Office of Federal Housing Enterprise Oversight (OFHEO)

NEWS RELEASE

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OFHEO ANNOUNCES SECOND QUARTER 2007 MINIMUM AND RISK-BASED CAPITAL CLASSIFICATION FOR FANNIE MAE and FREDDIE MAC

Reaffirms Fannie Mae Q1-4 2006 as Adequately Capitalized

WASHINGTON, DC — James B. Lockhart, Director of the Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie Mae and Freddie Mac, classified Fannie Mae and Freddie Mac as adequately capitalized as of June 30, 2007. Fannie Mae's classification is based on estimated numbers submitted by Fannie Mae and not financial statements released to shareholders. Freddie Mac's classification is based on numbers consistent with their Second Quarter Financial Statements and Information Statement released on August 30, 2007.

Fannie Mae had a 7.5 percent surplus above the OFHEO-directed requirement, which is 30 percent above the required minimum capital. Freddie Mac's surplus above the OFHEO-directed requirement was 5.1 percent. Both Enterprises' percentages reflect declines from the prior quarter, primarily due to higher capital requirements caused by asset growth.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the OFHEO Director to determine the capital level and classification of the Enterprises not less than quarterly, and to report the results to Congress. OFHEO classifies the Enterprises as adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. The Enterprises are required by federal statute to meet both minimum and risk-based capital standards to be classified as adequately capitalized.

Fannie Mae

Fannie Mae's second quarter 2007 classification of adequately capitalized remains subject to change as the company continues its ongoing accounting review and issuance of public financial statements. Fannie Mae's quarterly numbers carry forward its 2004, 2005 and 2006 accounting adjustments, and incorporate ongoing estimates of additional accounting changes for year-to-date 2007. This process of including ongoing adjustments in disclosures, coupled with ongoing supervisory activities, provides OFHEO additional assurance that the company is maintaining a capital surplus in excess of the OFHEO-directed requirement.

Fannie Mae's surplus as a percent of the OFHEO-directed requirement decreased significantly to 7.5 percent from 10.2 percent the prior quarter. The decline is due mainly to growth in MBS outstanding and the retained portfolio growth, which resulted in the increased capital requirement. Fannie Mae continues to operate under growth restrictions for its retained portfolio and has maintained compliance with this agreement throughout the quarter. There are no restrictions on its issuance of guaranteed MBS.

Fannie Mae resubmitted capital reports to OFHEO following Fannie Mae's public disclosure of 2006 financial results and its 2006 Annual Report on August 16, 2007. After analysis of these results, Director Lockhart is reaffirming the previous capital classification of adequately capitalized for all four quarters of 2006. All capital data for these historical quarters can be found in historical charts at www.fhfa.gov/Default.aspx?Page=150 (Risk-Based) and www.fhfa.gov/Default.aspx?Page=147 (minimum).

Although progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the second quarter 2007, the company's remediation process is not finished, a number of safety and soundness issues are not yet resolved, and the company is not yet a current and timely financial filer.

OFHEO continues to support Fannie Mae's current practice of managing the surplus above the OFHEO-directed requirement to compensate for its internal control and operational weaknesses, and to account for the sensitivity of the capital surplus to potential market valuation losses arising from changes in interest rates, market volatility, and credit loss expectations.

Freddie Mac

Freddie Mac's second quarter 2007 classification of adequately capitalized is based upon results consistent with its August 30, 2007 Information Statement Supplement.

Freddie Mac's surplus as a percent of the OFHEO-directed requirement decreased to 5.1 percent from 5.9 percent the prior quarter due primarily to growth in guaranteed MBS. Freddie Mac has agreed to growth restrictions on its retained portfolio as of July 1, 2006 and remains in compliance with these restrictions. There are no restrictions on its issuance of guaranteed MBS.

Although the filing of the Second Quarter 2007 Financial Statements and Information Statement Supplement continues to demonstrate progress for Freddie Mac in returning to timely and accurate financial reporting, internal control and operational weaknesses remain evident. Significant work remains before Freddie Mac becomes a timely filer and SEC registrant.

OFHEO continues to support Freddie Mac's current practice of managing the surplus above the OFHEO-directed requirement to compensate for its internal control and operational weaknesses, and to account for the sensitivity of the capital surplus to potential market valuation losses arising from changes in interest rates, market volatility, and credit loss expectations.

