reflect end-of-period amounts. Beginning 1Q95, data includes adoption of SFAS 114.

Freddie Mac Financial Data
Table 11

	Business Activity ($ in millions)							
	Purchases				MBS			
	Single-Family Mortgage Purchases	Multifamily Mortgage Purchases	Total Mortgage Purchases 1/	Mortgage Securities Purchased	Single-Family MBS Issued	Multifamily MBS Issued	Total MBS Issued	Multiclass MBS Issued
1Q98	47,445	296	47,741	30,229	44,268	0	44,268	26,559
4Q97	38,451	855	39,306	10,081	36,991	140	37,131	22,258
3Q97	28,000	435	28,435	10,363	26,670	0	26,670	22,290
2Q97	24,585	578	25,163	6,641	23,826	360	24,186	17,637
1Q97	24,124	373	24,497	8,300	26,271	0	26,271	22,181
Annual Data								
1997	115,160	2,241	117,401	35,385	113,758	500	114,258	84,366
1996	122,850	2,229	125,079	36,824	118,932	770	119,702	34,145
1995	89,971	1,565	91,536	39,384	85,522	355	85,877	15,372
1994	122,563	847	123,410	19,866	116,901	209	117,110	73,131
1993	229,051	191	229,242	Not Available Before 1994	208,724	0	208,724	143,336
1992	191,099	27	191,126		179,202	5	179,207	131,284
1991	99,729	236	99,965		92,479	0	92,479	72,032
1990	74,180	1,338	75,518		71,998	1,817	73,815	40,479
1989	76,765	1,824	78,589		72,931	587	73,518	39,754
1988	42,884	1,191	44,075		39,490	287	39,777	12,985
1987	74,824	2,016	76,840		72,866	2,152	75,018	Not Available Before 1988
1986	99,936	3,538	103,474		96,798	3,400	100,198	
1985	42,110	1,902	44,012		37,583	1,245	38,828	
1984	Not Available Before 1985	Not Available Before 1985	21,885		Not Available Before 1985	Not Available Before 1985	18,684	
1983			22,952				19,691	
1982			23,671				24,169	
1981			3,744				3,529	
1980			3,690				2,526	
1979			5,716				4,546	
1978			6,524				6,412	
1977			4,124				4,657	
1976			1,129				1,360	
1975			1,716				950	
1974			2,185				46	
1973			1,334				323	
1972			1,265				494	
1971			778				65	

Source: Freddie Mac

Freddie Mac Financial Data
Table 12

	Non-Mortgage Investments 1/ ($ in millions)					
	Federal Funds and Eurodollars	**Asset-backed Securities**	**Repurchase Agreements**	**Commercial Paper and Corporate Debt**	**Other**	**Total Non-Mortgage Investments**
1Q98	8,549	2,424	4,997	8,825	1,591	26,386
4Q97	3,003	2,199	6,982	3,160	1,523	16,867
3Q97	3,414	1,536	5,874	839	1,085	12,748
2Q97	9,584	1,810	7,848	1,133	2,041	22,416
1Q97	8,571	1,981	5,534	796	2,024	18,906
Annual Data						
1997	3,003	2,199	6,982	3,160	1,523	16,867
1996	10,183	2,084	6,440	1,077	2,740	22,524
1995	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	10,977
1994						23,264
1993						Not Available Before 1994
1992						
1991						
1990						

Source: Freddie Mac

1/ Excludes mortgage-related securities held for trading purposes

Freddie Mac Financial Data
Table 13

	Debt			
	Callable ($ in millions)	**Effective Long-Term ($ in millions) 2/**	**Callable %**	**Market share 1/ %**
1Q98	102,587	125,002	82%	42%
4Q97	96,414	118,293	82%	43%
3Q97	95,329	120,414	79%	39%
2Q97	88,057	114,352	77%	43%
1Q97	89,868	120,079	75%	42%
Annual Data				
1997	96,414	118,293	82%	42%
1996	83,640	113,376	74%	43%
1995	60,671	83,735	72%	42%
1994	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995	43%
1993				44%
1992				Not Available Before 1993
1991				
1990				

Source: Freddie Mac
1/ Freddie Mac share of combined enterprise purchases
2/ Included the effect of off-balance sheet transactions that convert short funding to long-term.

