Performance and Accountability Report

2008

Federal Housing Finance Agency Mission

Promote a stable and liquid mortgage market, affordable housing and community investment through safety and soundness oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

Federal Housing Finance Agency

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TABLE OF CONTENTS

TABLE OF CONTENTS, continued

Office of Federal Housing Enterprise Oversight (OFHEO) Performance and Accountability Report

Message from the FHFA Director

On behalf of the Federal Housing Finance Agency's dedicated employees, I am pleased to present this combined report on the progress and accomplishments for fiscal year (FY)2008 of the Federal Housing Finance Agency (FHFA), the Federal Housing Finance Board (FHFB) and the Office of Federal Housing Enterprise Oversight (OFHEO). This was a landmark year. FHFA was created to combine FHFB, OFHEO and the Department of Housing and Urban Development's (HUD's) mission group as a single regulator for Fannie Mae, Freddie Mac, the 12 Federal Home Loan Banks (FHLBanks), and the Office of Finance (OF). The signing of the Housing and Economic Recovery Act of 2008 (HERA) by President Bush on July 30, 2008, achieved one of OFHEO's three strategic goals. Although this bill addresses the major flaws in OFHEO's regulatory regime, it came too late to mitigate the impact of growing housing market turmoil on the safety, soundness and mission of Fannie Mae and Freddie Mac (the Enterprises). This report comes at a time of great uncertainty in the U.S. housing and financial markets, further underscoring the importance of FHFA's mission.

Mission and Goals of FHFA

FHFA's mission is to promote a stable and liquid mortgage market, affordable housing and community investment through safety and soundness oversight of Fannie Mae, Freddie Mac, the FHLBanks and the Office of Finance. As of September 2008, the combined debt and obligations of these 14 housing-related government sponsored enterprises (GSEs) totaled $6.8 trillion, exceeding the total publicly held debt of the United States by $1.0 trillion. The GSEs also purchased or guaranteed 86.9 percent of new mortgages for the quarter ending June 30, 2008. Due to their large impact on the housing finance market, FHFA's coordinated oversight of the GSEs should lead to innovation and cooperation among them to provide liquidity and stability to the mortgage market. FHFA achieves this mission by focusing on three main goals:

1. Enhance supervision to ensure that Fannie Mae, Freddie Mac and the Federal Home Loan Banks operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.

2. Promote homeownership and affordable housing and support an efficient secondary mortgage market.

3. Conserve the assets and property of Fannie Mae and Freddie Mac and enhance their ability to fulfill their mission during the conservatorship period.

Uncertainty and instability in the mortgage markets have captured the attention of the nation and the world in the past year. Problems with foreclosures and credit availability have been especially troublesome for many current and potential future homeowners. In this turbulent environment, FHFA's mission is even more critical. Despite all the problems, Fannie Mae and Freddie Mac did provide strong support to the conventional conforming mortgage market. They guaranteed or purchased more than $1.3 trillion in mortgages in the 12 months ending August 2008, up from $1.2 trillion in the 12 months ending August 2007.

The New Federal Housing Finance Agency

FHFA was created on July 30, 2008, through HERA to reform the oversight of all the housing-related GSEs—Fannie Mae, Freddie Mac, the 12 FHLBanks and the Office of Finance—by creating a single regulator with bank regulator-like powers and authorities to ensure their safety and soundness. In addition, the new FHFA was given responsibility for the affordable housing missions of these GSEs, combining the staff and resources from FHFB, OFHEO and HUD's GSE mission staff. The legislation calls for the wind-down and abolishment of FHFB and OFHEO within one year, as the FHFA "stands up." This reform was many years in the making and critically needed. I would like to thank the FHFB Board of Directors for their leadership during the first 10 months of the fiscal year and their assistance and cooperation in the transition to FHFA during these challenging times. As the first FHFA Director, I am working with the new FHFA employees to ensure coordinated and consistent oversight of the regulated entities during this time of turmoil in the financial markets.

Fannie Mae and Freddie Mac Conservatorship

The deteriorating conditions in the housing finance market, particularly in the areas of subprime mortgages and Alt-A mortgages, accelerated during the year. Increasing foreclosures, tighter credit and declining prices eventually began to affect even the prime loans. Illiquidity spread into the Enterprises' securities market for mortgage-backed securities (MBS), debt and equity. These developments threatened the careful balance between the mission to provide liquidity in the market and safety and soundness of the Enterprises by affecting their ability to raise and maintain capital. As house prices fell, their credit losses, earnings and capital continued to deteriorate, which threatened the Enterprises' ability to fulfill their mission.

FHFA has continued to monitor developments in the markets and worked closely with the federal banking regulators, the Bush Administration, the Treasury Department and the Board of Governors of the Federal Reserve to ensure an appropriate response. On September 6, 2008, in order to restore the balance between safety and soundness and mission, FHFA placed Fannie Mae and Freddie Mac into conservatorship. This statutory process was designed to stabilize troubled institutions with the objective of maintaining normal business operations while restoring the entities' financial safety and soundness. FHFA will act as the conservator of the Enterprises until they are stabilized. The agency quickly hired new CEOs and Chairmen for new Boards of Directors at each Enterprise.

Key components of the conservatorship are the liquidity, MBS investment and senior preferred stock facilities with the U.S. Treasury. These facilities will provide critically needed support to Freddie Mac and Fannie Mae to fulfill their mission. The Treasury's Senior Preferred facilities of $100 billion for each Enterprise provide that the Treasury will ensure that Fannie Mae and Freddie Mac will have a positive net worth over the very long term. FHFA will allow each Enterprise to increase its portfolio up to $850 billion over the next 15 months, before requiring gradual declines in the portfolios of 10 percent per year, consistent with the terms of the Treasury's financial assistance. In order to conserve more than $2 billion in annual capital, the common stock and preferred stock dividends were eliminated. In addition, FHFA immediately halted the Enterprises' lobbying activities.

Enterprises Remediation

Over the past several years, OFHEO, now FHFA, pressed the Enterprises to rectify their accounting, internal controls systems and risk management issues. Both Enterprises made good progress in many areas, but market conditions overwhelmed that progress. During this challenging time in the financial markets, an important milestone was reached in February 2008 when, for the first time in four years, both Enterprises released timely, audited annual financial statements. This constituted an important achievement in remediation of their respective operational and control weaknesses.

Federal Home Loan Banks

The Federal Home Loan Banks' (FHLBanks) cooperative ownership and countercyclical capital structure allowed them to grow and support the mortgage market as many others withdrew. Between December 31, 2006, and September 30, 2008, the FHLBanks' overall assets have grown by 40 percent and they provided member institutions through their advance program an additional $371.0 billion in funding. As of September 30, 2008, advances reached $1 trillion for the first time. Despite all the turmoil in the mortgage market their unique structure has meant all but one of FHFBanks continue to be profitable

Report Structure

FHFA, FHFB and OFHEO are in a unique position among government agencies. The enactment of HERA on July 30, 2008, and the creation of FHFA on the same day leads to a challenging Performance and Accountability Report (PAR) structure. Although HERA provided for a year to transfer the staff and resources of FHFB and OFHEO to FHFA, that was accomplished in less than three months.

Therefore, this Performance and Accountability Report has been organized to describe the performance of and show accountability for all three agencies. The first section describes the performance of FHFA since its creation several months ago. Since both FHFB and OFHEO were separate agencies for 10 months of the fiscal year, we have developed separate PARs to show their accomplishments and performance, including audited financial statements. I am pleased to report that both agencies received unqualified opinions on their financial statements and achieved all but one of their performance goals.

Program Data and Financial Performance

Both FHFB's and OFHEO's fiscal year (FY)2008 Performance and Accountability Reports contain performance and financial data that are complete and reliable. This year, OFHEO engaged an independent auditor to review the internal controls related to its performance measures and reporting for 12 Key Performance Indicators. The auditor found no significant issues, verifying the accuracy of our data. In FY2008, FHFB conducted an evaluation of the agency's internal controls in accordance with the requirements of OMB Circular A-123 and found no material weaknesses. The details of management assurances can be found in the Management's Discussion and Analysis section in each report.

Conclusion

2008 was the most challenging year in the history of OFHEO and FHFB, as the decline in the housing markets not only threatened Fannie Mae and Freddie Mac, but also financial markets worldwide. As we entered FY2009, nations around the world took unprecedented coordinated actions to strengthen the capital and liquidity of financial institutions. These actions and HERA's correction of the flawed regulatory regime for Fannie Mae and Freddie Mac should over time allow FHFA to better fulfill its mission. Working together with Congress and the Administration, we can restore confidence in the Enterprises and build a stronger and safer future for the mortgage markets, homeowners and renters in America.

James B. Lockhart III

James B. Lockhart III
Director
November 17, 2008

Federal Housing Finance Agency

2008 PERFORMANCE AND ACCOUNTABILITY REPORT

FHFA Purpose and Structure

MISSION

Promote a stable and liquid mortgage market, affordable housing and community investment through safety and soundness oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

Strategic Goals

FHFA has three strategic goals:

1. Enhance supervision to ensure that Fannie Mae, Freddie Mace and the Federal Home Loan Banks operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.
2. Promote homeownership and affordable housing and support an efficient secondary mortgage market.
3. Conserve the assets and property of Fannie Mae and Freddie Mac and enhance their ability to fulfill their mission during the conservatorship period.

FHFA Performance Highlights

The Creation of the Federal Housing Finance Agency

On July 30, 2008, President Bush signed the Housing and Economic Recovery Act of 2008 (HERA), which created a new regulator for the 14 housing-related government sponsored enterprises (GSEs)— Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks (FHLBanks). The Federal Housing Finance Agency (FHFA) has responsibility for the safety and soundness of the GSEs as well as oversight of their affordable housing missions. These 14 financial institutions had combined obligations of $6.8 trillion as of September 2008, $1.0 trillion more than the publicly held debt of the United States and a combined market share of 86.9 percent of new mortgages originated for the quarter ending June 30, 2008. The size and the impact of these financial institutions on the American housing market are tremendous. FHFA was given a critical responsibility and mission at a tumultuous time.

President Bush signs the Housing and Economic Recovery Act on July 30, 2008, which created the Federal Housing Finance Agency. Present are Brian D. Montgomery, Federal Housing Commissioner, James B. Lockhart III, Director of OFHEO, Steven Preston, Secretary of HUD, David G. Nason, Assistant Treasury Secretary for Financial Institutions, and Henry Paulson, Treasury Secretary.

The enactment of HERA achieved the Office of Federal Housing Enterprise Oversight's (OFHEO), the safety and soundness regulator for Fannie Mae and Freddie Mac, second strategic goal, of achieving comprehensive GSE reform to enhance the agency's powers. The Federal Housing Finance Board (FHFB) had responsibility for the safety and soundness of the 12 FHLBanks, as well as oversight of their affordable housing programs. The Department of Housing and Urban Development (HUD) had responsibility for oversight of the affordable housing goals for Fannie Mae and Freddie Mac. OFHEO's Director James B. Lockhart III was designated the first Director of FHFA. For more information on the newly established FHFA, please see page 16.

HERA created an independent, unified regulator for the safety and soundness and mission oversight of all 14 GSEs. OFHEO and FHFB began working even prior to the final passage of HERA to ensure a coordinated merger and actions in overseeing the secondary mortgage market. Officials from OFHEO, FHFB and the HUD Mission Office held joint meetings to promote open and frequent communication and to share information. Relevant supervision and legal staff began to develop regulations that would apply to the new agency and the regulated entities. On October 27, 2008, all OFHEO and FHFB employees were transferred to the new agency, effectively winding down their operations and continuing their efforts in support of the FHFA mission.

Conservatorship of the Enterprises

On September 6, 2008, due to safety and soundness concerns and market conditions that affected the Enterprises, FHFA placed both Fannie Mae and Freddie Mac under conservatorship to ensure that they could continue to fulfill their missions. Conservatorship is a statutory process designed to stabilize troubled institutions with the objective of maintaining normal business operations and restoring financial safety and soundness. Under conservatorship, FHFA is responsible for the overall management of the institution and has delegated operational and other duties to the Enterprises'

FHFA Director James B. Lockhart III, with Treasury Secretary Henry Paulson, announces the decision to place Fannie Mae and Freddie Mac under conservatorship at a news conference on September 7, 2008.

directors and officers. All existing contracts remain in effect and both Enterprises continue their normal business operations under the oversight of the conservator.

The agency took this significant step due to deteriorating market conditions that adversely affected both Fannie Mae and Freddie Mac, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury. Both Enterprises had been making progress on improving their accounting, internal controls and risk management, but market conditions overwhelmed that progress. Specifically, FHFA was concerned about the inability of the Enterprises to raise capital or issue debt according to normal practices and at reasonable prices, which was affecting their ability to fulfill their critical mission to support the nation's residential mortgage market. The Enterprises' capital was threatened by increasing credit losses in their guaranteed MBS and retained mortgage portfolios.

FHFA was concerned about safety and soundness weaknesses at the Enterprises related to credit risk, earnings outlook and capitalization, and the continued and substantial deterioration in equity, debt and MBS. During the months prior to the conservatorship, FHFA conducted an intense supervisory review of the deteriorating credit environment and the risks to the Enterprises. The Federal Reserve and Office of the Comptroller of the Currency assisted in this review. These reviews and rising yields on Enterprise debt and MBS relative to other benchmarks confirmed FHFA's concerns, and the agency decided to act to ensure that the Enterprises could continue their mission and to prevent systemic risks.

The Enterprises opened for business as usual on Monday, September 8, 2008, with FHFA examiners on-site at their headquarters and other key locations to ensure a smooth transition. The FHFA Director appointed new CEOs for both Enterprises and nonexecutive chairmen for the new Boards of Directors that will be formed. Under the terms of the Senior Preferred Stock Facility, each Enterprise may increase its portfolio of mortgages up to $850 billion over 15 months in order to support the troubled mortgage market, before requiring gradual declines of 10 percent per year. There are no restrictions on the amount of MBS that each Enterprise can guarantee. In addition, all lobbying by the Enterprises was immediately stopped, and neither departing CEO will receive "golden parachute" payments. The FHFA Director also eliminated dividends on all common and preferred stock.

Three finance facilities established by the Department of the Treasury are key components of the government's effort to stabilize Fannie Mae and Freddie Mac—the GSE Credit Facility, the MBS Purchase Program and the Senior Preferred Stock Purchase Agreement. These three facilities allow the Treasury Department to provide liquidity to the Enterprises and the mortgage market in different ways, as follows:

- The credit facility allows the Treasury to make short-term loans to Fannie Mae, Freddie Mac or the 12 FHLBanks using their MBS and advances as collateral.
- The MBS Purchase Program allows the Treasury to purchase Fannie Mae or Freddie Mac MBS directly with Treasury funds.

- The Senior Preferred Stock Purchase Agreement requires the Treasury to inject up to $100 billion in capital at each Enterprise in exchange for senior preferred stock to ensure that the Enterprises maintain a positive net worth. This Senior Preferred Stock facility effectively provides a U.S. government guarantee as it supports all outstanding and future senior and subordinated debt and MBS issuances until the terms of the facility are completely satisfied.

FHFA will continue to monitor capital levels, but the regulatory capital requirements will not be binding during the conservatorship.

New FHFA Regulations

Until FHFA issues new regulations, the GSEs continue to operate under regulations promulgated by OFHEO and FHFB. HERA calls for certain regulations to be issued in a specific timeframe. Other regulations are issued when the FHFA Director determines they are necessary. New regulations that apply to Fannie Mae, Freddie Mac and the FHLBanks have already been established. FHFA published a "Notice of Establishment" in the Federal Register on September 9, 2008, establishing the Federal Housing Finance Agency as the regulator of the 14 housing-related GSEs, outlining the scope of its authority and referencing the public law and the portion of the U.S. code that applies to FHFA.

FHFA issued an interim final regulation on golden parachute payments to GSE executives on September 16, 2008. This regulation clarified FHFA's authority to limit golden parachute payments if the GSE is in a troubled condition, insolvent or in conservatorship. While the regulation is final upon publication in the Federal Register, FHFA is soliciting comments on this regulation. In late September 2008, FHFA issued two final regulations—one to determine how assessments on the GSEs will be made to fund the agency and one that governs the eligibility and election of individuals to serve on the Boards of Directors of the 12 FHLBanks. These regulations were published in the Federal Register and are available on the agency's Website **www.fhfa.gov**.

In addition, in October 2008, FHFA published a regulation that implements Section 1218 of HERA, which provides temporary authority for the FHLBanks to use a portion of the money set aside for the Affordable Housing Program (AHP) to refinance mortgages for families at or below 80 percent of area median income. This regulation supports the refinance program in HERA's Hope for Homeowners program. FHFA continues to work on other regulations expected in the shortterm, including a regulation on the criteria governing the portfolio holdings of Fannie Mae and Freddie Mac, regulations to establish critical capital standards for the FHLBanks, and a capital classification process for all the regulated entities.

Testimony to Congress

Since HERA's enactment and in response to both the challenging market situation and FHFA's decision to place Fannie Mae and Freddie Mac under conservatorship, FHFA was invited to testify before Congress in two separate hearings. Director Lockhart testified before the Senate Committee on Banking, Housing and Urban Affairs on September 23, 2008, about FHFA's decision to place Fannie Mae and Freddie Mac under conservatorship. The Director also testified before the House Committee on Financial Services on the same topic on September 25, 2008. At both hearings, the Director described the events leading up to the conservatorship as well as the progress that Fannie Mae and Freddie Mac were making under new leadership appointed by FHFA. The Director's testimonies are available to the public on the agency Website **www.fhfa.gov**.

FHFA Mortgage Metrics Report

On September 24, 2008, FHFA released its first *Mortgage Metrics Report*, giving a comprehensive view of the Enterprises' borrower assistance efforts, including forbearance plans, short sales, deeds-in-lieu, assumptions and charge-offs in lieu of foreclosure. The agency will issue these reports quarterly in the future. The report presented key performance data on 30.4 million first-lien residential mortgages with outstanding balances totaling $4.4 trillion, serviced on behalf of Fannie Mae and Freddie Mac from 2007 through the first quarter of 2008. The report focused on the delinquencies, loss mitigation actions and foreclosure data reported by more than 3,000 approved servicers.

Also in this report, FHFA introduced a loss mitigation performance ratio as a measure of the extent of Enterprise efforts to assist borrowers at risk of losing their homes to foreclosure. The ratio measures specific loss mitigation actions as a percentage of all mortgages for which a completed foreclosure was likely. For the quarter ending March 31, 2008, the performance ratio was 53 percent—36,577 loss mitigation actions were completed for 68,984 loans for which foreclosure was likely.

Affordable Housing Mission

One of FHFA's key responsibilities is to oversee the affordable housing programs at Fannie Mae, Freddie Mac and the FHLBanks. This oversight had previously been the responsibility of the HUD's GSE Mission Office and FHFB. FHFA has made progress transitioning this critical oversight role to the new agency. FHFA officials have met with HUD officials about the affordable housing goals established for Fannie Mae and Freddie Mac for 2008 and reviewed the Enterprises' progress to date in meeting those goals. FHFA has also met with Fannie Mae and Freddie Mac about their 2007 and year-to-date 2008 results related to the affordable housing goals. FHFA continues to work with HUD to ensure that the appropriate information is transferred to the new agency.

FHLBanks also have affordable housing programs, although they do not have established goals as the Enterprises do. FHFA is continuing to oversee the FHLBanks' affordable housing and community investment programs through examination activities.

FHFA Management Challenges

FHFA Director James B. Lockhart III testifies before the Senate Committee on Banking, Housing and Urban Affairs on September 23, 2008, concerning the appointment of FHFA as conservator for Fannie Mae and Freddie Mac. Also testifying are Treasury Secretary Henry Paulson, Federal Reserve Chairman Ben Bernanke and SEC Chairman Christopher Cox.

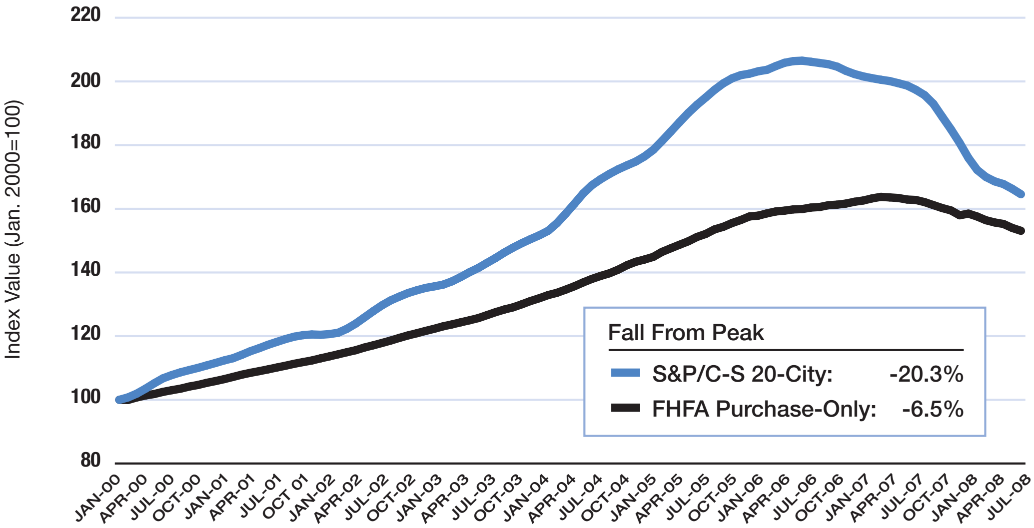
Housing and Mortgage Market Turmoil

The second half of 2007 and all of 2008 thus far have seen the worst housing market in decades. As measured by FHFA's monthly index, house prices in June were down 6.5 percent from their April 2007 peak (see Figure 1). The S&P/Case Shiller index, which has a narrower geographic range but covers real estate transactions with a broader range of prices, had fallen more than 20 percent from its peak. Falling prices have led to reduced housing starts and building permits, which at fiscal year-end were down almost two-thirds from their 2005 peaks. Despite that, inventories of houses for sale reached levels sufficient to satisfy 10 months of demand at current sales rates, almost twice typical levels.

Initially, the market's weakness mainly affected subprime mortgages. Falling house prices meant that more subprime borrowers lacked sufficient equity in their homes to refinance in order to avoid higher payments as their loans reset. Serious delinquency rates on subprime serious delinquencies have continued to rise, reaching 17.9 percent in the second quarter of 2008, a level that was almost three times its low in 2006. Serious delinquencies remained highest among adjustable-rate subprime loans, many of which were originated with teaser rates.

Falling home prices and a weakening economy have spread to a worsened performance of prime mortgages, as well. Serious delinquency rates on prime loans jumped to 2.4 percent, more than three times the low in 2005. Serious delinquencies of mortgages owned or securitized by Fannie Mae and Freddie Mac also rose sharply, but remained well below national averages. Nationally, mortgages in the process of foreclosure more than doubled to 2.75 percent between the second quarters of 2007 and 2008. Over the same period, real estate owned by the Enterprises, generally as a result of foreclosures, also more than doubled. To prevent foreclosures, the Bush Administration introduced the HOPE Now program in August

Figure 1 • FHFA and S&P/Case-Shiller® House Price Indexes: January 2000–August 2008



Note: For purposes of comparison, the FHFA purchase-only index has been re-based to January 2000 = 100 (the standard series is set so that January 1991 = 100)

2007 to encourage aggressive loan modifications. Fannie Mae and Freddie Mac are active participants. Since placing the Enterprises in conservatorships, FHFA has directed the Enterprises to become much more aggressive and innovative in their approaches to loan modification activities to reduce preventable foreclosures.

The bursting of the house price bubble has continued to be the major contributor to weakness in housing markets and growing mortgage credit problems in 2008. The burst also was the major cause of declines during the year in the market values of private-label mortgage securities and related credit derivatives that imposed large losses on many financial institutions and investors in the U.S. and elsewhere. The rapid appreciation that inflated the house price bubble was stimulated in large part by a dramatic weakening in 2005 through 2007 of underwriting standards for subprime and Alt-A mortgages that were financed by private-label mortgage securities. Although the underwriting standards of Fannie Mae and Freddie Mac did not deteriorate to the same degree, the mortgages directly purchased or guaranteed by each of them suffered increasingly from poorer credit quality, and they also purchased many private-label securities backed by subprime and Alt-A loans for their retained mortgage portfolios.

As broader financial market conditions weakened this year, the Federal Reserve System has aggressively sought to support market liquidity and stability by reducing its target for the Federal Funds Rate and providing liquidity to banks, other financial institutions, corporations and other central banks. However, despite those actions and the conservatorships for Fannie Mae and Freddie Mac, mortgage rates in the U.S. have not fallen, despite a halving of U.S. Treasury rates. The spreads between the yields of the Enterprises' debt and MBS and the yields of Treasury securities are double normal levels, reflecting the lack of confidence and confusion in financial markets. A major challenge going forward is to regain that lost confidence and, thereby, reduce those debt spreads and mortgage rates. Lower mortgage rates will be a key element in reversing the decline in house prices and increasing housing activity. The $700 billion Troubled Asset Purchase Program (TARP), passed by Congress in October, is designed to help that happen.

OFHEO Deputy Director Edward J. DeMarco addresses OFHEO, FHFB, and HUD GSE mission staff.

Conservatorship of Fannie Mae and Freddie Mac

FHFA's decision to place Fannie Mae and Freddie Mac into conservatorship represents a serious challenge to the agency going forward. The purpose of the conservatorship is to stabilize the Enterprises and restore their safety and soundness while continuing to fulfill their mission of providing liquidity to the mortgage market. FHFA has taken action to ensure that both Fannie Mae and Freddie Mac continue to provide stability, liquidity and affordability to the housing market, and the agency will be challenged in this difficult economic situation to balance this critical mission with the Enterprises' safety and soundness.

Director Lockhart appointed new CEOs for Fannie Mae and Freddie Mac immediately after announcing the conservatorship and instructed each Enterprise to examine their underwriting standards and pricing. FHFA will continue to develop the many regulations needed to implement HERA and ensure the Enterprises' safety and soundness, including revised minimum capital standards, prudential safety and soundness standards and portfolio limits. FHFA has also actively challenged Fannie Mae and Freddie Mac to be creative on foreclosure prevention, including loan modifications, in order to help distressed borrowers. All of these steps begin to address the serious market issues currently being experienced. FHFA will need to continue to monitor the market situation closely, working with the Treasury Department, the Federal Reserve and other regulators. FHFA will guide the Enterprises' activities and decisions and improve their operations to ensure that they are safe and sound and yet continue to provide liquidity and stability to the housing market.

Creating a New Regulatory Agency

The creation of FHFA and the merging of staff and resources of OFHEO, FHFB and the HUD GSE Oversight Team under a new, unified mission regulating the 14 housing-related GSEs is an immense challenge going forward. HERA requires the transfer of employees to the new agency and the abolishment of OFHEO and FHFB by July 30, 2009. FHFB and OFHEO employees were transferred to FHFA on October 27, 2008. Because of the important challenges facing Fannie Mae and Freddie Mac and the deteriorating conditions in the mortgage market, getting FHFA up and running as quickly as possible was a high priority. As a new, stronger regulator, FHFA will help restore confidence and ensure ongoing liquidity in the mortgage market.

This new agency must fulfill its mission during an unprecedented dislocation in the housing finance markets as well as its detrimental impact on the domestic and global financial system and economy. FHFA's regulatory approach will address the unique differences in risks of the Enterprises and FHLBanks, which include capital structures, the FHLBanks' cooperative form of organization and the joint-and-several nature of the consolidated obligations issued by the FHLBanks. FHFA will play an important role in defining the Enterprises' future structure and roles, and will employ a flexible and effective regulatory program that promotes market stability and the GSEs safety and soundness.

While the challenges in merging the regulatory mission are large, FHFA also faces administrative and cultural challenges in merging information technologies and systems, financial and human resources functions, and agency cultures into a new agency. The employees of FHFA must be united under one vision and mission, starting with the development of an agency strategic plan, which FHFA has begun to draft and expects to have completed in FY2009. The transition from OFHEO and FHFB to a united FHFA will take serious effort throughout the next year, but important progress has already been made connecting systems, developing unified policies, transferring employees to the new agency and issuing regulations and guidance related to FHFA's mission.

Implementing Enhanced Authorities and Powers

FHFA now has a series of additional responsibilities and requirements under the new law. The responsibilities include the issuance of numerous regulations and studies that impact the stability of the housing markets and the safety and soundness of the Enterprises and FHLBanks. FHFA is also required to complete and issue reports on guarantee fees, default risk evaluation, securitization of acquired member assets and collateral pledged to banks, among others. FHFA will be challenged to complete these required regulations and reports in a short timeframe and also to issue or revise other regulations, guidance and reports that the FHFA Director finds necessary to ensure effective supervision of the 14 GSEs.

FHFA is now responsible for overseeing the affordable housing programs at the GSEs. The responsibility for Enterprise mission oversight had previously been HUD's. FHFB had a similar responsibility for the FHLBanks. FHFA will be challenged with the responsibility for setting appropriate goals for affordable housing and for monitoring the programs at all 14 GSEs.

OFHEO's enabling statute created a capital requirement schema that included a minimum capital requirement and a risk-based capital requirement based on a 10-year stress test for Fannie Mae and Freddie Mac. These two capital requirements were inflexible and, in light of current market conditions, too low. The new law gives FHFA new flexibilities in setting and adjusting capital standards, including replacing or adjusting the risk-based capital stress test, establishing new minimum capital requirements, temporarily raising minimum capital requirements and establishing capital

The Federal Housing Finance Agency

FHFA was created with the enactment of the Housing and Economic Recovery Act of 2008 on July 30, 2008, to strengthen the nation's housing finance system. The new agency is charged with the safety and soundness and mission oversight of Fannie Mae, Freddie Mac and the 12 FHLBanks, as well as charter compliance and affordable housing goals. FHFA's stronger regulatory powers should help restore confidence in the 14 GSEs, which will enable them to better fulfill their public missions of providing liquidity to the troubled mortgage markets.

The new agency is a single, unified and independent regulator that is not subject to the appropriations process. FHFA's authorities are broadly based on safety and soundness, not primarily on capital levels as was the case for OFHEO. It has a more complete set of regulatory and enforcement authorities, including oversight of prudential management and operations standards at the GSEs and the authority to approve new products.

For example, OFHEO did not have receivership power over Fannie Mae and Freddie Mac, but FHFA does have receivership and conservatorship authority for all 14 GSEs. The new agency has authority to establish standards for the retained mortgage portfolios held by Fannie Mae and Freddie Mac, which OFHEO did not. Prior to that, OFHEO had to enter into voluntary agreements with Fannie Mae and Freddie Mac to limit their portfolio holdings in recent years. Most importantly FHFA now has the power and flexibility to set and adjust both minimum and risk-based capital standards for the Enterprises and the FHLBanks. Over the long term, if properly implemented, better capital standards could prevent the problems that led to conservatorship.

By having one regulator over all 14 housing-related GSEs, FHFA can provide a stronger, more consistent regulatory approach that addresses their unique characteristics, risks, and their role in a fundamentally changed mortgage market. The agency will fulfill its missions through a structure defined by the law – a Director appointed by the President and confirmed by the U.S. Senate, with three Deputy Directors requirements related to specific products or activities if the Director deems it necessary. FHFA is also responsible for developing capital classifications and a critical capital and risk-based capital standard for the 12 FHLBanks. The challenge for FHFA will be to implement the new flexibilities in appropriate and meaningful measures of capital adequacy.

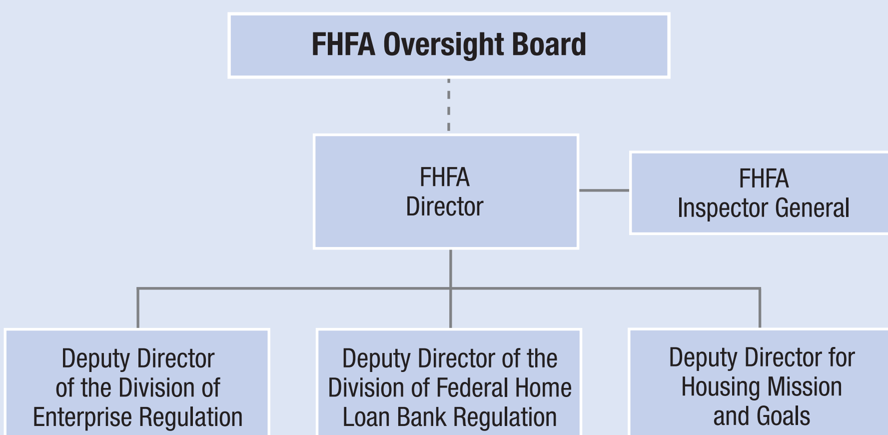
FHFA Oversight Board members and FHFA staff discuss the housing market, economy, TARP and other issues at the Board's inaugural meeting.

FHFA has a series of additional responsibilities and requirements under the new law, including issuing numerous regulations, reports and studies in the first year after the agency's creation. This includes Enterprise portfolio regulations, regulations on affordable housing goals and sharing information among the FHLBanks. FHFA is also required to complete and issue reports on guarantee fees, default risk evaluation, securitization of acquired member assets and

responsible for the safety and soundness supervision of Fannie Mae and Freddie Mac, the safety and soundness supervision of the FHLBanks and the affordable housing goals and mission oversight over all the GSEs. FHFA has an Oversight Board that meets quarterly and testifies before Congress. The Director of FHFA serves as the chairman. The Secretary of the Treasury, the Secretary of HUD and the SEC Chairman are the other three members of the Board. The Oversight Board is an advisory board and does not have any management responsibilities. The law also provides for an Inspector General and Ombudsman for FHFA. Figure 2 shows the major components of the new agency.

FHFA was established the day the legislation was signed into law by President Bush. OFHEO and FHFB are to wind down their operations in anticipation of their abolishment on July 29, 2009. While the staff of FHFB and OFHEO were merged on October 27, 2008, FHFA still has a great deal of work to do in its first year to unify the new agency and complete a series of regulations, reports and studies required by HERA. The creation of FHFA strengthened the nation's housing finance system by ensuring that Fannie Mae, Freddie Mac and the FHLBanks, vital components of the nation's secondary mortgage markets, operate in a safe and sound manner and fulfill their affordable housing and community investment missions.

Figure 2 • FHFA Oversight Board



collateral pledged to banks, among others. FHFA will be challenged to complete these required regulations and reports in a short timeframe and also to issue or revise other regulations, guidance and reports that the FHFA Director finds necessary to ensure effective supervision of the 14 GSEs.

Maintaining Capacity to Strengthen Supervision and Address Emerging Risks

FHFA continues to strengthen its supervisory standards and operations, including reviewing the 14 GSEs' risks and risk management on a continuous basis. Through continuous monitoring, research and analysis and risk-based examinations, the agency identifies issues that warrant additional attention and explores them further through targeted examinations. FHFA will strengthen oversight by assessing lessons learned from prior OFHEO and FHFB examinations, proactively issuing additional guidance and reviewing its work through a quality-assurance function. The new regulatory structure allows FHFA to take advantage of the experience of regulating the Enterprises and the FHLBanks, providing fresh perspective and alternate approaches on regulatory issues and collaboration in identifying issues that may affect all 14 GSEs.

FHFA's ongoing supervision puts the agency in a good position to identify and address emerging problems in a timely fashion. However, the size and complexity of the 14 GSEs' business activity, the changing dynamics of the mortgage markets, the scope of Fannie Mae and Freddie Mac's remediation activities and the credit problems in housing continue to present challenges for the agency. While OFHEO's and FHFB's resources and staff have increased over time, the competition for highly skilled and experienced staff in technical fields continues to challenge FHFA in recruiting staff with the quality and expertise necessary to oversee the Enterprises. Succession planning for supervisory staff, especially in the technical fields, is critical in this environment. FHFA must invest in its staff so they can stay abreast of the changes in their fields and reinforce the agency's knowledge base.

With the creation of FHFA, one key obstacle to investing in staff and planning new hires has been overcome, as the new regulator is no longer appropriated by Congress, as was OFHEO, while continuing to be fully funded by the GSEs. This is an important step for the agency and should improve FHFA's ability to reduce vacancies, improve training and grow as necessary with its supervisory work.

FHFA Budget

Under the authority of HERA, FHFA sets its budget to cover the ongoing costs of regulating the Enterprises and the 12 FHLBanks. Because of their critical role in the nation's housing finance system and the U.S. economy, it is important for FHFA to have the resources necessary to ensure their safety and soundness and to strengthen the supervision programs for the Enterprises and the FHLBanks. FHFA's FY2009 budget is $120.8 million. The budget includes the start-up costs associated with FHFA's new infrastructure, the costs associated with the new responsibility for mission regulation of the Enterprise, and the establishment of a working capital fund for the agency, in line with other federal financial regulators. FHFA collects assessments from its regulated institutions on a semiannual basis, on October 1 and April 1.

Federal Housing Finance Board

2008 PERFORMANCE AND ACCOUNTABILITY REPORT

Federal Housing Finance Board Mission

Ensure that the FHLBanks are safe and sound so they serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

FEDERAL HOUSING FINANCE BOARD 2008 PERFORMANCE AND ACCOUNTABILITY REPORT

Management's Discussion and Analysis

Overview

The Federal Housing Finance Board (FHFB) issues a Performance and Accountability Report (PAR) to promote transparency and improve the public's understanding of how FHFB operates and what the agency has accomplished with its funding. This report provides a three-part summary of FHFB's operations for fiscal year (FY) 2008:

Management's Discussion and Analysis contains the following sections:

- Overview
- Performance Summary
- Financial Performance Summary

This section:

- *Explains FHFB's purpose and structure*
- *Highlights the year's accomplishments*
- *Describes challenges facing the agency*
- *Summarizes FHFB's performance*
- *Presents a financial summary for FY2008*

The **Performance Section** contains the following sections:

- Overview
- Strategic Goal 1
- Strategic Goal 2

This section:

- *Describes FHFB's planning process*
- *Presents performance information for each goal*
- *Describes FHFB's historical performance for the past three years*
- *Explains how FHFB achieved its goals*

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

The **Financial Section** contains the following sections:

- Message from the Chief Financial Officer
- Statement of Assurance
- Report of Independent Auditors
- Financial Statements
- Notes to Financial Statements

This section:

- *Accounts for how FHFB spent its funds*
- *Describes how FHFB complied with relevant laws and regulations and used proper internal controls*
- *Includes letters and assurance statements from the Inspector General*

The Federal Home Loan Banks (FHLBanks) provide critical liquidity to member financial institutions by making secured loans, known as advances, primarily collateralized by mortgages or mortgage-related assets. The FHLBanks also provide direct liquidity to the domestic market by purchasing mortgages and mortgage-backed securities (MBS) and providing short-term unsecured credit to highly rated domestic and international banking organizations. Unlike Fannie Mae and Freddie Mac, the FHLBanks are each cooperatives, owned and capitalized by their member institutions. Each FHLBank is jointly and severally liable for the consolidated debt obligations issued by the FHLBanks through the Office of Finance (OF).

FHFB was created in 1989 and supervised the FHLBanks until the recently created Federal Housing Finance Agency (FHFA) assumed this role in July 2008. As the new regulator of the housing-related GSEs, FHFA will have to take into consideration the unique aspects of the FHLBanks, such as the nature of their capital structure, their cooperative form of organization, and the joint-and-several nature of the consolidated obligations issued by the FHLBanks.

The 12 FHLBanks have become critical providers of liquidity to financial institutions both large and small. Between June 30, 2007, and September 30, 2008, FHLBank advances to members increased by approximately $350 billion, from less than $650 billion on June 30, 2007, to more than $1 trillion by September 30, 2008.

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

FHFB Purpose and Structure

MISSION

FHFB's mission is to ensure that the FHLBanks are safe and sound so they serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

VISION

To maintain the public's trust, FHFB is dedicated to the highest professional standards of accountability and independence in carrying out its responsibilities for FHLBank supervision and oversight.

VALUES

FHFB's core values underlie the mission and vision, which guide its organizational decisions and actions. The core values are as follows:

- **Independence.** FHFB regulates the FHLBanks and the Office of Finance.
- **Accountability.** FHFB is a steward of the public's trust and will use its resources efficiently and in the public interest.
- **Responsiveness.** FHFB aligns its actions with its mission and responds promptly and effectively to emerging risks and opportunities in the finance system.
- **Integrity.** FHFB discharges its responsibilities fairly and adheres to the highest standards of ethical conduct.
- **Excellence.** FHFB strives for excellence in carrying out its responsibilities and recognizes the contributions of employees who demonstrate the highest professional standards in their work.