SECOND QUARTER CAPITAL RESULTS

Minimum and Critical Capital

Fannie Mae's adjusted[1] OFHEO-directed capital requirement on June 30, 2007 was $39.4 billion and its adjusted statutory minimum capital requirement was $30.3 billion. Fannie Mae's adjusted core capital of $42.4 billion exceeded the adjusted OFHEO-directed capital requirement by $3.0 billion. Fannie Mae's adjusted core capital exceeded the adjusted statutory critical capital requirement by $26.7 billion.

Freddie Mac's reported OFHEO-directed capital requirement on June 30, 2007 was $34.6 billion and its reported statutory minimum capital requirement was $26.6 billion. Freddie Mac's reported core capital of $36.3 billion exceeded the OFHEO-directed minimum capital requirement by $1.8 billion. Freddie Mac's core capital exceeded the statutory critical capital requirement by $22.7 billion.

Enterprise Minimum Capital Requirement
(Billions of Dollars) [a]

Fa	nnie Mae		Freddie Mac	
	30-Jun-07 [b,c,d]	31-Mar-07 [b,c,d]	30-Jun-07 [c]	31-Mar-07 [c]
Minimum Capital - Statutory Requirement	30.320	29.524	26.580	26.304
Minimum Capital - OFHEO Directed Requirement	39.416	38.381	34.555	34.196
Core Capital	42.375	42.277	36.334	36.230
Surplus (Deficit) (based on OFHEO Directed Requirement)	2.959	3.896	1.779	2.034
Surplus as a Percent of OFHEO Directed Requirement	7.5%	10.2%	5.1%	5.9%

Enterprise Critical Capital Requirement
(Billions of Dollars) [a]

Fa	nnie Mae		Freddie Mac	
	30-Jun-07 [b,d]	31-Mar-07 [b,d]	30-Jun-07	31-Mar-07
Critical Capital Level	15.665	15.247	13.637	13.484
Core Capital	42.375	42.277	36.334	36.230
Surplus (Deficit)	26.710	27.030	22.697	22.746

a. Numbers may not add due to rounding.
b. Subject to revision based upon results of ongoing financial restatement and audit processes.
c. OFHEO has directed both Fannie Mae and Freddie Mac to maintain an additional 30% capital in excess of the statutory minimum capital requirement. These requirements have been an additional requirement since January 28, 2004, for Freddie Mac and since September 30, 2005, for Fannie Mae. The OFHEO-directed minimum capital requirement and capital surplus numbers stated in these charts reflect the inclusion of the additional 30% OFHEO-directed capital requirement.
d. Fannie Mae's minimum capital, critical capital, and core capital are adjusted for accounting errors identified to date.

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1 The term "adjusted" reflects that Fannie Mae's minimum capital submissions adjust book capital based upon estimated accounting change impacts, including the roll-forward of 2004-2006 adjustments.

During the second quarter of 2007, Fannie Mae's minimum capital surplus over the OFHEO-directed minimum capital requirement decreased by $0.9 billion to $3.0 billion, approximately 7.5 percent over the OFHEO-directed minimum capital requirement of $39.4 billion. The OFHEO-directed minimum requirement rose $1.0 billion primarily due to growth in the retained portfolio and MBS outstanding. Core capital was $42.4 billion for the quarter ended June 30, 2007, an increase of $0.1 billion, as Fannie Mae redeemed $0.4 billion in preferred stock and retained earnings increased $0.5 billion[2] since OFHEO's prior reported results.

Freddie Mac's surplus over the OFHEO-directed minimum capital requirement decreased $0.3 billion to $1.8 billion, approximately 5.1 percent over the OFHEO-directed minimum capital requirement of $34.6 billion. The OFHEO-directed minimum capital requirement increased $0.4 billion due to growth in MBS outstanding. For the quarter ended June 30, 2007, core capital was $36.3 billion. The $0.1 billion increase in core capital from first quarter levels, included a preferred stock issuance of $0.5 billion, purchases of treasury stock of approximately $0.7 billion, and an increase in retained earnings of $0.3 billion. The increase in retained earnings was the result of net income of $0.8 billion less dividends of $0.5 billion.

Changes in critical capital mirrored changes in minimum capital for both Enterprises.

Risk-Based Capital

As of June 30, 2007, Fannie Mae's risk-based capital requirement was $10.2 billion. Fannie Mae's total capital of $43.6 billion on that date exceeded the requirement by $33.4 billion.

As of June 30, 2007, Freddie Mac's risk-based capital requirement was $18.9 billion. Freddie Mac's total capital of $37.1 billion on that date exceeded the requirement by $18.2 billion.