Freddie Mac Financial Data
Table 14

	Derivative Financial Instruments1/ ($ in millions)						
	Interest-Rate Swaps	**Interest-Rate caps, floors, corridors**	**Spread-lock Agreements 2/**	**Options**	**Foreign Currency**	**Futures**	**Total Outstandings**
1Q98	50,867	24,510	4,071	17,400	1,112	30,000	127,960
4Q97	54,172	21,995	12,228	6,000	1,152	0	95,547
3Q97	53,381	19,773	12,625	0	1,424	0	87,203
2Q97	51,909	15,285	11,590	0	1,281	0	80,065
1Q97	48,883	14,283	6,445	0	807	0	70,418
Annual Data							
1997	54,172	21,995	12,228	6,000	1,152	0	95,547
1996	46,646	14,095	651	0	544	0	61,936
1995	45,384	13,055	24	0	0	0	58,463
1994	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995
1993							
1992							
1991							

Source: Freddie Mac

1/ Notional balances or contractual amounts at period end

2/ Included options prior to 4Q97

Aggregate Financial Data
Table 15

	Balance Sheet/ MBS ($ in millions)				
	Total Assets	Retained Mortgage Portfolio Outstanding	Debt Outstanding	Total MBS Outstanding	Multiclass MBS Outstanding
1Q98	630,564	513,099	573,961	1,056,068	611,446
4Q97	586,270	481,135	538,348	1,055,123	621,951
3Q97	563,500	464,300	517,541	1,035,712	614,993
2Q97	550,000	446,470	506,858	1,032,276	600,017
1Q97	531,452	436,385	489,298	1,027,514	598,514
Annual Data					
1997	586,270	481,135	538,348	1,055,123	621,951
1996	524,907	424,353	487,761	1,021,238	571,337
1995	453,731	360,574	418,502	972,275	600,497
1994	378,707	293,986	349,283	947,001	642,395
1993	300,859	246,107	249,622	910,335	645,987
1992	240,480	189,889	194,473	831,958	529,399
1991	193,932	153,346	162,237	714,447	367,766
1990	173,692	135,586	151,778	604,434	210,715
1989	159,777	129,429	140,166	489,382	112,399
1988	146,610	117,017	130,305	396,503	37,537
1987	129,133	106,019	114,518	348,369	11,359
1986	122,850	107,216	106,941	264,754	Not Applicable Before 1987
1985	115,375	108,156	105,739	154,460	
1984	100,973	94,153	93,905	105,763	
1983	87,337	82,732	81,376	82,841	
1982	79,010	74,035	74,135	57,402	
1981	67,904	64,807	64,031	20,614	
1980	63,357	60,595	59,566	16,962	
1979	55,948	53,780	52,405	15,316	
1978	47,203	45,141	44,051	12,017	
1977	37,481	36,456	35,000	6,765	
1976	37,225	35,950	33,916	2,765	
1975	37,495	35,698	34,013	1,643	
1974	34,572	33,135	32,157	780	
1973	27,191	26,110	25,699	791	
1972	22,124	21,378	20,878	444	
1971	19,629	18,821	18,587	64	