The Federal Home Loan Bank System

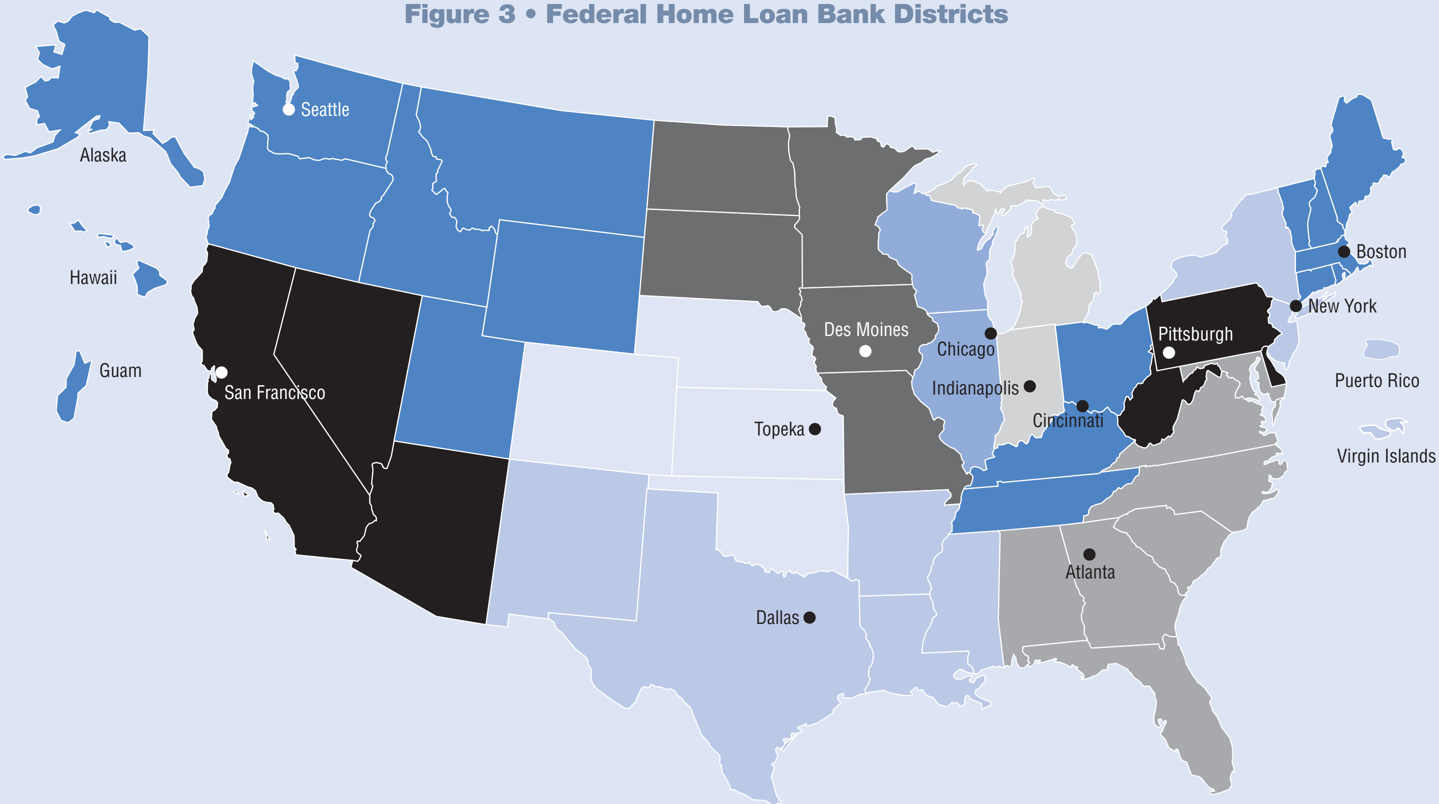
FHLBanks were created by the Federal Home Loan Bank Act of 1932 (the Bank Act) to stimulate mortgage finance and provide liquidity to credit markets. Until 1989, FHLBank members consisted primarily of savings and loan associations engaged in home financing. In 1989, Congress extended eligibility for FHLBank membership to commercial banks and federally insured credit unions (subject to a home financing requirement). In 1999, Congress made FHLBank membership voluntary for all types of eligible institutions. There are 12 FHLBank districts across the nation. Each district covers at least two whole states or U.S. territories.

FHLBanks are privately capitalized GSEs. They provide wholesale credit to members and certain nonmembers to be used for mortgage lending and related activities. In addition, the FHLBanks must promote housing and community investment finance. FHLBanks provide both short- and long-term, flexible financing to more than 8,100 member financial institutions around the country. As of September 30, 2008, the FHLBanks had combined assets exceeding $1.4 trillion.

FHLBanks are funded principally by the issuance of consolidated obligations of FHLBanks, consisting of bonds (usually with original maturities of one year or longer) and discount notes (with original maturities of less than one year and sold at a discount).

FHLBanks have been able to raise funds at rates about one-fourth of one percent higher than comparable obligations issued by the U.S. Treasury because of their status as government-sponsored

Figure 3 • Federal Home Loan Bank Districts



Atlanta	Alabama, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia
Boston	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont
Chicago	Illinois, Wisconsin
Cincinnati	Kentucky, Ohio, Tennessee
Dallas	Arkansas, Louisiana, Mississippi, New Mexico, Texas
Des Moines	Iowa, Minnesota, Missouri, North Dakota, South Dakota
Indianapolis	Indiana, Michigan
New York	New Jersey, New York, Puerto Rico, Virgin Islands
Pittsburgh	Delaware, Pennsylvania, West Virginia
San Francisco	Arizona, California, Nevada
Seattle	Alaska, Guam, Hawaii, Idaho, Montana, Oregon, Utah, Washington, Wyoming
Topeka	Colorado, Kansas, Nebraska, Oklahoma

Funding of the Federal Home Loan Banks

The principal liabilities of the FHLBanks are "consolidated obligations." These are unsecured debt obligations sold in the public capital markets and are the joint-and-several obligation of all the FHLBanks. At September 30, 2008, total consolidated obligations outstanding of $1.3 billion consisted of *bonds* (original maturity usually of one year or longer) of $876.6 billion and *discount notes* (original maturity shorter than one year and sold at a discount) of $446.8 billion. Joint-and-several liability means that the other 11 FHLBanks are liable for the payment of principal and interest on a consolidated obligation for which another FHLBank is the primary obligor if that FHLBank is unable to fulfill its obligations.

All FHLBank consolidated obligations are issued through the FHLBanks' Office of Finance (OF). OF makes extensive use of technology, including Internet-based auctions to sell debt. Located in Reston, Virginia, OF is the only joint office of the FHLBanks. Its principal responsibilities are issuing and servicing consolidated obligations on behalf of the FHLBanks. OF serves as an agent of the FHLBanks; it has no portfolio of its own and issues debt only upon the specific request of an FHLBank.

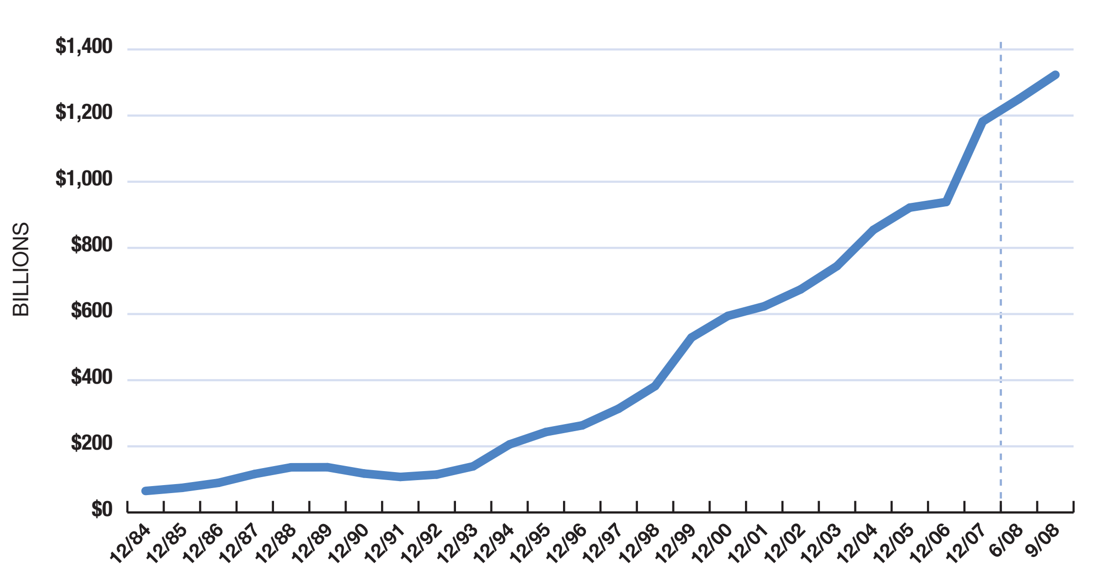
OF auctions discount notes every Tuesday and Thursday. Standard maturities are four, nine, 13 and 26 weeks. It also has a "window" program where the OF posts rates each day for a range of maturities on discount notes going out one year.

OF issues a wide variety of bonds for the FHLBanks. It issues both callable and noncallable bonds. While most bonds have fixed interest rates, some bonds have floating rates and others have complex coupon-payment terms, such as step-up bonds and range bonds. Individual bond issues may be as small as $10 million or as large as $10 billion.

All consolidated obligations are issued through underwriters except for a very small amount of direct placements. OF has qualified approximately 90 firms to underwrite and sell bonds; there is a 15-member discount note selling group. The underwriter is obligated to purchase the consolidated obligations; it acts as a principal and not as an agent of OF or FHLBanks.

OF qualifies underwriters to sell FHLBank debt. Each underwriter must sign a master underwriting agreement and a global underwriting agreement if it wishes to participate in the global debt program. OF requires each underwriter to have the policies and procedures in place to make sure that FHLBank consolidated obligations are suitable for the investor purchasing the obligation. OF performs compliance reviews of underwriters (annual on-site reviews for the larger underwriters) to make sure these policies and procedures are in place. Consolidated obligations (COs) are issued by the FHLBanks through OF, are the joint and several liabilities of all 12 FHLBanks and are not guaranteed or insured by the U.S. government.

Figure 4 • FHLBank System Consolidated Obligations



The Office of Finance is the only joint office of the FHLBank System and its fiscal agent. Its principal role is to issue and service consolidated obligations on behalf of the 12 FHLBanks.

enterprises. Since mid-2007, FHLBank bonds have traded at spreads of more than one percent above comparable obligations issued by the U.S. Treasury. In September 2008, the interest rate on bonds issued by the FHLBanks that mature in two years was 1.8 percent above the rate on comparable obligations issued by the U.S. Treasury as turmoil in the capital markets continued.

Members use short- and long-term advances to fund lending and maintain liquidity for their operations. Members can use long-term advances only to support residential housing finance or, in the case of a community financial institution, to also support lending to small businesses, farms and agricultural businesses. Most collateral supporting advances are mortgage assets.

FHLBanks also purchase qualifying mortgage loans from members under acquired member asset programs. Under these programs, the FHLBanks manage the market risk associated with the loans while members bear most of the credit risk through a loss-sharing arrangement or the purchase of mortgage insurance for the loans sold to the FHLBank. The FHLBanks no longer emphasize these programs. As a result, mortgage loan balances at the FHLBanks have declined to $89 billion, well below the peak of $115 billion reached at the end of 2004.

Members have access to several programs to support affordable housing and community investment activities. The Bank Act requires each FHLBank to contribute 10 percent of its annual net income to fund the Affordable Housing Program (AHP), subject to a requirement that the aggregate allocation be at least $100 million. In recent years, aggregate AHP contributions have greatly exceeded the minimum requirement of $100 million.

Key Federal Home Loan Bank Financial Statistics (In Millions)

	Sep 30 2008	Dec 31 2007	Dec 31 2006
Advances to Members	$1,011,662	$ 875,061	$ 640,682
Mortgage Loans, Net	87,918	91,611	97,974
Investments	316,781	301,110	275,267
Other Assets	13,226	8,106	7,215
Total Assets	$1,429,637	$1,275,888	$1,021,138
Consolidated Obligations	$1,323,410	$1,181,972	$ 938,762
Deposits and Borrowings	28,825	23,355	21,186
Other Liabilities	20,109	16,935	16,155
Capital	57,293	53,626	45,035
Net income	$ 2,137*	$ 2,808	$ 2,808

**Reflects income for the first nine months of 2008.*

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

Since 1989, FHLBank affordable housing programs have awarded members AHP subsidies as grants or subsidized interest rates on advances to expand homeownership and rental opportunities for low- or moderate-income households. AHP funds subsidize the cost of owner-occupied housing targeted to households with incomes at or below 80 percent of area median income and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of area median income. The subsidies can be used for construction, purchase or rehabilitation of housing. AHP projects address a wide range of housing needs. For example, since the program's inception, AHP has helped to subsidize housing for the following:

- Very low-income renter households;
- Special needs households, including the elderly, the disabled and victims of domestic violence;
- Homeless individuals and families;
- Households in rural communities and urban areas.

Each FHLBank administers two AHP programs, a mandatory competitive application program and a voluntary homeownership set-aside program.

The competitive application programs generally comprise at least 65 percent of an FHLBank's annual statutory AHP contribution.

Under the competitive application program, FHLBank member financial institutions submit applications on behalf of one or more sponsors of eligible housing projects to their FHLBank. Projects must meet certain statutory and regulatory requirements under this program. Each FHLBank establishes a point allocation system for scoring applications based on nine regulatory criteria. In each funding round, an FHLBank awards AHP subsidies to projects, starting with the highest scoring application, until it exhausts the total amount available.

From 1990 through 2007, FHLBanks funded more than $3.2 billion in subsidies for more than 623,000 housing units.

Each FHLBank voluntarily offers at least one homeownership set-aside program. Under these set-aside programs, FHLBanks may set aside up to the greater of $4.5 million or 35 percent of its AHP contribution each year to assist low- and moderate-income households purchase homes, provided that at least one-third of the FHLBank's set-aside allocation is made available to assist first-time homebuyers. Members obtain the AHP set-aside awards from the FHLBank and then use them as grants to eligible households. Set-aside awards may be used for down payment, closing cost, counseling or rehabilitation assistance in connection with the household's purchase or rehabilitation of an owner-occupied unit. Each FHLBank sets its own maximum grant amount, which may not exceed $15,000 per household.

FHFB Chairman Ronald A. Rosenfeld speaks at the FHFA Kick-Off Meeting.

AHP Overview	Competitive Application Program	Set-Aside Program
Time Period	1990–2007	1995–2007
Units Receiving Assistance (in thousands)	556	67
Total Funds Awarded ($ in millions)	$2,974	$297

Figure 5 • Amount of AHP Subsidy Awarded, by Year 1990-2007
Cumulative $3.2 billion

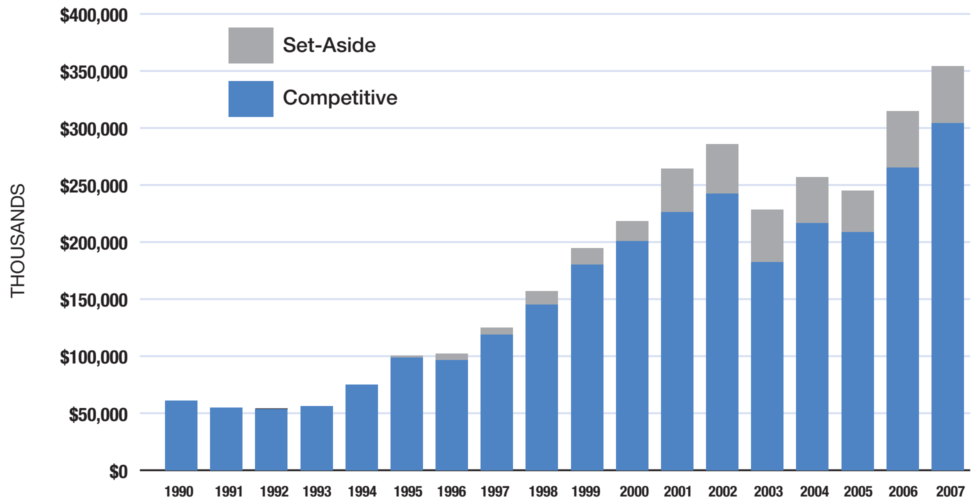
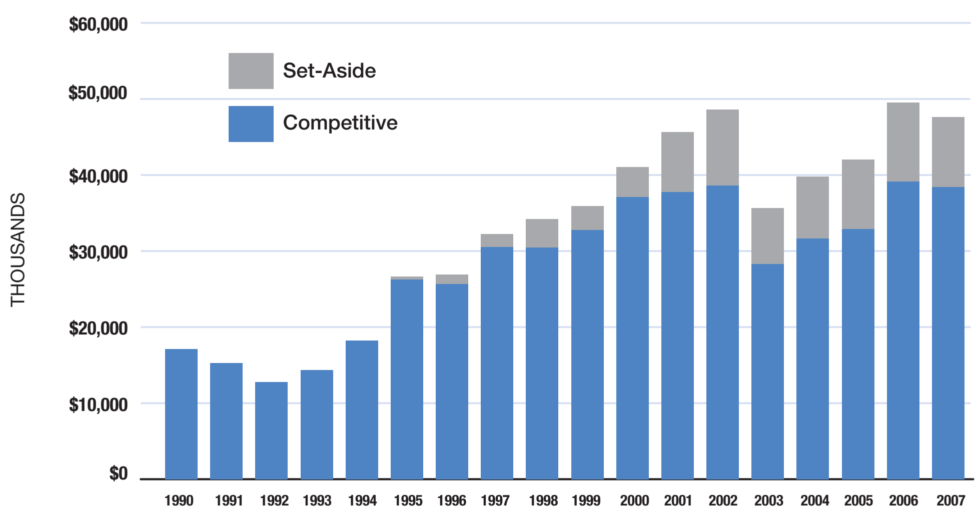


Figure 6 • Number of Units Assisted with AHP Awards, by Year
1990-2007 Cumulative 623,503



The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

The Federal Housing Finance Board

FHFB was established as an independent agency by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. It was the successor agency to the former Federal Home Loan Bank Board, which had been established by the Bank Act. FHFB's statutory mandate was to ensure that FHLBanks are financially safe and sound with adequate capital, carry out their housing finance mission and are able to raise funds in the capital markets. In addition to supervising the FHLBanks, FHFB had regulatory authority and supervisory oversight responsibility for OF.

Federal Housing Finance Board of Directors

Ronald A. Rosenfeld, *Chairman*
Geoff Bacino, *Director (resigned 11/2/08)*
Alicia R. Castanada, *Director*
Allan I. Mendelowitz, *Director*
Steven Preston, *Secretary of HUD, Ex Officio*

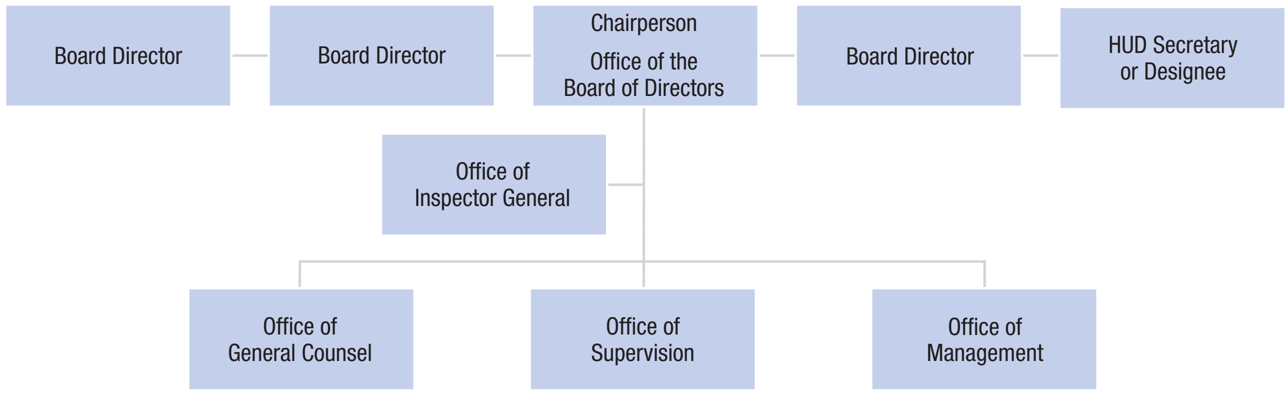
FHFB was governed by a five-member Board of Directors. Four directors were appointed by the President and confirmed by the Senate and were required to have extensive experience or training in housing finance or a commitment to providing specialized housing credit. The fifth member was the Secretary of the U.S. Department of Housing and Urban Development (HUD). No more than three directors could be members of the same political party.

FHFB was organized into five Offices:

The Office of the Board of Directors (OBD) set the agency's strategic direction and approved policies and regulations. By delegation from the full Board, the chairperson supervised management and policy execution. The Board generally met monthly in public sessions. The agency's chief information officer, who was responsible for FHFB technology and information systems, reported to the chairperson.

The Office of Supervision (OS) was responsible for the supervision and examination of the FHLBanks and OF. OS performed this function through annual on-site examinations, periodic visitations and off-site monitoring. Other OS responsibilities included supervisory policy and program development, regulatory analysis and development, and economic research and analysis.

Figure 7 • Federal Housing Finance Board Organization Chart as of September 30, 2008



The Office of General Counsel (OGC) provided legal support and guidance on interpretations of laws, regulations and policies to FHFB officials. OGC prepared legal documents on behalf of FHFB and represented the agency in judicial and administrative proceedings. OGC managed FHFB's ethics and Freedom of Information Act programs and acted as the secretary to the Board.

The Office of Management (OM) was the principal advisor to the Chairperson of FHFB on management and organizational policies and was responsible for FHFB's administrative management programs. This included responsibility for FHFB's finance and accounting, budget, personnel, payroll, contracting and procurement and facilities and property management.

The Office of Inspector General (OIG) operated pursuant to the Inspector General Act of 1978, as amended. OIG conducted and supervised audits and investigations related to FHFB programs and operations, and recommended policies to promote economy, efficiency and effectiveness, and to prevent and detect fraud, waste and abuse.

On July 30, 2008, the President signed the Housing and Economic Recovery Act of 2008 (HERA), which created a new regulator for the 14 housing-related GSEs – the 12 FHLBanks, Fannie Mae and Freddie Mac. The new agency, FHFA, has responsibility for the safety and soundness of the government-sponsored enterprises as well as oversight of the affordable housing missions. HERA recognized the unique aspects and functions of the FHLBanks, Fannie Mae and Freddie Mac by creating three divisions: the Division of Enterprise Regulation, the Division of Federal Home Loan Bank Regulation and the Division of Housing Mission and Goals. FHFB and OFHEO remain in existence to wind up the affairs of both agencies and will cease to exist on July 29, 2009.

Priorities, Resources, and Performance Measures

FHFB's planning, budgeting and performance management process set the strategic direction, determined planned activities and resources, measured and monitored performance throughout the year and performed an annual performance assessment. These components reflected a continuous cycle of performance management centered on outcomes. The agency used annual performance assessments to analyze performance and improve effectiveness and efficiency.

FHFB produced three main reports as a result of the agency performance management process. The agency's Strategic Plan covered a five-year period and set overall strategic goals for the agency. The agency produced an Annual Performance Budget, which described how it allocated its resources for the upcoming fiscal year to achieve the strategic priorities outlined in the Strategic Plan. This is the agency's last annual Performance and Accountability Report, which summarizes the agency's success during FY2008 in meeting its goals and objectives as set forth in the Annual Performance Budget for that fiscal year and FHFB financial and program performance information.

In its FY2007-2012 Strategic Plan, FHFB established two strategic goals that guide its operation. The Strategic Plan is available on the agency's Website, **www.fhfb.gov**. The two strategic goals are:

1. The FHLBanks operate safely and soundly.
2. The affordable housing and community investment programs of the FHLBanks operate effectively and efficiently.

For each strategic goal, FHFB established strategic outcomes to indicate the degree to which it achieved the stated goal; annual performance goals to determine the degree to which FHLBanks acted promptly to correct deficiencies identified by FHFB; and annual performance measures as indicators of how well FHFB carried out its mission to ensure the safe and sound operation of the FHLBanks.

Strategic Goals	Strategic Outcomes	Annual Performance Goals	Annual Performance Measures
1. The FHLBanks operate safely and soundly.	1. The FHLBanks effectively identify and manage risk. 2. The FHLBanks remain adequately capitalized, and able to raise funds in the capital markets.	1. The FHLBanks address principal safety and soundness examination findings to the satisfaction of FHFB prior to the next examination. 2. The FHLBanks correct supervisory or compliance issues within required timeframes. 3. The FHLBanks' combined financial statements comply with applicable laws, rules, and regulations.	1. Conduct all safety and soundness activities, including annual examinations, visitations, and off-site monitoring. 2. Review safety and soundness examination findings with the FHLBanks semiannually to ensure the FHLBanks are making progress to remedy identified shortcomings. 3. Conduct on-site examination of OF and review annual and quarterly combined statements issued by OF for compliance with disclosure requirements.
2. The FHLBanks' affordable housing and community investment programs operate effectively and efficiently.	1. The FHLBanks foster the development of owner-occupied and affordable rental housing for eligible very low-, low-, and moderate-income households.	1. The FHLBanks address principal affordable housing examination findings to the satisfaction of FHFB prior to the next examination. 2. The FHLBanks distribute affordable housing funds as approved in the AHP application.	1. Conduct all affordable housing activities, including annual examinations and off-site monitoring. 2. Review affordable housing and community investment examination findings with the FHLBanks semiannually to ensure the FHLBanks are making progress to remedy identified shortcomings. 3. Use examinations to review program effectiveness as well as compliance with the Bank Act, FHFB regulations, and FHLBank policies.

Performance Summary

FHFB achieved all of its performance goals in FY2008. The agency continued its efforts to strengthen its supervisory program through more intense integration of its off-site monitoring program and tools into the examination program. As part of these efforts, FHFB formalized the organization of its OS into two principal functional areas—Examinations and Off-Site Monitoring and Analysis.

The following list summarizes key FHFB achievements during FY2008.

Major Accomplishments by Strategic Goal

STRATEGIC GOAL 1: THE FEDERAL HOME LOAN BANKS OPERATE SAFELY AND SOUNDLY

- Conducted safety and soundness examinations at all 12 FHLBanks and OF.
- Appointed the full slate of public interest directors at each FHLBank.
- Adopted a resolution expanding the ability of the FHLBanks to invest in MBS in order to provide support to the housing markets.
- Monitored negotiations between the FHLBanks of Chicago and Dallas regarding a merger of the two FHLBanks, and evaluated the public policy, business, and accounting implications of the proposed transaction.
- Entered into a cease-and-desist order with the FHLBank of Chicago, following cessation of merger discussions with the FHLBank of Dallas, to strengthen the FHLBank's capitalization and to restrict payment of dividends or redemption or repurchase of member capital stock.
- Amended the cease-and-desist order with the FHLBank of Chicago to permit repurchase or redemption of newly issued capital stock to support new advances, subject to certain conditions set forth in the order.
- Developed procedures for creating market risk and modeling profiles for FHLBanks based on off-site monitoring and on-site interviews.
- Revised the risk modeling program to provide more exacting data that are widely used to evaluate FHLBank conditions.
- Created and implemented examiner guidance and work programs for review of advances and collateral risk management.
- Completed revisions to the safety and soundness examination manual that included guidance on the preparation of examination work papers.
- Conducted examiner training on revisions to the safety and soundness manual and work programs.
- Issued the semiannual FHLBank profile books, quarterly and monthly risk monitoring reports, weekly reports of advance levels to monitor credit conditions, reports on financial

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

markets, data, and developments and daily monitoring and reporting of FHLBank liquidity positions.

- Issued three advisory bulletins addressing certain aspects of fair-value accounting, temporary authority to purchase additional agency MBS, and requirements to implement policies and practices that establish risk limits for, and mitigation of, credit exposure on nontraditional and subprime mortgage loans.
- Established guidance for minimum liquidity requirements for the FHLBanks in light of adverse economic conditions.
- Managed and coordinated the execution of the GSE Credit Facility for the 12 FHLBanks. The GSE Credit Facility will serve as a lender of last resort to assure investors in GSE debt that the FHLBanks will be able to meet obligations as they come due, thereby mitigating rollover risk for those investors. The facility is created pursuant to authorities contained in the Housing and Economic Recovery Act of 2008 to promote financial market stability and liquidity.
- Expanded the use of a stylized model of FHLBanks (i.e., "Model Bank") in examinations and in support of enforcement actions.
- Continued the review of the retained earnings analysis for each of the FHLBanks to evaluate whether the level of retained earnings at each FHLBank is adequate.

Stephen M. Cross, FHFB's Director of Supervision, poses a question at the FHFA Kick-Off Meeting.

- Developed guidance on subprime or alternative MBS that instructed FHLBanks regarding the purchase of whole loans, the purchase of MBS, and the acceptance of collateral in light of federal financial institution regulatory agencies' guidelines with respect to subprime and nontraditional mortgage loans.
- Began using credit risk modeling techniques to assess the credit quality of private-label MBS during the examination process and to establish asset classification standards for examiners.
- Monitored ratings actions by Nationally Recognized Statistical Rating Organizations (NRSROs) and identified sub-investment grade securities ahead of NRSRO rating downgrades.
- Analyzed MBS holdings of FHLBanks, including monitoring, rating and pricing information for private-label MBS held by FHLBanks supporting the increase in MBS authority to six times capital.
- Initiated and substantially completed a horizontal review of the FHLBanks' prepurchase analyses, postpurchase monitoring and corporate governance of their MBS.
- Implemented examination process quality assurance reviews and conducted reviews for two examinations.

- Enhanced data management and information systems for the monthly and quarterly collection of FHLBank financial data.
- Developed a secure bank portal for transmitting FHLBank data and documents in a structured and auditable method of review by examiners, economists and analysts.
- Developed a reporting and analysis intranet page to better coordinate the availability of various reports and information for analytical purposes.
- Developed and secured peer review for a revised methodology to be used to generate market risk-based capital requirements for the FHLBanks.

STRATEGIC GOAL 2: THE AFFORDABLE HOUSING AND COMMUNITY INVESTMENT PROGRAMS OF THE FHLBANKS OPERATE EFFECTIVELY AND EFFICIENTLY.

- Conducted AHP examinations at 11 FHLBanks. The FHLBank of Chicago was removed from the AHP examination schedule due to safety and soundness issues being addressed by FHFB.
- Developed a draft AHP examination manual and held AHP examiner training on assessing FHLBanks' implementation plans.
- Conducted examiner training on revisions to the AHP manuals including how to assess FHLBank implementation plans.
- Completed an AHP Waiver Resolution for the FHLBank of San Francisco to use a portion of its homeownership set-aside allocation for restructuring or refinancing certain adjustable and nontraditional mortgage loans made to low- and moderate-income households.
- Prepared an interim final AHP rule authorizing the temporary the allocation of set-aside funds for refinancing or restructuring troubled mortgage loans to low- and moderate-income households.
- Completed the first upload of AHP set-aside and Community Investment Cash Advance Program (CICA) data elements, which will assist the off-site monitoring program and examination of AHP examinations.
- Completed AHP examiner guidance on the use of public housing authority income documentation information to verify compliance with AHP income requirements.
- Prepared initial designs for monitoring programs to evaluate on an ongoing basis the FHLBanks' AHPs, their capital level and composition, credit risk management, operations risk and corporate governance at the FHLBanks.

The Year in Review

FHFB's FY2008 accomplishments were concentrated in the following areas:

Ongoing Supervision. FHFB's FY2008 operating expenses allocated $29.6 million, which is 81.6 percent of the total agency budget, to undertake its safety and soundness supervisory program. To fulfill their housing finance mission, the FHLBanks offer advances, mortgage purchase programs and other services. These activities result in the FHLBanks assuming varied and complex market, credit and operational risks that they must evaluate and manage. FHFB's safety and soundness supervisory program evaluated and monitored the FHLBanks' condition and earnings and whether the risk management processes at each FHLBank effectively reflect and control the FHLBank's level of risk.

FHFB's FY2008 budget included $6.7 million to undertake its affordable housing and community investment supervisory program. FHFB examiners monitored the FHLBanks' compliance with statutory and regulatory requirements for affordable housing and community investment, evaluated program operations and controls and assessed program effectiveness. Resources were devoted to AHP reviews for both the competitive application program and the homeownership set-aside program.

Risk-Focused Supervision

A risk-focused examination is designed to target examination resources on bank functions that pose the greatest risk exposure, thereby increasing the effectiveness of the examination process without requiring increased resources.

During FY2008, FHFB's supervisory program focused on (1) activities, operations, and strategies that pose risks to the safety and soundness of the FHLBanks and (2) the FHLBanks' effectiveness in carrying out their housing finance mission, which included, but was not limited to, their affordable housing and community investment programs. The following processes were central to FHFB's application of a risk-based supervisory approach: (1) identification of market, credit and operational risks; (2) use of common methods of evaluation to measure these risks; and (3) determination of whether the policies, systems and processes employed by each FHLBank and OF enable its Board of Directors and senior management to manage existing and prospective levels of risk.

At the conclusion of an on-site examination, FHFB examiners discussed their findings with the FHLBank's senior management. Through communication of examination findings, the agency influenced the practices of the FHLBanks. When the examination findings were raised to a level of significance, FHFB may have also used informal and/or formal enforcement actions to correct an FHLBank's practices, conditions or violations of law and/or regulations. In FY2008, the FHLBank of Chicago entered into a voluntary cease-and-desist order with FHFB designed to stabilize and strengthen that FHLBank's capital.

Risk-Focused Supervision. As had been its practice, during 2008, FHFB's examinations reflected the most pressing risks facing the FHLBanks. For example, examiners and market risk modeling staff assessed the adequacy and prudence of the FHLBanks' market risk limits, as well as the adequacy of their retained earnings levels. During 2008, examiners and individuals from the market risk modeling and risk analysis and research divisions analyzed the risks inherent in the FHLBanks' private-label MBS holdings. The agency also investigated the FHLBanks' policies and practices for collateral supporting advances. Examiners followed up on adverse findings from 2007 examinations, paying particular attention to findings related to operational risk and information technology, derivatives practices, capital and liquidity management. This required greater integration between risk modeling and capital markets examination staff.

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

In October 2007, FHFB, with the consent of the FHLBank of Chicago Board of Directors issued a cease-and-desist order pertaining to the FHLBank's capital adequacy, redemption and repurchase of capital stock, risk management, hedging policies and procedures, capital structure plan and dividends. While the FHLBank of Chicago had been and remains in compliance with this order, FHFB had not accepted the FHLBank of Chicago's submissions to satisfy concerns regarding risk management, hedging and the bank's capital plan. The FHLBank of Chicago delayed, with FHFB concurrence, implementing a new capital structure until the first or second quarter of calendar year 2009, primarily depending on its ability to show net profits. The cease-and-desist order was amended by FHFB on July 23, 2008, to allow the repurchase or redemption of newly issued capital stock from any member meeting certain conditions. This amendment enabled the FHLBank of Chicago to increase its level of advances.

Off-Site FHLBank Monitoring and Analysis. FHFB analysts reviewed FHLBank activities, financial condition, fiscal and operating performance and regulatory compliance, and assessed market developments that may have affected the FHLBanks. These analysts also worked closely with the examination staff to establish the scope of examination of the FHLBanks and reviewed the financial condition and performance of the FHLBanks at the on-site examinations. FHFB analysts also prepared analytical papers on market conditions and trends and their effects on the FHLBanks' condition, profitability and stability.

In FY2009, agency analysts will work to expand and systematize data collection to improve off-site monitoring capacity. These efforts include more frequent collection of interest rate data and the collection of collateralized obligations data from OF, expanded market risk sensitivity data collection supplemented by on-site interviews with key personnel and simulation results from the model bank, to produce a market risk profile for each of the 12 FHLBanks. In addition, a wide range of data on FHLBank practices will be used to support the monitoring programs evaluating credit risk, operational risk, AHP programs, capital level and composition, and corporate governance at the FHLBanks.

Economic and Financial Analysis. The principal means of providing support to the examinations is through evaluations of the quality of risk modeling at the FHLBanks and through the research and analysis of systemic trends affecting the FHLBanks and the FHLBank System. The staff contributes to each report of examination. The primary means of providing program analysis and regulatory and policy development support is through statistical and other quantitative analyses of factors influencing FHLBank performance. Additionally, research and analytical support for FHFB regulatory or policy initiatives, including longer-term policy-oriented research, is used to support regulatory and supervisory initiatives. The staff also prepares semiannual profiles of the 12 FHLBanks and the FHLBank System, along with periodic reporting of trends or market developments affecting the FHLBanks. FHFB monitors trends affecting housing finance and the housing industry.

In FY2009, staff will continue to develop models that will simulate the risks and expected returns of an FHLBank with similar asset, liability, and hedging strategies. The research necessary to update FHFB's risk-based capital standards also continues into FY2009. As part of this work, economists will also be examining the potential for a link between risk-based capital and the appropriate level of retained

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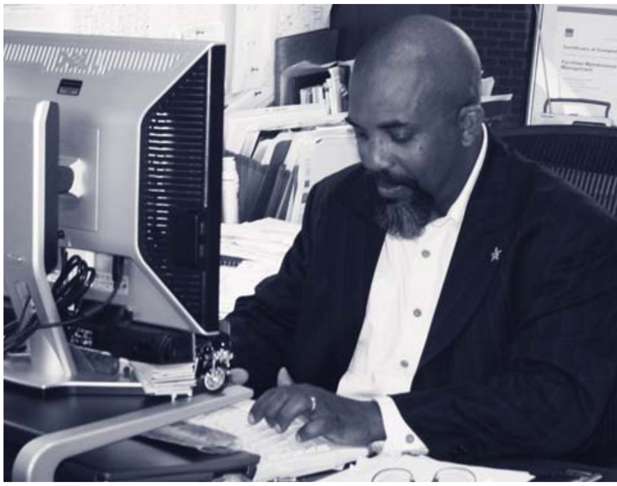
earnings at an FHLBank. Another part of the modeling work will involve a continuation and enhancement of our efforts to model the credit risk in private-label MBS held by the FHLBanks.

Quality Assurance. In FY2008, the Office of Supervision's Quality Assurance (QA) unit conducted periodic reviews of examination work flows and products and developed written procedures for conducting objective assessments of the Office's supervisory function. The purpose of the reviews is to identify potential opportunities to improve or enhance existing practices. QA staff launched the first two formal reviews of FHFB examinations to assess their quality, accuracy, completeness, organization and conformance with agency policies. The QA unit identified several potential process improvements now under consideration, including new or revised product templates, proposed changes to the examination manual and potential reports such as a quarterly report of regulatory enforcement actions on FHLBank members.

Policy and Regulations. During FY2008, FHFB approved a two-year expansion of the authority of an FHLBank to purchase mortgage-backed securities. This expanded authority allows an FHLBank to purchase additional MBS issued by Fannie Mae or Freddie Mac (or private-label MBS made up entirely of Fannie Mae or Freddie Mac MBS) by an amount equal to three times the FHLBank's capital. FHFB issued guidance on the application of the federal financial institutions regulatory agencies' interagency guidance on nontraditional and subprime residential mortgage lending to the FHLBanks' acquired member assets, private-label MBS and collateral securing advances. The interagency guidance was originally issued by the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Office of Thrift Supervision, and National Credit Union Administration. Monitoring related developments in this area will remain a priority in FY2009. Also in FY2008, FHFB issued examiner guidance on procedures for reviewing private-label MBS and the use of public housing authority income documentation to verify compliance with affordable housing program income requirements, as well as on examination procedures covering areas such as examination scoping and work program completion. In FY2009, efforts will continue to reassess and refine the agency's regulatory infrastructure, including the development of various regulations and reports required by HERA. For example, as part of the newly created FHFA, staff members from FHFB and OFHEO will formulate new rules on prudential standards, enforcement powers, prompt corrective action and receivership. The safety and soundness examination manual will also be updated.



Jacques Wilson, FHFB's Support Services Specialist, at work.