Enterprise Risk-Based Capital Requirement
(Billions of Dollars) [a]

	Fannie Mae [b]				Freddie Mac			
	30-Jun-07		31-Mar-07		30-Jun-07		31-Mar-07	
Interest Rate Scenario	Up	Down	Up	Down	Up	Down	Up	Down
Risk Based Capital Requirement	4.847	10.225	20.536	14.630	7.956	18.944	13.784	9.742
Total Capital [c]		43.578	42.627			37.141	36.765	
Surplus (Deficit)		33.354	22.092			18.197	22.981	

a. Numbers may not add due to rounding.
b. Subject to revision based upon results of ongoing financial restatement and audit processes.
c. The total capital number does not reconcile to the core capital submissions, because only the latter includes the impact of accounting adjustments made during the month of September.

By statute, stress test interest rate levels are a function of the average 10-year Constant Maturity Treasury (CMT) over the most recent nine months. The nine-month average of the 10-year CMT remained relatively constant from the prior quarter. As a result, 10-year CMT levels at the end of the first year in the risk-based capital stress test remained approximately the same at 8.26 percent in the up-rate stress test versus 8.29 percent in the first quarter, and 2.36 percent in the down-rate stress test versus 2.37 percent in the first quarter.

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[2] Net impact of retained earnings was $0.5 billion which includes a $0.3 billion decrease in retained earnings from 2006 as reflected in the 2006 Form 10-K Fannie Mae filed with the SEC on August 16, 2007.

Spot rates in 10-year CMT and 10-year interest rate swaps widened over the quarter with most of the widening occurring in May. Expected prepayment speeds decreased and the duration of fixed-rate mortgage assets increased during the quarter. Fannie Mae and Freddie Mac were able to maintain an equal duration exposure in its assets and liabilities.

Overall, Fannie Mae's rebalancing actions decreased its interest rate exposure in both the up-rate and down-rate scenarios. The binding scenario changed to the down-rate stress test in the second quarter of 2007. Fannie Mae's risk-based capital requirement in the down-rate stress test decreased to $10.2 billion, a $4.4 billion decrease from the first quarter. The risk-based capital requirement in the up-rate stress test decreased to $4.8 billion, a $15.7 billion decrease from the first quarter. Fannie Mae's risk-based capital surplus increased from $22.1 billion to $33.4 billion.

Freddie Mac's risk-based capital requirements were $18.9 billion in the down-rate stress test and $8.0 billion in the up-rate stress test or $9.2 billion higher and $5.8 billion lower than the first quarter, respectively. During the quarter, Freddie Mac's risk-based capital surplus decreased from $23.0 billion to $18.2 billion. Rebalancing actions increased exposure in the down-rate scenario and reduced exposure in the up-rate. In additon, Freddie Mac made opportunistic purchases as Option Adjusted Spreads (OAS) widened, which will settle in the third quarter and are not considered in the stress test; however, the Enterprise hedged its positions immediately through its funding and derivative portfolio. Similar to Fannie Mae, Freddie Mac's binding scenario changed to the down-rate stress test.

QUALIFICATIONS AND COMPLIANCE

Fannie Mae's capital classification is based upon Fannie Mae's best estimates of its financial condition, as certified and represented as true and correct to the best of Fannie Mae management's belief and knowledge. The second quarter 2007 capital classification remains subject to revision pending Fannie Mae's submission of audited financial statements and corresponding regulatory capital reports.

Fannie Mae remains subject to the requirements imposed by the Consent Order dated May 23, 2006 and the Capital Restoration Plan approved February 17, 2005. The Capital Restoration Plan required Fannie Mae to achieve a 30 percent capital surplus over the minimum capital requirement by September 30, 2005 (OFHEO-directed capital requirement) and maintain it thereafter. Fannie Mae met the initial September 30, 2005 achievement of 30 percent surplus and it has continued to maintain the surplus through the second quarter 2007.

Freddie Mac's capital classification is based upon its financial condition, as certified and represented as true and correct by Freddie Mac's management, and consistent with the publicly disclosed Information Statement Supplement issued on August 30, 2007. OFHEO imposed a capital surcharge of 30 percent of the minimum capital requirement for Freddie Mac in January 2004 due to increased operational risk. Freddie Mac has continued to maintain its minimum capital surplus in excess of the OFHEO-directed capital requirement through the second quarter 2007.