Aggregate Financial Data
Table 16

	Capital			
	Stockholders' Equity ($ in millions)	Equity / (Assets + MBS) (%)	(Equity + Loss Reserves) / (Assets + MBS) (%)	Net Earnings ($ in millions)
1Q98	22,275	1.32	1.41	1,217
4Q97	21,314	1.30	1.39	1,166
3Q97	20,506	1.28	1.38	1,129
2Q97	20,771	1.31	1.41	1,093
1Q97	19,989	1.28	1.37	1,063
		Annual Data		
1997	21,314	1.30	1.39	4,451
1996	19,504	1.26	1.36	3,968
1995	16,822	1.18	1.28	3,235
1994	14,703	1.11	1.23	3,115
1993	12,489	1.03	1.16	2,659
1992	10,344	0.96	1.11	2,245
1991	8,113	0.89	1.05	1,918
1990	6,077	0.78	0.93	1,587
1989	4,907	0.76	0.90	1,244
1988	3,844	0.71	0.85	888
1987	2,993	0.63	0.77	677
1986	2,135	0.55	0.69	352
1985	1,788	0.66	0.80	201
1984	1,524	0.74	0.89	73
1983	1,421	0.84	1.00	209
1982	1,249	0.92	1.10	(132)
1981	1,330	1.50	1.72	(175)
1980	1,678	2.09	2.33	48
1979	1,739	2.44	2.70	198
1978	1,564	2.64	2.88	234
1977	1,350	3.05	3.28	186
1976	1,139	2.85	3.03	141
1975	1,003	2.56	2.72	131
1974	898	2.54	2.66	112
1973	801	2.86	2.98	138
1972	669	2.96	3.02	100
1971	567	2.88	Not Available	67

Aggregate Financial Data
Table 17

	Business Activity ($ in millions)							
	Purchases				MBS			
	Single-Family Mortgage Purchases	Multifamily Mortgage Purchases	Total Mortgage Purchases	Mortgage Securities Purchased	Single-Family MBS Issued	Multifamily MBS Issued	Total MBS Issued	Multiclass MBS Issued
1Q98	113,515	2,007	115,522	49,079	101,052	1,475	102,527	48,941
4Q97	90,825	3,026	93,851	25,413	82,530	2,001	84,531	48,283
3Q97	72,065	2,223	74,288	25,779	65,728	1,644	67,372	41,752
2Q97	58,350	1,945	60,295	16,380	53,090	1,542	54,632	38,006
1Q97	58,354	1,659	60,013	16,661	56,025	1,127	57,152	41,740
Annual Data								
1997	279,594	8,853	288,447	84,233	257,373	6,314	263,687	169,781
1996	289,815	9,171	298,986	81,840	263,133	6,438	269,571	64,925
1995	217,959	6,595	224,554	73,420	191,791	4,542	196,333	25,053
1994	287,182	4,687	291,869	44,418	245,286	2,446	247,732	146,496
1993	532,122	4,326	536,448	Not Available Before 1994	429,209	959	430,168	353,966
1992	453,154	2,983	456,137		372,389	855	373,244	301,489
1991	244,246	3,440	247,686		203,967	1,415	205,382	184,840
1990	190,676	4,519	195,195		168,004	2,506	170,510	108,770
1989	164,211	6,660	170,871		139,420	3,862	143,282	81,469
1988	116,692	5,371	122,063		90,610	4,045	94,655	29,990
1987	157,101	3,499	160,600		134,933	3,314	138,247	Not Available Before 1988
1986	189,451	5,415	194,866		156,815	3,949	160,764	
1985	86,069	3,102	89,171		60,725	1,752	62,477	
1984	Not Available Before 1985	Not Available Before 1985	52,152		Not Available Before 1985	Not Available Before 1985	32,230	
1983			53,849				33,031	
1982			52,757				38,139	
1981			10,574				4,246	
1980			11,791				2,526	
1979			16,523				4,546	
1978			18,829				6,412	
1977			8,908				4,657	
1976			4,761				1,360	
1975			6,036				950	
1974			9,204				46	
1973			7,586				323	
1972			5,129				494	

Aggregate Financial Data
Table 18

	Non-Mortgage Investments ($ in millions)					
	Federal Funds and Eurodollars	Asset-backed Securities	Repurchase Agreements	Commercial Paper and Corporate Debt	Other	Total Non-Mortgage Investments
1Q98	25,488	19,256	11,500	20,713	16,636	93,593
4Q97	22,215	18,838	13,697	14,905	11,808	81,463
3Q97	24,320	13,371	12,485	8,696	17,229	76,101
2Q97	32,755	14,017	13,062	7,752	14,113	81,699
1Q97	30,105	14,149	9,403	7,037	15,329	76,023
Annual Data						
1997	22,215	18,838	13,697	14,905	11,808	81,463
1996	31,917	16,719	11,107	7,268	12,119	79,130
1995	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996	Not Available Before 1996
1994						
1993						
1992						