New Business Activities. When an FHLBank wants to engage in a new business activity, it must notify FHFB for approval to engage in the proposed activity. FHFB assesses whether the proposed activity is legal, identifies the risks associated with the activity and evaluates the ability of the FHLBank to manage those risks. During FY2008, FHFB reviewed multiple new business activity notices, including a request on behalf of the Mortgage Partnership Finance FHLBanks to purchase and concurrently sell mortgages to Fannie Mae and a request by an FHLBank to create an open-ended mutual fund to make investments that allow its members in a particular state to meet certain Community Reinvestment Act requirements. These proposals were approved and will be reviewed as part of the next on-site examination.

Combined FHLBanks Financial Statements. Each FHLBank is subject to the periodic disclosure requirements in the Securities Exchange Act of 1934, which include public disclosures and filings relating to the Bank's financial condition, results of operations, trends or uncertainties affecting its business, and management's assessment of its business and financial condition, including supporting financial information and certifications. OF prepares the combined statement; FHFB assesses whether the combined financial statements comply with the agency's regulations and policies.

Data Management and Monitoring. FY2008 was a transitional year for the management and monitoring of data collected from the FHLBanks. FHFB continued to collect information in accordance with the requirements outlined in the *Data Reporting Manual*, significant projects to rebuild the membership database and expand the Call Reporting System (CRS) were begun, and FY2009 projects such as the renovation of the Acquired Member Asset (AMA) database were moved forward into FY2008 to address the mortgage reporting and housing goal requirements of HERA.

In FY2009, FHFA will continue efforts to expand CRS and renovate the membership database. In addition, one major objective will be making significant enhancements to the AMA database. In addition, the agency will continue work on both dashboard metrics to address its expanded off-site monitoring role and extending its reporting efforts.

FY2008 Representative Accomplishments

Strategic Goal 1 ■ The FHLBanks Operate Safely and Soundly.

Strategic Outcome 1. The FHLBanks effectively identify and manage risk

2008 ACCOMPLISHMENTS

- FHFB conducted on-site safety and soundness examinations at all 12 FHLBanks using the risk-rating system implemented in FY2007.
- Each FHLBank was assigned an overall rating, as well as component ratings for corporate governance, credit risk, market risk, operational risk and financial condition and performance.

Strategic Outcome 2. The FHLBanks remain adequately capitalized and able to raise funds in the capital markets

2008 ACCOMPLISHMENTS

- Each FHLBank continuously met or exceeded its minimum capital requirements.
- FHFB approved three capital plan amendments submitted by three FHLBanks.

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Partially Achieved

Not Achieved

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

Strategic Goal 2 ■ The Affordable Housing and Community Investment Programs of the FHLBanks Operate Effectively and Efficiently.

Strategic Outcome 1. The FHLBanks foster the development of owner-occupied and affordable rental housing for eligible very low-, low-, and moderate-income households

2008 ACCOMPLISHMENTS

- **FHFB conducted examinations at 11 of the 12 FHLBanks. The AHP examination of the 12th FHLBank was deferred in order to focus examination resources on areas of heightened supervisory concern.**
- **Expanded data collection to include set-aside and CICA programs in addition to competitive application program data.**
- **Performed off-site monitoring of AHP activities.**
- **As of June 30, 2008, the FHLBanks had awarded more than $115 million in subsidies to assist 13,590 housing units.**

Key External Factors

External conditions beyond the control of the organization can affect the performance of FHFB and the FHLBanks. These factors include developments in capital and housing markets, broader macroeconomic forces affecting interest rates or national or regional activity, and regulatory and legislative initiatives that can change the environment in which the FHLBanks operate. Regardless of the source of the influences on FHLBank performance, FHFB must respond promptly to ensure that the FHLBanks meet challenges.

Significant events, influences and risks that may affect the priorities, and expenditure of FHFB funds are dependent on a variety of issues, from possible areas of risk identified during FHLBank examinations requiring resources not originally budgeted or planned for, to the volatility of the secondary mortgage markets and financial banking industry in general. Some of the factors that influence the priorities and expenditure of FHFB funds include:

Legislation. HERA combined FHFB, OFHEO and HUD's GSE Mission Office.

Developments in Banking and Financial Markets. The housing market, financial sector and banking developments of the past year were the most dramatic since the Great Depression. The FHLBanks, created in the depth of the Depression to provide liquidity to the banking industry and to support the mortgage market, played a critical role in this most recent crisis. Demands for advances increased dramatically over the past year at most of the FHLBanks. In addition, FHFB issued a temporary authorization for the FHLBanks to purchase additional MBS in an effort to further support mortgage markets.

The FHLBanks' borrowing costs went up significantly as bond investors shifted toward debt issued and backed directly by the U.S. Department of the Treasury. Access to term debt is more costly and the volume is more restricted than in the past. In addition, a number of member financial institutions either have been acquired or have failed. The direct result on the FHLBanks from these banking failures and restructuring moves has been limited. Still, FHFB responded to events in a number of ways:

- First, FHFB initiated and is still conducting a system-wide analysis of the FHLBanks' collateral practices and policies to ensure that the FHLBanks have accurate values for the collateral they accept to support advances.
- Second, FHFB launched and is still conducting a system-wide analysis of the FHLBanks' policies and practices associated with purchases and management of MBS.
- Third, FHFB has investigated the process the FHLBanks use to account for MBS and the potential for those securities to be other than temporarily impaired.
- Fourth, FHFB closely monitored the process the FHLBanks use to secure adequate credit protection for the mortgages they purchase from members under the AMA programs.
- Fifth, FHFB strengthened its working relationship with FDIC to coordinate efforts on troubled banks.
- Finally, FHFB required the FHLBanks to re-evaluate their retained earnings and liquidity holdings in light of the current mortgage market turmoil.

Economic Variables. Adverse economic conditions currently affecting the nation's financial and mortgage industry, including the stock market, foreign banks and increasing unemployment, have the potential to affect the financial condition of the FHLBanks. Restricted access to term financing poses new challenges for the FHLBanks' management of interest rate risk. Federal government support for Fannie Mae, Freddie Mac and certain large depository institutions, may disadvantage the FHLBanks in their efforts to raise funds in the capital markets. However, FHLBanks entered credit facilities with the U.S. Treasury as provided by HERA and have the ability to ask for further support if needed

Staffing. In the competitive financial services environment, highly skilled personnel are in great demand, and recruiting and retaining a highly skilled workforce are continuing challenges. FHFB's recruitment and retention efforts have focused on attracting and retaining examiners, economists, accountants, analysts and attorneys with the requisite financial, legal and technological skills to model, monitor and assess the risks undertaken by the FHLBanks and OF. In FY2008 FHFB made changes to its compensation and benefits program to attract and retain highly skilled personnel. To that end, 13 mission-critical positions were filled in FY2008.

Continuity of Operation Program (COOP). Financial institutions must maintain the capability to resume business during and after a crisis. Ensuring preparedness for a crisis continues to be a priority for FHFB both for its own operations and those of the FHLBanks and OF.

FHFB maintains an Emergency Operations Center that provides essential personnel with the necessary resources to continue agency operations during a COOP event. During a crisis, FHFB employees can securely access the agency's information technology systems remotely. In FY2008 FHFB participated in the government-wide continuity of operations test Eagle Horizon. All systems were tested under various scenarios to ensure that in the event of a disruption to agency operations, FHFB could operate at its remote facility and continue its supervision and oversight of the FHLBanks.

Performance Assessment Rating Tool

FHFB provided limited assistance to the Office of Management and Budget (OMB) but did not participate in the Performance Assessment Rating Tool (PART) process in 2007. FHFB was unable to develop quantifiable performance measures that OMB would consider meaningful without revealing confidential bank examination information.

Diagnostic Analyses of 2008 Program Performance Results

Throughout FY2008 FHFB continually evaluated its progress in meeting the goals established in its performance plan. Program operations were consistently reviewed and assessed and adjustments were made as needed to improve program effectiveness, realign resources to address emerging priorities, and resolved issues identified through its supervisory program, internal assessment programs, and key external factors affecting the FHLBanks.

FHFB and OFHEO staff meet to discuss plans for the new FHFA budget, performance, and consolidation of resources.

In 2007, OMB completed its PART assessment of FHFB with a rating of "Results Not Demonstrated." OMB's PART assessment and rating was completed without the active participation of FHFB and, therefore was not a complete or accurate reflection of FHFB's program's success. FHFB's lack of participation in the OMB PART was based on a legal opinion that quantifiable and meaningful performance measures acceptable to OMB could not be developed without revealing confidential bank examination information. (See **www.ExpectMore.gov** for details of FHFB's plan and program assessment.)

However, FHFB took positive and aggressive steps to evaluate the effectiveness of its programs and address issues impacting successful achievement of performance results. Changes implemented to improve program effectiveness were based on information received from an OIG audit of the examination process, just recently finalized in mid-November 2008; annual FHLBank examinations and periodic visitations to assess FHLBank progress to correct previously identified deficiencies including the cease and desist order with the FHLBank of Chicago; two reviews conducted by the OS quality assurance staff of examination workflow, products and written procedures for conducting objective assessments that resulted in identification of possible improvements to include new or revised examination templates, changes to the examination manual, and issuance of periodic reports of regulatory enforcement actions on FHLBank members. In addition to these formal reviews, during FY2008, FHFB Chairman held weekly management meetings with the agency's three office directors, held monthly FHFB Board of Director meetings comprised of an open session to discuss issues of a non-confidential nature and a closed session to discuss specific supervisory or regulatory issues affecting the FHLBanks or FHLBank system. From an operational perspective, monthly budget meetings were held between OM and OS to review the status of resources, availability of funds, and progress towards meeting performance measures identified in the annual performance budget. OS held its annual training conference for all OS employees to discuss emerging issues, process and program changes implemented as a result of the reviews previously mentioned in this section, and to provide a forum for sharing best practices and ensure consistency in the treatment of issues among all

FHLBanks. In addition, OS initiated a program to strengthen its off-site monitoring and analysis function, merging four divisions and appointing a senior executive to manage the function in coordination with the examination program. Monitoring programs covering a wide range of FHLBank activities, from credit risk, operational risk, capital level and composition, to AHP and corporate governance were designed to ensure program success in meeting performance goals. In addition, horizontal reviews of the FHLBanks' prepurchase analyses, postpurchase monitoring, and corporate governance of its MBS was initiated and substantially completed.

Management Challenges

In accordance with OMB Circular A-136, the Office of Inspector General identified the most serious management and performance challenges facing FHFB and made an assessment of the agency's progress in addressing those challenges. The Office of Inspector General's position is based on the audit work performed to date and is summarized below. A copy of the referenced memo from the Inspector General can be found on page 61. As FHFB has been merged into FHFA, there is only one management challenge for FHFB.

ENSURING THE PROPER "WIND-UP" OF FHFB OPERATIONS

Under HERA, the board of FHFB is responsible only for winding up its affairs by July 30, 2009. The appropriate steps should be taken to ensure that such affairs are completed in the most efficient, economical and effective manner and in the absence of fraud, waste and abuse.

AGENCY PROGRESS

FHFB has taken positive steps toward ensuring the proper wind-up of its affairs. Agency management has positively approached resolving related audit findings and committed to continuing corrective actions at the newly created FHFA. On October 27, 2008, FHFB employees were transferred to FHFA.

Financial Performance Summary

Allocating Resources to Meet FHFB Goals

FHFB prepared its FY2008 Annual Performance Budget to link the agency's strategic and performance goals to the costs of achievement. FHFB identified and resolved safety and soundness issues, promulgated regulations to enhance the safety and soundness of the FHLBanks, monitored the FHLBanks' activities to serve the nation's housing finance and community investment needs and aligned the agency's human capital and information technology initiatives to FHFB's mission, goals and outcomes.

Strategic Goal 1 ■ The FHLBanks Operate Safely and Soundly

SUMMARY	FY2007 Actual	% of Total Budget	FY2008 Actual	% of Total Budget	FY2009 Approved	% of Total Budget
Program FTE	87.8	81.0%	93.4	82.9%	105.7	82.1%
Infrastructure & Support FTE	20.6	19.0%	19.3	17.1%	23.0	17.9%
Total Budget	**108.4**	**100.0%**	**112.7**	**100.0%**	**128.7**	**100.0%**
Program Expenses ($M)	$21.7	81.0%	$24.5	82.8%	$26.9	82.3%
Infrastructure & Support Expenses ($M)	$5.1	19.0%	$5.1	17.2%	$5.8	17.7%
Total Budget	**$26.8**	**100.0%**	**$29.6**	**100.0%**	**$32.7**	**100.0%**

Strategic Goal 2 ■ The Affordable Housing and Community Investment Programs of the FHLBanks Operate Effectively and Efficiently

SUMMARY	FY2007 Actual	% of Total Budget	FY2008 Actual	% of Total Budget	FY2009 Approved	% of Total Budget
Program FTE	20.4	81.3%	21.3	82.6%	25.2	81.8%
Infrastructure & Support FTE	4.7	18.7%	4.5	17.4%	5.6	18.2%
Total Budget	**25.1**	**100.0%**	**25.8**	**100.0%**	**30.8**	**100.0%**
Program Expenses ($M)	$5.3	80.3%	$5.6	82.4%	$6.4	82.1%
Infrastructure & Support Expenses ($M)	$1.3	19.7%	$1.2	17.6%	$1.4	17.9%
Total Budget	**$6.6**	**100.0%**	**$6.8**	**100.0%**	**$7.8**	**100.0%**

Strategic Goals 1 and 2 ■ FTEs and Expense Summary

SUMMARY	FY2007 Actual	% of Total Budget	FY2008 Actual	% of Total Budget	FY2009 Approved	% of Total Budget
Safety & Soundness FTE	108.4	81.2%	112.7	81.4%	128.7	80.7%
AHP FTE	25.1	18.8%	25.8	18.6%	30.8	19.3%
Total Budget	**133.5**	**100.0%**	**138.5**	**100.0%**	**159.5**	**100.0%**
Safety & Soundness Expenses ($M)	$26.8	80.2%	$29.6	81.3%	$32.7	80.7%
AHP Expenses ($M)	$6.6	19.8%	$6.8	18.7%	$7.8	19.3%
Total Budget	**$33.4**	**100.0%**	**$36.4**	**100.0%**	**$40.5**	**100.0%**

Most resources available were allocated—in both full-time equivalents (FTE) and budgeted dollars—to support Strategic Goal 1, which reflected the primary duty of FHFB.

Financial Highlights

As of September 30, 2008, the financial condition of FHFB was sound. There were sufficient funds to meet program needs and adequate controls in place to ensure that obligations did not exceed budget authority.

FHFB drew its financial resources from assessments levied upon the 12 FHLBanks. It receives no appropriations, and its funds were neither government funds nor appropriated monies and were not subject to apportionment.

FHFB's budget for FY2008 was approximately $38.7 million with 150 Full-Time Equivalent (FTE) budgeted staff. The FY2008 budget represented a 7.8 percent increase from the FY2007 budget.

Actual expenditures in FY2008 were $36.4 million with 138.5 full-time equivalent staff on board at the end of the fiscal year up 8 percent from fiscal year-end 2007. As in the past, in FY2008, approximately 80 percent of the agency's budget was allocated to supervision of the FHLBanks.

Figure 8 • FHFB Financial Statement Key Comparison of FY2008 to FY2007

In U.S. Millions	2008	2007
Total Assets	$9.27	$7.93
Total Liabilities	$5.35	$4.32
Total Net Positon	$3.91	$3.60
Net Cost of Operations	$0.63	$4.46
Total Budgetary Resources	$44.82	$36.44

Financial Statement Major Changes

Major changes in the financial operations from FY2007 to FY2008 were caused by an increase in overall program expenditures and the transition activities associated with the creation of FHFA. Program expenditures increased primarily due to the hiring of additional staff and an increased use of professional services for FHLBank supervisory matters. The transition activities were staff time allocated to the creation of FHFA. These amounts resulted in an increase in the total budgetary resources and decrease in the net cost of operations from FY2007 to FY2008, as reflected in Figure 8. In addition, total assets increased due to an accounts receivable resulting from the transition activities.

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. § 3515(b). While the statements have been prepared from the books and records of FHFB in accordance with Generally Accepted Accounting Principles (GAAP) for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

Management Assurances

FHFB provides reasonable assurance that its systems of internal accounting and administrative control fully comply with the requirements of the Federal Managers' Financial Integrity Act of 1982 and OMB Circular A-123 (rev. December 21, 2004). FHFB provides this statement of reasonable assurance that the agency's management accountability and internal controls were adequate and effective, and there were no material weaknesses to report. The objectives of the system of internal control of FHFB were to provide reasonable assurance of the following:

- Programs achieved their intended results.
- Financial reporting was reliable.
- Resources were used consistent with the agency mission.
- Programs and resources were protected from waste, fraud and mismanagement.
- Laws and regulations were followed.
- Reliable and timely information was obtained, maintained, reported and used for decision making.

The concept of reasonable assurance recognizes that the cost of management control should not exceed the benefits expected to be gained and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of management accountability and control, including those limitations resulting from resource constraints and other factors. The statement of assurance and determination are based on the following:

- An independent outside audit of FHFB's financial statements provided an unqualified opinion and found no weaknesses involving FHFB's internal control structure determined to be material.
- An internal evaluation of the internal controls covering the period from October 1, 2007, through September 30, 2008, was completed by the agency's senior program management and reviewed by the Office of Inspector General. The evaluation found no material weaknesses and concluded that FHFB's internal controls are achieving their intended objectives.

FHFB was committed to a strong internal control program. The agency employed sound financial management techniques, had developed oversight procedures and emphasized the importance of a strong risk management and internal control program to meet its statutory, regulatory and fiduciary responsibilities.

As part of the creation of FHFA, management will establish new systems, processes and procedures for FHFA. Improvements to processes and controls will be considered in the overall effort to establish FHFA.

Performance Section

Measuring and Reporting Performance

This section presents information on FHFB's FY2008 key initiatives, major accomplishments, outcomes for established goals and measures and evaluation results from completed studies.

Performance Measurement System

FHFB's planning, budgeting and performance management process set the strategic direction, determined planned activities and resources, measured and monitored performance throughout the year, and performed an annual performance assessment. These components reflect a continuous cycle of performance management centered on outcomes. The agency used annual performance assessments to analyze performance and improve effectiveness and efficiency.

FHFB completed a triennial update of its Strategic Plan and review of its performance measures in 2006. FHFB continually seeks effective means to measure, report and ultimately improve its performance. The update of the Strategic Plan for FY2007–2012 provided an opportunity to develop and implement effective practices in performance measurement, reporting and management.

Aligning Resources to Goals

Collectively, the outcome-based performance goals are the key indicators for successful progress in achieving the agency's strategic goals. FHFB plans, manages and monitors programs and activities based on contributions to the achievement of these goals, with the safety and soundness of the FHLBanks as the primary consideration. Ongoing program evaluations identify FHFB success in achieving goals and indicate if revised or new initiatives are appropriate.

Goals, Outcomes and Annual Performance Measures

For each strategic goal, the agency established strategic outcomes that it expected to achieve and annual performance goals to provide indicators of progress by FHFB and the FHLBanks. Finally, in recognition of the fact that the goals FHFB set depended not only on the actions of FHFB but also on the actions of each of the FHLBanks, FHFB adopted annual performance measures for FHFB actions to ensure that the agency was doing the most it could to meet the strategic goals and outcomes.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

Outcomes

The following strategic outcomes serve as indicators of the degree to which the FHLBanks operate safely and soundly. To the extent that the FHLBanks are able to identify and manage risk, remain adequately capitalized and raise funds in the capital markets, they are more likely to operate safely and soundly.

Strategic Goal 1: The FHLBanks Operate Safely and Soundly.

STRATEGIC OUTCOME ■ The FHLBanks Effectively Identify and Manage Risk.

2008	Achieved
2007	Achieved
2006	New Metric
2005	New Metric

FHFB evaluated the effectiveness of the FHLBanks' identification and management of risk through its risk-based supervisory program. When the supervisory program revealed deficiencies in risk management, FHFB communicated its findings to the FHLBank, ensured that the FHLBank responded substantively and promptly to the identified deficiencies and required corrective action by the FHLBank. FHFB's risk-based supervisory program focused on the FHLBanks' activities and operations that presented the highest risk to the safety and soundness of the FHLBanks. The following processes were central to the agency's application of a risk-based supervisory approach: (1) identification of market, credit and operational risks; (2) use of common methods of evaluation to measure these risks; and (3) assessment of governance, e.g., the policies, systems and processes employed by each FHLBank and OF in managing existing and prospective levels of risk. This was accomplished through on-site examinations, visitations and a robust monitoring and analysis program.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

STRATEGIC OUTCOME ■ The FHLBanks Remain Adequately Capitalized and Able to Raise Funds in the Capital Markets.

2008	Each FHLBank continuously met or exceeded its minimum capital requirements. FHFB approved capital plan amendments submitted by three FHLBanks.
2007	Each FHLBank continuously met or exceeded its minimum capital requirements. FHFB approved capital plan amendments submitted by two FHLBanks.
2006	Each FHLBank continuously met or exceeded its minimum capital requirements.
2005	Each FHLBank continuously met or exceeded its minimum capital requirements.

The Gramm-Leach-Bliley Act of 1999 (GLB Act) required each FHLBank to adopt a capital plan and convert to a new capital structure. FHFB rules that implemented these provisions of the GLB Act require each FHLBank to establish risk-based capital structures that address minimum capital standards and set the amount of FHLBank stock members must hold. Eleven of the 12 FHLBanks have implemented FHFB-approved capital structure plans in accordance with GLB Act requirements. The FHLBank of Chicago has not yet implemented a Gramm-Leach-Bliley-compliant capital plan. Circumstances at the FHLBank of Chicago that gave rise to supervisory criticism—an informal enforcement action in 2003, a formal written agreement in 2004 and a cease-and-desist order in 2008—precluded implementation of a GLB-compliant capital plan. The cease-and-desist order to which the FHLBank of Chicago is subject required it to submit a capital structure plan to FHFB. FHFB received the capital structure plan from the FHLBank of Chicago, but agreed to the Bank's request to delay implementing the plan until financial performance at the Bank improves.

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Partially Achieved

Not Achieved

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

STRATEGIC GOAL 1 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 1.1 ■ Conduct All Safety and Soundness Activities, Including Annual Examinations, Visitations, and Off-Site Monitoring.

2008	FHFB conducted onsite safety and soundness examinations at all 12 FHLBanks using the FHLBank Risk Rating System implemented in FY2007. Examinations assigned an overall rating to the FHLBank, as well as component ratings to corporate governance, credit risk, market risk, operational risk and financial condition and performance. OS initiated program to strengthen off-site monitoring capabilities.
2007	FHFB conducted on-site safety and soundness examinations at all 12 FHLBanks using the FHLBank Risk Rating System implemented in FY2007. Examinations assigned an overall rating to the FHLBank, as well as component ratings to corporate governance, credit risk, market risk, operational risk, and financial condition and performance.
2006	FHFB conducted on-site safety and soundness examinations at all 12 FHLBanks. Examinations reached conclusions for each FHLBank based upon factors including the level of credit, market and operational risk, as well as financial condition and performance.
2005	FHFB conducted on-site safety and soundness examinations at all 12 FHLBanks. Examinations reached conclusions for each FHLBank based on factors including the level of credit, market and operational risk, as well as financial condition and performance.

Data for this measure are complete and reliable. Data are collected internally.

Description. The FHLBanks provide wholesale credit to members and certain nonmembers for mortgage lending and related activities such as advances and mortgage purchase programs. As a result of these activities, the FHLBanks assume market, credit and operational risks. The FHLBanks must evaluate and manage these varied and complex risks in accordance with their condition and earnings. FHFB's supervisory program evaluated and monitored whether the risk management processes at each FHLBank effectively reflected and controled the level of risk undertaken.

During the year, FHFB conducted all safety and soundness and affordable housing examinations, with the exception of the AHP examination at the FHLBank of Chicago, which was suspended owing to pressing safety and soundness issues at that FHLBank.

During the year, FHFB's Office of Supervision initiated a program to strengthen its off-site monitoring and analysis function. Monitoring programs covering a wide range of FHLBank activities, from credit risk, operational risk, capital level and composition to AHP and corporate governance, were designed. Some of those programs will be rolled out in FY2009, depending on resource availability.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

STRATEGIC GOAL 1 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 1.2 ■ Review Safety and Soundness Examination Findings with the FHLBanks Semi-Annually to Ensure the FHLBanks Are Making Progress to Remedy Identified Shortcomings.

2008 (Fully Achieved)	Examiners-in-charge visited assigned FHLBanks between examinations to assess progress with examination findings. Financial analysts and economists reviewed and evaluated examination results for items to evaluate on a system-wide basis. Supervision staff continued regular monitoring of trends at the FHLBanks, particularly advance volumes, as a result of market conditions. Examination staff started an in-depth review of the FHLBanks' management of secured credit (advances and collateral).
2007 (Fully Achieved)	FHFB strengthened its supervisory program through the implementation of risk-based examinations and with additional monitoring programs and tools. Financial analysts and economists reviewed and evaluated examination results for items to evaluate on a system-wide basis. Supervision staff initiated weekly monitoring of trends at the FHLBanks, particularly advance volumes, as a result of market conditions.
2006	New Metric
2005	New Metric

Data for this measure are complete and reliable. Data are collected internally.

Description. FHFB's Office of Supervision monitored the FHLBanks on an ongoing basis through the analysis of Call Record System (CRS) data, audited financial statements, strategic business plans and other reports. It monitored FHLBank operations, financial condition and performance, legal compliance and actions taken in response to previously identified deficiencies through off-site monitoring and system-wide or "horizontal" reviews that focused on a specific FHLBank activity, function or program.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

STRATEGIC GOAL 1 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 1.3 ■ Conduct On-Site Examination of the Office of Finance and Review Annual Quarterly Combined Statements Issued by the Office of Finance for Compliance with Disclosure Requirements.

2008	FHFB completed an examination of OF and assigned a composite rating based on the risk-rating system implemented in FY2007. FHFB reviewed the FHLBanks' combined financial statements. FHFB reviewed the controls over the combining process used to prepare the FHLBanks' combined financial statements.
2007	FHFB completed an examination of OF and assigned a composite rating based on the risk-rating system implemented in FY2007. FHFB reviewed the FHLBanks' combined financial statements.
2006	New Metric
2005	New Metric

Data for this measure are complete and reliable. Data are collected internally.

Description. FHFB conducted an annual on-site examination of OF to (1) follow up on issues identified through pre-examination analysis and planning; (2) test systems, controls and reports for adequacy and accuracy, including the internal audit function; (3) assess the risk profile and operational soundness; (4) identify issues that may affect the risk or operating profile; (5) evaluate the quality of corporate governance; and (6) test for compliance with laws, regulations and policies, including sales suitability practices by participating underwriters and broker-dealers.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

Strategic Goal 2: The FHLBanks' Affordable Housing and Community Investment Programs Operate Effectively and Efficiently.

STRATEGIC OUTCOME ■ The FHLBanks Foster the Development of Owner-Occupied and Affordable Rental Housing for Eligible Very Low-, Low-, and Moderate-Income Households.

2008	Achieved
2007	Achieved
2006	New Metric
2005	New Metric

AHP subsidizes the cost of affordable owner-occupied and rental housing. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an FHLBank advance to a member. The Bank Act requires each FHLBank to contribute at least 10 percent of its net earnings from the previous year to the AHP, subject to a minimum annual combined contribution by all 12 FHLBanks of $100 million.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

STRATEGIC GOAL 2 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 2.1 ■ Conduct All Affordable Housing Activities, Including Annual Examinations and Off-Site Monitoring.

Year	Results
2008	Conducted examinations at 11 of the 12 FHLBanks. AHP examination of the 12th FHLBank was deferred in order to focus examination resources on areas of heightened supervisory concern. Expanded data collection to include set-aside and CICA programs, in addition to competitive application program data. Performed off-site monitoring of AHP activities.
2007	Conducted examinations at 11 of the 12 FHLBanks. AHP examination of the 12th FHLBank was deferred in order to focus examination resources on areas of heightened supervisory concern. Updated and enhanced collection of AHP data from all 12 FHLBanks. Conducted AHP training for examiners and policy analysts. Performed off-site monitoring of AHP activities.
2006	New Metric
2005	New Metric

Data for this measure are complete and reliable. Data are collected internally.

Description. The Bank Act requires each FHLBank to establish an AHP, the purpose of which is to enable members to provide long-term subsidized financing for very-low, low- and moderate-income, owner-occupied and affordable housing. FHFB supports the Bank Act's affordable housing and community investment objectives by maintaining an effective program of annual on-site examinations for the AHP, CIP and, as applicable, other CICA programs. At the end of each examination, the examiner-in-charge discussed with FHLBank management the quality of its corporate governance and operation risk based on evaluation of various aspects of its operations, including overall condition and effectiveness of AHP activities.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

STRATEGIC GOAL 2 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 2.2 ■ Review Affordable Housing and Community Investment Examination Findings with the FHLBanks Semi-Annually to Ensure the FHLBanks are making progress to Remedy Identified Shortcomings.

2008	Resolution of identified concerns discussed at annual examinations at 11 FHLBanks and at interim visitations at three FHLBanks.
2007	Resolution of identified concerns discussed at annual examinations and interim monitoring.
2006	New Metric
2005	New Metric

Data for this measure are complete and reliable. Data are collected internally.

Description. FHFB's FY2008 operating budget included $6.7 million to perform the AHP and community investment supervisory program. The examiners conducted on-site reviews of the AHP, CIP and other CICA programs. Examiners reviewed policies, procedures and controls that addressed Board of Directors and management oversight, the subsidy awards process, uses of funds and recipient eligibility.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of the Federal Home Loan Banks transferred from FHFB to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

STRATEGIC GOAL 2 ■ Annual Performance Measures

ANNUAL PERFORMANCE MEASURE 2.3 ■ Use Examinations to Review Program Effectiveness As Well As Compliance With the Bank Act, FHFB Regulations and FHLBank Policies.

2008	Continued to review and catalog previous policy decisions. As reviews were completed, relevant documents were posted on the agency's computer network as a resource for examiners and other OS staff. This also creates a single repository of formal and informal decisions and guidance. Redesigned the AHP examination manual to incorporate analytical review of AHP data collections. Issued an interim final rule allowing the AHP homeownership set-aside subsidy to assist in the refinancing of mortgages held by distressed low- and moderate-income homeowners.
2007	Approved amendments to the AHP regulation in September 2006 and effective January 2007. Began review and cataloging of previous policy decisions relative to the amended regulation. Completed draft of the AHP examination.
2006	New Metric
2005	New Metric

Data for this measure are complete and reliable. Data are collected internally.

Description. FHFB remained committed to ensuring that the FHLBanks carried out effective affordable housing and community investment programs. FHFA will continue to monitor program effectiveness and supervise the affordable housing and community investment programs. In FY2009, FHLBank examinations will be more consistent with a results-oriented program evaluation. The Bank Act mandates housing goals for the FHLBanks and permits a Community Development Financial Institution to become a FHLBank member. These two initiatives will require issuance of regulations.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

Program Evaluation

FHFB evaluated its supervisory, financial management, information technology and human capital management functions to improve and enhance mission performance. Recommendations made were evaluated and implemented as appropriate. Evaluations were conducted by organizations both inside and outside the agency and included the following:

Government Accountability Office: The Government Accountability Office conducts program and program support-related evaluations of the agency's supervisory program.

Office of Inspector General: The Office of Inspector General evaluates the agency's supervisory program and program support operations.

Quality Assurance: The OS quality assurance program conducts periodic reviews of examination work flow and products. Quality assurance reviews add value by identifying potential opportunities to improve or enhance existing practices. QA staff conducted the first two formal reviews of FHFB examinations that assessed their quality, accuracy, completeness, organization, and conformance with agency policies. As a result, several potential process improvements were identified, including new or revised product templates, proposed changes to the examination manual, and issuance of a quarterly report of regulatory enforcement actions.

Financial Audits: Annually, the Office of Inspector General contracts with a public accounting firm to audit FHFB's financial statements annually. This audit is conducted in accordance with generally accepted auditing standards (GAAS) and the standards applicable to financial audits contained in Generally Accepted Government Auditing Standards (GAGAS).

Federal Information Security Management Act (FISMA): The Office of Inspector General annually reviews and evaluates the agency's information technology systems for FISMA compliance. This includes evaluating information technology controls for financial management systems. The FHFB Inspector General completed the FHFB's annual FISMA audit on September 30, 2008. There were no significant deficiencies noted in the report. There was one reportable condition that was self declared by the FHFB CIO through the quarterly CRS.Net's Plan of Action and Milestones (POAM) process. The reportable condition was related to the expiration of the CRS.Net's Interconnection Service Agreement with the Office of Finance and was discovered through the internal review conducted on all FISMA Major Applications. All previous year findings were closed.

Network Penetration: The FHFB's Inspector General, as part of the FISMA audit process, contracted an independent firm to perform internal and external vulnerability and penetration scans of the FHFB's network. The FHFB's network was determined to be secure. The same independent firm performed the internal and external vulnerability and penetration scans for the FHFB in FY2007. At the beginning of the 2008 scan engagement, the firm provided the FHFB team with an Excellence in Network Security Award for 2007. The award was given to the top one percent most secure networks of the 660 networks that were scanned by the firm during 2007.

Customer Satisfaction Survey: FHFB conducted an annual survey to obtain opinions on the quality of the agency's information technology products and services. This provided a better understanding of user needs and resulted in improved service.

Human Capital Management Survey: FHFB participated in the Office of Personnel Management's Human Capital Management Survey as well as conducting its own survey. These surveys gave agency employees the opportunity to evaluate how well FHFB was managing its human capital. The results provided valuable insight into the challenges FHFB management and leaders faced in ensuring FHFB improved the quality of its leadership, sustained a results-oriented performance culture, and promoted continuous workforce improvement.

Training and Development Program: FHFB approved funding and hired a training officer in FY2008. The training officer assessed the knowledge, skills and abilities FHFB employees needed and developed programs designed to meet those needs. In addition, OS continued to train new examiners and developed specialized training to address emerging issues.

Workplace Improvement Committee: FHFB established a Workplace Improvement Committee to provide an open and flexible forum for identifying and pursuing opportunities to improve FHFB's work environment and to provide focus and direction for FHFB's commitment to support employees in their work and careers. FHFB was committed to maintaining a positive and productive work environment.

Equal Employment Opportunity: FHFB was committed to equal employment opportunity and the implementation of a strong program to promote employment and advancement opportunities without regard to race, sex, sexual orientation, religion, color, national origin, age or disability. In addition, FHFB took advantage of employment programs that integrated veterans, disabled people, and other populations into the public sector workforce. FHFB provided an online training course designed to instruct employees about their rights and remedies available under the antidiscrimination, retaliation and whistleblower protection laws, as required by the Notification and Federal Anti-Discrimination and Retaliation Act of 2002. FHFB completed this requirement in FY2007 with 100 percent participation.

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FHFB
Financial Section

FHFB 2008 PERFORMANCE AND ACCOUNTABILITY REPORT

Michele L. Horowitz,
FHFB Chief Financial Officer

Message From The Chief Financial Officer

I am pleased to report that the Federal Housing Finance Board (FHFB) has received an unqualified "clean" opinion from the Office of Inspector General on the audit of its 2008 financial statements. This clean opinion attests to the fact that our financial statements were fairly presented and demonstrated discipline and accountability in the execution of our responsibilities. This is the 19th year for this achievement. In addition, OIG did not note any material internal control weaknesses or noncompliance with laws and regulations. Also the OIG has not noted any management letter issues related to internal controls on the financial statements, since 2005.

The FHFB has evaluated its risk management and internal control systems in accordance with the reporting requirements of the Federal Managers' Financial Integrity Act (FMFIA) and the Government Accountability Office's (GAO) internal control standards. The objectives of the agency's risk management and internal control systems are to provide management with reasonable, but not absolute, assurance that:

- Obligations and costs comply with applicable laws;
- Assets are safeguarded against waste, loss, unauthorized use and misappropriation;
- Revenues and expenditures applicable to agency operations are recorded and properly accounted for, so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained;
- Programs are efficiently and effectively carried out in accordance with applicable laws and management policies; and,
- Systems are established to alert management of potential weaknesses.

Based on this evaluation, I can provide a reasonable assurance that the agency's risk management and internal control systems, taken as a whole, are in conformance with the standards prescribed by GAO and the objectives of FMFIA.

As the FHFB winds down its operations, a strong risk management and internal control program remains important. As the Federal Housing Finance Agency takes shape, sound financial management systems and processes that emphasize the importance of strong risk management and internal controls will provide a solid framework for the new agency.

Sincerely,

Michele L. Horowitz

Michele L. Horowitz
Chief Financial Officer

Federal Housing Finance Board

October 14, 2008

MEMORANDUM

TO: Ronald A. Rosenfeld
Chairman

FROM: Edward Kelley
Inspector General

SUBJECT: Finance Board Management Challenges

In accordance with OMB Circular A-136, I am providing my summary of the most serious management and performance challenges facing the Finance Board and my assessment of the agency's progress in addressing those challenges.

MANAGEMENT CHALLENGE

Ensuring the proper wind up of the Federal Housing Finance Board operations

On July 30, 2008, the president signed the "Housing and Economic Recovery Act of 2008". The Act gives the Finance Board only responsibility for winding up the affairs of the Federal Housing Finance Board by July 30, 2009. The Finance Board needs to take appropriate steps to ensure that the wind up of FHFB affairs is completed in the most efficient, economical and effective manner and in the absence of fraud, waste or abuse.

Agency Progress – The Finance Board has taken very positive steps towards ensuring the proper wind up of FHFB affairs. Agency management has taken a very positive approach to resolving related audit findings and committing to continue corrective actions at the newly created Federal Housing Finance Agency when appropriate.

If you have any questions or if I can be of any assistance, please contact me at extension 2544.

cc: Stephen Cross
David Lee
Christopher Curtis

BROWN & COMPANY CPAs, PLLC
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the accompanying balance sheet of the Federal Housing Finance Board (the Finance Board) as of September 30, 2008 and the related statements of net cost, changes in net position, and budgetary resources for the year then ended. We also audited the balance sheet as of September 30, 2007 and the related statements of revenue, expenses and changes in net position and cash flows for the year then ended. These financial statements are the responsibility of the Finance Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirement for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Housing Finance Board as of September 30, 2008 and 2007, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with U.S. Government Auditing Standards and OMB Bulletin No. 07-04, we have also issued a report dated November 6, 2008 on our consideration of the Finance Board's internal control over financial reporting and its compliance with provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with U.S. Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The information in "Management's Discussion & Analysis" is presented for the purpose of additional analysis and is required by OMB Circular No. A-136, revised *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.

Brown & Company

Largo, Maryland
November 6, 2008

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CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITORS REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Office of Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2008 and have issued our report thereon dated November 6, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in U.S Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

In planning and performing our audit, we considered the Finance Board's internal control over financial reporting by obtaining an understanding of the Finance Board's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide an opinion on internal control and therefore, we do not express an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 07-04, Significant Deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. Material Weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

In addition, with respect to internal control objective related to the performance measures included in the "Management's Discussion & Analysis," we obtained an understanding of the design of internal controls relating to the existence and completeness assertions, and determined whether they have been placed in operation as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide opinion on internal control over reported performance measures, and, accordingly, we do not express an opinion on such controls.

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This report is intended solely for the information and use of the management of the Federal Housing Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Brown & Company

Largo, Maryland
November 6, 2008

BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2008, and have issued our report thereon dated November 6, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

The management of the Finance Board is responsible for complying with laws and regulations applicable to the Finance Board. As part of obtaining reasonable assurance about whether the Finance Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Finance Board.