SECOND QUARTER QUALIFYING SUBORDINATED DEBT RESULTS

Additionally, OFHEO is releasing qualifying subordinated debt positions of Fannie Mae and Freddie Mac in accordance with the September 1, 2005 Agreements between OFHEO and the Enterprises. (See 9/2/05 release at http://www.fhfa.gov/webfiles/2098/9205SubDebtDiscAgreements.pdf)

Fannie Mae's total capital and qualifying subordinated debt for the second quarter 2007 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Freddie Mac's total capital and qualifying subordinated debt for the second quarter 2007 exceeded the requirements outlined in the Agreement dated September 1, 2005.

Enterprise Qualifying Subordinated Debt Disclosure
(Billions of Dollars) [(a)]

	Fannie Mae		Freddie Mac	
	30-Jun-07	**31-Mar-07**	**30-Jun-07**	**31-Mar-07**
Total Capital & Qualifying Subordinated Debt	50.405	50.172	41.767	41.383
Capital Requirement at 4% for On-Balance Sheet Assets and at 0.45% for Net MBS / PCs Outstanding	42.928	41.940	38.452	38.093
Surplus (Deficit)	7.477	8.232	3.315	3.290

Footnote:

a. Qualifying Subordinated Debt is defined as subordinated debt that contains the interest deferral feature. The interest deferral requires the deferral of interest payments for up to 5 years if:
1) The corporation's core capital falls below 125% of critical capital, or
2) The corporation's core capital falls below minimum capital AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

DEFINITION OF CAPITAL STANDARDS

Core Capital is the sum of outstanding common stock, perpetual, noncumulative preferred stock, paid-in capital, and retained earnings. Core capital does not include Accumulated Other Comprehensive Income (AOCI), which is captured as part of stockholder's equity.

Total Capital is the sum of Core Capital plus the allowance for loan losses.

Minimum capital represents an essential amount of capital needed to protect an Enterprise against broad categories of business risk. For purposes of minimum capital, an Enterprise is considered by law adequately capitalized if core capital — common stock; perpetual noncumulative preferred stock; paid in capital; and retained earnings — equals or exceeds minimum capital. The minimum capital standard is 2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations, including guaranteed mortgage securities.

The OFHEO-directed capital requirement is the amount of capital the Enterprise needs to maintain to compensate for increased operational risks including systems, accounting, and internal control risks. The level is prescribed by the Director of OFHEO. At this time, both Enterprises are required to hold 30 percent over the statutory minimum capital requirement. This is calculated by multiplying the minimum capital requirement by 1.3 times.

OFHEO's risk-based capital requirement is the amount of total capital — core capital plus a general allowance for loan losses less specific reserves — that an Enterprise must hold to absorb projected losses flowing from future adverse interest-rate and credit-risk conditions specified by statute, plus 30 percent mandated by statute to cover management and operations risk. The risk-based capital standard is based on stress test results calculated for the two statutorily prescribed interest rate scenarios, one in which 10-year Treasury yields rise 75 percent (up-rate scenario) and another in which they fall 50 percent (down-rate scenario). Changes in both scenarios are generally capped at 600 basis points. The risk-based capital level for an Enterprise is the amount of total capital that would enable it to survive the stress test in whichever scenario is more adverse for that Enterprise, plus 30 percent of that amount to cover management and operations risk.

The **critical capital** level is the amount of core capital below which an Enterprise must be classified as critically undercapitalized and generally must be placed in conservatorship. Critical capital levels are computed consistent with the Federal Housing Enterprises Safety and Soundness Act of 1992 as follows: One-half of the portion of minimum capital requirement associated with on-balance-sheet assets plus five-ninths of the portion of the minimum capital requirement associated with off-balance-sheet obligations.

QUALIFYING SUBORDINATED DEBT

Qualifying subordinated debt is defined as subordinated debt that contains the interest deferral feature described below:

The interest deferral requires the deferral of interest payments for up to 5 years if:

- The corporation's core capital falls below 125 percent of critical capital, or
- The corporation's core capital falls below minimum AND, pursuant to the corporation's request, the Secretary of the Treasury exercises discretionary authority to purchase the company's obligations under Section 306(c) of the Freddie Mac Charter Act and Section 304(c) of the Fannie Mae Charter Act.

The September 1, 2005 agreement requires that:

Subordinated debt will be issued in a quantity such that the sum of total capital (core capital plus general allowance for losses) plus the outstanding balance of qualified subordinated debt will equal or exceed the sum of outstanding net MBS times 0.45 percent and total on-balance sheet assets times 4 percent.

Technical questions regarding these results should be directed to: rbcquestions@ofheo.gov.

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OFHEO's mission is to promote housing and a strong national finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.