Aggregate Financial Data
Table 19

	Debt		
	Callable ($ in millions)	Effective Long-Term ($ in millions)	Callable %
1Q98	242,535	429,068	57%
4Q97	232,690	411,929	56%
3Q97	229,211	404,454	57%
2Q97	219,386	387,457	57%
1Q97	220,086	391,171	56%
Annual Data			
1997	232,690	411,929	56%
1996	210,458	380,192	55%
1995	166,750	304,911	55%
1994	Not Available Before 1995	Not Available Before 1995	Not Available Before 1995
1993			

Mortgage Interest Rates
Table 20

	Average Commitment Rates on Loans		Effective Rates on Closed Loans	
	Conventional		Conventional	
	30 Year Fixed Rate (%)	One Year ARMs (%)	Fixed Rate (%)	Adjustable Rate (%)
IQ98	7.1	5.6	7.3	6.6
4Q97	7.2	5.5	7.6	6.7
3Q97	7.5	5.6	7.9	6.8
2Q97	7.9	5.8	8.2	7.1
1Q97	7.8	5.6	8.0	7.0
Annual Data				
1997	7.6	5.6	7.9	6.9
1996	7.8	5.7	8.0	7.0
1995	7.9	6.1	8.2	7.1
1994	8.4	5.3	8.2	6.4
1993	7.3	4.6	7.5	5.7
1992	8.4	5.6	8.5	6.6
1991	9.2	7.1	9.7	8.3
1990	10.1	8.4	10.4	9.2
1989	10.3	8.8	10.5	9.4
1988	10.3	7.9	10.4	8.5
1987	10.2	7.8	9.9	8.5
1986	10.2	8.4	10.5	9.4
1985	12.4	10.0	12.4	10.9
1984	13.9	11.5	13.2	12.1
1983	13.2	Not Available Before 1984	13.0	12.3
1982	16.1		15.2	15.4
1981	16.6		Not Available Before 1982	Not Available Before 1982
1980	13.8			
1979	11.2			
1978	9.6			
1977	8.8			
1976	8.9			
1975	9.0			
1974	9.2			
1973	8.0			
1972	7.4			

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

Housing Market Activity
Table 21

	Housing Starts (units in thousands)			Home Sales (units in thousands)	
	Single-Family Housing Starts	**Multifamily Housing Starts**	**Total Housing Starts**	**New Single-Family Home Sales**	**Existing Single-Family Homes Sales**
IQ98	1298	292	1590	849	4687
4Q97	1197	329	1526	828	4380
3Q97	1182	274	1456	809	4267
2Q97	1147	293	1440	777	4153
1Q97	1211	258	1469	824	4013
Annual Data					
1997	1179	296	1474	803	4215
1996	1206	271	1477	757	4087
1995	1110	244	1354	667	3802
1994	1234	224	1457	670	3946
1993	1155	133	1288	666	3802
1992	1061	139	1200	610	3520
1991	876	138	1014	509	3220
1990	932	260	1193	534	3211
1989	1059	318	1376	650	3346
1988	1140	348	1488	676	3594
1987	1212	409	1621	671	3526
1986	1263	542	1805	750	3565
1985	1166	576	1742	688	3214
1984	1206	544	1750	639	2868
1983	1181	522	1703	623	2719
1982	743	320	1062	412	1990
1981	796	288	1084	436	2419
1980	962	331	1292	545	2973
1979	1316	429	1745	709	3827
1978	1558	462	2020	817	3986
1977	1573	414	1987	819	3650
1976	1248	289	1538	646	3064
1975	956	204	1160	549	2476
1974	956	382	1338	519	2272
1973	1250	795	2045	634	2334
1972	1451	906	2357	718	2252
1971	1271	781	2052	656	2019

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

Weighted Repeat Sales House Price Index

(Annual Data)