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

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

This report is intended solely for the information and use of the management of the Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Brown & Company

Largo, Maryland
November 6, 2008

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FEDERAL HOUSING FINANCE BOARD

Balance Sheet

As of September 30, 2008 and 2007

	(In Dollars)	
	2008	2007
Assets:		
Intragovernmental:		
Fund Balance With Treasury (Note 2)	$ 6,778,649	$ 6,727,173
Accounts Receivable (Note 1)	1,462,000	-
Total Intragovernmental	8,240,649	6,727,173
Accounts Receivable (Note 1)	3,080	2,189
General Property, Plant and Equipment, Net (Note 3)	1,012,730	1,186,745
Other	10,840	10,671
Total Assets	$ 9,267,299	$ 7,926,778
Liabilities:		
Intragovernmental:		
Accounts Payable	$ 131,643	$ 225,033
Other (Note 4)	173,207	134,627
Total Intragovernmental	304,850	359,660
Accounts Payable	2,059,730	1,459,183
Other (Note 4)	2,988,500	2,503,516
Total liabilities	$ 5,353,080	$ 4,322,359
Net Position:		
Cumulative Results of Operations - Other Funds	$ 3,914,219	$ 3,604,419
Total Net Position	3,914,219	3,604,419
Total Liabilities and Net Position	$ 9,267,299	$ 7,926,778

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING FINANCE BOARD

Statement of Net Cost

for the Years Ended September 30, 2008 and 2007

(In Dollars)

	2008	2007
Payment Costs:		
Review of Federal Home Loan Banks:		
Gross Costs (Note 6)	$ 38,620,598	$ 35,568,057
Less: Earned Revenue	37,989,374	31,111,239
Net Program Costs	631,224	4,456,818
Net Cost of Operations	$ 631,224	$ 4,456,818

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING FINANCE BOARD

Statement of Changes in Net Position

for the Years Ended September 30, 2008 and 2007

(In Dollars)

	2008	2007
Cumulative Results of Operations:		
Beginning Balances	$ 3,604,419	$ 7,002,116
Budgetary Financing Sources:		
Transfers In/Out Without Reimbursement	$ (80,904)	$ -
Other Financing Sources (Non-Exchange):		
Imputed Financing Sources	1,021,928	1,059,121
Total Financing Sources	$ 941,024	$ 1,059,121
Net Cost of Operations	631,224	4,456,818
Net Change	$ 309,800	$ (3,397,697)
Cumulative Results of Operations	$ 3,914,219	$ 3,604,419
Net Position	$ 3,914,219	$ 3,604,419

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING FINANCE BOARD

Statement of Budgetary Resources

for the Years Ended September 30, 2008 and 2007

(In Dollars)

	2008	2007
Payment Costs:		
Budgetary Resources:		
Unobligated Balance:		
Unobligated Balance Brought Forward, October 1	$ 2,151,043	$ 4,742,569
Recoveries of Prior Year Unpaid Obligations	636,680	589,351
Budget Authority		
Spending Authority From Offsetting Collections		
Earned		
Collected	36,527,374	31,111,239
Change In Receivables From Federal Sources	1,462,000	-
Change In Unfilled Customer Orders		
Without Advance From Federal Sources	4,038,000	-
Subtotal	42,027,374	31,111,239
Total Budgetary Resources	$ 44,815,097	$ 36,443,159
Status of Budgetary Resources:		
Obligations Incurred		
Reimbursable	$ 42,966,644	$ 34,292,116
Unobligated Balance		
Exempt From Apportionment	1,848,453	2,151,043
Total Status of Budgetary Resources	$ 44,815,097	$ 36,443,159
Change in Obligated Balance:		
Obligated Balance, Net		
Unpaid Obligations, Brought Forward, October 1	$ 4,576,130	$ 4,200,271
Obligations Incurred Net	42,966,644	34,292,116
Less: Gross Outlays	36,475,898	33,326,906
Less: Recoveries of Prior Year Unpaid		
Obligations, Actual	636,680	589,351
Change In Uncollected Customer Payments		
From Federal Sources	(5,500,000)	-
Obligated Balance, Net, End of Period		
Unpaid obligations	10,430,196	4,576,130
Less: Uncollected Customer Payments From		
Federal Sources	5,500,000	-
Total, Unpaid Obligated Balance, Net, End of Period	$ 4,930,196	$ 4,576,130
Net Outlays:		
Net Outlays:		
Gross Outlays	$ 36,475,898	$ 33,326,906
Less: Offsetting Collections	36,527,374	31,111,239
Net Outlays	$ (51,476)	$ 2,215,667

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING FINANCE BOARD

Notes to the Financial Statements

NOTE 1 • SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and the status and availability of budgetary resources of the Federal Housing Finance Board (FHFB). The statements are a requirement of the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994 and the Accountability of Tax Dollars Act of 2002. They have been prepared from, and are fully supported by, the books and records of the FHFB in accordance with the hierarchy of accounting principles generally accepted in the United States of America, standards approved by the principals of the Federal Accounting Standards Advisory Board (FASAB), Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements and the FHFB accounting policies which are summarized in this note. These statements, with the exception of the Statement of Budgetary Resources, are different from financial management reports, which are also prepared pursuant to OMB directives that are used to monitor and control the FHFB's use of budgetary resources.

The statements consist of the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources. In accordance with OMB Circular No. A-136, the financial statements and associated notes are presented on a comparative basis. Unless specified otherwise, all amounts are presented in dollars.

B. Reporting Entity

The FHFB is an independent non-appropriated Agency in the Executive Branch. The FHFB ensures that Federal Home Loan Banks, which are privately capitalized, government-sponsored enterprises, operate in a safe and sound manner, carry out the housing and community development finance mission, and remain adequately capitalized and able to raise funds in the capital markets. The Federal Home Loan Bank System raises its money through the Office of Finance that acts as the central debt issuance facility for all 12 Federal Home Loan Banks.

The Federal Home Loan Bank System was created in 1932 to promote home ownership and a strong home-finance industry. It is a network of 12 district banks that provide lending, deposit, and other services to mortgage-lending institutions. The members of the Federal Home Loan Bank System originate and hold a significant portion of the nation's home mortgages. Membership includes the thrift institutions, commercial banks, credit unions, and a small number of insurance companies.

Each Federal Home Loan Bank and the Office of Finance operates with its own staff and funding. Accordingly, the accompanying financial statements summarize only the financial activities of the FHFB.

The FHFB is located in Washington, DC, where it operates with a staff of approximately 140 employees under the direction of a five member Board of Directors, four of whom are appointed from the private sector by the President. The fifth is the Secretary of Housing and Urban Development or designee. Operation of the FHFB is funded by the collection of assessments from each of the Federal Home Loan Banks. These assessments are used to fund the salaries and expenses of staff engaged in supervision and compliance activities, policy development, strategic planning, and administration. These funds are neither appropriated nor subject to apportionment.

C. Establishment of Federal Housing Finance Agency

On July 30, 2008 the President signed into law the Housing and Economic Recovery Act of 2008 (HERA). HERA created the Federal Housing Finance Agency (FHFA) which is empowered with supervisory and regulatory oversight of the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. Under HERA, the transfer of personnel, property, and program activities of the Federal Housing Finance Board (FHFB), Office of Federal Housing Enterprise Oversight (OFHEO), and certain employees and activities of the Department of Housing and Urban Development related to the regulation of the mission of Fannie Mae and Freddie Mac are transferred to FHFA. In addition, all regulatory authority of the FHFB has been transferred to FHFA.

NOTE 1, continued

HERA abolishes the FHFB effective at the end of the 1-year period beginning on the date of enactment. During this 1-year period, the FHFB exists solely for the purpose of winding up the affairs of the FHFB.

Upon enactment of HERA, the assessments of the FHFB became the assessments of FHFA. Such assessments may be used for expenses associated with winding up the affairs of the FHFB and other related operational expenses. The FHFB transferred $80,904 to FHFA to fund the non-personnel obligations incurred by FHFA from July 30, 2008 to September 30, 2008. This transfer is reflected in the Balance Sheet, the Statement of Changes in Net Position and in the Statement of Budgetary Resources. The FHFA incurred $593,140 in personnel costs from FHFB related to FHFA activities. These personnel costs were paid directly from FHFB's fund as they were incurred. Also, FHFA requested the FHFB procure legal services for FHFA in the amount of $5,500,000 related to the conservatorship of Fannie Mae and Freddie Mac.

D. Basis of Accounting

Transactions are recorded on both an accrual accounting basis, consistent with accounting principles generally accepted in the United States of America, and a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or disbursement of cash. Budgetary accounting facilitates compliance with legal requirements on the use of federal funds.

E. Revenues & Other Financing Sources

Operating revenues of the FHFB are obtained through assessments of the 12 Federal Home Loan Banks. The banks are collectively assessed based on amounts needed to fund the FHFB's annual budget. The agency's Board of Directors, in September 2007, approved the budget. Each Federal Home Loan Bank's share is based upon the dollar value of its capital stock relative to the combined dollar value of all Federal Home Loan Banks' capital stock. The FHFB's expenses are met through assessments paid by the Federal Home Loan Banks, which totaled $36,520,186 and $31,109,690 for the fiscal years ended September 30, 2008 and 2007, respectively.

The FHFB recognizes as an imputed financing source the amount of accrued pension and post-retirement benefit expenses for current employees paid on the FHFB's behalf by the Office of Personnel Management (OPM).

F. Taxes

The FHFB, as a federal entity, is not subject to federal, state, or local income taxes, and, accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

G. Fund Balance with Treasury

The U.S. Treasury processes cash receipts and disbursements. Funds held at the Treasury are available to pay agency liabilities. The FHFB does not maintain cash in commercial bank accounts or foreign currency balances.

Significant receipts are transmitted to Treasury monthly by the 12 Federal Home Loan Banks which are assessed amounts necessary to cover the FHFB's expected operating needs for the fiscal year.

Disbursements are made as necessary to fund the biweekly payroll and administrative costs of the organization. Due to of the nature of the FHFB's program, disbursements do not vary significantly from month to month.

H. Accounts Receivable

Accounts receivable consists of amounts owed to the FHFB by other federal agencies and the public. Amounts due from federal agencies are considered fully collectible. Accounts receivable from the public include reimbursements from employees. An allowance for uncollectible accounts receivable from the public is established when either (1) based upon a review of outstanding accounts and the failure of all collection efforts, management determines that collection is unlikely to occur considering the debtor's ability to pay, or (2) an account for which no allowance has been established is submitted to the Department of the Treasury for collection, which takes place when it becomes 180 days delinquent. As of September 30, 2008 and 2007 the balance in accounts receivable from the public was $3,080 and $2,189 respectively.

NOTE 1, continued

I. Property and Equipment, Net

Equipment acquisitions greater than or equal to $25,000 are capitalized and depreciated using the straight-line method over the estimated useful life of the asset. Additionally, for bulk purchases of similar items, which individually do not meet the test for capitalization, the acquisition is capitalized and depreciated if the depreciated basis of the bulk purchase is $100,000 or more. Applicable standard governmental guidelines regulate the disposal and convertibility of agency property, plant and equipment. The useful life classifications for capitalized assets are as follows:

Description	Useful Life (years)
Furniture, Fixtures, and Equipment	6
Electronic Data Processing Systems	3
Data Handling Equipment (Excluding computers)	6
Software and Computer Programs	3
Real Property Improvements	30

Leasehold Improvement's useful life is equal to the remaining lease term or the estimated useful life of the improvement, whichever is shorter.

J. Advances and Prepaid Charges

Advance payments are generally prohibited by law. There are some exceptions, such as reimbursable agreements, subscriptions and payments to contractors and employees. Payments made in advance of the receipt of goods and services are recorded as advances or prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received. As of September 30, 2008 and 2007 prepaid expenses were $10,840 and $10,671, respectively.

K. Liabilities

Liabilities covered by budgetary or other resources are those liabilities for which funding is available to pay amounts due.

Intragovernmental liabilities are claims against the FHFB by other federal agencies. Additionally, the Government, acting in its sovereign capacity, can abrogate liabilities.

L. Accounts Payable

Accounts payable consists of amounts owed to other federal agencies and the public.

M. Employee Leave and Benefits

Accrued Leave: FHFB employees are entitled to accrue annual leave and sick leave at a rate based on years of federal service. For most employees, annual leave may be accrued up to 240 hours each year. Senior Executive Service (SES) employees may accrue annual leave consistent with the rules for SES level employees. Any unused annual leave balance is paid to the employee upon leaving federal service, based on the employee's earnings per hour. There is no maximum limit on the amount of sick leave that may be accrued. Upon separation, any unused sick leave of CSRS plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. For FERS plan employees, unused sick leave is held indefinitely and may be used if rehired.

Health Benefits and Life Insurance: The FHFB, through programs established for all agencies by the federal government, offers its employees health and life insurance coverage. The cost of each is shared by the FHFB and its employees. The FHFB's fiscal year 2008 contribution to health and life insurance coverage was $1,061,688. The fiscal year 2007 contribution was $1,022,594. In addition, all employees have 1.45% of gross earnings withheld to pay for future Medicare coverage.

NOTE 1, continued

N. Accrued Workers' Compensation

A liability is recorded for actual and estimated future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The actual costs incurred are reflected as a liability because the FHFB will reimburse the Department of Labor (DOL) two years after the actual payment of expenses. The liability consists of (1) the net present value of estimated future payments calculated by the DOL, and (2) the unreimbursed cost paid by DOL for compensation to recipients under the FECA.

O. Retirement Plans

FHFB employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The employees who participate in CSRS are beneficiaries of FHFB's matching contribution, equal to 7% of pay, distributed to the employee's annuity account in the Civil Service Retirement and Disability Fund.

FERS went into effect on January 1, 1987. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984 elected to join either FERS and Social Security, or remain in CSRS. FERS offers a Thrift Savings Plan to which the FHFB automatically contributes 1% of pay and matches any employee contribution up to an additional 4% of pay. For FERS participants, the FHFB also contributes the employer's matching share of Social Security.

FERS employees and certain CSRS reinstatement employees are eligible to participate in the Social Security program after retirement. In these instances, the FHFB remits the employer's share of the required contribution.

The FHFB recognizes the imputed cost of pension and other retirement benefits during the employees' active years of service. OPM actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicates these factors to the FHFB for current period expense reporting. OPM also provides information regarding the full cost of health and life insurance benefits. The FHFB recognized the offsetting revenue as imputed financing sources to the extent these expenses will be paid by OPM.

The FHFB does not report on its financial statements information pertaining to the retirement plans covering its employees. Reporting amounts such as plan assets, accumulated plan benefits, and related unfunded liabilities, if any, is the responsibility of the OPM.

The FHFB's 401(K) is administered by T. Rowe Price. Eligible employees may contribute up to 10% of salary on a pre-tax basis while the FHFB will match contributions up to 3% of the employee's salary. Qualified employees may participate in both the Federal Thrift Savings Plan and/or the FHFB's 401(K) Savings Plan, up to the Internal Revenue Code limitations established for salary deferral and annual additions.

P. Use of Estimates

Management has made certain estimates when reporting assets, liabilities, revenue, and expenses, and in the note disclosures. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Q. Imputed Costs/Financing Sources

Federal government entities often receive goods and services from other federal government entities without reimbursing the providing entity for all the related costs. In addition, federal government entities also incur costs that are paid in total or in part by other entities. An imputed financing source is recognized by the receiving entity for costs that are paid by other entities. The FHFB recognized imputed costs and financing sources in fiscal years 2008 and 2007 to the extent directed by OMB.

NOTE 1, continued

R. Contingencies

Liabilities are deemed contingent when the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. The FHFB recognizes contingent liabilities, in the accompanying balance sheet and statement of net cost, when it is both probable and can be reasonably estimated. The FHFB discloses contingent liabilities in the notes to the financial statements when the conditions for liability recognition are not met or when a loss from the outcome of future events is more than remote.

Litigation: As of the end of the period beginning on October 1, 2007 and ending on September 30, 2008, there was one case consolidating two civil actions previously filed by the same plaintiff pending in the U.S. District Court for the District of Columbia. The FHFB anticipates that following the discovery period, it will file a dispositive motion with regard to all claims that have not already been dismissed. Each civil action in the consolidated case has a potential loss ranging from $0 to $300,000. An unfavorable outcome is considered unlikely. As of July 30, 2008 (see Housing and Economic Recovery Act of 2008, Pub. L. No 110-289, 122 Stat. 2654), the FHFB's responsibilities were transferred to the newly created Federal Housing Finance Agency.

S. Reclassification

Certain fiscal year 2007 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation.

NOTE 2 • FUND BALANCE WITH TREASURY

Fund balance with Treasury account balances as of September 30, 2008 and 2007 were:

	2008	2007
Fund Balances:		
Total Other Fund Types	$ 6,778,649	$ 6,727,173
Status of Fund Balance with Treasury:		
	2008	2007
Unobligated Balance - Available	$ 1,848,453	$ 2,151,043
Obligated Balance Not Yet Disbursed	4,930,196	4,576,130
Total	$ 6,778,649	$ 6,727,173

NOTE 3 • GENERAL PROPERTY AND EQUIPMENT

Property and equipment account balances as of September 30, 2008 and 2007 were as follows:

Schedule of Property and Equipment as of September 30, 2008

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Software	$ 3,397,262	$ 3,014,234	$ 383,028
Furniture & Equipment	1,995,950	1,385,937	610,013
Internal-Use Software In Development	19,689	-	19,689
Total	$ 5,412,901	$ 4,400,171	$ 1,012,730

Schedule of Property and Equipment as of September 30, 2007

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Software	$ 3,237,769	$ 2,820,907	$ 416,862
Furniture & Equipment	2,247,170	1,543,342	703,828
Internal-Use Software In Development	66,055	-	66,055
Total	$ 5,550,994	$ 4,364,249	$ 1,186,745

NOTE 4 • OTHER LIABILITIES

The accrued liabilities for the FHFB are comprised of program expense accruals, payroll accruals, and funded annual leave earned by employees. Program expense accruals represent expenses that were incurred prior to month-end but were not paid. Similarly, payroll accruals represent payroll expenses that were incurred prior to month-end but were not paid.

	2008	2007
Intragovernmental		
Payroll Taxes Payable	$ 173,207	$ 134,627
Total Intragovernmental	173,207	134,627
Accrued Payroll and Benefits	1,040,911	803,187
Capital Lease Obligations	906	6,097
Funded Annual Leave	1,946,683	1,694,232
Total Other Liabilities	$ 3,161,707	$ 2,638,143

All liabilities are current liabilities.

NOTE 5 • LEASES

Capital Leases

The FHFB leases a copier under a lease-to-own agreement. The lease term is 60 months. The minimum future lease payments and the present value of the net minimum lease payments are as follows:

Fiscal Year	Amount
2009	$ 457
Total Future Minimum Lease Payments	457
Less: Imputed Interest	3
Present Value of the Net Minimum Lease Payments	454
Less: Current Portion	454
Lease Obligation – Long Term	$ -

Operating Leases

The FHFB leases office space at 1625 Eye Street, Washington D.C., under a non-cancelable long-term lease that expires on June 30, 2015, and requires monthly payments. Contingency space at an undisclosed location is also leased with the lease expiring on January 31, 2009. Total rental payments for the fiscal years ended September 30, 2008 and 2007 were $3,556,495 and $3,290,278, respectively. The rental payments for the fiscal year ending September 30, 2007 were reduced by a tenant improvement allowance in the amount of $166,453. The minimum future payments for both locations, as required by the leases, are as follows:

Fiscal Year	Amount
2009	$ 3,425,166
2010	3,475,652
2011	3,602,273
2012	3,674,395
2013	3,747,925
Thereafter	6,732,958
Total	$ 24,658,369

NOTE 6 • OPERATING/ PROGRAM COSTS

Costs by major budgetary object classification as of September 30, 2008 and 2007 are as follows:

	2008	2007
Budgetary Object Classifications		
Personnel Compensation	$ 18,444,812	$ 17,131,753
Personnel Benefit	6,741,994	6,221,904
Benefits to Former Employees	7,677	3,231
Travel	1,460,191	1,157,875
Transportation	10,992	20,456
Rents, Communication & Utilities	4,204,312	4,006,525
Printing and Reproduction	(58,620)	248,930
Other Services	7,176,078	6,067,179
Supplies and Materials	215,695	258,488
Equipment	417,467	451,716
Total	$ 38,620,598	$ 35,568,057

The FHFB has incurred personnel costs of $593,140 for the activities and start up of FHFA.

NOTE 7 • IMPUTED FINANCING SOURCES

The FHFB recognizes as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees. The assets and liabilities associated with such benefits are the responsibility of the administering agency, OPM. For the fiscal years ended September 30, 2008 and 2007, respectively, imputed financing was $1,021,928 and $1,059,121.

NOTE 8 • BUDGETARY RESOURCE COMPARISONS TO THE BUDGET OF THE UNITED STATES GOVERNMENT

Statement of Federal Financial Accounting Standards No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, calls for explanations of material differences between amounts reported in the Statement of Budgetary Resources (SBR) and the actual balances published in the Budget of the United States Government (President's Budget). However, the President's Budget that will include FY08 actual budgetary execution information has not yet been published. The President's Budget is scheduled for publication in February 2009 and can be found at the OMB Web site: http://www.whitehouse.gov/omb. The 2009 Budget of the United States Government, with the Actual column completed for 2007, has been reconciled to the Statement of Budgetary Resources and there were no material differences.

NOTE 9 • UNDELIVERED ORDERS AT THE END OF THE PERIOD

Statement of Federal Financial Accounting Standards No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, states that the amount of budgetary resources obligated for undelivered orders at the end of the period should be disclosed. For the fiscal years ended September 30, 2008 and 2007, undelivered orders amounted to $5,077,117 and $253,772, respectively.

NOTE 10 • RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

The FHFB has reconciled its budgetary obligations and non-budgetary resources available to its net cost of operations.

	2008	2007
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 42,966,644	$ 34,292,116
Less: Spending Authority From Offsetting Collections and Recoveries	42,664,054	31,700,590
Obligations Net of Offsetting Collections and Recoveries	302,590	2,591,526
Net Obligations	302,590	2,591,526
Other Resources		
Imputed Financing From Costs Absorbed By Others	1,021,928	1,059,121
Net Other Resources Used to Finance Activities	1,021,928	1,059,121
Total Resources Used to Finance Activities	$ 1,324,518	$ 3,650,647
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change In Budgetary Resources Obligated For Goods, Services and Benefits Ordered But Not Yet Provided	$ 785,514	$ (493,323)
Resources That Finance the Acquisition of Assets	116,110	-
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	80,904	-
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	$ 982,528	$ (493,323)
Total Resources Used to Finance the Net Cost of Operations	$ 341,990	$ 4,143,970
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period		
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	$ 417,164	$ 510,838
Revaluation of Assets or Liabilities	-	5,383
Other	(127,930)	(203,373)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources In The Current Period	289,234	312,848
Net Cost of Operations	$ 631,224	$ 4,456,818

Glossary

Advances – Collateralized loan made by an FHLBank to a member to fund lending activities and to maintain liquidity for the member's operations. The FHLBank Act requires all advances to be collateralized and limits collateral to Treasury and agency securities, deposits in an FHLBank, residential mortgage loans, and other real estate-related collateral.

Affordable Housing Program (AHP) – This program subsidizes the cost of owner-occupied housing for individuals and families with incomes at or below 80 percent of the area median income and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of area medium income. AHP funds are available through a competitive application program and a homeownership set-aside program at each of the FHLBanks. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an advance. Each of the 12 FHLBanks contributes 10 percent of its previous year's net earnings to fund its AHP.

AHP Competitive Application Program – This program awards and disburses AHP subsidy through a scoring process established by an FHLBank. The competitive application program is a required program under the Federal Home Loan Bank Act.

AHP Homeownership Set-Aside Program – FHLBanks may set aside up to the greater of $4.5 million or 35 percent of its AHP funds each year to assist low-and moderate-income households purchase homes. Set-aside funds may be used for down payment, closing cost, counseling or rehabilitation assistance in connection with the household's purchase or rehabilitation of an owner-occupied unit. Homeownership set-aside programs are voluntary, although each FHLBank offers at least one set-aside program.

AHP Income Categories – Categories are defined by regulation as:

Low- or Moderate-Income Household – An income of 80 percent or less of the median income for the area, with the income limit adjusted for household size in accordance with the methodology of the applicable median income standard, unless such median income standard has no household size adjustment methodology.

Very Low-Income Household – An income at or below 50 percent of the median income for the area, with the income limit adjusted for household size in accordance with the methodology of the applicable median income standard, unless such median income standard has no household size adjustment methodology.

Bonds – Consolidated obligations generally with maturity of one year or longer. The majority of the FHLBanks bonds are fixed-rate bonds with original maturities of five years or less.

Community Investment Cash Advance Program (CICA) – Offers funding, including low-cost, long-term funding, for FHLBank members and housing associates to use for financing economic development projects for targeted beneficiaries and targeted income levels. Economic development projects include commercial, industrial, manufacturing, social service and public facility projects and activities, and public or private infrastructure projects such as roads, utilities and sewers. Members may use CICA funds to provide financing through loan originations, loan participations, revolving loan funds, and purchases of low-income housing tax credits and mortgage securities.

Community Investment Program (CIP) – The Bank Act requires that the FHLBanks provide CIP advances for members to use to finance eligible targeted housing and economic development projects. CIP can be used for financing certain types of economic development projects and for financing housing projects for households at targeted income levels, including rental housing, owner-occupied housing and manufactured housing parks. FHLBanks may use advances and letters of credit for CIP.

Consolidated Obligations (COs) – Debt obligations issued by OF on behalf of the FHLBanks. All consolidated obligations, regardless of term, are joint-and-several liabilities of all FHLBanks. This means that if any one FHLBank were to default on its debt obligations, the other FHLBanks would be required to ensure prompt payment of the debt owed by that FHLBank. The joint-and-several liability structure of FHLBank system debt, along with the *perceived* backing of the U.S. government has traditionally allowed the FHLBanks to borrow from capital markets at rates below those of other financial institutions. Consolidated obligations issued by the FHLBanks carry no explicit backing from the U.S. Government.

Discount Notes – Consolidated obligations with maturity of less than one year that are sold at a discount.

FHLBank Membership – According to the FHLBank Act, membership in an FHLBank is limited to savings associations, cooperative banks, homestead associations, commercial banks, savings banks, credit unions, and insurance companies. Eligible institutions must apply for membership to the FHLBank that serves the geographical area where the institution has its principal place of business. All members must purchase and hold stock issued by their respective FHLBanks.

Horizontal Reviews – Another supervisory activity to assess a function, or program across all 12 of the FHLBanks. Such reviews compare operations, strategies, and policies in place at the FHLBanks and enable the Office of Supervision to identify and share best practices. In addition, concerns, deficiencies and other matters can be identified and are often addressed in advisory bulletins issued by the Office of Supervision following the review.

Model FHLBank – Developed and used by analysts at the FHFB to simulate the risks and expected returns of FHLBanks with similar asset, liability, and hedging strategies. The model can be used to conduct baseline and sensitivity analyses of an FHLBank's risk and return profile.

Private-Label Mortgage-Backed Securities – Securities that are issued by financial institutions other than Fannie Mae and Freddie Mac and backed by payments on mortgages.

Qualifying Mortgage Loans – In addition to advances, the FHLBanks purchase qualifying mortgage loans from members under various acquired member asset (AMA) programs. Under these programs, the FHLBank manages the market risk associated with the loans while members bear most of the credit risk through a loss-sharing arrangement or the purchase of mortgage insurance for loans sold to the FHLBank.

Office of Federal Housing Enterprise Oversight

2008 PERFORMANCE AND ACCOUNTABILITY REPORT

Office of Federal Housing Enterprise Oversight Mission

Promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.

Management's Discussion and Analysis

Overview

The Office of Federal Housing Enterprise Oversight (OFHEO) issues its Performance and Accountability Report (PAR) to promote transparency and improve the public's understanding of how OFHEO operates and what the agency has accomplished with its funding. This report provides a three-part summary of OFHEO's operations for fiscal year (FY) 2008:

Management's Discussion and Analysis contains the following sections:

- Overview
- Performance Summary
- Financial Summary

This section:

- *Explains OFHEO's purpose and structure*
- *Highlights the year's accomplishments*
- *Describes challenges facing the agency*
- *Summarizes OFHEO's performance*
- *Presents a financial summary for FY2008*

The **Performance Section** contains the following sections:

- Strategic Goal 1
- Strategic Goal 2
- Strategic Goal 3
- Resource Management

This section:

- *Describes OFHEO's planning process*
- *Presents performance information for each goal*
- *Describes OFHEO's historical performance for the past three years*
- *Explains how OFHEO achieved its goals*

The **Financial Section** contains the following sections:

- Message from the Chief Financial Officer
- Statement of Assurance
- Report of Independent Auditors
- Financial Statements
- Notes to Financial Statements

This section:

- *Accounts for how OFHEO spent its funds*
- *Describes how OFHEO complied with relevant laws and regulations and used proper internal controls*
- *Includes letters from the agency's external auditors and Director's assurance statement*

Purpose and Structure

OFHEO's Mission

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

OFHEO's Strategic Goals

To achieve OFHEO's mission, the agency has set three strategic goals:

1. Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.

2. Provide support for statutory reforms to strengthen our regulatory powers.

3. Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

This year, OFHEO established eight annual performance goals to support the agency's mission-related strategic goals and five annual performance goals to support its resource management strategy. OFHEO substantially achieved all but one of its performance goals. To measure results in achieving goals, OFHEO established 38 performance measures for fiscal year 2008, 81 percent of which were achieved or substantially achieved.

Most importantly, OFHEO's second strategic goal was achieved. The Federal Housing Finance Agency (FHFA), a new and stronger regulator, was created this year. This will be the last Performance and Accountability Report for OFHEO.

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

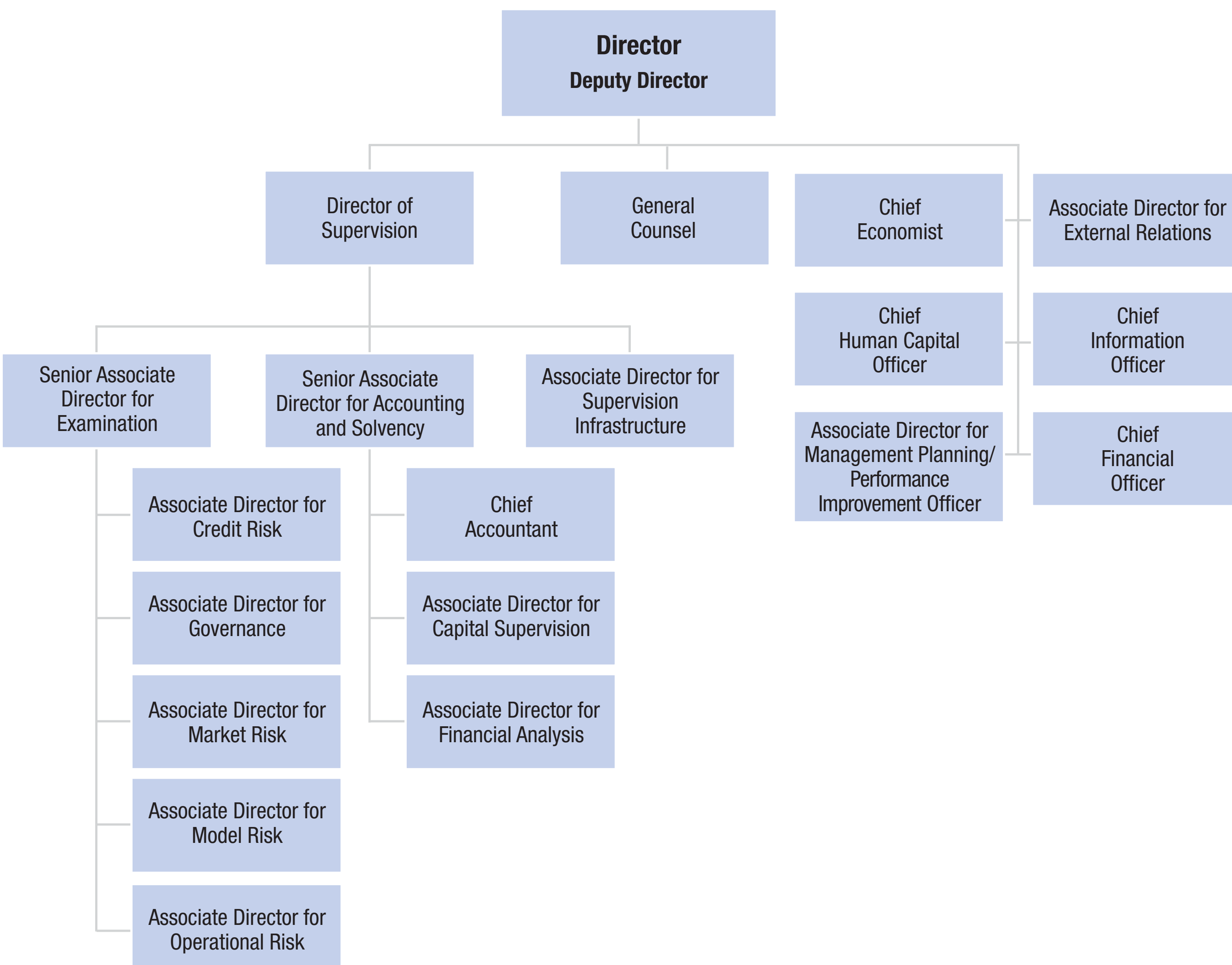
About OFHEO

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq) established OFHEO as an independent entity within the Department of Housing and Urban Development (HUD).

OFHEO's mission is to promote housing and a strong national housing finance system by ensuring the safety and soundness of two housing government-sponsored enterprises (GSEs)–Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac). OFHEO works to ensure the capital adequacy and financial safety and soundness of the two GSEs, also referred to as the Enterprises. OFHEO is funded by assessments from Fannie Mae and Freddie Mac, and although appropriated by Congress, its operations represent no direct cost to taxpayers.

On July 30, 2008, enactment of the Housing and Economic Recovery Act of 2008 (HERA) was enacted, created FHFA. This new agency combines the responsibilities of OFHEO, the Federal Housing Finance Board (FHFB) and the HUD GSE Mission Office team with additional authorities to ensure

Figure 9 • Organization Chart for OFHEO



The Role of Fannie Mae and Freddie Mac in the Secondary Mortgage Market

The primary and secondary mortgage markets work together to provide homeownership opportunities to as many Americans as possible. The secondary market provides liquidity to the primary market and helps establish mortgage rates.

In the primary mortgage market, financial institutions make mortgage loans directly to homebuyers. This process begins when the potential homeowner, or borrower, applies for a mortgage loan from a mortgage broker or lender. The lender can be a savings bank, credit union, mortgage banking company, commercial bank, savings and loan, state or local housing finance agency or community bank. Once the lender approves the application and the loan is processed, the mortgage lender provides the money to the borrower, who then applies the proceeds of the mortgage to the cost of the home. The lender in the primary market either holds the loans in its own portfolios or sells the home loans.

Congress established Fannie Mae and Freddie Mac to perform an important role in the nation's housing finance system: providing liquidity, stability and affordability to the secondary mortgage market. The Enterprises make funds readily accessible for thousands of banks, savings and loans and mortgage companies that make loans to finance housing. Fannie Mae and Freddie Mac are the largest buyers of mortgages in the secondary market. Fannie Mae and Freddie Mac buy mortgages up to the conforming loan limit ($417,000) from lenders and either hold these mortgages in their portfolios or package the loans into mortgage-backed securities (MBS) sold to the public. The Enterprises also buy for their own portfolio other agency and private-label MBS. Lenders can then use the cash raised by selling mortgages to the Enterprises to lend more so individuals and families who buy homes

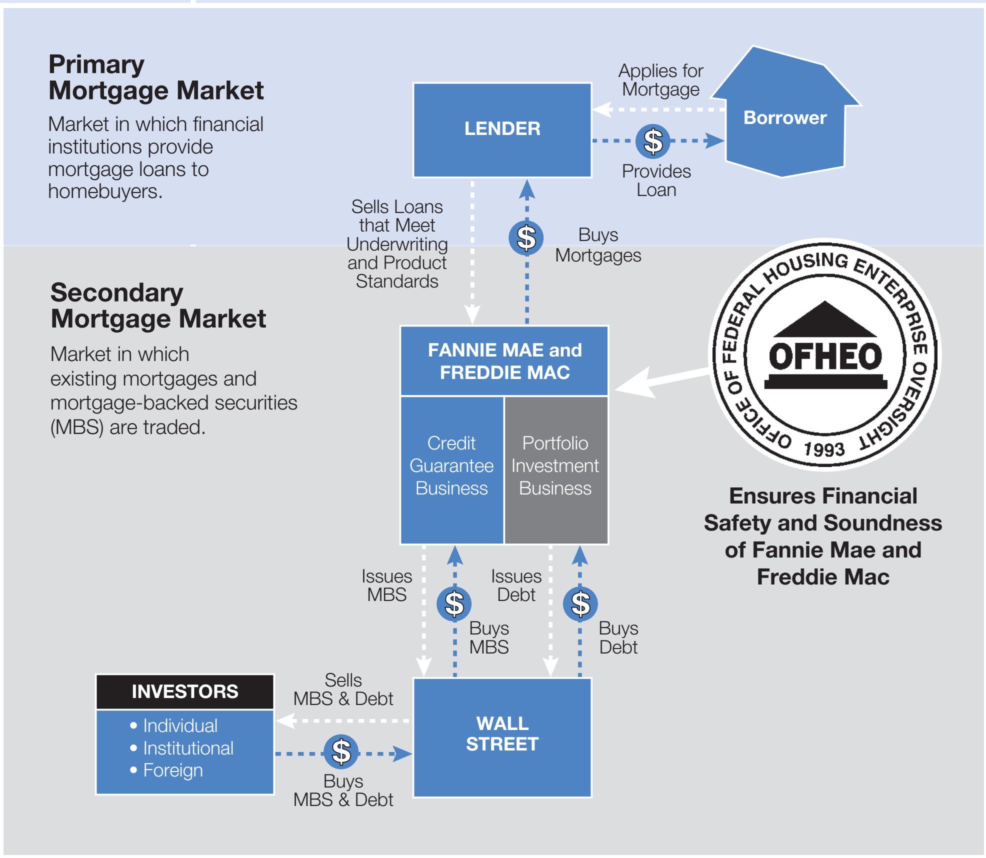


Figure 10 • OFHEO's Oversight Role

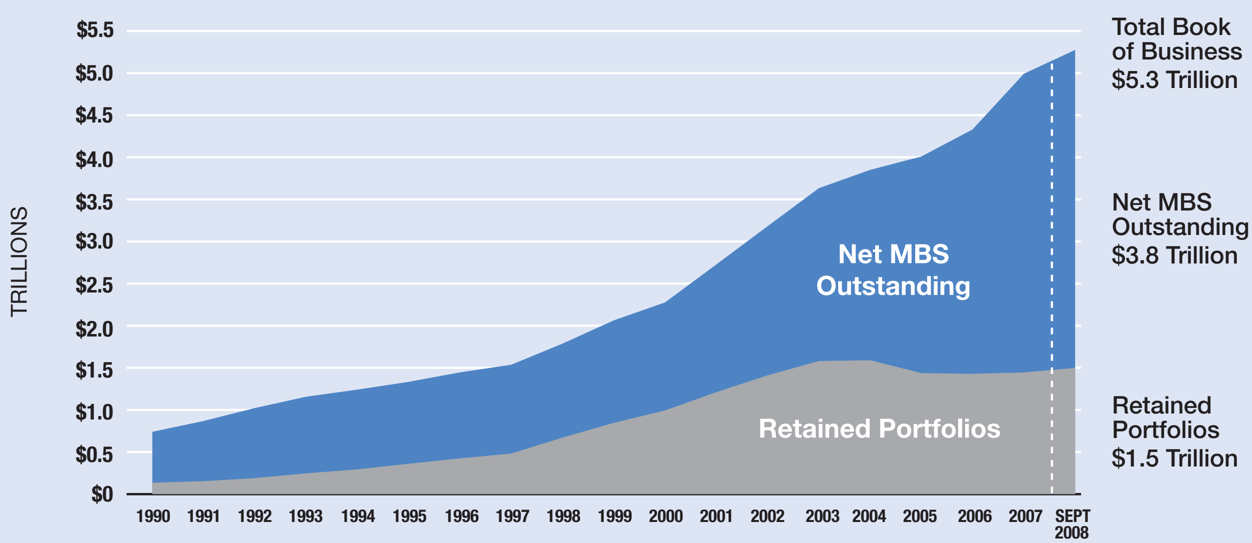
and investors who purchase apartment buildings and other multifamily dwellings will have a continuous, stable supply of mortgage money. In addition, roughly half of the mortgages purchased by Fannie Mae and Freddie Mac finance dwelling units that are affordable to low- and moderate-income households, and more than one-third are located in geographic areas designated as underserved.

MBS are traded in the secondary mortgage market. Because Fannie Mae and Freddie Mac package mortgages as MBS and guarantee timely payment of principal and interest on the underlying mortgages, investors who might not otherwise invest in mortgages enter the secondary mortgage market, which expands the pool of funds available for housing. That makes the secondary mortgage market more liquid and helps lower the interest rates paid by homeowners and other mortgage borrowers.

Fannie Mae and Freddie Mac also can help stabilize mortgage markets and protect housing during extraordinary periods when stress or turmoil in the broader financial system threatens the economy. Over the past year, in response to significant turmoil in the housing and credit markets, Fannie Mae and Freddie Mac accelerated their mortgage purchase and MBS issuance activities while other market participants withdrew from the residential mortgage market. Fannie Mae and Freddie Mac's market share of new originations climbed to 84 percent in the second quarter of 2008, up from 46 percent in the same period in 2007.

The Economic Stimulus Act of February 2008 authorized up to $729,750 for higher housing price areas to further support the mortgage market. HERA lowered that level to $625,500 for 2009. At the end of the third quarter of 2008, the Enterprises had $3.8 trillion in MBS held by others and $1.6 trillion in debt outstanding, which was used to buy mortgages. At the end of the second quarter of 2008, Fannie Mae and Freddie Mac owned or guaranteed 43 percent of all single- and multifamily mortgages in the United States.

Figure 11 • Enterprises' Combined Total Book of Business, 1990–2008 Q3



($ in billions)	FANNIE MAE 2006	FANNIE MAE 2007	FANNIE MAE 3Q08	FREDDIE MAC 2006	FREDDIE MAC 2007	FREDDIE MAC 3Q08
Mortgage Portfolio, Net	$ 773.7	$ 722.9	$ 744.7	$ 699.9	$ 709.8	$ 694.6
Investments	16.7	91.7	91.7	80.0	50.2	68.6
Other Assets	53.6	64.8	60.2	25.0	34.3	41.2
Total Assets	$ 843.9	$ 879.4	$ 896.6	$ 804.9	$ 794.4	$ 804.4
Debt	$ 767.0	$ 796.3	$ 831.3	$ 744.3	$ 738.6	$ 784.0
Other Liabilities	35.4	39.1	56.0	33.7	29.1	34.2
Capital	41.5	44.0	9.3	26.9	26.7	(13.8)

The adverse impact of rapidly deteriorating housing, mortgage and credit market conditions is reflected in the erosion of capital (stockholders' equity) at both Enterprises. The primary drivers of decreases in capital at both Enterprises were increased credit losses and charges to earnings to record valuation allowances that reduced their deferred tax assets. The decision to reduce deferred tax assets was the result of managements' conclusions that, given the uncertainty of future market conditions on the results of operations and the uncertainty surrounding the future business model, as of September 30, 2008, it was more likely than not that the Enterprises would not generate sufficient taxable income in future periods to realize the full value of the assets.

Other factors contributing to the decline in capital were substantial increases in provisions for credit losses due to increased estimates of losses; increases in security impairments and unrealized losses on available-for-sale securities; and increases in fair value losses on trading securities and derivatives.

At September 30, 2008, Freddie Mac's stockholders' equity (deficit) totaled $(13.8) billion. Freddie Mac entered into a senior preferred stock purchase agreement with Treasury on September 7, 2008, pursuant to which Treasury provided a commitment to provide up to $100 billion in funding to Freddie Mac if FHFA determines that the Enterprise's liabilities exceed its assets on a GAAP basis.

Accordingly, the Director of FHFA has submitted a request to Treasury under the Purchase Agreement in the amount of $13.8 billion. The Enterprise expects to receive such funds by November 29, 2008.

the stability of the nation's housing finance system by regulating the safety and soundness of Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. The new law allows a year to transition employees and consolidate functions within the new agency. After one year, both OFHEO and FHFB will be abolished. Work will continue through FHFA and performance results will be reported for that entity next year.

OFHEO's Organizational Structure

OFHEO's operations are structured efficiently to accomplish its mission with a relatively small staff. OFHEO's Director sets the direction for the agency to achieve its mission, and the component offices have specific responsibilities and work together to ensure effective oversight of Fannie Mae and Freddie Mac.

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

OFHEO had a staff of 258 employees at the end of FY2008. The agency is currently actively recruiting to fill more than 13 vacancies.

OFHEO, FHFB, and HUD GSE mission staff at the FHFA Kick-Off meeting.

OFHEO's **Office of Supervision** examines the Enterprises, identifies matters requiring attention or enforcement, determines capital adequacy, reviews compliance and conducts continuous and targeted supervision activities. In 2008, OFHEO introduced a new risk rating standard, GSE Enterprise Risk, to be used in examinations and reorganized its examination teams around it. GSE Enterprise Risk stands for Governance, Solvency, Earnings and Enterprise Risk includes credit, market and operational risks. The Director of the Office of Supervision coordinates and oversees a wide range of supervision activities by the Office of Examinations, the Office of Accounting and Solvency and the Office of Supervision Infrastructure (see Figure 9).

- **Office of Examinations.** The Office of Examinations plans and conducts risk-based examinations of the Enterprises, prepares and issues reports of finding and seeks preventative and corrective action. Within the Office of Examinations, supervision staff are divided into five teams focusing on the main categories of risk at the Enterprises—credit risk, market risk, operational risk, model risk and governance issues. These offices continuously examine Fannie Mae and Freddie Mac and work together to assess the Enterprises from various risk perspectives through on-site activities and off-site analysis of safety and soundness.
- **Office of Accounting and Solvency.** The Office of Accounting and Solvency includes three teams that focus on the inputs to capital adequacy of Fannie Mae and Freddie Mac. These include accounting policy, financial reporting and audit issues, and financial analysis of the Enterprises' financial statements with a focus on earnings. This office develops and maintains capital adequacy models, guidance, and regulations, and issues quarterly capital classifications for both Fannie Mae and Freddie Mac.
- **Office of Supervision Infrastructure.** The Office of Supervision Infrastructure assures the quality of OFHEO's supervisory program through a quality assurance program, provides policy support and supervision guidance, and maintains the automated supervisory tool that OFHEO uses to manage work papers and relevant data.

The **Office of the General Counsel** advises the Director and all OFHEO staff on legal matters related to the functions, activities and operations of OFHEO and the Enterprises, specifically providing support for supervision functions and enforcement actions.

The **Office of Policy Analysis and Research** conducts research and policy analysis to assess the short- and long-term impact of trends and issues in the activities of the Enterprises, housing finance and financial regulation on the regulatory and supervisory functions of OFHEO. The office also prepares data series and publications that inform the public about the housing finance system and changes in house prices. It helps support development of OFHEO regulatory policies.

The **Office of External Relations** works with OFHEO's external stakeholders to effectively communicate, respond to public and congressional inquiries, and release pertinent information to the public.

The **Office of Budget and Financial Management** develops, manages and implements financial management practices within OFHEO, including agency policies and procedures governing accounting operations, contracting and procurement programs, and financial management and budgeting, including travel, financial reporting and internal controls under the direction of the Chief Financial Officer.

The **Office of Human Resources Management** develops, manages and implements agency policies and procedures governing all human resources functions, including staffing, personnel security, employee relations, performance management, training, benefits management and compensation, under the direction of the Chief Human Capital Officer. This office also carries out a strategic plan aligned with the agency's Human Capital Plan to ensure that the agency hires individuals who are skilled, trained and capable of carrying out the duties required to support the agency's mission. This office also provides payroll and processing functions and personnel security functions.

The **Office of Management Planning** assists the Director in maintaining a long term strategic plan, annual performance plans and reports and viable business continuity plans, under the direction of the Performance Improvement Officer. The office also provides performance management functions for the agency and is responsible for ensuring that the agency has suitable facilities, equipment and supplies management. The Office of Management Planning has lead responsibility for producing this report.

The **Office of Technology and Information Management** is responsible for ensuring the integrity, confidentiality and availability of OFHEO's information systems and assets under the direction of the Chief Information Officer. The office develops information systems, provides support to OFHEO employees on IT systems and maintains information security.

Market Developments in FY2008

FY2008 was an extremely difficult year for mortgage markets and broader financial markets. The housing sector weakened for the second year in a row, with significant declines in housing starts and sales of new homes. House prices, as measured by OFHEO's quarterly seasonally adjusted purchase-only House Price Index (HPI), fell at an accelerating rate in each quarter of the year. The share of single-family—especially subprime—loans that were seriously delinquent or in foreclosure rose steadily.

Conditions in the secondary markets for subprime, Alt-A and other non-traditional single-family mortgages, which had become illiquid in the third quarter of 2007 following a sharp deterioration in the performance of recently originated subprime loans, worsened throughout FY2008. Many investors suffered large losses because of declines in the market values of private-label MBS and related credit derivatives, which was driven by falling house prices and increasing delinquencies and foreclosures. Uncertainty about the magnitude and frequency of losses led to higher interest rates and illiquidity in interbank loan and other credit markets. Although banks, the Enterprises and other financial institutions were able to raise additional capital, the prospect of sizable further mortgage credit losses and credit market illiquidity threatened the financial system's ability to maintain sufficient capital and finance continued economic growth. In the fourth quarter of 2007 the Enterprises raised almost $14 billion in capital.

Actions to encourage then to raise more capital and ease the statutory and regulatory restraints on the activities of Fannie Mae and Freddie Mac initially bolstered their ability to support the mortgage market in FY2008. Those steps included the lifting of caps on the growth of their retained mortgage portfolios as they became timely filers of their financial statements in the first quarter of 2008 and reductions in the add-on to each Enterprise's minimum capital requirement. (For more information on these topics, see page 93). Supported by those initiatives and additional private capital, Fannie Mae and Freddie Mac continued to perform their mission despite reporting large losses in the first two quarters of 2008. As other market participants withdrew from the market in response to deteriorating conditions, the Enterprises increased their support to new mortgage lending. The Enterprises' purchases and guarantees as a share of new mortgage originations climbed to 82 percent in the second quarter of 2008, up from 46 percent in the same period in 2007. Temporary increases in the conforming loan limit from the $417,000 national limit up to a maximum of $729,750 in high-cost areas marginally increased their market share.

Myrtle S. Habersham, Performance Improvement Officer, introduces James B. Lockhart III at the FHFA Kick-Off meeting.

During the second half of FY2008, the Enterprises faced additional credit losses because the performance of Alt-A and other mortgages backing their guaranteed MBS and in their retained mortgage portfolios was deteriorating. In March, the prospect of further Enterprise losses, as well as diminished capital for investment in MBS throughout the financial system, led to significantly less liquidity and sharply falling prices on Enterprise debt and MBS. The Bear Stearns rescue and OFHEO's March agreement with the Enterprises to begin lowering the OFHEO-directed minimum capital requirement in return for commitments to raise significant capital, led to a temporary improvement in market conditions. HERA, which created FHFA to oversee the Enterprises and the FHLBanks with strengthened oversight powers and authorized the U.S. Treasury to provide financial assistance to each Enterprise, was passed in July.

However, the prospect of further losses and uncertainty about liquidity led to a sharp sell-off of the Enterprises' shares in the third quarter, which limited their ability to raise additional capital and raised the possibility that they would have to curtail their activities and shrink at a time when they were needed to help stabilize the mortgage market. FHFA placed Fannie Mae and Freddie Mac in conservatorship on September 6, 2008, to enable them to continue to perform their mission and to protect their assets. That action was supported by a commitment by the U.S. Treasury to invest up to $100 billion equity in each Enterprise to keep them solvent.

James B. Lockhart III, Director of OFHEO participates in May17, 2008 meeting of President's Working Group on Financial Markets at the White House with President Bush, SEC Chairman Christopher Cox, Treasury Secretary Henry Paulson, and Federal Reserve Chairman Ben Bernanke.

Performance Highlights

The Creation of the Federal Housing Finance Agency

On July 30, 2008, President Bush signed HERA, which created a new regulator for the 14 housing-related GSEs — Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks (FHLBanks). FHFA has responsibility for the safety and soundness of the GSEs as well as oversight of their affordable housing missions.

OFHEO, as the safety and soundness regulator for Fannie Mae and Freddie Mac, has supported reform to make the agency's authorities stronger and parallel to other federal financial regulators. With the enactment of this new law, OFHEO's responsibilities and employees were transferred to the new regulator, with all the authorities necessary to oversee these vital components of the secondary mortgage market. OFHEO's Director was designated the Director of the FHFA, until the President nominates and the Senate confirms another Director. (See page 16 for more on FHFA.)

Conservatorship of the Enterprises

On September 6, 2008, due to market conditions that affected the Enterprises, FHFA placed both Fannie Mae and Freddie Mac under conservatorship. Conservatorship is a statutory process designed to stabilize troubled institutions with the objective of maintaining normal business operations and restoring safety and soundness. The agency took this significant step due to worsening market conditions that adversely affected both Fannie Mae and Freddie Mac and after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury. Both Enterprises had been making progress on improving their accounting, internal controls and risk management, but market conditions overwhelmed that progress. Specifically, FHFA was concerned about the inability of the Enterprises to raise capital or issue debt and the subsequent effect on their ability to fulfill their critical role supporting the nation's residential mortgage market. The Enterprises' capital was threatened by increasing credit losses, impairments, counterparty risks and other accounting issues, which they described as part of their projected financial performance reflected in their second quarter financial reports.

The Enterprises opened for business as usual on September 8, 2008, with FHFA examiners on-site at their headquarters and other key locations to ensure a smooth transition. The FHFA Director appointed new CEOs for both GSEs and nonexecutive chairmen for new Boards of Directors to be formed. FHFA will allow each Enterprise to increase its portfolio of mortgages up to $850 billion in order to support the troubled mortgage market before requiring gradual declines of 10 percent per year. There are no restrictions on the amount of MBS each Enterprise can guarantee. In addition, all lobbying by the Enterprises was immediately stopped, and neither departing CEO received "golden parachute" payments. The FHFA Director also eliminated dividends on all common and preferred stock. (See page 9 for more information on conservatorship.)

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

The Enterprises Progress Prior to the Conservatorship

Although Fannie Mae and Freddie Mac remain a "significant supervisory concern," as described in OFHEO's 2008 Report to Congress, in April, the Enterprises made significant progress on the issues outlined in their respective consent orders and other improvements. As a result of special examinations of each Enterprise, OFHEO entered into consent agreements with each Enterprise to address operational and control weaknesses in 2003 (Freddie Mac) and 2006 (Fannie Mae). In February 2008, Fannie Mae and Freddie Mac both filed timely annual financial statements with the Securities and Exchange Commission, the culmination of several years of effort aimed at improving and correcting their accounting, internal controls, and financial disclosure processes. They also made substantial strides toward the completion of their remediation processes. Fannie Mae has completed 100 percent of its consent order items and Freddie Mac has only one remaining item: separating the Chief Executive Officer from the Chairman of the Board. These positions were separated after FHFA put Freddie Mac under conservatorship. OFHEO worked with both Enterprises to review completed work and to test new systems and controls. FHFA will validate the effectiveness of remedial measures during ongoing examination activities.

In addition to that progress, each Enterprise made improvements to its operations and management by addressing Matters Requiring Attention (MRAs) identified during OFHEO's examinations of their condition and operations. MRAs are issues or conditions that need correcting or improving and are brought to Fannie Mae's and Freddie Mac's attention through supervisory letters throughout the year. In FY2008, 77 percent of the MRAs due during the year were completed and validated by OFHEO. The MRA process is integral to OFHEO's continuous supervision and examination of Fannie Mae and Freddie Mac.

On March 1, 2008, in recognition of the achievement of these important milestones, and consistent with the terms of the consent agreements, OFHEO lifted the portfolio growth caps that had been established in 2006. Also in March 2008, OFHEO reduced the additional required capital (known as OFHEO-directed capital) from 30 percent to 20 percent above the minimum requirement for both Enterprises. Both the additional capital requirement, established by OFHEO in 2004, and the portfolio growth caps agreed to in 2006 served Fannie Mae and Freddie Mac by ensuring they were in a better capital position to deal with the current volatile market conditions and their significant losses. The reduction in the OFHEO-directed capital requirement was made in light of their progress in remediating prior weaknesses and their commitment to raise capital and maintain overall capital levels well in excess of requirements. The reduced additional capital requirement provides additional capital for the Enterprises to continue to support their mission of providing support the mortgage market.

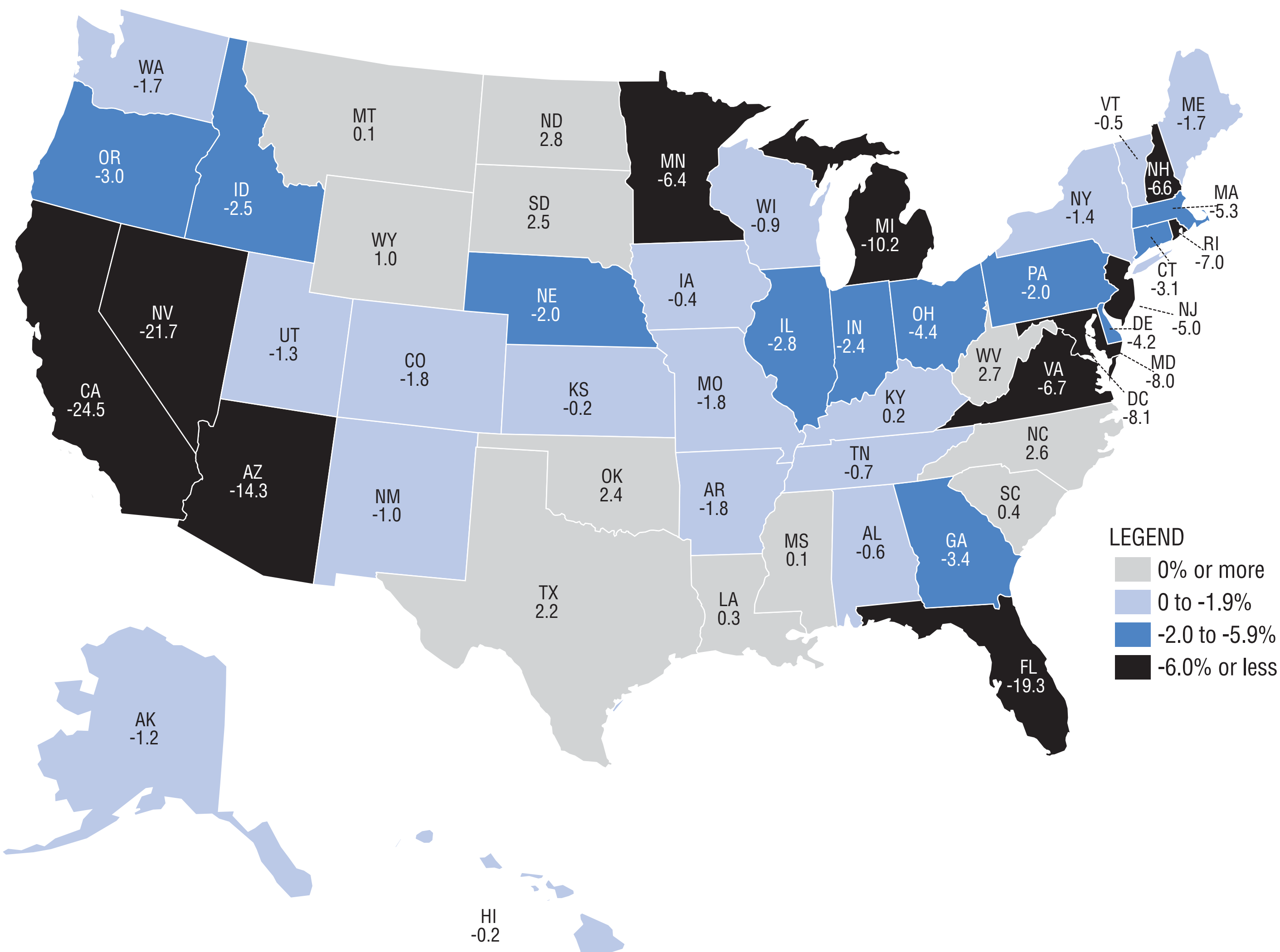
In June 2008, OFHEO further reduced Fannie Mae's OFHEO-directed capital to 15 percent above the minimum capital level after Fannie Mae raised significant additional capital of approximately $7.4 billion in May 2008. Fannie Mae also had completed the corrections called for in its consent order, allowing OFHEO to lift the 2006 Consent Order with Fannie Mae. Freddie Mac was unable to meet its commitment to raise additional capital.

New Conforming Loan Limits

The conforming loan limit is the maximum size loan that the Enterprises can buy from lenders. As house prices had fallen in 2007, OFHEO kept the same conforming loan limit for 2008. The conforming loan limit is $417,000 for one-unit properties for most of the U.S., with higher limits applying to Alaska, Hawaii, Guam and the U.S. Virgin Islands and to properties with more than one unit. It will also remain at $417,000 for 2009.

In February 2008, the Economic Stimulus Act of 2008 (ESA) was signed into law by President Bush. ESA temporarily increased the conforming loan limit in designated high-cost areas, allowing Fannie Mae and Freddie Mac to purchase loans that were as much as 125 percent of the median home price in certain Metropolitan Statistical Areas (MSAs) up to a maximum of 175 percent of the conforming loan limit. In March 2008, OFHEO announced the temporary conforming loan limit of $729,750 for one-unit properties, with higher limits in certain MSAs in Alaska, Hawaii, Guam and the U.S. Virgin Islands for loans that are originated between July 1, 2007, and December 31, 2008. These loans are referred to as "Temporary Jumbo Conforming" mortgages. The new temporary conforming loan limit

Figure 12 • Map of Four Quarter House Price Changes: Second Quarter 2007 – Second Quarter 2008



was intended to provide liquidity and stability to the jumbo portion of the residential mortgage market, which had been severely affected by the credit problems throughout the economy.

During the year, OFHEO also finalized its examination guidance for calculating the conforming loan limit. The agency issued this guidance as a proposal for public comment in October 2007 and received two rounds of public comment before making it final.

HERA established Enterprise loan limits in high-cost areas in a manner similar to the framework set forth in ESA. The primary difference between HERA and ESA requirements is that the new high-cost loan limits, which will be in effect starting in 2009, will be equal to 115 percent of local price medians rather than 125 percent. Also, the maximum loan limit for high-cost areas in the continental U.S. will be 150 percent of the national limit under HERA, as opposed to 175 percent in ESA resulting in a maximum of $625,000. During FY2008, FHFA began work on implementing the changes to the conforming loan limit required by HERA.

OFHEO Establishes Monthly House Price Index

Since 1995, OFHEO has published a quarterly House Price Index (HPI), which provides important information to consumers, analysts, and policymakers on changes in house prices. In February 2008, OFHEO began releasing a new monthly HPI for the nation and each of the nine Census divisions. This is a significant achievement, one that informs public policy decisions by providing more timely and detailed information on house prices, which is critical in this challenging market.

Based on data from Fannie Mae and Freddie Mac, the HPI is a broad measure of the movement of single-family house prices. It serves as a timely, accurate indicator of house price trends at various geographic levels. It also provides a very useful analytical tool for estimating changes in the rates of mortgage defaults, prepayments, and housing affordability in specific geographic areas. HPI is a measure designed to capture changes in the value of single-family homes in the U.S. as a whole, in various regions, in individual states and in the District of Columbia.

Fannie Mae and Freddie Mac provide OFHEO with information on their most recent mortgage transactions for both the monthly and quarterly HPI reports. These data are combined with the data from the previous 33 years to establish price differentials on properties where more than one mortgage transaction has occurred. The updated historical database is then used to produce the index.

For more information about OFHEO's HPI, please visit OFHEO's Website at **www.ofheo.gov/hpi.aspx.**

New Appraisal Code to Combat Mortgage Fraud

In March 2008, Fannie Mae and Freddie Mac took steps to combat appraisal fraud by signing an agreement with the New York Attorney General and OFHEO to strengthen the independence of the appraisal process. Appraisals estimate the market value of a property to secure mortgage finance. They are completed by a licensed and certified real estate appraiser. However, during the last few years when house prices were growing rapidly, not all appraisers followed best practices and some were pressured to provide flawed appraisals. The agreement outlines additional guidelines for appraisals that add to the underwriting standards of Fannie Mae and Freddie Mac.

For example, the agreement includes provisions that prohibit coercing appraisers and that assure lenders take appropriate steps to receive valid, accurate, and reliable appraisals. The agreements also enhance quality control in the appraisal process and would establish a complaint hotline for consumers.

An important part of the agreement is a Home Valuation Code of Conduct, known as the Appraisal Code, which is expected to be implemented early in 2009. The Appraisal Code is one way that Fannie Mae and Freddie Mac seek to ensure that homebuyers and secondary mortgage market investors get fair and independent property valuations.

In addition, FHFA is working with other federal regulatory and law enforcement agencies to report suspected mortgage fraud and encourage state regulatory agencies to actively police appraisal practices.

Improvements to the Structure of Supervision

During FY2008, OFHEO made significant enhancements to its oversight and supervision of the Enterprises through the development and implementation of new measures of risk, issuance of new supervision guidance and revision of the supervision handbook and a restructuring of the Office of Supervision.

OFHEO Works to Prevent and Report Fraud

Over the last several years, OFHEO has worked with the Enterprises to detect and report suspected mortgage fraud to aid law enforcement investigations. Since 2005, OFHEO has required the Enterprises to create programs and provide training to employees in the detection and reporting of suspected mortgage fraud. As defined by OFHEO for purposes of Enterprise reporting, mortgage fraud is any material misstatement, misrepresentation or omission relied upon by an Enterprise to fund or purchase a mortgage. It includes, for example, false information contained in identification and employment documents, false mortgagee or mortgagor identity, fraudulent appraisals, theft of custodial funds, nonremitted payoff funds, misrepresentations of borrower funds and property flipping where designed to falsely inflate property value. One of the specific areas of mortgage fraud on which OFHEO focused in 2008 is the appraisal of real estate. Inaccurate appraisals could hurt homebuyers who pay a higher price because of inflated appraisals and could also hurt lenders and investors whose loans may not be supported by adequate housing value.

In 2006, OFHEO signed an agreement with the Treasury Department's Financial Crimes Enforcement Network (FinCEN) to share information provided by the Enterprises. The information coming from the Enterprises is then used by law enforcement agencies throughout the country to investigate and combat mortgage fraud. The number of suspected mortgage fraud cases has increased since OFHEO began sharing information with FinCEN. In 2008, OFHEO filed several thousand suspicious activity reports. As part of the ongoing process of working with the Enterprises, OFHEO revised its Enterprise guidance in January 2008 to clarify detection program requirements and reporting obligations.

OFHEO also participates regularly with the Department of Justice Mortgage Fraud Working Group, which shares ideas with others agencies on how to combat mortgage fraud.

During FY2008, OFHEO developed and implemented a new risk rating structure, GSE Enterprise Risk (GSEER). This risk rating structure captures the safety and soundness of the Enterprises by focusing on Governance, Solvency, Earnings and Enterprise Risk, which encompasses market, credit and operational risks. GSE Enterprise Risk combines the two bank-like measures OFHEO used in prior years. The new rating system better captures the risks that are central to an Enterprise safety and soundness assessment, reduces the overlap inherent in the prior risk rating system and is internally consistent. OFHEO rates each Enterprise in each risk category and also establishes a composite safety and soundness rating at the end of the annual calendar year examination cycle. The GSE Enterprise Risk rating is assigned one of four levels — no or minimal concerns, limited concerns, significant concerns or critical concerns. Calendar year 2008 will be the first year that Fannie Mae and Freddie Mac are rated using this system. Those results will be available in the second quarter of FY2009. (For more information about GSE Enterprise Risk, please see page 123.)

In December 2007, OFHEO appointed a new Director of Supervision, Chris Dickerson, a seasoned veteran with extensive experience in regulatory supervision. Later in FY2008, the Office of Supervision was reorganized to focus on risk assessment across the Enterprises. This reorganization implements the concept of "horizontal" examinations, either by simultaneous examination activities at each Enterprise on the same topic or by sequential examination using the same exam team and procedures. This approach helps ensure that each Enterprise is evaluated on the same standards and provides OFHEO with comparative analysis. In addition, a number of targeted examinations are conducted throughout the year, delving more deeply into specific areas identified through the annual examination and continuous supervision process.

In July 2008, OFHEO published a revised and updated Supervision Handbook consistent with the new risk rating structure, GSE Enterprise Risk. The Supervision Handbook describes OFHEO's supervision processes, outlines the core supervision principles and identifies the supervision strategy for each focus area. The handbook helps OFHEO apply uniform standards to both Enterprises and clarifies OFHEO's expectations of Fannie Mae and Freddie Mac. The handbook is an integral part of the quality assurance program that OFHEO established last year.

During FY2008, OFHEO also published examination guidance on evaluating the Enterprises' use of the fair value option outlined in the Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* and policy guidance outlining examination standards for mortgage fraud programs at Fannie Mae and Freddie Mac.

In June 2008, OFHEO published a final rule related to the loss severity calculation in the risk-based capital stress test, which is used to determine the Enterprises' risk-based capital requirement each quarter. The rule change had originally been proposed in December 2007 for public comment. The final rule implemented two changes that corrected overestimations in the amount the Enterprises would recover on some defaulted loans. Both guidances and the proposed and final risk-based capital rule change are available on OFHEO's Website, **www.ofheo.gov**.

Management Challenges

Ensuring the Proper "Wind-Down" of OFHEO Operations

On July 30, 2008, the President signed into law HERA, which created a single regulator empowered with all the regulatory authorities necessary to oversee vital components of the country's secondary mortgage markets—Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks, including the Office of Finance. Upon enactment of HERA, OFHEO has responsibility only for winding down its affairs by July 30, 2009. All other responsibilities are transferred to FHFA. Therefore, appropriate steps must be taken to ensure that such affairs are completed in the most efficient, economical, and effective manner and in the absence of fraud, waste and abuse. OFHEO has made significant progress toward ensuring the proper wind-down of its affairs. Agency management has taken a very positive approach to transferring resources, integrating functions and continuing its supervision function at the newly created FHFA.

Performance Summary

Strategic Planning at OFHEO

OFHEO uses strategic planning and performance planning to set long-term and annual goals and monitor progress throughout the year to produce results. The second section of this report describes in greater detail OFHEO's results and efforts to achieve its FY2008 performance goals. FHFA is developing a performance plan for FY2009.

In FY2006, OFHEO established a five-year strategic plan with three strategic goals and one resource management strategy:

1. Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.
2. Provide support for statutory reforms to strengthen our regulatory powers.
3. Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

Resource Management Strategy: Manage effectively OFHEO's human capital and other resources to support our mission.

OFHEO set eight annual performance goals to reach its strategic goals, five annual performance goals to support its resource management strategy and a total of 38 performance measures. OFHEO's FY2008 Performance Budget outlines the means and strategies to achieve these annual performance goals and related measures. As for all regulators, the outcomes or results of OFHEO's work depend on the actions of the Enterprises, markets and others. The agency provides regulation, supervision, guidance, review and a variety of products that influence the Enterprises and the financial markets. Highlights of the accomplishments for each strategic goal are described below.

OFHEO Substantially Achieved Its Performance Goals

OFHEO achieved or substantially achieved all but one of its performance goals in FY2008. The performance section outlines in detail the agency's performance goals for each strategic goal and its accomplishments related to each goal and performance measure. Performance goals are achieved when targets for all performance measures have been achieved. Substantially Achieved indicates that at least one performance target has not been achieved, although a substantial majority of the targets related to the goal were met. In FY2008, OFHEO achieved 76 percent of its performance measures, compared to 82 percent in FY2007. The agency substantially achieved 5 percent of performance measures in 2008 versus 15 percent in 2007, and did not achieve 16 percent in 2008 compared to 3 percent in 2007. Data for one performance measure in 2008 were not available at the time of publication. The majority of measures not achieved in FY2008 were affected by changing priorities at the agency, the passage of HERA and the deteriorating market conditions throughout the year.

For FY2008, OFHEO identified 12 of its 38 performance measures as key performance indicators. These selected measures represent all three strategic goals and the agency's resource management strategy and are critical measures of the agency's mission and operations. During the year, the agency made improvements to the documentation and reporting process related to these indicators and contracted with an external auditor to review the internal controls related to these performance measures. Figure 17 shows OFHEO's accomplishments in achieving the key performance indicators.

Key Performance Indicators for FY2008

Strategic Goal 1 ■ Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.

GOAL 1.1 ■ The Enterprises comply with safety and soundness standards.

1.1(1)(a) Percentage of Enterprises with CAMELSO ratings of 1, 2 or 3.	**FY2008 Target:** 100% **Status:** 100%; Achieved **Timeframe:** Rating as of December 31, 2007 **2007 Performance:** 100%	**Highlights:** OFHEO completed an annual examination cycle in December 2007. For the 2007 calendar year, both Enterprises received CAMELSO scores of three or better but were still considered "significant concerns." Details of OFHEO's evaluation of the Enterprises' safety and soundness can be found in the 2008 Report to Congress. On September 6, 2008, because of market conditions that affected the Enterprises, FHFA placed both Fannie Mae and Freddie Mac under conservatorship.
1.1(2)(a) For both Enterprises, the percentage of OFHEO's five risk assessment categories with an acceptable risk/risk management profile.	**FY2008 Target:** 90% **Status:** 90%, Out of five categories at two Enterprises (a total of 10) nine were acceptable risk/risk management profiles; Achieved **Timeframe:** Rating as of December 31, 2007 **2007 Performance:** 80%	**Highlights:** At the end of the 2007 calendar year, OFHEO assessed the Enterprises on five risk categories — governance, market, credit, operational and model — and determined that in only one category at one Enterprise there was a high quantity of risk and weak risk management. However, in nine of the risk categories, the ratings were high quantity of risk with risk ratings of "needs improvement." Since then, the Enterprises' financial performance has deteriorated. During 2008, latent credit risk exposures embedded in the Enterprises' respective books of business became manifest as home values continued to deteriorate. OFHEO's analyses of the potential extent of these exposures relative to capital levels, compounded by the Enterprises' inability to raise sufficient supplemental capital, precipitated the need to take forceful supervisory action. On September 6, 2008, because of market conditions and the consequent adverse threat to the Enterprises' financial condition, FHFA placed both Fannie Mae and Freddie Mac under conservatorship.
1.1(3) Average number of days to issue annual report of examinations to Enterprise Boards of Directors and meet with them after field work is complete.	**FY2008 Target:** 90 days **Status:** 63.5 days; Achieved **Timeframe:** Number of days from December 31, 2007 **2007 Performance:** 71 days	**Highlights:** OFHEO presented the Report of Examinations to the Boards of Directors of both Enterprises in late February, describing major supervision findings and recommendations for Board and management action.

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 1.2 ■ Ensure the Enterprises are adequately capitalized.*

1.2(1) The Enterprises meet OFHEO's determination of capital adequacy.	**FY2008 Target:** Each quarter **Status:** Achieved for the two quarters ending December 31 and March 31. Both GSEs classified as undercapitalized for quarter ending June 30. FHFA announced the suspension of capital classifications during conservatorship, so a classification for the period ending September 30 will not be performed; Not Achieved. **Timeframe:** Capital determination based on minimum capital, risk-based capital and OFHEO-directed capital requirements made at the end of each quarter **2007 Performance:** Four quarters	**Highlights:** At the beginning of the fiscal year, both Enterprises were required to hold an additional 30% of capital above the minimum requirement, called OFHEO-directed capital. In March 2008, OFHEO reduced the OFHEO-directed requirement to 20% over minimum capital since both Enterprises released timely, accurate financial statements and made commitments to raise significant capital. Both GSEs were placed into conservatorship on September 6, 2008. In accordance with the Senior Preferred Stock Agreement, FHFA, as conservator, has suspended capital classification as the test is a positive GAAP net worth.

GOAL 1.3 ■ Ensure the Enterprises comply with applicable laws, regulations, directives and agreements, including executive compensation, corporate responsibility and disclosure.

1.3(2) Percentage of actions required by formal regulatory agreements with the Enterprises that are resolved as planned.	**FY2008 Target:** 95% **Status:** 97%; Achieved **Timeframe:** Enterprise actions due by June 30, 2008 and validated by September 30, 2008 **2007 Performance:** 90%	**Highlights:** Fannie Mae successfully completed its consent order items and the 2006 consent order was lifted in May 2008. Freddie Mac has completed all items in its consent order except the separation of the CEO and Chairman positions. After the conservatorship announced on September 6, 2008, FHFA appointed a non-executive chairman.
1.3(3) Percentage of Matters Requiring Attention (MRA) and items related to OFHEO guidances and directives in non-compliance that are resolved to OFHEO's satisfaction.	**FY2008 Target:** 95% **Status:** 77%; Not Achieved **Timeframe:** Enterprise actions due by June 30, 2008, and validated by September 30, 2008 **2007 Performance:** 94%	**Highlights:** A majority of MRAs were completed by the Enterprises and validated by OFHEO. The MRAs not completed are long-standing issues related to internal controls and new product approval process that require remediation.

Strategic Goal 2 ■ Provide support for statutory reforms to strengthen our regulatory powers.

GOAL 2.1 ■ Support efforts to strengthen OFHEO's authorities.

2.1(2) Make recommendations to Congress about legislative changes OFHEO needs to accomplish its mission.	**FY2008 Target:** At least annually **Status:** Included in OFHEO's annual Report to Congress 2008, Achieved. **Timeframe:** Completed by September 30, 2008 **2007 Performance:** Achieved	**Highlights:** Congress passed legislation, which was enacted in July 2008, to create a new, stronger GSE regulator, consistent with OFHEO's recommendation in the annual Report to Congress.
2.1(3) Respond to all Congressional inquiries.	**FY2008 Target:** Within 10 business days **Status:** Achieved **Timeframe:** All inquiries received by September 30, 2008 **2007 Performance:** Achieved	**Highlights:** During a busy year with major legislation to overhaul OFHEO's regulatory authorities, the agency responded quickly to congressional inquiries.

Strategic Goal 3 ■ Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

GOAL 3.1 ■ Promote an efficient secondary mortgage market by increasing transparency of mortgage market developments, and Enterprise risks and activities.

3.1(3) Publish reports to enhance understanding of mortgages, mortgage markets and the nation's housing finance system.	**FY2008 Target:** At least six **Status:** A total of nine reports, research papers, staff working papers and mortgage market notes were published, as well as three market data updates; Achieved. **Timeframe:** Published by September 30, 2008 **2007 Performance:** Nine reports, research papers, staff working papers and mortgage market notes were published	**Highlights:** OFHEO established a new publication, the *Mortgage Market Note*, which provides plain English explanations of market issues and terminology. The agency published four *Notes* on its Website this fiscal year.

GOAL 3.2 ■ Communicate effectively with all stakeholders on Enterprise risks and activities, mortgage markets, the nation's housing finance system and regulatory issues.

3.2(1) Percentage of survey respondents visiting OFHEO's Website who find it a useful resource.	**FY2008 Target:** Greater than 93.6% **Status:** 92.1%; Substantially Achieved **Timeframe:** Survey results as of September 30, 2008 **2007 Performance:** 93%	**Highlights:** OFHEO revamped its Website in FY2007 and continually updated it throughout the fiscal year. OFHEO's Website includes a house price calculator, an interactive house price map of the U.S. with historical information and links to the latest mortgage market data.

Resource Management Strategy ■ Manage OFHEO resources effectively to enable the Office to fulfill its mission.

GOAL 4.1 ■ Maintain a diverse workforce that is skilled, flexible, and performance-oriented to fulfill the goals of the agency.

4.4(1) Percent of vacancies filled within OPM's 45-day time-to-hire standard.	**FY2008 Target:** 70% **Status:** Achieved **Timeframe:** All vacancies through September 30, 2008 **2007 Performance:** N/A	**Highlights:** During the year, OFHEO hired 53 new employees with 79% of those selections being made within 45 days. Of the 53 hires, 40 were from external sources and 13 were internal competitive promotions or reassignments. The agency also hired 19 summer interns, for a total hiring of 72 people.

GOAL 4.5 ■ OFHEO's internal operations effectively support the mission and goals of the agency.

4.5(2) Get to "green" on the President's Management Agenda (PMA) initiatives status scores.	**FY2008 Target:** Green on four of five initiatives **Status:** Green on four of five initiatives; Achieved. **Timeframe:** For the quarter ending September 30, 2008 **2007 Performance:** N/A	**Highlights:** During FY2008, OFHEO strengthened the implementation of the the President's Management Agenda on all five government-wide initiatives. The agency set up a process to independently score itself against the OMB criteria and, based on these results, was asked by OMB to pilot the PMA program for small agencies. For more information, see the PMA section, below.