Table 22

% Change	USA	New England	Mid-Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific
1Q98	4.8	5.5	3.9	4.9	4.2	4.4	4.5	4.8	4.6	6.9
4Q97	5.0	5.6	3.3	4.9	5.5	5.0	5.4	3.8	5.6	6.1
3Q97	4.9	5.3	3.1	4.6	5.6	5.2	5.3	3.8	6.1	5.8
2Q97	3.6	3.6	1.2	3.3	5.6	4.5	4.2	2.4	5.0	3.4
1Q97	3.2	1.8	0.4	3.0	6.2	4.7	4.6	2.2	5.0	1.7
1996	3.3	1.9	0.8	2.9	6.0	4.8	4.8	2.8	5.5	1.7
1995	5.1	4.8	3.7	5.1	6.1	5.4	6.0	4.8	8.1	3.8
1994	1.3	-2.8	-2.8	0.6	6.0	6.2	5.2	1.6	9.9	-3.3
1993	2.3	0.7	1.6	2.2	3.7	4.0	4.2	4.2	8.5	-1.6
1992	1.9	-1.0	1.7	2.2	3.9	3.0	3.5	3.5	5.4	-1.1
1991	2.7	-1.9	1.6	3.2	4.5	3.8	4.1	3.7	4.8	1.6
1990	0.4	-7.3	-2.3	0.4	3.8	0.7	0.7	0.7	2.0	2.9
1989	6.2	1.1	2.6	5.3	6.1	3.3	3.4	2.9	2.6	19.5
1988	6.4	4.2	6.3	7.2	6.7	2.7	2.8	-2.0	0.7	17.1
1987	7.8	12.9	17.5	7.9	8.7	4.1	5.4	-8.0	-0.8	10.0
1986	9.9	20.9	19.9	8.9	8.4	6.0	9.0	0.9	4.5	7.5
1985	6.5	24.1	12.6	6.0	4.4	3.2	11.7	-2.4	0.5	4.6
1984	4.0	18.2	12.4	0.6	2.7	4.9	-3.4	-0.9	1.1	4.5
1983	3.9	15.3	10.4	4.3	3.0	3.7	4.6	-0.1	-2.8	0.9
1982	2.6	5.6	3.9	4.6	-3.0	-0.3	5.1	6.0	6.8	0.8
1981	3.8	4.4	0.2	4.3	0.6	0.0	-0.5	11.6	6.2	6.5
1980	5.7	5.8	7.1	6.9	0.9	3.0	1.7	7.0	6.2	11.5
1979	12.2	9.4	14.1	13.2	9.8	9.1	6.9	12.8	15.6	16.8
1978	12.7	13.5	8.1	8.8	14.3	13.2	9.0	17.4	15.8	16.5
1977	12.6	9.2	9.3	9.3	12.9	12.1	9.3	10.1	18.8	25.5
1976	8.2	3.1	6.4	3.8	7.7	6.1	9.7	9.5	10.8	20.4

All data is measured based on percentage change over the previous 4 quarters. Data from 1976-1996 is measured based on fourth quarter to fourth quarter percentage change.

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

APPENDIX

Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of Public Law 102-550)

Office of Federal Housing Enterprise Oversight

OFHEO Senior Officials

Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title 13 of Public Law 102-550)

Section 1313. DUTY AND AUTHORITY OF DIRECTOR.

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

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

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

(2) examinations of the enterprises under section 1317;

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

(4) decisions to appoint conservators for the enterprises;

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

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

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

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

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

(10) conducting research and financial analysis;

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

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

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

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

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

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

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

Fannie Mae and Freddie Mac are the nation's largest housing finance institutions. They buy mortgages from commercial banks, thrift institutions, mortgage banks, and other primary lenders, and either hold these mortgages in their own portfolios or package them into mortgage-backed securities for resale to investors. These secondary mortgage market operations play a major role in creating a ready supply of mortgage funds for American homebuyers. Combined assets and off-balance sheet obligations of Fannie Mae and Freddie Mac were $1.6 trillion at the end of 1997.

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

OFHEO's oversight responsibility includes:

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

OFHEO is funded through assessments of Fannie Mae and Freddie Mac. OFHEO's operations represent no direct cost to the taxpayer. OFHEO's 1998 budget of $16 million supports a full time staff of 72.

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

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

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