President's Management Agenda

The President's Management Agenda (PMA) contains five government-wide initiatives that focus on making government more citizen-centered, results-oriented and market-based. The PMA principles and concepts represent good management practices that focus on results for the public and are designed to improve the efficiency and effectiveness of government. The PMA standards also provide a foundation for an integrated and structured management process that helps the agency achieve immediate, concrete and measurable results. Progress on meeting the standards of the PMA is presented in a traffic light format, with "red" indicating unsatisfactory performance, "yellow" indicating mixed results and "green" indicating success. Detailed descriptions of the PMA initiatives and criteria for success can be found at **www.results.gov**. OFHEO is not an OMB scorecard agency, so the agency's results are not found on this Website. Instead, OFHEO's PMA scorecard results as of September 30, 2008, are shown below and on page 155.

During FY2008, OFHEO expanded its commitment to the five government-wide PMA initiatives by establishing a formal PMA program within the agency, using the same standards and processes that OMB uses for scorecard agencies. OFHEO established "Proud to Be" plans for all five initiatives, setting specific milestones for 2008 and 2009 to achieve "green" status. Initiative sponsors submitted quarterly status reports that detailed the steps that the agency took to meet the same government-wide criteria applied by OMB to scorecard agencies. OFHEO established an Independent Internal Evaluation Team (IIET) to assess the agency's progress and status on achieving the PMA initiatives through quarterly scorecards, which were reported to OFHEO's senior management through the performance management process described in this report.

OFHEO also took steps to share its results, successful practices and benchmarks with other federal agencies through the Performance Improvement Council (PIC). Through the PIC, OMB has identified OFHEO's PMA program as a pilot for small agencies. Efforts are currently underway to establish this pilot program.

OFHEO expects its adoption of the PMA program to result in more efficient operations and better service in support of its public mission to oversee and regulate the Enterprises. During FY2008, OFHEO took tangible steps to move toward the "green" status for all five initiatives. As of September 30, 2008, OFHEO is green in status on four initiatives, and red in status on one initiative.

Presidential Management Agenda Initiative	Status
Strategic Management of Human Capital	GREEN
Commercial Services Management	RED
Improved Financial Performance	GREEN
Expanded Electronic Government	GREEN
Performance Improvement Initiative	GREEN

Strategic Management of Human Capital. The goals of this initiative are to develop a mission-focused, results-oriented performance culture, make better use of flexibilities to acquire and develop diverse talent and leadership and better align the agency's organization toward the achievement of outcomes and results. OFHEO's most valuable resources are its employees. Recruitment, retention, recognition and employee development are critical to ensuring that OFHEO meets its goals. Significant accomplishments this year included the following:

- OFHEO improved the timeliness of hiring by exceeding the target of 70 percent of the agency's vacancies filled within 45 days. OFHEO filled 79 percent of vacancies within 45 days.
- OFHEO implemented a fully compliant Human Capital Accountability Program, including reviewing the best practices of agencies across government.
- OPM recognized OFHEO as a Federal Best Practice for its Quality of Work/Life Programs.
- OFHEO put in place a formal Learning and Development Strategy to ensure knowledge management and leadership development.
- All OFHEO managers and executives completed a leadership development program, a significant milestone in addressing competency gaps identified in an agency-wide competency analysis last year.
- During the year, OFHEO shifted its resources to better achieve its goals, including reorganizing or detailing staff to critical-need functions when necessary.
- OFHEO conducted an employee survey to assess the workforce climate with the goal of making OFHEO a more effective agency and an even better place to work.
- OFHEO completed its first Strategic Recruitment and Outreach Plan, which provides a roadmap for deploying innovative recruitment strategies and helps establish a improved partnership between hiring managers and human resources staff.

OFHEO, FHFB, and HUD GSE mission staff at the FHFA Kick-Off Meeting.

- The agency developed a Plan to Close Competency Gaps, which provides a blueprint for assessing gaps and establishing strategies for closing them.
- OFHEO achieved a 67 percent increase over the previous year in the number of minority applicants for the agency's vacancies, far exceeding this year's target.
- OFHEO implemented an electronic performance management system that clearly ties employee performance to the agency performance goals.
- The agency enhanced its awards program to include two new awards — the Director's Award and the Distinguished Service Award. An awards ceremony was held to formally recognize staff achievements.
- OFHEO established an executive compensation program that clearly ties executive performance to agency goals and executive pay to individual accomplishments.

Commercial Services Management. The goals of this initiative are to use a market-based approach to improve the performance and efficiency of federal programs by simplifying and improving the procedures for evaluating public and private sources for commercial activities. OFHEO continually evaluates its operations to create the Most Efficient Organizations. Significant accomplishments this year included the following:

- OFHEO contracts for many services and commercial activities. Instead of hiring permanent personnel, OFHEO obtained significant computer systems support and litigation services through contracts.
- OFHEO also used other federal agencies' services for payroll, background security adjudication, relocation, executive development, travel, systems certification and accreditation and independent review of computer security.
- The agency developed a plan to complete a series of simplified express cost comparisons for OFHEO functions that may be better accomplished through contracting for commercial services. OFHEO began to convert the information technology help desk and the agency's training functions to Most Efficient Organizations/High Performing Organizations.
- OFHEO completed the annual Fair Act report, an inventory of commercial and inherently governmental activities performed by the agency.

Improved Financial Performance. The goal of this initiative is to ensure that federal financial systems produce accurate and timely information to support operating, budget and policy decisions. OFHEO relies on strong financial management practices using the integrated financial information management system. Significant accomplishments this year included the following:

- OFHEO received an unqualified audit opinion on its FY2008 financial statements from its external auditor with no material weaknesses reported. OFHEO has received clean audit opinions for 11 consecutive years.
- OFHEO implemented an enhanced internal controls monitoring system. The Executive Committee on Internal Controls meets at least quarterly to discuss issues and remedial plans and progress with respect to operational and financial internal controls.
- In FY2008, OFHEO commissioned an "Agreed-Upon Procedures Review" of internal controls relating to performance measure reporting with no major findings. Last year OFHEO had two major systems reviewed with no major findings. These reviews are precursors to a full internal controls audit.
- OFHEO's financial accounting system is compliant with Financial Systems Integration Office (FSIO) standards.
- OFHEO continued its multiyear strategy to expand available data to line managers and to enhance systems features related to budget execution and other financial data.

Expanded Electronic Government. The goals of this initiative are to focus the application of information technology on improving agency performance, more effectively plan IT investments, implement E-government (E-Gov) projects that deliver significant productivity and performance gains, automate internal processes to reduce costs internally and improve the agency's use of the internet to help citizens find information and obtain services. OFHEO relies heavily on information technology to complete the work needed to achieve its goals. Significant accomplishments this year included the following:

- OFHEO completed the process of certifying and accrediting all of its major information systems.
- The agency developed an Enterprise Architecture plan and implemented Earned Value Management for its major systems, including completing Exhibit 300s for these systems.
- OFHEO continued to use the Investment Review Board (IRB) to focus more closely on technology investments, better manage major systems, make efficient information technology decisions and comply with federal guidelines.
- OFHEO worked with the Office of Personnel Management (OPM) and other agencies as part of a small agency consortium to develop an electronic Official Personnel Folder. The agency automated the performance evaluation process and implemented E-quip and E-verify for processing security investigations and citizenship checks.
- An independent auditor identified no significant or material weaknesses in OFHEO's compliance with the Federal Information Security Management Act (FISMA).

Performance Improvement Initiative. The goals of this initiative are to improve agency performance and management decision making by integrating performance review with budget decisions, to assess agency programs through the use of outcome measures and to align budget resources with program goals. OFHEO continues to improve and expand the integration of budget and performance information as a tool to improve its performance and management. Significant accomplishments this year included the following:

- OFHEO management met quarterly to review agency performance and risks to make management decisions to realign priorities and resources when necessary.
- OFHEO tracked the cost of achieving its strategic goals throughout the year.
- OFHEO initiated a program evaluation of the agency's effectiveness in achieving its mission.
- OFHEO received a rating of "Adequate" in OMB's review of the program using the PART during 2006 and continued to use the PART measures in the 2008 Performance Plan.
- OFHEO developed a new efficiency measure for its 2009 performance budget to capture costs related to outcomes and revised other performance measures based on OMB's quality review.
- OFHEO appointed a Performance Improvement Officer and established an internal panel and performance improvement plan to ensure integration of performance improvement strategies across the agency.

Performance Assessment Rating Tool

OFHEO was reviewed by its management and OMB using the Performance Assessment Rating Tool (PART) in 2006 and received an "Adequate" score, which is considered "performing." The assessment identified obstacles inherent in the design of OFHEO's regulatory powers and ways in which the agency could make strides in improving its effectiveness.

PART is a standard questionnaire of approximately 25 important questions about a program's performance and management. For each question, the PART assessment includes a short answer and a detailed explanation with supporting evidence. The answers to these questions determine a program's overall rating. For the purposes of the PART assessment, OFHEO was considered one program. After the assessment was completed, OMB worked with OFHEO to develop a program improvement plan to improve the agency's performance. The results of this assessment are publicly available at **www.expectmore.gov**.

Bank-like Rating Measures

The PART assessment noted that the program had significantly improved effectiveness but needed to adopt bank-like risk rating measures. OFHEO has adopted a safety and soundness framework called GSE Enterprise Risk (GSEER) that meets this expectation. The GSE Enterprise Risk rating structure, described in more detail on page 123, assesses each Enterprise's Governance, Solvency, Earnings and the Enterprise risks of credit risk, market risk and operational risk. OMB accepted two measures related to the GSE Enterprise Risk framework in the PART as improvements over the former CAMELSO (capital adequacy, asset quality, management, earnings, liquidity, sensitivity to market risk and operational risk) measure and a related risk assessment measure. OFHEO is measuring the results of its work with these outcome measures and ambitious targets. However, many external influences, including the actions of the Enterprises and other market players, the state of the economy, the conservatorships, and the conditions of the mortgage market, affect these measures. Due to these conditons, while FHFA will apply the rating system to the Enterprises, it would be a significant challenge for the Enterprises to meet the targets. Progress on achieving these measures is described more fully on page 115.

Legislative Reform

OFHEO's PART assessment also identified limited statutory authority as a restriction on the program's effectiveness, and the PART improvement plan called for legislative changes to create a new regulator with receivership authority, flexible authority to set capital standards and a full range of enforcement powers. The Housing and Economic Recovery Act of 2008, enacted on July 30, 2008, created the Federal Housing Finance Agency, a new and stronger regulator responsible for the financial safety and soundness of Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks, as well as the affordable housing mission.

Program Evaluation

The PART assessment also noted that there had been no independent program evaluations of OFHEO in recent years. This year, OFHEO began a program evaluation of the agency's effectiveness in achieving its mission, focusing on a methodology that was of sufficient scope, quality and independence as outlined in the PART criteria. The agency is reviewing documentation on the quality assurance programs at other federal financial regulators to identify best practices that would be appropriate to adopt in the agency's quality assurance function. OFHEO will develop a Proud to Be plan that outlines milestones to implement those best practices. In addition, the quality assurance function will develop and regularly report on quality metrics relating to supervision, both to the Director of Supervision and to the agency's Executive Committee on Internal Controls. This type of program evaluation will provide OFHEO with results that can be used to improve its supervision and oversight program. Results are expected in FY2009.

Diagnostic Analysis of 2008 Program Performance Result

Throughout FY2008, OFHEO continually evaluated its performance achieved toward meeting our performance goals relative to the performance plan. Program operations were consistently reviewed, assessed, and adjustments were made to improve our program and related operations.

In FY2006, OFHEO's program was rated "Adequate" by OMB (third highest PART rating). To address the actions noted in the PART assessment, the agency designed a PART Improvement Plan that was approved by OMB. One key action item was achieved on July 30, 2008, with the passage of HERA. (See **www.ExpectMore.gov** for details of OFHEO's plan and program assessment.)

Following OMB guidance, OFHEO identified and diagnosed root causes that had the potential to adversely impact performance results. As part of the evaluative process, OFHEO executive leadership held weekly senior manager staff meetings as well as regular "supervisory roundtable" meetings where they discussed progress in meeting performance goals/objectives and provided early alerts to risks in achieving agency goals. Additionally, the Chief Financial Officer held regular budget and performance meetings with the Director and senior management to identify risks associated with the agency's budget and performance commitments. Results from these meetings were used to reallocate resources to meet program objectives as needed.

OFHEO held quarterly performance tracking meetings to assess progress toward meeting all performance measures and to improve the agency's performance for year-end FY2008. During these meetings, achievements and potential risks were examined to make periodic program management decisions in each strategic goal area. Modifications were made where appropriate to strategies needed to meet performance/PART goals. OFHEO also evaluated and assessed performance measures through strengthening the Executive Committee on Internal Controls (ECIC). The ECIC monitored and provided senior management oversight of OFHEO's internal controls over financial management, operations and agency performance in order to maintain a strong internal controls environment in FY2008.

With the passage of HERA, and the resulting stronger regulatory regime, FHFA is better-positioned to address the external challenges that may impact its ability to meet its goals. The continued stress in the mortgage markets and the turmoil in the financial sector have the potential to affect several performance measure targets. However ongoing monitoring of performance goals through the activities discussed above will work to ensure that appropriate steps are taking to strengthen program activities.

James B. Lockhart III, Director of OFHEO, and Susan Jacobs, Chief Strategic Planning Officer, OFHEO, accept a Certificate of Excellence in Accountability Reporting award from Samuel T. Mok, National President of the Association of Government Accountants, and Clay Johnson, Deputy Director for Managment, OMB.

Financial Summary

Fiscal Year 2008 Financial Results

Prior to HERA, as mandated by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, OFHEO received its funding through assessment collections from Fannie Mae and Freddie Mac. Congress set the appropriated funding level; however, no taxpayer funds were used. Fannie Mae and Freddie Mac bear the full cost of OFHEO operations through an annual assessment based on the annual operating budget as appropriated. Each Enterprise pays a *pro rata* share of the annual assessment, paid in semiannual payments on October 1 and April 1. The combined assets and off-balance sheet obligations of each Enterprise determine the *pro rata* shares. In the event that OFHEO is operating under a continuing resolution, the Enterprises are assessed for operating funds based on the provisions of the continuing resolution. The funding appropriated to OFHEO is collected from Fannie Mae and Freddie Mac and deposited in the U.S. Treasury to pay OFHEO expenses and FHFA expenses for its first two months of operation.

In FY2008, OFHEO's appropriation was for $66.0 million in budget authority. During FY2008, OFHEO recovered $2.9 million in unspent prior obligations, bringing the total budgetary resources to $68.9 million. OFHEO transferred $6.2 million of resources to FHFA to fund overhead and GSE obligations, leaving a balance of $62.7 million of FY2008 budgetary resources. OFHEO obligated all but $3.3 million of that amount. The total budgetary resources for FY2007 were $67.6 million composed of the appropriation of $60.0 million, a supplemental appropriation of $6.2 million and $1.4 million prior year recovery of unspent obligations.

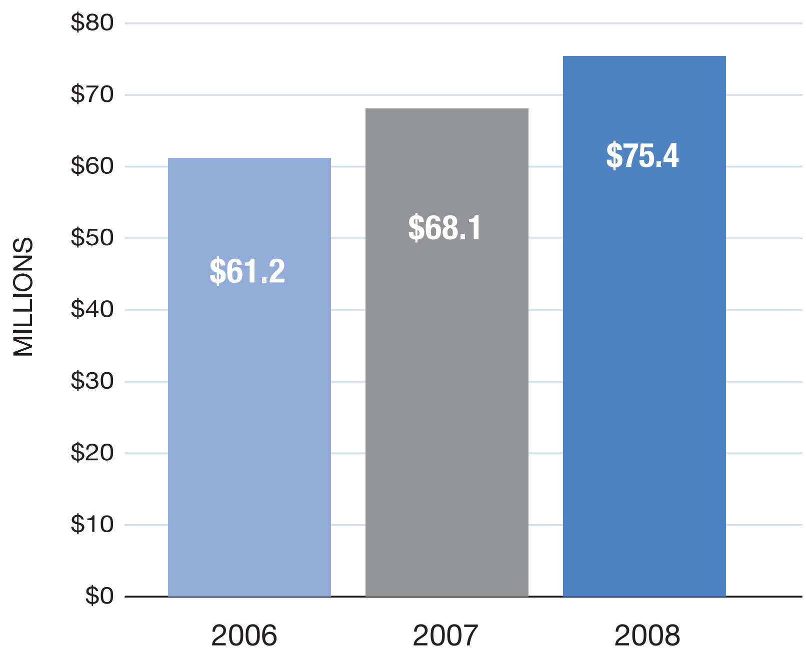
While budget authority is the maximum amount that OFHEO can obligate in the year, net cost represents a calculation of program costs. Net cost includes expenses paid and depreciation expense for the year, but excludes money paid for capitalized assets. It also includes year-end accruals and unfunded expenses for retirement plans, health benefits and life insurance paid by OPM for OFHEO. The net cost of OFHEO operations was $75.4 million in FY2008. Net cost increased in FY2008 over FY2007 by $7.3 million or 10.7 percent, as reflected in the Statements of Net Cost for the Years Ended September 30, 2008, and 2007. Figure 13 shows OFHEO's cost of operations from FY2006 to FY2008. The increase in net cost from FY2007 to FY2008 is primarily due to expenses associated with strengthening supervisory activities and litigation costs associated with enforcement actions arising from the Freddie Mac and Fannie Mae special examinations. Some of these expenses were obligated in the prior year but were paid in FY2008, as goods and services were received.

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

Human Capital Cost. Funded payroll expenses increased $5.3 million from FY2007 to FY2008. The increase in net cost is primarily associated with incurring the full year cost in FY2008 for the six full time equivalents (FTE) added in FY2007 plus the 21 new FTE in FY2008. Other factors contributing to the increase include merit pay increases for a larger FTE base and a $1.1 million rise in benefits for the greater number of participants and higher benefits costs.

Continuous Supervision Costs and Related Litigation Costs. Net cost rose more than $1.8 million, or 13 percent, from FY2007 to $13.6 million for contract legal and document management services, expert witnesses supporting the Freddie Mac and Fannie Mae continuous supervision, and litigation costs and other contractual agreements.

Figure 13 • OFHEO Net Costs FY2006–2008

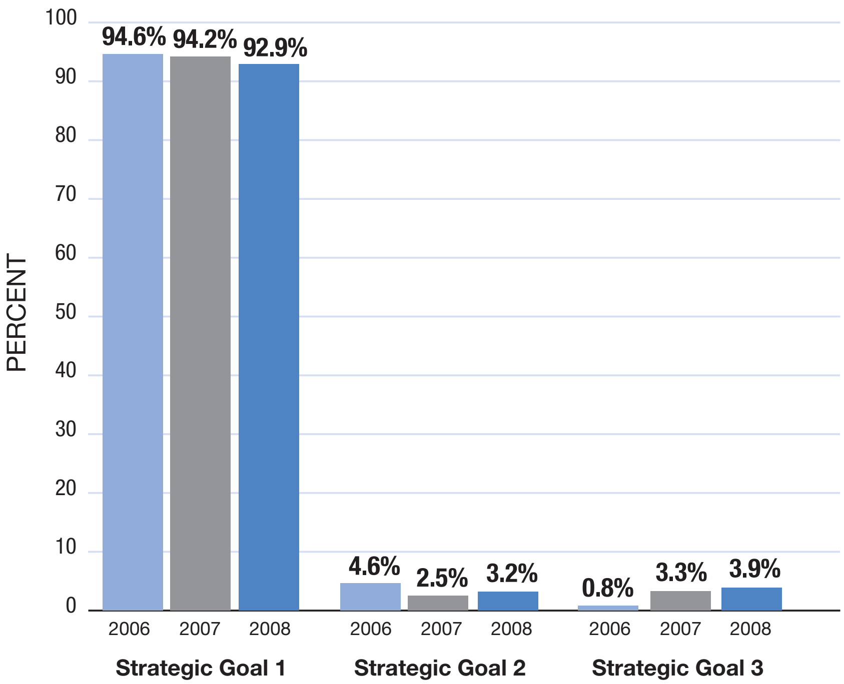


Other Factors. A number of expenses, such as rent, administrative support systems and information technology purchases, increased by smaller amounts in 2008, helping to offset the gains in other areas. During FY2008, OFHEO continued to focus on hiring and retaining staff to ensure effective oversight of the Enterprises. FTE rose from 230 in FY2007 to 251 at the end of FY2008, an increase of 9 percent.

Establishment of FHFA. Upon the enactment of HERA, the funds of both OFHEO and FHFB are treated as amounts received from assessments by FHFA of the regulated entities. These funds may be used to provide for reasonable expenses (including administrative and start-up costs) of FHFA, and for use by FHFA in the wind-up of the affairs of OFHEO and FHFB. As a practical matter, funds from OFHEO and FHFB were kept in their respective Treasury funds. Also, a simplified accounting structure was created for FHFA within OFHEO's accounting system to segregate and track the non-personnel expenses for FHFA. For the year ending September 30, 2008, FHFA incurred $6.256 million in obligations. To fund these obligations, OFHEO transferred $6.175 million to FHFA and FHFB transferred $0.081 million. The net cost for FHFA was $1.520 million. Personnel costs related to FHFA activities were $1.603 million: OFHEO contributed $1.010 million in personnel costs and FHFB contributed $0.593 million. Personnel costs were paid directly from OFHEO's and FHFB's funds as they were incurred.

* *FY2007 was the first year OFHEO operated under its FY2006-2011 Strategic Plan, issued September 30, 2006. In FY2006, OFHEO operated under the Strategic Plan it adopted at the end of 2003.*

Figure 14 • OFHEO Obligations by Strategic Goal, FY2006–2008*



* *FY2007 was the first year OFHEO operated under its FY2006-2011 Strategic Plan, issued September 30, 2006. In FY2006, OFHEO operated under the Strategic Plan it adopted at the end of 2003.*

Unqualified Audit Opinion for Fiscal Year 2008

For FY2008, OFHEO again received an unqualified ("clean") audit opinion on its financial statements, which the agency has received continuously since its initial financial statement audit in FY1998. No material weaknesses were noted in internal controls or any noncompliance with laws and regulations.

In addition to the financial statement audit, OFHEO contracted for an agreed-upon procedures review of its performance measures. No significant control weaknesses were identified.

Compliance with Appropriation Mandate

OFHEO is in compliance with language in OFHEO's FY2008 appropriation that requires "[t]hat not less than 80 percent of total amount made available … shall be used only for examination, supervision, and capital oversight of the enterprises." OFHEO dedicates the vast majority of its staff and financial resources to achieving its first strategic goal, which focuses on examinations, capital adequacy, compliance and enforcement, verified by quarterly staff time studies and financial management system data recorded at the transaction level by strategic goal. Figure 14 demonstrates that, during FY2008, OFHEO used 92.9 percent of its available resources toward the examination, supervision and oversight of Fannie Mae and Freddie Mac. OFHEO has had a similar appropriations requirement since 2004.

Compliance with Other Laws and Regulations

MANAGEMENT ASSURANCES

Pursuant to OMB Circular A-123, Appendix A, effective for FY2008 activities, OFHEO's Executive Committee on Internal Controls (ECIC) meets quarterly to oversee internal controls and provide recommendations to the Director pertaining to management assurances on the effectiveness of OFHEO's internal controls. In 2008, the ECIC was composed of the Deputy Director, who served as the Chair, the Director of Supervision and the General Counsel. The ECIC advises the Director on all internal control matters. The ECIC is supported by a Senior Assessment Team chaired by the Chief

Financial Officer. The Chief Information Officer is a permanent member of the Senior Assessment Team and other members are appointed as appropriate to review specific internal control issues. The assessment of internal controls has been further strengthened by the purchase and installation of the Integra system in the Financial Information Management System (FIMS) to track internal controls.

During FY2008, OFHEO continued to require managers to monitor internal controls and report on the effectiveness of controls to the Director. The ECIC and the Director reviewed documentation from program managers as well as documentation on financial system and accounting processes. In compliance with the new OMB requirements, the Director issued an unqualified opinion on internal controls over financial reporting as of June 30, 2008. This assurance can be found in the Financial Section of this report and meets the reporting requirement for internal controls in the Federal Managers Financial Integrity Act of 1982.

The Federal Financial Managers Improvement Act of 1996 (FFMIA) requires that "each agency shall implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level." OFHEO's FIMS, the core accounting and financial system to which OFHEO converted in FY2005, meets the standards established by FFMIA. OFHEO also uses the National Finance Center (NFC), a service provider agency within the Department of Agriculture, for its payroll and personnel processing. OFHEO has streamlined accounting processes by electronically interfacing data from Bank of America purchase credit card charges and NFC payroll costs and FIMS.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT

Title III of the Electronic Government Act of 2002, the Federal Information Security Management Act (FISMA), requires that all federal agencies develop and implement an agency-wide information security program. The program provides the framework to protect the government's information, operations and assets. Annually, OFHEO reviews the agency's information security program through an independent contractor and reports the results to OMB. The independent review found no significant or material weaknesses for FY2008. OFHEO's report showed that the agency improved its overall security posture with respect to safeguarding its information assets and systems, including the completion and maintenance of certification and accreditation for all major systems and the development and implementation of a security policy handbook for all OFHEO employees. Specific recommendations in the report included improving information technology contingency plans, involving the information technology security function in change management related to systems and addressing specific technical deficiencies for OFHEO's information systems that were noted during the review.

During FY2008, OFHEO developed a comprehensive security policy. The agency began developing procedures related to the security handbook and will continue this effort into FY2009. OFHEO also addressed security-related weaknesses for systems based on the prior year FISMA review and completed a review to validate and document system configurations. During the year, OFHEO provided expanded and improved security awareness training to 100 percent of OFHEO employees and contractors.

ERRONEOUS PAYMENTS

The Improper Payments Act of 2002 requires that agencies (1) review activities that are susceptible to significant erroneous payments; (2) estimate the amount of annual erroneous payments; (3) implement a plan to reduce erroneous payments; and (4) report the estimated amount of erroneous payments and the progress to reduce them.

The Act defines significant erroneous payments as the greater of 2.5 percent of program activities or $10 million. The agency has implemented and maintains internal control procedures that ensure disbursement of federal funds for services and goods rendered under valid obligations as established through proper requisition and procurement processes. OFHEO issued zero erroneous payments in FY2008.

PROMPT PAY

The Prompt Payment Act requires federal agencies to make timely payments to vendors and improve the cash management practices of the government by taking discounts when they are justified. This means that OFHEO must pay its bills within a narrow window of time — not too early and not late. In FY2008, the dollar amount subject to prompt payment was $25.5 million, an increase of 26 percent over $20.2 million in FY2007. The amount of interest penalty paid in FY2008 was $1,167 or 0.00004 percent of the total dollars disbursed. This compares to the $11 interest penalty paid in FY2007, or 0.0000006 percent of total dollars disbursed.

FINANCIAL STATEMENT REQUIREMENTS

OFHEO prepares financial statements and submits those statements for annual audit. The statements have been prepared from the books and records of OFHEO in the format prescribed by OMB and reflect financial activities that were recorded in compliance with generally accepted accounting principles for federal government agencies. These statements supplement the periodic financial reports used to monitor and control budgetary resources that were prepared from the same books and records. The statements should be read with the understanding that they are for a component of the U.S. government and an entity of the Department of Housing and Urban Development in its consolidated financial statements as of September 30, 2008.

Performance Section

Overview

MISSION STATEMENT

To promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.

OFHEO's three strategic goals support the clear and important mission of the agency. The goals focus on the critical supervision and oversight role OFHEO plays to ensure the safe and sound operations of the Enterprises in order to foster an efficient secondary mortgage market and a healthy housing finance system. A strong housing finance system promotes the government-wide goals of homeownership and affordable housing.

OFHEO's Strategic Goals

1. Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.
2. Provide support for statutory reforms to strengthen our regulatory powers.
3. Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

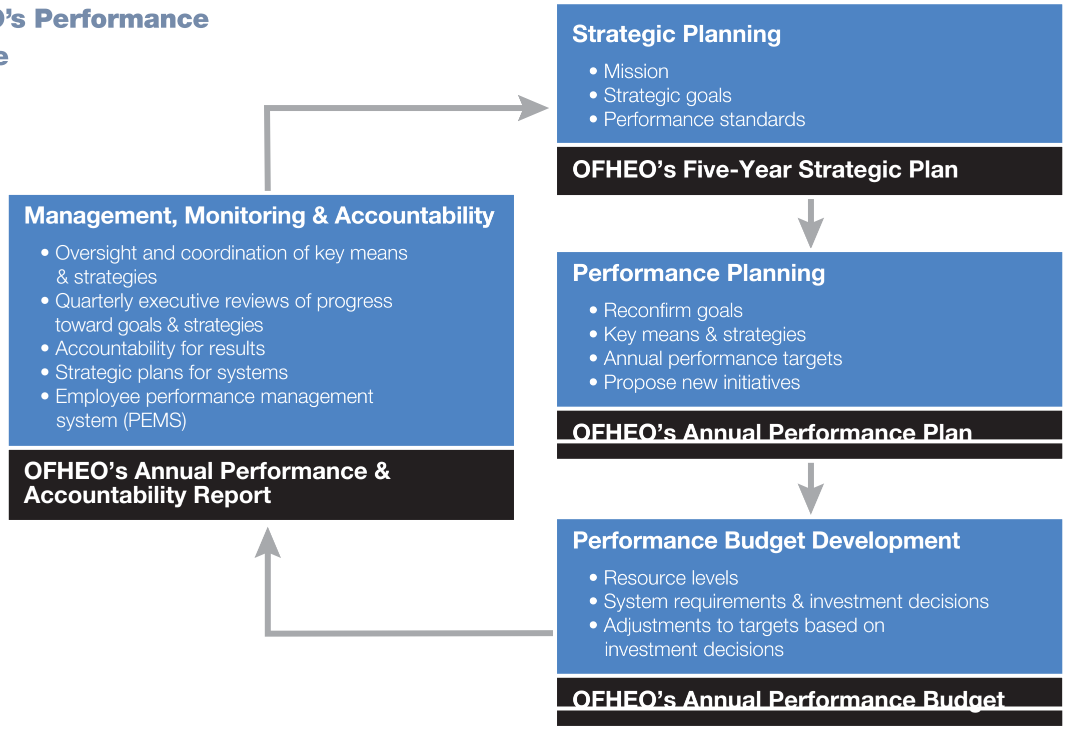
Resource Management Strategy: manage effectively OFHEO's human capital and other resources to support our mission.

Managing and Measuring Performance

Figure 15 outlines the relationship between OFHEO's performance-related documents and performance management practices. OFHEO's long-term strategic goals are presented in the agency's strategic plan. Each year, OFHEO develops outcome-based performance goals that lead to the accomplishment of the strategic goals. For FY2008, there were a total of 13 performance goals. These are described in the agency's performance plan. OFHEO's performance goals reflect challenging yet achievable targets for key program areas. Each performance goal has at least one corresponding performance measure that may be outcome- or output-based. For FY2008, there were a total of 38 performance measures. Performance measures provide an indication of the level of achievement of the larger performance goal. This hierarchy of goals ensures that OFHEO is constantly working to achieve its mission in practical and measurable ways (see Figure 16).

Performance measures are connected to a strategic and performance goal through the numbering system. The first digit of each performance measure number represents the strategic goal that it

Figure 15 • OFHEO's Performance Management Cycle



supports. The second digit represents the performance goal, and the third digit is the performance measure number related to that performance goals. For example, performance goal 1.2(2) supports strategic goal 1, performance goal 1.2 and is the second performance measure under that performance goal.

OFHEO accomplishes its mission primarily by conducting examinations of the Enterprises, monitoring their progress in completing their remediation plans, assessing their capital adequacy, monitoring credit and financial market conditions, conducting research and analysis about the Enterprises and the housing markets and working toward regulatory reform. OFHEO's regulatory framework supports these functions. The OFHEO annual performance budget describes how OFHEO achieves its goals and the costs, systems and initiatives associated with them.

Figure 16 • OFHEO's Goal Hierarchy

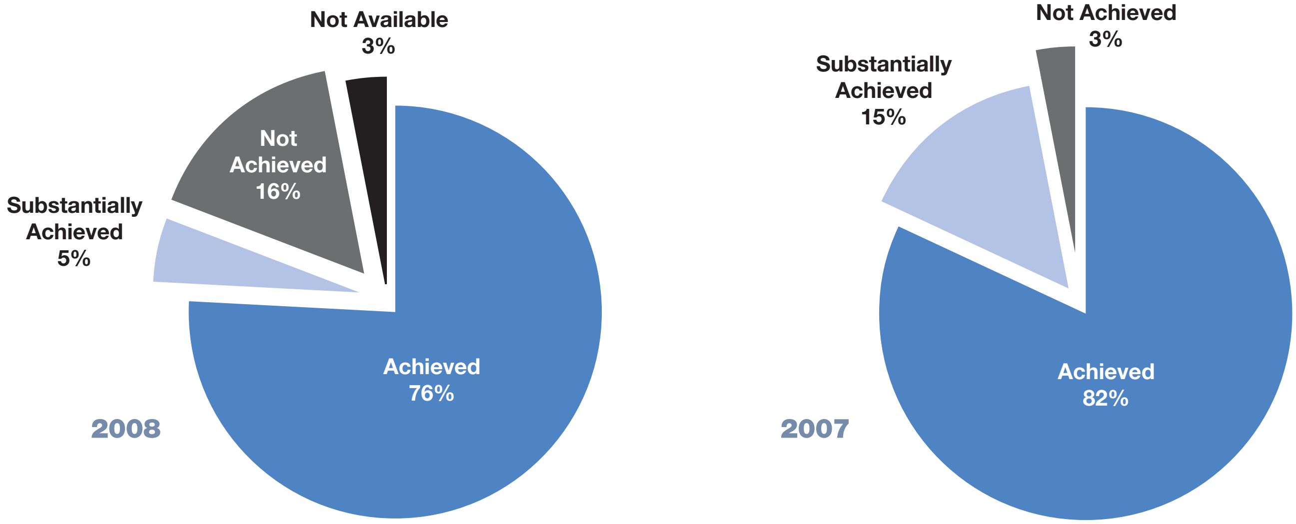
Over the course of the year, OFHEO executives reported their progress in achieving the performance goals for which they were accountable and then met with the Director to review status and accomplishments each quarter. Through weekly meetings, senior management was made aware of progress toward achieving performance goals before the quarterly report was prepared. The Director was able to use timely budget information throughout the year to promptly redirect resources to facilitate the achievement of OFHEO's goals and to address emerging issues, such as disruptions in the financial markets. This ongoing monitoring and performance management was key to achieving OFHEO's goals. The agency used the quarterly reports as the basis for developing this Performance and Accountability Report.

James B. Lockhart III, Director of FHFA, meets with agency executives to discuss quarterly performance goals and achievements.

Most of OFHEO's performance indicators reflect data and milestones internal to the agency, with the exception of external data from the Enterprises used as input for the capital calculations. The performance information reported in this Performance and Accountability Report is complete and reliable. In FY2008, OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review of the internal controls related to key performance indicators. There were no significant findings; however, the auditor made recommendations to improve data collection and presentation, some of which are incorporated in this PAR.

OFHEO achieved or substantially achieved all but one of its performance goals in FY2008. This section outlines in detail the agency's performance goals for each strategic goal and OFHEO's accomplishments related to each goal and performance measure. Performance goals are achieved when targets for all performance measures have been achieved. Substantially Achieved indicates that at least one performance target has not been achieved, although a substantial majority of the targets related to the goal were met. As shown in Figure 17, in FY2008, OFHEO achieved 76 percent of its performance measures compared with 82 percent in FY2007. The agency substantially achieved 5 percent of performance measures in 2008 versus 15 percent in 2007, and did not achieve 16 percent in 2008 compared with 3 percent in 2007. Data for one performance measure in 2008 were not available at the time of publication. The majority of measures not achieved in FY2008 were affected by changing priorities at the agency, the passage of HERA and the deteriorating market conditions through the year.

Figure 17 • OFHEO Performance Measures for FY2008 and FY2007



Strategic Goal 1: Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.

The primary duty of OFHEO as a regulator is to ensure that the Enterprises operate in a safe and sound manner in order to fulfill their important role in the nation's housing finance system. A comprehensive and effective oversight program requires attention to the Enterprises, the dynamic environment in which they operate, the risks inherent in their activities and their management. Maintaining risk-based standards and understanding the risk profiles of the Enterprises are fundamental to the ability of OFHEO to ensure their safe and sound operation.

OFHEO must ensure that specific issues and emerging trends that may affect safety and soundness are identified early and that potential vulnerabilities are appropriately addressed. At the time of the publication of the annual Report to Congress in April 2008, FHFA considered both Enterprises to be significant supervisory concerns. Both Fannie Mae and Freddie Mac are currently under conservatorship because of safety and soundness concerns, housing market conditions and a flawed regulatory model. Therefore, the agency must make an extra effort with hands-on monitoring and supervision to ensure that the Enterprises are operating in a safe and sound manner. The knowledge and expertise OFHEO acquires through its examinations and the insights gained from its research and analyses are critical to accomplishing its mission. A rapid and effective OFHEO response requires maintaining a solid understanding of Enterprise exposures, risk management techniques, operating strategies and financial condition.

A key part of the oversight program is ensuring capital adequacy. Adequate capital protects an Enterprise from severe losses due to unexpected events such as economic crises or management missteps. Without sufficient capital, an Enterprise could fail or provide inadequate support to the nation's housing finance system. As a result of the conservatorship, and in accordance with the Senior Preferred Stock Agreement, FHFA has directed the Enterprises to focus on managing to a positive GAAP net worth. During conservatorship, both Enterprises will work to ensure that they fulfill their mission of providing liquidity, stability and affordability to the mortgage market.

FHFA seeks to identify and encourage resolution of problems at the Enterprises or in the marketplace before the problems cause significant harm. Also, FHFA is committed to ensuring that its supervisory practices are both up-to-date and adaptable to rapid changes in the environment and the Enterprises.

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 1.1

The Enterprises comply with safety and soundness standards.

MEASURE 1.1(1)

Measure	Target
(A) Percentage of Enterprises with CAMELSO ratings of 1, 2 or 3.	TARGET: 100%
(B) Percentage of Enterprises with an overall GSE Enterprise Risk safety and soundness rating of “Limited Concerns” or better.	TARGET: Acquire baseline results in 2008

2008 PERFORMANCE

(A) At the end of the calendar year 2007 examination, OFHEO determined that both Enterprises had CAMELSO ratings at 3 or higher; however, both Enterprises were still considered “significant” supervisory concerns at that time.

(B) OFHEO implemented the new GSE Enterprise Risk rating system during FY2008. Results for calendar year 2008 will be available in FY2009.

MEASURE 1.1(2)

Measure	Target
(A) For both Enterprises, the percentage of OFHEO’s five risk assessment categories with an acceptable risk/risk management profile.	TARGET: 90% for both Enterprises
(B) For both Enterprises, the percentage of GSE Enterprise Risk categories (Governance, Solvency, Earnings, market, credit and operational risk) with a safety and soundness rating of “Limited Concerns” or better.	TARGET: Acquire baseline results in 2008

2008 PERFORMANCE

(A) OFHEO’s five risk assessment categories are: governance, market risk, credit risk, operational risk and model risk. At the end of the calendar year 2007 examination, most areas had acceptable risk profiles at both Fannie Mae and Freddie Mac, with only one area rated as high quantity of risk and weak risk management.

(B) OFHEO implemented the new GSE Enterprise Risk rating system during FY2008. Results for calendar year 2008 will be available in FY2009.

MEASURE 1.1(3)

Measure	Target
Average number of days to issue report of examination to Enterprise Boards of Directors and meet with them after field work is complete.	TARGET: 90 days

2008 PERFORMANCE

OFHEO’s calendar year 2007 examination was completed on time and the Enterprises’ Boards of Directors were briefed on OFHEO’s findings and conclusions within an average time of 63.5 days. OFHEO met with the Fannie Mae Board of Directors on February 29, 2008, and the Freddie Mac Board of Directors on March 7, 2008.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

GOAL 1.1 ■ Prior Year Performance

2007	Both Enterprises continued to pose supervisory concerns including internal controls and accounting problems. Both Enterprises continued to make improvements, and OFHEO continued to identify other issues requiring attention. Although both Enterprises continued to respond to OFHEO's concerns, they had considerable work to do to correct their accounting and internal controls problems.
2006	Both Enterprises continued to pose supervisory concerns, including internal controls and accounting problems. Both Enterprises had remedial plans in place to address Special Examination findings, and OFHEO continued to identify other issues requiring attention. Both Enterprises had considerable work to do to correct their accounting and internal controls problems.
2005	Both Enterprises met safety and soundness standards; however, OFHEO found inadequate controls and improper accounting at Fannie Mae and took remedial action. OFHEO continued to monitor both Enterprises' progress toward completing remedial actions to address Special Examination findings. OFHEO continues its review, monitoring and remedial steps.
2004	Both Enterprises met safety and soundness standards; however, OFHEO continued to monitor required remedial actions based on unsafe and unsound practices identified by OFHEO at Freddie Mac in FY2003. In FY2004, OFHEO identified safety and soundness concerns at Fannie Mae and took remedial action.

2008 Performance Discussion for Goal 1.1

Overall

During the year, OFHEO completed its calendar year 2007 annual examination of Fannie Mae and Freddie Mac and began its calendar year 2008 annual examination. OFHEO found for calendar year 2007 that both Enterprises remained significant supervisory concerns. The performance measures reported here are point-in-time measures, reflecting the safety and soundness conditions of the Enterprises at the end of December 2007. During 2008 their ratings and market conditions deteriorated, with the credit markets especially affected. In September 2008, as the deteriorating market conditions began to affect the ability of the Enterprises to fulfill their mission, FHFA placed both Fannie Mae and Freddie Mac in conservatorship. FHFA outlined the following reasons affecting both Enterprises for taking this significant step:

- Accelerating safety and soundness weaknesses, especially with regard to credit risk, earnings outlook and capitalization;
- Continued and substantial deterioration in equity, debt and MBS market conditions;
- The current and projected financial performance and condition of each company as reflected in its second quarter financial reports and the agency's ongoing examinations;
- The inability of the Enterprises to raise capital or to issue debt according to normal practices and prices;

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

- The critical importance of each Enterprise in supporting the country's residential mortgage market;
- Concerns that a growing proportion of the Enterprises' respective statutory core capital was made up of items other than retained earnings.

OFHEO summarized its findings and conclusions about the 2007 examination in the annual Report to Congress, issued in April 2008. OFHEO presented its 2007 findings in a CAMELSO framework, describing the Enterprises' condition based on Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk and Operational risk. Both Enterprises were rated at three or better on a five-level scale, where five is the weakest and one is strongest CAMELSO score. The report characterized each Enterprise as a significant supervisory concern. It also highlighted that extraordinary declines in the housing and mortgage markets had put additional pressure on their credit management, interest-rate risk management and financial modeling processes.

As the 2008 annual examination of the Enterprises began, OFHEO implemented a new safety and soundness risk rating system, called GSE Enterprise Risk to replace the previous two rating systems. GSE Enterprise Risk stands for Governance, Solvency, Earnings and Enterprise Risk. Enterprise Risk covers credit, market and operational risk. Ratings on each of these areas of risk will roll up into one composite score (see page 123 for more information). Results of the calendar year 2008 examination will be available in FY2009 and reported in next year's report.

During the year, OFHEO monitored the progress that each Enterprise made in resolving weaknesses and returning to timely financial reporting. OFHEO tracked the completion of Matters Requiring Attention (MRA), which were identified during the agency's annual examination, target examinations and other supervisory reviews during the year (see performance goal 1.3 for more information). FHFA continuous supervision included reviews of asset quality, management of counterparty concentration risk, market and interest-rate risk management practices and earnings performance and the impact on the Enterprises of market events. Given the rapid negative changes in the mortgage markets during the year, credit risk emerged as a major risk for both Enterprises.

Throughout the year, as OFHEO identified deficiencies in the Enterprises' operations, which were communicated with each Enterprise's management and Board of Directors as appropriate. The conclusions of the annual examination were shared with the Board before being summarized in the annual Report to Congress. OFHEO's annual Report to Congress, on the OFHEO Website at **www.ofheo.gov**, describes in more detail the agency's findings and the Enterprises' progress and condition.

Fannie Mae

OFHEO's supervision activities and examination of Fannie Mae for calendar year 2007 concluded that the Enterprise remained a significant supervisory concern primarily due to poor financial performance and the quantity of credit risk from the continued market deterioration, including house price declines. Fannie Mae achieved several milestones and implemented fundamental satisfactory controls in nearly all areas of the Enterprise. However, several projects are in progress but not yet complete, and many of the improvements are new and require time to ensure sustainability. Fannie Mae achieved a critical goal of issuing timely financial statements during the year by issuing its 2007 financial statement in February 2008. OFHEO recommended that the Board carefully oversee Fannie Mae's credit risk management, financial performance and capital planning, risk oversight functions, infrastructure project on internal controls and public disclosures. Due to the effect of deteriorating market conditions on Fannie Mae, FHFA placed the Enterprise in conservatorship on September 6, 2008. At that time, FHFA also replaced the CEO and eliminated dividends on common and preferred stock.

Freddie Mac

OFHEO's examination of Freddie Mac for calendar year 2007 concluded that the Enterprise remained a significant supervisory concern, primarily due to poor financial performance, deteriorating credit quality and internal control weaknesses. Freddie Mac made significant efforts to address internal control weaknesses but needed additional efforts to improve financial performance, mitigate credit weaknesses and complete the internal controls remediation effort. Freddie Mac achieved a critical goal of issuing timely financial statements during the year by issuing its 2007 financial statement in February 2008. OFHEO recommended that the Board carefully oversee Freddie Mac's financial performance, analytics and metrics, credit risk management, internal controls and risk oversight functions and improve its governance. Due to the effect of deteriorating market conditions on Freddie Mac, FHFA placed the Enterprise in conservatorship on September 6, 2008. At that time, FHFA also replaced the CEO and eliminated dividends on common and preferred stock.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed quarterly by senior management. Data related to supervision activities are collected through OFHEO's supervision process and reviewed by quality assurance staff and OFHEO management. Standards for the GSE Enterprise Risk rating system are outlined in OFHEO's Supervisory Handbook, which is available to the public on the OFHEO Website at **www.ofheo.gov**. CAMELSO ratings and standards for each risk category in the risk profile measure are based on criteria from the prior year's Supervisory Handbook. OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for the reporting for these performance measures and related internal controls. No significant weaknesses were found.

GSE Enterprise Risk Rating Structure

In FY2008, OFHEO began implementing a new rating system for evaluating and measuring the risks related to the safety and soundness of Fannie Mae and Freddie Mac. This new system, called GSE Enterprise Risk (GSEER), replaces an older system called CAMELSO that OFHEO had used previously and reported on in its annual Performance and Accountability Reports, including this fiscal year for the examination that concluded in December 2007. GSE Enterprise Risk stands for Governance, Solvency, Earnings and Enterprise Risk covers credit risk, market risk and operational risk. OFHEO determines individual ratings for each risk area and an overall composite rating that provides the agency with a picture of the overall condition and safety and soundness of each Enterprise.

To determine the risks related to each of the categories that comprise GSE Enterprise Risk, throughout the year examiners review the operations and transactions of Fannie Mae and Freddie Mac against standards outlined in the Supervisory Handbook, which is available on OFHEO's Website. Examiners complete an assessment and rating at the end of each quarter in a process of continuous supervision and examination. This allows OFHEO to recognize and address areas of concerns before they lead to significant issues that may affect the safety and soundness of the Enterprises. At the end of the calendar year, OFHEO summarizes the safety and soundness and financial condition of each Enterprise in the annual Report to Congress, including the overall composite GSE Enterprise Risk rating.

There are several components within each category of risk included in the GSE Enterprise Risk rating system:

- **Governance** – includes policies and controls related to financial and regulatory reporting, leadership effectiveness of both the Board of Directors and Enterprise management, compliance, overall risk management, strategy, internal audit and reputation risk.
- **Solvency** – includes capital adequacy as determined by regulatory standards, economic capital, capital management and planning.
- **Earnings** – includes adequacy of earnings to build and maintain capital and provide acceptable returns to shareholders, the quality of earnings, earnings projections, the integrity of management information systems and the soundness of the business model.
- **Enterprise Risk** – includes credit risk, market risk and operational risk. Credit risk rating relates to a borrower's failure to meet the term of any financial contract with the Enterprise or other failure to fulfill a financial commitment (counterparty risk). Market risk arises from the adverse effects of changes in interest rate or foreign exchange rates. Operational risk is the exposure to loss from inadequate or failed internal processes, people and systems, or from external events.

When determining the safety and soundness level for each of the GSE Enterprise Risk categories, examiners look at both the quantity of risk and quality of risk management in each area. In this way, the rating scheme takes into account external factors such as current market conditions and internal factors, including how much risk each Enterprise takes on and how well they measure and manage it. Ratings are given for each area on a four-point scale — No or Minimal Concerns, Limited Concerns, Significant Concerns and Critical Concerns. The overall rating reflects OFHEO's judgment about the safety and soundness of the Enterprise. OFHEO's target for FY2008 was to establish a baseline for future years.

	Quantity of Risk		
Quality of Risk Management	Low	Moderate	High
Strong	No or Minimal Concerns	No or Minimal, or Limited Concerns	Limited Concerns
Satisfactory	No or Minimal, or Limited Concerns	Limited Concerns	Significant Concerns
Requires Improvement	Limited Concerns	Significant Concerns	Significant or Critical Concerns
Weak	Significant Concerns	Significant or Critical Concerns	Critical Concerns

GOAL 1.2

Ensure the Enterprises are adequately capitalized.

MEASURE 1.2(1)

The Enterprises meet OFHEO's determination of capital adequacy.

TARGET:
Meet quarterly

2008 PERFORMANCE

Freddie Mac: Classified as adequately capitalized for the first two quarters and using the Director's discretion undercapitalized for the quarter ending June 30, 2008.[1]

Fannie Mae: Classified as adequately capitalized for the first two quarters and using the Director's discretion undercapitalized for the quarter ending June 30, 2008.[1]

MEASURE 1.2(2)

Complete the market risk component of an alternative risk-based capital standard as a measure of adequate regulatory economic capital.

TARGET:
Meet by the end of the fiscal year

2008 PERFORMANCE

OFHEO completed the first stage, the market risk component, in the development of an alternative risk-based capital standard that is based on a market valuation approach.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

[1] *The capital classification and supporting data for the period ending September 30, 2008 will not be available due to the suspension of capital classifications during the conservatorship.*

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 1.2 ■ Prior Year Performance

2007	**Freddie Mac:** Classified as adequately capitalized each quarter. **Fannie Mae**: Classified as adequately capitalized each quarter. OFHEO completed or met milestones on the six projects that it had planned for the year to improve the measures of capital adequacy and analysis of Enterprise capital.
2006	**Freddie Mac:** Classified as adequately capitalized each quarter. **Fannie Mae**: Classified as adequately capitalized each quarter.
2005	**Freddie Mac**: Classified as adequately capitalized each quarter. **Fannie Mae:** Classified as adequately capitalized for two quarters and classified as significantly undercapitalized for the quarter ending December 31, 2004.
2004	**Freddie Mac:** Classified as adequately capitalized each quarter. **Fannie Mae:** Classified as significantly undercapitalized for three quarters in FY2004 and adequately capitalized for the quarter ending December 31, 2003.

2008 Performance Discussion for Goal 1.2

On a quarterly basis, OFHEO is required to classify the capital adequacy of each GSE. The statute requires OFHEO to classify the GSEs based on minimum capital and risk-based capital as defined in the statute. Minimum capital requirements are based on core capital, which is shareholder's equity minus Accumulated Other Comprehensive Income. Classification levels are as follows: adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

In the first quarter of the fiscal year, at OFHEO's urging, the Enterprises raised almost $14 billion in capital. For the first two quarters of FY2008, both Fannie Mae and Freddie Mac were adequately capitalized. For the quarter ending June 30, 2008, OFHEO classified both Enterprises as undercapitalized, using the Director's discretionary authority. Although both Enterprises' capital calculations for June 30, 2008, reflect that they met the minimum and risk-based requirements for capital, the continued market downturn during late July and August raised significant questions about the sufficiency of capital and ultimately led to conservatorship on September 6, 2008. FHFA will suspend capital classifications during the conservatorship. A capital classification will not be made for the quarter ending September 30, 2008.

For two consecutive quarters, OFHEO released the classifications for both GSEs on an accelerated timeline, with the press release issued approximately 70 days following quarter-end. This release date reflected enhancements to processes and the ongoing commitment by OFHEO to release capital information in a timely manner. Due to events surrounding the conservatorship, the classification for the period ending June 30, 2008, was delayed beyond 90 days following quarter-end.

In addition to the statutory requirements, OFHEO previously imposed a requirement that both GSEs maintain capital at 30 percent above the minimum statutory requirements. In March 2008, OFHEO reduced the OFHEO-directed capital requirement to 20 percent from 30 percent in light of improvements at both GSEs and their commitment to raise significant capital and keep capital levels well above regulatory requirements. The reduction in capital requirement increased the capital surplus and provided an opportunity for both Enterprises to better support the mortgage market. In June 2008, OFHEO announced a further reduction of the OFHEO-directed capital requirement for Fannie Mae to 15 percent above the minimum capital level in light of its raising $7.4 billion additional capital in May 2008. Freddie Mac failed to raise capital. OFHEO is statutorily required to determine capital adequacy of the Enterprises on the basis of both minimum and risk-based capital standards. Figures 18–21 show each Enterprise's capital levels in comparison to their requirements. During conservatorship, the Enterprises will focus on managing to a positive shareholder equity.

Although both Enterprises achieved a surplus above the statutory capital requirement as of June 30, 2008, as described earlier FHFA placed both Enterprises in conservatorship on September 6, 2008. On a combined basis, the Enterprises raised more than $23.3 billion of capital over the course of the fiscal year. However, market conditions deteriorated more rapidly, raising questions of capital sufficiency. Further, the lack of investor confidence in the Enterprises eliminated their ability to raise new equity in the market. (Please see the discussion on conservatorship on page 9 for more information.)

Definition of Capital

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, which is captured as part of stockholder's equity.

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 equals or exceeds 2.5 percent of assets plus 0.45 percent of adjusted off-balance-sheet obligations, including guaranteed mortgage securities.

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

Risk-based Capital is the amount of total capital 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 operational risk. The risk-based capital standard is based on stress test results calculated for the two statutorily prescribed interest rate scenarios.

OFHEO publishes the OFHEO-directed, minimum and risk-based capital requirements for each Enterprise on its Website, **www.ofheo.gov**. During the conservatorship, FHFA will not issue a quarterly capital classification. The Enterprises will continue to submit capital reports to FHFA during the conservatorship. Relevant capital figures, including minimum capital requirement, core capital and GAAP net worth, will be available on FHFA's Website to ensure market transparency. FHFA does not intend to publish critical capital, risk-based capital, or subordinated debt levels during the conservatorship.

In FY2008, OFHEO continued to augment the required minimum and risk-based capital calculations with evaluation of factors that impact the Enterprises' capital, such as the effects of alternative interest rate scenarios and the Enterprises' performance on key capital assessment factors that cover a broad range of risks, such as capital projections, credit, earnings and access to markets.

Under HERA, FHFA will be developing new approaches and regulations on both minimum and risk-based capital. During FY2008, OFHEO completed the first stage in the development of an alternative risk-based capital standard that is based on a market valuation approach. This new model will include market, credit and operational risk components and will provide an additional economic capital perspective as a complement to the current cash flow-based, risk-based capital model and the minimum capital requirement in assessing capital adequacy. OFHEO completed the market risk component of the new model and began to develop a methodology for a risk-based capital requirement for operational risk during FY2008. Operational risk is the exposure to loss from inadequate or failed internal processes, people and systems, or from external events; it includes all direct and indirect economic losses, including those related to consequences of operational events. Using data on operational risk, including external data and Enterprise internal data plus the results of Enterprise scenario analyses, OFHEO will apply statistical techniques to model economic capital for operational risk. The economic risk-based capital model is expected to be completed in FY2009.

In FY2008, OFHEO continued to make improvements to the capital regulation within OFHEO's current statutory authority by updating the data, methodologies and components in the risk-based capital stress test. OFHEO made final the amendment to the risk-based capital regulation to correct

Figure 18 • Fannie Mae Minimum and OFHEO-Directed Capital, FY2007–FY2008

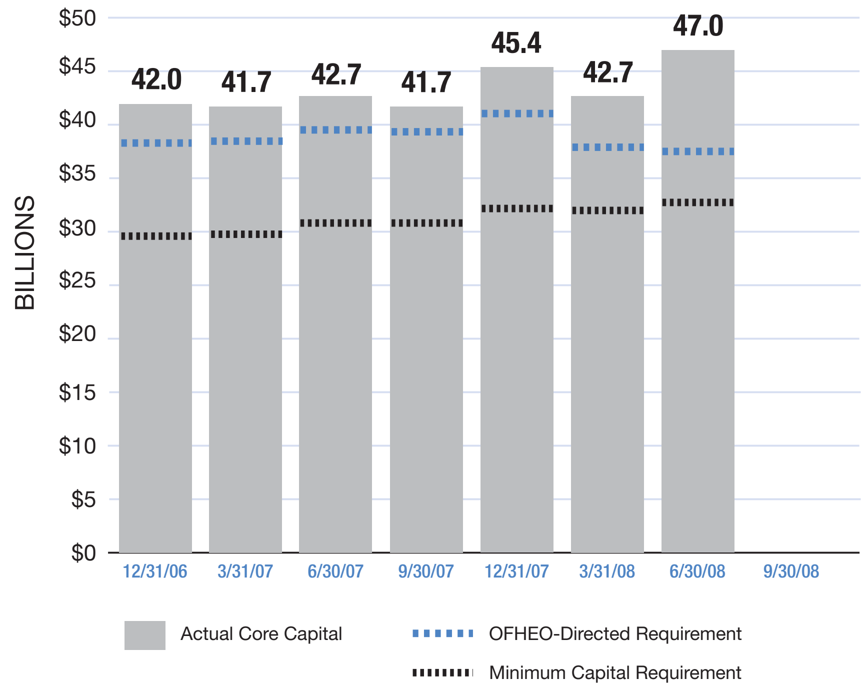


Figure 19 • Freddie Mac Minimum and OFHEO-Directed Capital, FY2007–FY2008

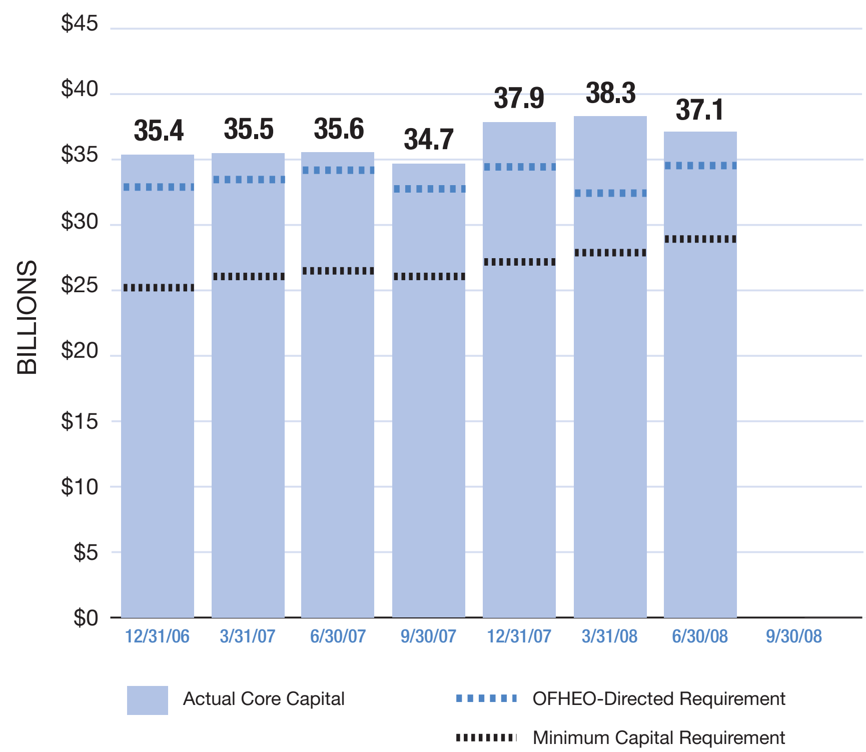


Figure 20 • Fannie Mae Risk-Based Capital (RBC) Requirements, FY2007–FY2008

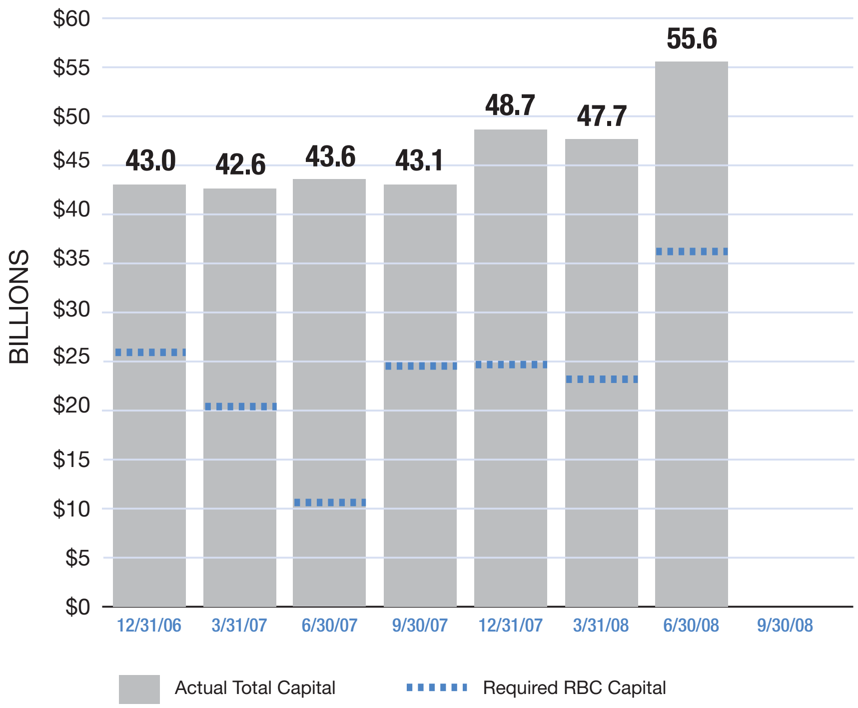
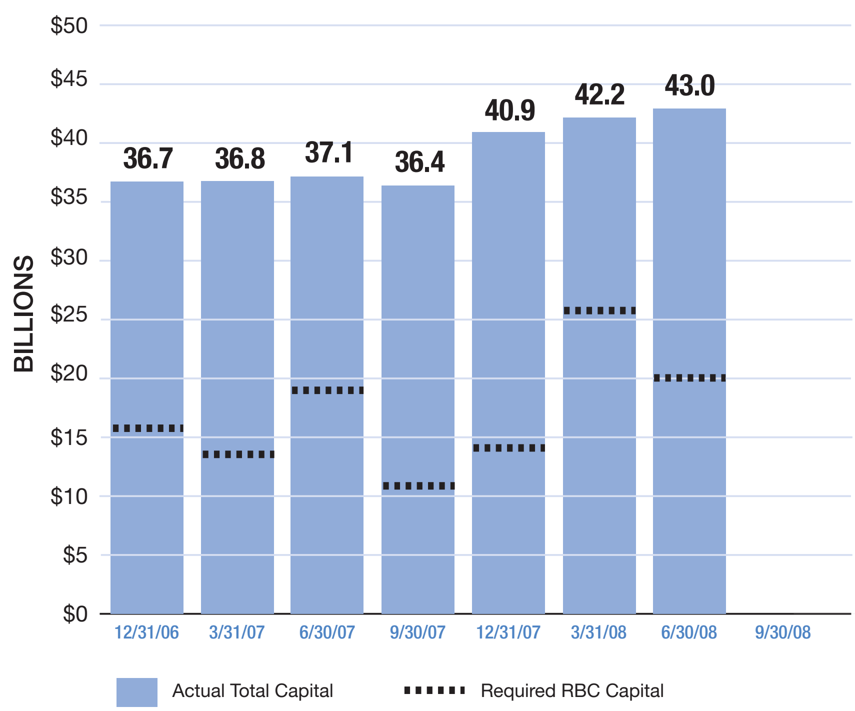


Figure 21 • Freddie Mac Risk-Based Capital (RBC) Requirements, FY2007–FY2008



deficiencies in the loss severity equations, with publication in the *Federal Register* on June 25, 2008.

Completeness and Reliability of Performance Data

The data for this performance goal are complete for the first three quarters of the fiscal year. A capital classification for the quarter ending September 30, 2008, will not be made. Select data will be available on OFHEO's Website at that time. FHFA will incorporate select data as appropriate during the conservatorship for all four quarters of data in its annual Report to Congress in April 2009 and in subsequent agency performance budgets and reports.

The data for both minimum capital and risk-based capital come directly from the GSEs and are certified by them as true and accurate. Each quarter, senior officers of each Enterprise transmit their data and attest to its accuracy. For the risk-based capital standard, OFHEO uses data validation protocols to ensure the consistency and integrity of the data received. Both Enterprises were timely financial filers during 2008, eliminating the qualifications and need for restated capital positions, as has been the case in previous years.

OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for reporting for performance measure 1.2(1) and related internal controls. No significant weaknesses were found.

GOAL 1.3

Ensure the Enterprises comply with applicable laws, regulations, directives and agreements, including executive compensation, corporate responsibility and disclosure.

MEASURE 1.3(1)

Any identified instances of noncompliance with laws, regulations or directives are resolved to OFHEO's satisfaction.

TARGET: 100%

2008 PERFORMANCE

Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to address issues identified by OFHEO.

MEASURE 1.3(2)

Percentage of actions required by formal regulatory agreements with the Enterprises that are resolved as planned.

TARGET: 95%

2008 PERFORMANCE

Monitored each Enterprise’s progress in implementing the requirements of consent orders and agreements each Enterprise had entered into with OFHEO. Overall, Fannie Mae and Freddie Mac have completed 97% of the items outlined in these formal agreements due as of June 30, 2008, and validated September 30, 2008. In September 2008, as the deteriorating market conditions began to affect the financial performance of the Enterprises, FHFA placed both Fannie Mae and Freddie Mac in conservatorship.

MEASURE 1.3(3)

Percentage of Matters Requiring Attention (MRA) and items related to OFHEO directives that are resolved to OFHEO’s satisfaction.

TARGET: 95%

2008 PERFORMANCE

Identified examination findings and conclusions that required resolution by the Enterprises (designated as MRAs) and monitored each Enterprise’s progress in implementing the correction. Overall, Fannie Mae and Freddie Mac completed 77% of the MRAs due by June 30, 2008, and validated by September 30, 2008.

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Partially Achieved

Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 1.3 ■ Prior Year Performance

2007	Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to address issues identified by OFHEO. Monitored each Enterprise's progress in implementing the requirements of consent orders and agreements each Enterprise had entered into with OFHEO. Identified examination findings and conclusions that required resolution by the Enterprises (designated as MRAs) and monitored each Enterprise's progress in implementing the correction.
2006	Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to address issues identified by OFHEO.
2005	Issued corporate governance regulation and mortgage fraud regulation. Issued examination guidance and a Director's Advisory. Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility, executive compensation and disclosure requirements. Each Enterprise responded appropriately to issues identified by OFHEO.
2004	Reviewed Enterprise compliance with applicable laws, regulations and directives, including corporate responsibility and disclosure requirements. Each Enterprise responded appropriately to issues identified by OFHEO.

2008 Performance Discussion for Goal 1.3

During FY2008, OFHEO monitored compliance with laws, regulations, guidance and directives through continuous supervision activities, including examinations and compliance reviews and enforcement actions. OFHEO also closely monitored the Enterprises' progress toward meeting the requirements of consent orders and agreements between each Enterprise and OFHEO.

In FY2003 Freddie Mac and in FY2006 Fannie Mae entered into consent orders with OFHEO based on the results of OFHEO's special examinations. In September 2005 agreements between OFHEO, each Enterprise formalized the previously voluntary adoption of commitments designed to enhance market discipline, liquidity and capital. Both Enterprises have made progress toward implementing these corrections and improvements. For both Enterprises, the combined compliance achieved across all agreements is 97 percent for the period ending June 30, 2008. Freddie Mac achieved 97 percent full compliance and 3 percent noncompliance. Freddie Mac's one remaining item, separating the CEO and Chairman of the Board positions, was accomplished under the conservatorship FHFA announced on September 6, 2008. On May 6, 2008, OFHEO lifted the consent order with Fannie Mae based on OFHEO's assessment of the Enterprise's compliance with the consent order. Fannie Mae achieved full compliance on 72 percent of the issues covered in the consent order, and ongoing compliance on the remaining 28 percent. FHFA's next step is to

Definition of Compliance

Full Compliance indicates that the Enterprise has complied with the intent of the consent order, the item has been validated as completed by OFHEO and no further actions are required.

Ongoing Compliance indicates that the Enterprise has complied with the intent of the consent order; however, the item has not been validated by OFHEO or requires periodic reports.

Non-Compliance indicates that the Enterprise has not met the intent of the consent order.

validate the remaining 28 percent during the course of examination/supervisory activity to ensure that management's actions have been implemented in accordance with the intent of the consent order.

In FY2008 OFHEO also monitored each Enterprise on its progress toward correcting MRAs identified through the course of the OFHEO examinations and other supervision reviews. An MRA is a specific recommendation made to the Enterprise that requires management's attention and correction. MRAs include any items that are noncompliant related to OFHEO directives but do not include consent order items. An MRA is detailed in written communication to the Enterprise, and a specific due date for correction is established. When an MRA is resolved to OFHEO's satisfaction, it is considered to be closed. Resolved to OFHEO's satisfaction indicates that the Enterprise has corrected the item and it has been validated by OFHEO.

As of June 30, 2008, Fannie Mae and Freddie Mac had completed 77 percent of the MRAs due. OFHEO aggressively monitored the Enterprises' progress on addressing the outstanding MRAs and validated corrections; however, the Enterprises did not sufficiently complete all the MRAs due by June 30, 2008. Long-standing issues related to internal controls and new products processes remain outstanding. Agency resources for validation were also diverted due to changing market conditions and FHFA's decision to put both Enterprises under conservatorship. FHFA will continue to work with the Enterprises to ensure that the MRAs are completed as soon as possible. The agency is also working to define a more realistic target for this measure in future years.

In April 2008, OFHEO issued three consent orders dealing with the former CEO, CFO and Controller of Fannie Mae. The consent orders settle OFHEO's administrative actions against the former officers arising out of the events related to the accounting and internal control problems at Fannie Mae uncovered by OFHEO and detailed in two special examination reports. Overall, these consent orders required former Fannie Mae Board Chairman and CEO Raines, former CFO Howard and former Controller Spencer to pay civil money penalties, reimbursement and other relief totaling $31.4 million.

OFHEO resolved the administrative actions against former officers of Freddie Mac with a consent order in November 2007 with the former Board Chairman and CEO Brendsel. Among other things, the consent order required Mr. Brendsel to pay $2.5 million to the U.S. government, disgorge previously paid salary and bonuses of $10.5 million to Freddie Mac and waive claims against Freddie Mac for additional compensation, valued at more than $3.4 million. OFHEO had previously settled administrative actions against two other former Freddie Mac officers, former Executive Vice President and CFO Clarke and former President and COO Glenn.

Completeness and Reliability of Performance Data

The data for this performance goal are reliable and complete for the first three quarters of the fiscal year. Data on compliance with consent orders and MRAs are collected in OFHEO's automated supervisory tool and reviewed by agency management and staff as part of the quality assurance program. All compliance measures are reported with a one-quarter lag to allow OFHEO time to validate the corrective actions. Except in the case of the regulatory agreements, compliance indicates that the Enterprise has submitted the required item and OFHEO has validated it and finds it

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Partially Achieved

Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

acceptable and sustainable. For regulatory agreements, the validation process is under way, and FHFA will continue to validate the completion and effectiveness of remedial measures during ongoing examination activities. Compliance does not necessarily indicate that the Enterprise has fully resolved the underlying problem. Resolved to OFHEO's satisfaction indicates that the Enterprise has corrected the item and it has been validated by OFHEO.

Data on the Enterprises' compliance with regulatory agreements and MRAs as of September 30, 2008, will be available in December 2008. OFHEO will include these data in its annual Report to Congress in April 2009 and in subsequent agency performance budgets and reports.

OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for reporting for performance measures 1.3(2) and 1.3(3) and related internal controls. No significant weaknesses were found.

GOAL 1.4	Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.	
MEASURE 1.4(1)	Revise and implement policies, guidances and regulations for the Enterprises to augment current regulatory infrastructure.	TARGET: Meet Milestones
	2008 PERFORMANCE Met 12 of 18 milestones related to new or revised guidance, regulations and policies. Completed revision related to loss severity in the risk-based capital regulation. Completed new guidance on conforming loan limits and mortgage fraud. Completed interim final regulation on golden parachute payments.	
MEASURE 1.4(2)	Percentage of quality assurance recommendations implemented in the supervision program.	TARGET: Establish Baseline
	2008 PERFORMANCE Due to the market developments during the year and conservatorship of Fannie Mae and Freddie Mac in the last quarter of the fiscal year, the quality assurance review was temporarily suspended, preventing completion of a baseline. New Supervision Handbook issued earlier in the year.	
MEASURE 1.4(3)	Final Call Report regulation issued.	TARGET: July 31, 2008
	2008 PERFORMANCE Draft submitted to OMB for review, but withdrawn due to the enactment of the Housing and Economic Recovery Act of 2008. OFHEO will reevaluate the draft and ensure that it conforms to the new regulatory authorities granted to FHFA.	
MEASURE 1.4(4)	Revisions made to Prompt Supervisory Response and Corrective Actions regulation.	TARGET: September 30, 2008
	2008 PERFORMANCE Draft of revised regulation was prepared and ready to send to OMB for review, however due to the enactment of the Housing and Economic Recovery Act of 2008, OFHEO will reevaluate the draft and ensure it conforms to the new regulatory authorities granted to FHFA.	

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 1.4 ■ Prior Year Performance

2007

New Performance Measure
Met quarterly milestones to revise and implement guidances, policies and regulations to enhance the current regulatory infrastructure. Developed a quality assurance function and issued a revised Supervisory Handbook outlining the principles and standards for OFHEO's examination of the Enterprises. Began to develop an Enterprise call report regulation but did not achieve two of the four milestones to complete this project in FY2007.

2008 Performance Discussion for Goal 1.4

OFHEO made a significant effort in FY2008 to enhance the supervision of Fannie Mae and Freddie Mac by improving the guidance provided on key topics, updating the capital standards that the Enterprises must meet, making progress on developing an Enterprise call report and implementing recommendations from the newly developed quality assurance program to ensure the integrity of the supervision process. However, despite these efforts and accomplishments, OFHEO did not achieve any of the four performance measures for this performance goal.

During the fiscal year, OFHEO issued two new guidances that improved the transparency of OFHEO's supervision process and provided clarity to the Enterprises and the public on the standards OFHEO applies to the Enterprises. The guidance on conforming loan limits reflected the comments solicited from the public in FY2007. The guidance on mortgage fraud programs at both Fannie Mae and Freddie Mac established standards for the examination of mortgage fraud programs. This included an evaluation of the extent to which internal policies, procedures and training programs of an Enterprise minimize risks from mortgage fraud and the extent to which that mortgage fraud or possible mortgage fraud is consistently reported to OFHEO.

On June 25, 2008, OFHEO published in the *Federal Register* a revision to the risk-based capital rule that addressed changes to the loss severity equation in the risk-based capital stress test. This change updated the calculation for loss severity and may have an effect on future capital classifications for the Enterprises. OFHEO has posted both the revised capital regulation and the new guidances on its Website, **www.ofheo.gov**.

OFHEO established an agenda of regulations and guidance to complete for the year and focused on completing two specific regulations in FY2008. The agency anticipated finalizing changes and updates to its Prompt Supervisory Response Regulation and publishing a regulation establishing a call report for Fannie Mae and Freddie Mac. OFHEO made significant progress in drafting these regulations, but was not able to submit them for formal OMB review during FY2008. With the passage of the Housing and Economic Recovery Act of 2008, OFHEO will reevaluate the drafts and ensure that they conform to the new regulatory authorities granted to FHFA.

Last year, OFHEO implemented a quality assurance function. Quality assurance ensures that supervision policies, procedures and standards are applied to the Enterprises in a consistent and uniform manner. The function also supports the supervision program through training to address issues identified through the quality assurance process. During FY2008, OFHEO updated the Supervisory Handbook and made recommendations to improve the supervision process based on the findings of the quality assurance review.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed by quarterly senior management.

Strategic Goal 2: Provide support for statutory reforms to strengthen our regulatory powers.

Edward J. DeMarco, FHFA COO and Senior Deputy Director for Housing Mission and Goals, discusses accomplishments and challenges during FHFA All Hands Meeting.

OFHEO's ability to ensure the financial safety and soundness of the Enterprises faced major limitations under its enabling statute, as pointed out in OMB's PART assessment of the agency. As OFHEO has identified problems through its special examinations of both Enterprises, the agency has had to rely on consent agreements with each Enterprise to effect change. OFHEO needed the full set of regulatory powers similar to the tools available to bank regulators so it could act quickly to address problems. The turmoil in the mortgage market in 2008 and its effects on the Enterprises reemphasized the need for regulatory reform. The need to place the Enterprises in conservatorship proved the inadequacy of the existing regulatory regime. In July 2008, Congress passed legislation to create the Federal Housing Finance Agency, establishing with it the necessary authorities and powers for the new regulator.

GOAL 2.1 Support efforts to strengthen OFHEO's authorities.

MEASURE 2.1(1)

Conduct and disseminate research and analysis to identify issues and areas requiring legislative change.

TARGET: As needed

2008 PERFORMANCE
Issued four Mortgage Market Notes on topics relevant to GSE reform legislation.

MEASURE 2.1(2)

Make recommendations to Congress about legislative changes OFHEO needs to accomplish its mission.

TARGET: At least annually

2008 PERFORMANCE
Presented OFHEO's legislative recommendations in the 2008 annual Report to Congress. Provided technical assistance to Congress during consideration of GSE reform legislation. Director James B. Lockhart III testified February 7, 2008, before the Senate Committee on Banking, Housing and Urban Affairs on GSE reform legislation.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

MEASURE 2.1(3)	Respond to all congressional inquiries.	TARGET: Within 10 business days
	2008 PERFORMANCE Responded to all congressional inquiries within the timeframe.	

GOAL 2.1 ■ Prior Year Performance

2007	**New Goal This Year** Made legislative recommendations in the 2008 annual Report to Congress. Responded to all congressional inquiries within 10 business days.

2008 Performance Discussion for Goal 2.1

President Bush signed into law H.R. 3221, the Housing and Economic Recovery Act of 2008, on July 30, 2008. This law created the Federal Housing Finance Agency and charged it with safety and soundness oversight over Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. (For more information on FHFA, please see page 16.) The law provides bank regulator-like powers for the new regulator in addition to authority to approve new Enterprise products and set and oversee affordable housing goals.

OFHEO supported statutory reforms to strengthen the agency's regulatory powers during FY2008 by conducting research and responding to congressional inquiries. OFHEO produced analysis, presentations and research papers on topical issues, including market developments related to subprime and nontraditional mortgages. This research informed the agency's position, provided the basis for OFHEO's decisions and illuminated areas where legislative improvements could be made to provide for more effective oversight of Fannie Mae and Freddie Mac. OFHEO also continued its publication of Mortgage Market Notes in order to inform policymakers and the public on current issues and trends in mortgage markets. Two Mortgage Market Notes published in 2008 addressed historical trends in the conforming loan limit and the potential implications of increasing that limit.

In 2008, OFHEO continued to respond to questions and work with the Administration, congressional members and staff on issues related to legislative proposals. Throughout the year, the Director gave many press interviews and addressed various groups with interests in the housing and mortgage finance industry to explain the need for statutory changes and their possible effects and to gather their input. The agency also responded to numerous media inquiries about the legislation. OFHEO provided draft language, analyses, comments and technical assistance to Congress during the consideration of legislation regarding OFHEO's mission. GSE reform legislation, Public Law 110-289, included the necessary enhanced powers and oversight authorities that the Director and senior staff discussed with Members of Congress and their staffs, as well as Treasury and Administration officials, during the year. OFHEO responded to questions and provided information and technical assistance to the committees of both houses, at their request, as they worked together with the Administration to enact a bill.

OFHEO maintained communication with Congress during the fiscal year and provided technical assistance as the House of Representatives and the Senate worked on GSE regulatory reform legislation. OFHEO continued briefings with congressional committee members and staff on issues related to ongoing oversight of the Enterprises, developments in the housing finance markets and the need for statutory changes to reform the regulation of the housing GSEs. OFHEO responded quickly and accurately to congressional inquiries.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed quarterly by senior management.

OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for the reporting for performance measures 2.1(2) and 2.1(3) and related internal controls. No significant weaknesses were found.

Strategic Goal 3:

Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

In recent years, consolidation, new technologies, new standards and new approaches to pricing and managing financial risks have transformed the U.S. financial system and made safety and soundness regulation of financial institutions increasingly complex. The Enterprises are the dominant firms in the secondary housing finance markets, and their importance as participants in the financial system as a whole has become clearer with the deteriorating market conditions this year. Their market share of new mortgage originations reached over 80 percent during the year. These developments have important implications for the federal policy objectives of promoting the efficiency of the financial system and mortgage markets, ensuring the safety and soundness of the Enterprises, increasing homeownership and enhancing the availability of affordable housing. OFHEO has been working with other federal agencies to coordinate efforts to analyze current trends, understand their implications for federal policy objectives, identify and analyze policy options, share regulatory knowledge and expertise and promote regulatory best practices related to safety and soundness issues.

GOAL 3.1

Promote an efficient secondary mortgage market by increasing the transparency of mortgage market developments and Enterprise risks and activities.

MEASURE 3.1(1)	Enhance OFHEO's House Price Index Report by publishing a monthly HPI.	TARGET: March 31, 2008
	2008 PERFORMANCE Issued HPI report quarterly. Monthly HPI established March 25, 2008, and published monthly thereafter. Provided additional information in the regular quarterly reports.	
MEASURE 3.1(2)	Report on OFHEO activities, examination results and conclusions, and the secondary mortgage market in the OFHEO annual Report to Congress.	TARGET: April 11, 2007
	2008 PERFORMANCE Annual Report to Congress sent to Congress on April 15, 2008.	
MEASURE 3.1(3)	Publish reports to enhance understanding of mortgages, mortgage markets and the nation's housing finance system.	TARGET: At least 6 per year
	2008 PERFORMANCE Published three research papers, two staff working papers and four mortgage market notes.	

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

GOAL 3.1 ■ Prior Year Performance

2007	HPI report issued quarterly. Provided additional information in the regular quarterly reports. Annual Report to Congress sent to Congress on April 10, 2007. Published five staff working papers and three research papers on OFHEO's Website during the year.
2006	HPI Report issued quarterly. Annual Report sent to Congress on June 15, 2006. Report of the Special Examination of Fannie Mae issued in May 2006. One research paper and one staff working paper published.
2005	HPI Report issued quarterly. Two research papers published, one more than planned. Annual Report sent to Congress on June 15, 2005.
2004	HPI Report issued quarterly. A report on the special examination of Freddie Mac and a report with findings-to-date on the Fannie Mae special examination were published. Two research papers and two staff working papers were published. Annual Report sent to Congress on June 15, 2004.

2008 Performance Discussion for Goal 3.1

During FY2008, OFHEO began publishing a new monthly House Price Index (HPI) report to augment the quarterly report and other information that the agency provides to the public. The quarterly HPI documents changes in home prices for the nation, each state, many Metropolitan Statistical Areas (MSAs) and the nine census divisions. The monthly HPI includes changes in home prices at the national level and for nine census divisions. OFHEO has used the HPI to provide pertinent information to the public on the cyclical status of house prices. The monthly HPI is a significant achievement that helps inform public policy decisions by providing more timely and detailed information on national and regional changes in house prices. This information is of even greater value to policymakers and to the public in times of market disruption. Beginning in March, OFHEO began posting the monthly reports on its Website in a predetermined schedule. The HPI section of the Website, **www.ofheo.gov/hpi.aspx**, also has a house price calculator and additional resources and information about house prices.

OFHEO published its annual Report to Congress, describing the results and conclusions of the OFHEO calendar year 2007 examinations of the Enterprises and some of the regulatory activities of the agency, on April 15, 2008. Beginning last year, OFHEO established an ambitious target date for the report, several months ahead of the statutory requirement of June 15 of each year. While OFHEO missed this year's target date by a few days, the report was released a full eight weeks ahead of the statutory requirement. The report explained the results of its examinations of Fannie Mae and Freddie Mac and this year included an Executive Summary, detail on capital classifications of the Enterprises, as well as sections on housing market deterioration and on fair value and guarantee obligation accounting. Section 4521 of the Federal Housing Enterprises Financial Safety and Soundness Act of

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Partially Achieved

Not Achieved

1992 (12 U.S.C. 4501 *et seq*) requires OFHEO to publish an annual report that includes examination findings and conclusions. OFHEO is unique among financial regulators as it is required by law to make public its examination findings.

This year OFHEO contributed substantially to the public understanding of housing-related topics of interest through published reports, including how and why the two most widely quoted measures of house price change (the S&P/Case-Shiller index and OFHEO's HPI) differ so greatly. The agency published analyses of the structural differences between the two indexes that were clearly appreciated by housing market participants and followers. OFHEO also contributed to public understanding of the credit default swaps (CDS) of the Enterprises and other large financial institutions. The extent to which CDS are valid leading indicators is a topic of significant interest to regulators and financial market participants.

While much of OFHEO's research and analysis involves projects for internal purposes only, all OFHEO reports, research papers and staff working papers available to the public are posted on the OFHEO Website. OFHEO published three research papers in 2008, *Revisiting the Differences between the OFHEO and S&P/Case-Shiller House Price Indexes: New Explanations* in January, *Mortgage Markets and the Enterprises in 2007* in July and *Recent Trends in Home Prices: Differences across Mortgage and Borrower Characteristics* in August. The agency also issued two working papers during FY2008: *Real Estate Futures Prices as Predictors of Price Trends* in January and *Enterprise Credit Default Swaps and Market Discipline: Preliminary Analysis* in July. In addition, four Mortgage Market Notes were issued in FY2008:

- Mortgage Market Note 07-2: Historical Trends in the Conforming Loan Limit (October 2007)
- Mortgage Market Note 08-1: Potential Implications of Increasing the Conforming Loan Limit in High-Cost Areas (January 2008)
- Mortgage Market Note 08-2: Fannie Mae and Freddie Mac Capital (July 2008)
- Mortgage Market Note 08-3: A Primer on the Secondary Mortgage Market (July 2008)

OFHEO also published three market data updates in FY2008, which can also be found on the OFHEO Website: Single-Family Mortgage Originations, 1990–2007, Single-Family Mortgages Outstanding, 1990-2007 and Enterprise Share of Residential Mortgage Debt Outstanding: 1990–2008 Q1. These data updates provide important information to the public on the mortgage market.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly.

OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for the reporting for performance measure 3.1(3) and related internal controls. No significant weaknesses were found.

Loan Limits Changes

On February 13, 2008, the President signed into law the Economic Stimulus Act (ESA) of 2008. Under ESA, the Enterprises' conforming loan limits were temporarily increased so that they could purchase mortgages for one-unit properties with loan amounts in excess of $417,000 in the Continental United States. Although ESA had many components, the intent of the new loan limit rules was to help lower mortgage rates for homebuyers in high-cost parts of the country and to promote liquidity to the U.S. housing markets. Interest rates for jumbo mortgages had grown substantially more than rates for conforming mortgages, exacerbating already-weak housing market conditions in high-cost areas like California and Florida. It was hoped that Enterprise participation in secondary markets for these higher-balance loans would bring down mortgage rates.

For loans originated between July 1, 2007, and December 31, 2008, ESA set temporary loan limits for one-unit properties at 125 percent of the local house price median, with a maximum of $729,750 (i.e., 175 percent of the U.S. conforming limit). In no case could the temporary loan limit be less than $417,000, the 2008 loan limit established before the passage of ESA.

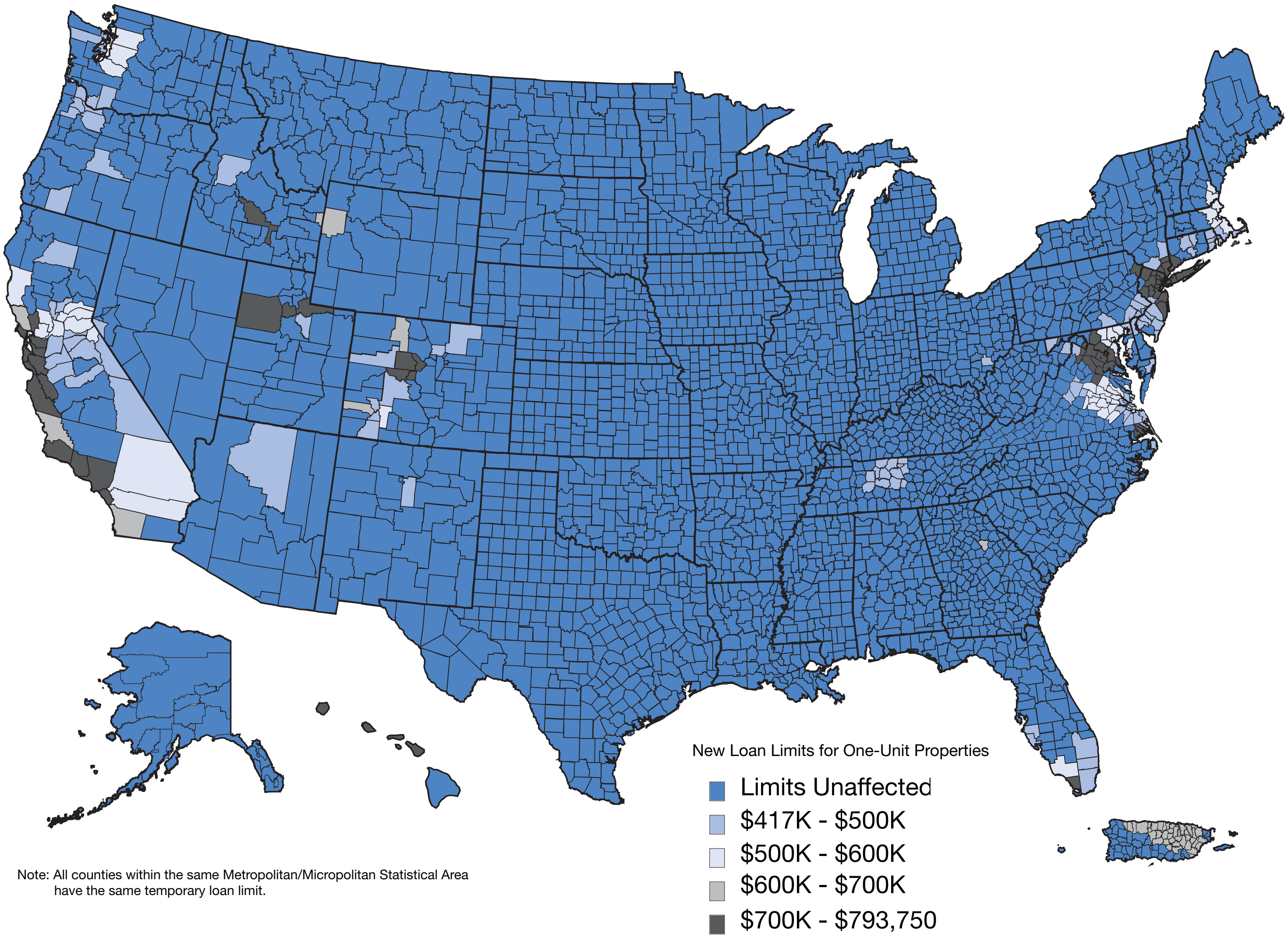
Under the terms of ESA, HUD calculated local house price medians for the purposes of determining the loan limits. HUD released its initial estimates of price medians in early March and made limited modifications to those medians in May in response to public appeals. The Enterprises began purchasing temporary jumbo mortgages in April.

Figure 22 reports the areas of the country that were affected by the legislation. Counties that had no change in the loan limit (because price medians were sufficiently low) are shown in blue, while other counties are shown in colors that reflect the magnitude of the new temporary loan limits. Metropolitan areas in California, Florida and parts of the East Coast were the primary beneficiaries of ESA because of the volume of temporary conforming jumbo loans in those areas. Many coastal areas in California, including Los Angeles and San Francisco, saw loan limits rise to the maximum allowed, $729,750, as did the Washington, DC, and New York City areas.

The full impact of the temporary loan limit increases on housing markets has yet to be measured. The effect of the limit increases on mortgage rates has been more muted than some anticipated, in part because of growing problems in secondary mortgage markets and weakness in financial markets more generally. It is nevertheless likely that the increases, at least in some areas, ultimately spurred more housing demand than would have been evident without the change.

The Housing and Economic Recovery Act of 2008 (HERA), which was passed on July 30, 2008, established Enterprise loan limits in high-cost areas in a manner similar to the framework set forth in ESA. The primary difference with ESA is that the new high-cost loan limits, which will be in effect starting in 2009, will be equal to 115 percent of local price medians rather than at 125 percent. Also, the maximum loan limit for high-cost areas in the continental U.S. will be 150 percent (as opposed to 175 percent) of the national limit. As the national limit remained at $417,000 for one-unit properties in 2008, the maximum limit for high-cost areas is $625,500.

Figure 22 • Maximum Temporary Jumbo Conforming Loan Limits under the Economic Stimulus Act of 2008: Counties with Different Limits under the Temporary Program



Note: All counties within the same Metropolitan/Micropolitan Statistical Area have the same temporary loan limit.

GOAL 3.2	Communicate effectively with all stakeholders on Enterprise risks and activities, mortgage markets, the nation's housing finance system and regulatory issues.	
MEASURE 3.2(1)	Percentage of survey respondents visiting OFHEO's Website who find it a useful resource.	TARGET: Greater than average of 2 prior years
	2008 PERFORMANCE The target for this year, the average of the two prior years, was 94% During FY2008, 92% of respondents indicated they found OFHEO's Website a valuable resource.	
MEASURE 3.2(2)	Respond to all public inquiries.	TARGET: Within 15 business days
	2008 PERFORMANCE Responded to all inquiries within the timeframe.	
MEASURE 3.2(3)	Meet with industry stakeholders to address current topics and receive input from the industry.	TARGET: Quarterly
	2008 PERFORMANCE Director Lockhart and senior OFHEO staff met often with trade associations, industry representatives and housing advocacy groups.	

GOAL 3.2 ■ Prior Year Performance

2007	More than 93% of respondents indicated they found OFHEO's Website a valuable resource. OFHEO responded to all public inquiries within 15 days. Director Lockhart and senior OFHEO staff met regularly with trade associations, industry representatives and housing advocacy groups.
2006	Over 93% of respondents indicated they found OFHEO's Website a valuable resource. Responded to all public inquiries within 21 days.
2005	Responded to all public inquiries within 21 days.
2004	Responded to all public inquiries within 21 days.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

2008 Performance Discussion for Goal 3.2

OFHEO has supported an efficient housing finance system and transparent regulatory structure by maintaining communication links with the public. The agency's main forum for sharing information with the public is its Website, which serves as a repository for the information, research, guidance and data that OFHEO has produced in its oversight of the Enterprises. In 2006, OFHEO initiated an ongoing survey to ensure that the agency's Website served the needs of stakeholders and the general public by providing them valuable information. For FY2008, more than 92 percent of survey respondents found the OFHEO Website valuable and many provided suggestions for further improvements. While the results were marginally lower than the target, this difference is not significant, given the high percentage who did respond favorably. OFHEO has received positive results of more than 92 percent for the last three years.

OFHEO also continued to respond promptly to inquiries from the public during FY2008. The agency resolved all public inquiries within the target time frames despite a significantly increased volume due to regulatory events and developments in the market. When inquiries are submitted from the public that do not fall under the agency's purview, OFHEO staff make every effort to help the inquirer find the appropriate source instead of just turning the request away. FHFA is committed to responding accurately and as promptly as possible to public inquiries.

In FY2008 OFHEO also maintained strong communications with industry stakeholders. During the year, Director Lockhart and senior staff met with trade associations, industry representatives and house advocacy groups to discuss specifics of GSE reform legislation and market developments from the agency's and the group's perspectives. The Director and/or senior staff also participated in industry-sponsored conferences to share OFHEO's views and listen to the views of others. Meetings with stakeholders about GSE reform legislation continued extensively as the Housing and Economic Recovery Act of 2008 progressed.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. With the exception of Website data, the data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly. Website survey data is collected by a contractor external to OFHEO and summarized for use by OFHEO management.

OFHEO engaged an independent auditor to perform an Agreed Upon Procedures Review for the reporting for performance measure 3.2(1) and related internal controls. No significant weaknesses were found.

GOAL 3.3	Cooperate with other Federal agencies on mortgage markets, the nation's housing finance system and regulatory issues.	
MEASURE 3.3(1)	Meet with HUD to discuss issues related to the regulation of the Enterprises, including affordable housing goals.	TARGET: At least quarterly
	2008 PERFORMANCE Director Lockhart and/or other senior members of OFHEO's management met with HUD monthly on common issues.	
MEASURE 3.3(2)	Respond to requests from other Federal agencies for information about housing finance markets and the Enterprises	TARGET: Within 30 days
	2008 PERFORMANCE Responded to all requests within the time frame.	
MEASURE 3.3(3)	Meet with other Federal financial regulators to discuss issues related to the regulation of the Enterprises and the housing finance system.	TARGET: At least quarterly
	2008 PERFORMANCE Director Lockhart and/or other senior members of OFHEO's management met with other Federal financial regulators on multiple occasions each quarter.	

GOAL 3.3 ■ Prior Year Performance

2007	Responded to all requests within the time frame. Director Lockhart and/or other senior members of OFHEO's management met with HUD monthly on common issues. Entered into Memorandum of Understanding with HUD regarding sharing data, report and other information relating to Fannie Mae and Freddie Mac.
2006	Responded to all requests within the time frame. Worked on various issues, such as accounting policy and mortgage fraud, and participated in interagency task forces, such as the Financial and Banking Information Infrastructure Committee
2005	Worked with other federal agencies on various issues, participated in interagency task forces, and responded to federal agencies' requests for information within the timeframe.
2004	Cooperated with other federal financial agencies on regulatory issues.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

2008 Performance Discussion for Goal 3.3

During FY2008, OFHEO continued regular liaison among regulators and worked with them as they developed regulatory standards that are aimed at improving financial safety and soundness. OFHEO considers coordination with HUD, the Enterprises' mission regulator (until the passage of HERA), a critical link in meeting OFHEO's safety and soundness mission and ensuring an efficient secondary mortgage market.

This past fiscal year, OFHEO continued its cooperative working relationship with HUD and worked with the Secretary of HUD to raise any safety and soundness implications of proposed changes to the Secretary's goals regarding Enterprise purchases of mortgages that finance affordable housing. As a member of the HUD GSE Working Group, OFHEO continued to actively participate in policy discussions with HUD regarding other safety and soundness issues impacting the Enterprises, such as charter and affordable housing issues.

OFHEO initiated a process to improve information exchange and met periodically with HUD's GSE Office and HUD OGC to address several issues, including Freddie Mac's authority to engage in selling credit default swaps, the Enterprises' investment in mixed-use assets and commercial mortgage-backed securities and Fannie Mae's authority to invest in "other" assets, including Acquisition, Development and Construction Loans.

In addition, OFHEO continued to work with other federal agencies by responding to their requests for information and participating in task forces and other interagency efforts on regulatory issues. During FY2008, OFHEO worked with the following federal agencies and departments, including executive and legislative branch organizations:

- Department of Housing and Urban Development (HUD)
- Federal Reserve Board (FRB)
- Office of Thrift Supervision (OTS)
- Federal Housing Finance Board (FHFB)
- Office of the Comptroller of the Currency (OCC)
- Federal Deposit Insurance Corporation (FDIC)
- Office of Management and Budget (OMB)
- Department of the Treasury
- National Credit Union Administration (NCUA)
- Securities and Exchange Commission (SEC)
- Department of Justice (DOJ)
- Congressional Budget Office (CBO)
- Congressional Research Service (CRS)

- Federal Reserve Banks of Boston, New York, Atlanta and Chicago
- Government Accountability Office (GAO)
- Federal Housing Administration (FHA)
- Pension Benefit Guaranty Corporation (PBGC)

In FY2008, OFHEO maintained a dialogue with the Federal Reserve Board, the Treasury Department, the Securities and Exchange Commission and other appropriate agencies about broad public policy issues affecting housing finance markets and the Enterprises, such as mortgage fraud, the developments in the credit markets and, ultimately, FHFA's decision to place Fannie Mae and Freddie Mac in conservatorship.

Building upon the Memorandums of Understanding with other financial regulators that OFHEO has established in recent years, OFHEO kept them informed about OFHEO's regulatory activities and solicited their views about issues related to the Enterprises. OFHEO evaluated this information and took it into account when making decisions consistent with its mission. OFHEO contributed to the Federal efforts to address policy issues such as systemic risk, adequate financial disclosure, consistent supervisory standards, the development of capital requirements for other Federally-regulated financial institutions and the security and emergency preparedness of the nation's financial system.

OFHEO attended several meetings of the President's Working Group on Financial Markets. OFHEO also continued to participate in a number of interagency task forces, forums and groups, such as the President's Council of Economic Advisors, the Interagency Task Force on Nondiscrimination in Lending, the President's Advisory Council on Financial Liberty, the Bank Fraud Working Group, the Mortgage Fraud Working Group, the Interagency Task Force on National Flood Insurance, the Federal Financial Regulators Results Act Working Group, the Financial and Banking Information Infrastructure Committee and the Federal Financial Institutions Examination Council (FFIEC) Information Systems Subcommittee. OFHEO also continued to meet informally with members of these groups and others, such as the Council of State Bank Supervisors, to keep informed of issues and topics of note. OFHEO also had extensive discussions with and reached an agreement on appraisal standards with the Attorney General of New York.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly.

Resource Management Strategy: Manage Effectively OFHEO'S Human Capital and Other Resources to Support Our Mission

The success of OFHEO in achieving its strategic goals depends on the effective management of resources and seamless financial and administrative support functions. The size of the budget in relation to the mission requires OFHEO to use limited resources efficiently and ensure that resources be tied directly to mission achievement. As a small but growing agency, OFHEO relies on staff and management to accomplish its goals through cross-organizational teams, timely information for decision-making, and internal coordination.

GOAL 4.1

Maintain a diverse work force that is skilled, flexible and performance-oriented to fulfill the goals of the agency.

MEASURE 4.1(1)	Percent of vacancies filled within OPM's 45-day time-to-hire standard	TARGET: 70%
	2008 PERFORMANCE Filled 79% of vacancies within the timeframe. OFHEO filled a total of 53 vacancies during the fiscal year.	
MEASURE 4.1(2)	Close technical and leadership competency gaps for critical competencies that align to OFHEO's mission and strategic goals.	TARGET: Develop a plan to competency close gaps identified in 2007
	2008 PERFORMANCE The OFHEO plan to close competency gaps was completed on April 8, 2008.	
MEASURE 4.1(3)	The percentage of employees responding favorably to the annual employee survey.	TARGET: Improve over baseline
Data Not Available	2008 PERFORMANCE Data for FY2008 not yet available. OFHEO does not expect to receive the 2008 data from OPM for the Federal Human Capital Survey until January 2009. The FY2007 baseline is 62%.	
MEASURE 4.1(4)	Maintain a diverse workforce by increasing the number of minority, women, and disable applicants for open vacancy announcements.	TARGET: Increase over 2007 baseline by 10%
	2008 PERFORMANCE OFHEO averaged 52 minority and women applicants per vacancy, a 67% increase over the FY2007 baseline of 35.	

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

GOAL 4.1 ■ Prior Year Performance

2007	Conducted an agency-wide employee survey in July 2007. Completed an assessment of competency gaps. Revised the performance management system to incorporate individual work plans tied to the agency's goals and implemented an automated tool for employee and manager use.
2006	Completed annual revision of individual development plans for all staff members. Training and development ongoing.
2005	Completed annual revision of individual development plans for all staff members. Training and development ongoing.
2004	Completed annual revision of individual development plans for all staff members. Training and development ongoing.

2008 Performance Discussion for Goal 4.1

In FY2008, OFHEO maintained a strong commitment to recruiting and retaining a high-caliber workforce and ensuring that its employees have the skills and expertise necessary to meet the important goals and mission of the agency. In order to achieve this, OFHEO worked to quickly fill its vacancies with high quality applicants and uses outreach efforts including job fairs and a student intern program to recruit minorities and female candidates. In FY2008, 79 percent of OFHEO's vacancies were filled within the 45-day time to hire standard established by the Office of Personnel Management. In addition OFHEO made major strides in increasing the percentage of minority and women applicants by 67 percent over the 2007 baseline. This represents an average of 52 minority or female applicants for each job OFHEO posted to fill. This large increase was the result of hiring a part-time recruiter and conducting outreach to minority institutions, attending job fairs where minorities, women and the disabled were targeted, and sending vacancy announcements to hundreds of minority, female and disabled organizations. Figure 23 shows OFHEO's growth in FTE over the last five years.

In 2007, OFHEO completed an assessment of competency gaps, focusing on technical competencies for mission-critical occupations and leadership competencies. This year, OFHEO developed and began to implement a plan to close competency gaps. The plan provides a framework for minimizing competency gaps in the future by documenting the methodology, and providing staff with guides to acquiring competencies at the various grade levels and providing several options for ways to close gaps. OFHEO also recently completed a follow up gap assessment using OPM's Federal Competency Assessment Tool – Management.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

2007 marked the first OFHEO annual employee survey and the agency received results that were better than the government-wide results in 27 out of 40 standard questions. OFHEO achieved a 62 percent positive score overall. During 2008, OFHEO implemented a process to improve scores on the survey by establishing focus groups and recommending specific actions to address issues based on the results of the survey. The action plan was reviewed and approved by the Director and executives across the agency. The results of the FY2008 Federal Human Capital Survey will be available in FY2009.

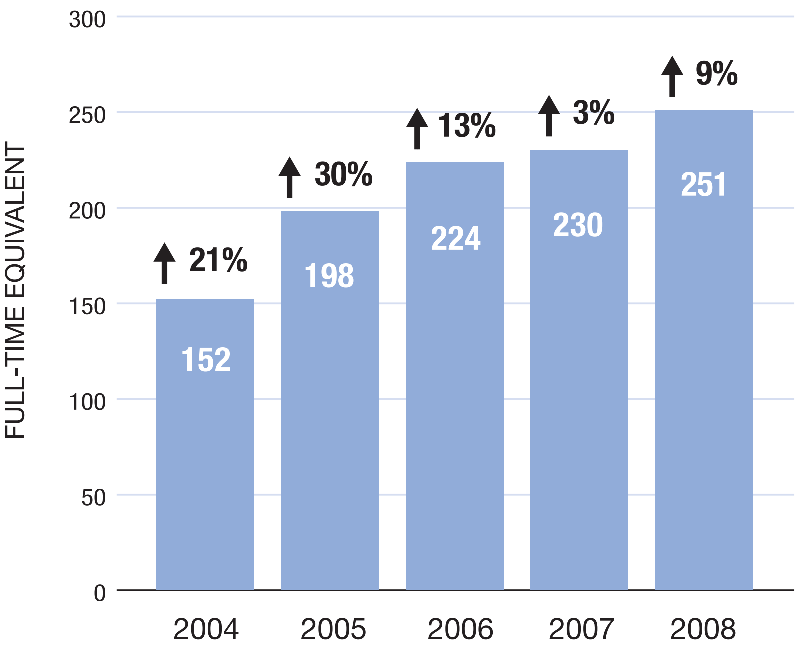
Sandy Comenetz, Executive Advisor to the OFHEO Deputy Director, listens to presentation by James B. Lockhart III, Director FHFA, at the FHFA Kick-Off Meeting.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. For performance measure 4.1(1) and 4.1(2), the data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly. Data on minority and women applicants is collected through the use of an online application system maintained by a contractor and reported to OFHEO. Employee survey data is collected by OPM and summarized for OFHEO's use.

OFHEO engaged an independent auditor to perform an Agreed Upon Procedures Review for the reporting for performance measure 4.1(1) and related internal controls. No significant weaknesses were found.

Figure 23 • OFHEO's Growth in Full-Time Equivalents, FY2004 – 2008



GOAL 4.2	Provide effective information resource management services to OFHEO managers and staff to support the goals of the agency.	
MEASURE 4.2(1)	Increase compliance with OMB Enterprise Architecture Assessment Framework	TARGET: Achieve an Enterprise Architecture score of 4 in the “Completion” Section and a score of 3 in either the “Use” or “Results” Sections.
	2008 PERFORMANCE Completed the Enterprise Architecture Assessment Framework assessment scorecard, which rates OFHEO with a 4 in “Completion,” 4.13 in “Use” and a 2.67 in “Results.”	
MEASURE 4.2(2)	Percentage of help desk requests during the business day that are responded to within 4 hours.	TARGET: 95%
	2008 PERFORMANCE 98% of the help desk requests were responded to within the four-hour timeframe.	
MEASURE 4.2(3)	Percent of time OFHEO’s IT systems are available for use by the OFHEO staff.	TARGET: 98%
	2008 PERFORMANCE System availability exceeded 99% during the year.	
MEASURE 4.2(4)	Maintain or complete required Certification and Accreditation of OFHEO major information systems in production.	TARGET: 100%
	2008 PERFORMANCE Completed Certification and Accreditation for four major systems.	

GOAL 4.2 ■ Prior Year Performance

2007	Published the five-year IT Strategic Plan on OFHEO's Website in June 2007. Completed most milestones for four major projects in the FY2007 plan. System availability exceeded 97% during the year. Completed Certification and Accreditation for six major systems.
2006	Successfully implemented four of six projects outlined in the FY2006 component of the five-year IT Strategic Plan. Substantially completed the remaining two projects and expect to have them completed in the first and second quarter of FY2007.
2005	Implemented all three projects outlined in the FY2005 Component of five-year IT Strategic Plan.
2004	Implemented all three projects outlined in the FY2004 Component of five-year IT Strategic Plan.

2008 Performance Discussion for Goal 4.2

OFHEO has depended upon the strategic use of information technology in order to effectively supervise and oversee the Enterprises. OFHEO has made significant strides in improving its information technology (IT) processes and systems. In FY2008, OFHEO finalized and implemented an enterprise architecture plan which helped it score highly in an evaluation based on OMB's Enterprise Architecture Assessment Framework. An enterprise architecture plan is a blueprint for systematically and comprehensively reviewing the current IT structure and designing future systems to execute OFHEO's mission requirements. These high scores demonstrate OFHEO's robust operational processes related to information technology. OFHEO also completed certification and accreditation of all major systems, building on last year's progress and ensuring that the agency has incorporated all of the National Institute of Standard and Technology (NIST) guidelines into its normal operations.

OFHEO also maintained availability of its network for staff use over 97 percent of business hours during the year. In addition, 98 percent of help desk calls were responded to within four hours. This low level of system outages and quick response rate helped maintain employee productivity and ensures that the agency is using its IT hardware and software to its fullest capacity.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly. Data on the outages for OFHEO systems and help desk response time are collected through an automated help-desk system.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

The responsibility of oversight and supervision of Fannie Mae and Freddie Mac transferred from OFHEO to FHFA on July 30, 2008, with the enactment of the Housing and Economic Recovery Act of 2008.

GOAL 4.3	Maintain a strong internal control and risk management program.	
MEASURE 4.3(1)	Percent of OFHEO's external audits or external reviews with an unqualified opinion and no material weaknesses.	TARGET: 100%
	2008 PERFORMANCE Received unqualified audit opinion on FY2008 financial statements and report of no significant findings on an "Agreed Upon Procedures" review of internal controls related to OFHEO's performance measures. No material or significant weaknesses were reported during the independent review of the OFHEO information security program. OFHEO's Human Capital Accountability Assessment Framework received a positive review.	

GOAL 4.3 ■ Prior Year Performance

2007	Received unqualified audit opinion on FY2007 financial statements, internal controls and compliance with laws and regulations from an independent external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program.
2006	Received an unqualified audit opinion on 2006 financial statements, internal controls and compliance with laws and regulations from an independent external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program.
2005	Received an unqualified audit opinion on 2005 financial statements, internal controls, and compliance with laws and regulations from an independent external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program. The HUD Inspector General (IG) found that OFHEO's allocation of resources, staffing and compensation was comparable to other regulators.
2004	Received an unqualified audit opinion on 2003 and 2004 financial statements, internal controls and compliance with laws and regulations from an independent external auditor. No material weaknesses were reported during the independent review of the OFHEO information security program. The HUD IG found OFHEO exceeded the requirements of the 2004 Appropriations Act to use no less than 60 percent of its 2004 funds for examination, supervision, and capital oversight of the Enterprises.

2008 Performance Discussion for Goal 4.3

To ensure that its resources are managed effectively and efficiently, OFHEO continued to expand its use of financial and performance information in managing program operations, integrating its budget and performance development, and making program improvements.

During the year, external auditors conducted a complete financial audit and issued a clean audit opinion finding no material weaknesses for OFHEO for FY2008. Throughout the year, OFHEO continued its quarterly time studies, begun in 2005, to more accurately estimate expenses by strategic

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

goal. These time studies survey employees about the time they spent working on projects and activities to achieve each strategic goal. Using OFHEO's integrated financial management system and specific guidance to match activities, projects, work products and expenses directly to the appropriate strategic goal, OFHEO is able to better estimate the cost of achieving each goal.

In addition, OPM completed an audit of OFHEO's Human Capital Assessment and Accountability Framework (HCAAF) systems in June 2008. OPM concluded that OFHEO has made outstanding progress in meeting the accountability requirements under 5 CFR 250 and is not deficient in any of the HCAAF systems. OFHEO is the first non-scored small agency to implement a fully compliant Accountability System. OFHEO also received an opinion from an independent review of the information security program, as required by the Federal Information Security Management Act (FISMA), indicating no significant weaknesses or high risk issues.

As precursor to a full internal controls audit, OFHEO initiated an "Agreed-Upon Procedures" review with an independent auditor to review internal controls associated with reporting for performance measures related to 12 key performance indicators. No significant weaknesses were identified in this review.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created externally by independent auditors and reviewers and their findings are reviewed by OFHEO management.

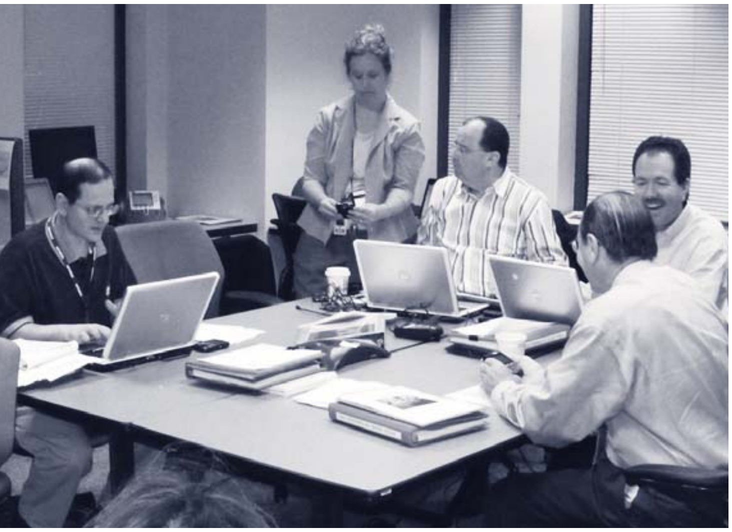
GOAL 4.4	Ensure the continuity of OFHEO's business functions.	
MEASURE 4.4(1)	Percentage of continuity of operations testing and after action reviews completed as outlined by Federal Preparedness Circular 65.	TARGET: 100%
	2008 PERFORMANCE OFHEO completed all of the testing requirements outlined in FPC 65 for FY2008.	

GOAL 4.4 ■ Prior Year Performance

2007	Issued a revised OFHEO's Continuity of Operations Plan consistent with federal guidance.

2008 Performance Discussion for Goal 4.4

OFHEO has been committed to the good business practice of business continuity planning, ensuring that the agency can continue to perform its essential functions during an unplanned event that would prevent normal business operations. OFHEO has made great strides in testing and making operational its updated and revised Continuity of Operations (COOP) plan.



OFHEO's Executives participate in the May 2008 National Level Exercise, a government-wide Continuity of Operations Test.

During FY2008, OFHEO conducted extensive testing to meet the requirements of Federal Protective Circular 65 and participated in three COOP-related exercises. During the year, the Department of Homeland Security (DHS) issued new continuity requirements, Federal Continuity Directives 1 and 2, that were much more robust than the previous standard. Because of OFHEO's testing efforts in FY2008, the agency is well-prepared for the new testing requirements.

OFHEO participated in three exercises during the year, including an assessment of OFHEO's pandemic response plan through a large exercise with financial institutions and other financial regulators, a simulated emergency scenario to test the processes in OFHEO's COOP plan and a National Level Exercise called Eagle Horizon 2008, led by DHS and the Federal Emergency Management Agency (FEMA). Eagle Horizon included all federal government agencies as well as state and local organizations in the largest scale COOP exercise run in the United States. OFHEO was evaluated during this exercise in 13 major areas outlined in the new federal requirements and scored the highest level of green in 10 of those areas.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed by senior management quarterly.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Partially Achieved
- Not Achieved

GOAL 4.5	OFHEO's internal operations effectively support the mission and goals of the agency.	
MEASURE 4.5(1)	The composite score from an annual employee customer survey that asks how well internal services and processes help get their job done	TARGET: Establish baseline
	2008 PERFORMANCE OFHEO implemented the survey for internal services for the first time in FY2008. Results from this survey indicate that 75% of OFHEO's employees were very satisfied or satisfied with how well internal services help them get their job done.	
MEASURE 4.5(2)	Get to "green" on the President's Management Agenda (PMA) initiatives status	TARGET: Green on 3 of 5
	2008 PERFORMANCE OFHEO got to "green" on 4 out of 5 President's Management Agenda (PMA) initiatives status scores, including Strategic Management of Human Capital, Improved Financial Performance, E-government, and Performance Improvement Initiative. OMB's criteria for each initiative can be found at www.whitehouse.gov/results/agenda/Standards_for_Success_8_11_2008.pdf	

GOAL 4.5 ■ Prior Year Performance

2007	This is a new goal for 2008.

2008 Performance Discussion for Goal 4.5

In FY2008, OFHEO made a significant effort to ensure that its internal operations supported its mission function. The agency conducted its first annual customer service satisfaction survey to evaluate how well internal services and processes help employees get their job done. The survey assessed employees satisfaction with employee benefits and the agency's facilities and solicited their input for improvements. Results from this survey indicate that 75 percent of OFHEO's employees were very satisfied or satisfied with how well internal services helped them get their job done. OFHEO will create action plans for improvement based on the survey results and implement them in FY2009 before conducting the next annual survey.

In FY2008, OFHEO began a more formal program to implement the President's Management Agenda (PMA), a strategy for improving the management of the federal government established by President Bush. The PMA focuses on five key initiatives: Strategic Management of Human Capital, Commercial Services Management, E-Government, Improved Financial Performance and Performance Improvement Initiative. Although not reviewed directly by the Office of Management and Budget (OMB), OFHEO made improvements in its operations and processes based on the criteria established by OMB for all agencies government-wide. According to these criteria, for FY2008, OFHEO scored the highest level of "green" on four out of five PMA initiatives: Strategic Management of Human Capital, E-Government, Improved Financial Performance and Performance Improvement Initiative. To further improve OFHEO's PMA program, OFHEO is participating in a government-wide initiative focused on small agencies through OMB's Performance Improvement Council, which is using OFHEO as a pilot agency for the PMA program.

Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. The data are created internally, reported in the agency's performance tracking system and reviewed quarterly by senior management.

OFHEO engaged an independent auditor to perform an Agreed-Upon Procedures Review for the reporting for performance measure 4.5(2) and related internal controls. No significant weaknesses were found.

OFHEO Financial Section

OFHEO 2008 PERFORMANCE AND ACCOUNTABILITY REPORT

Mark Kinsey,
OFHEO Chief Financial Officer

Message From The Chief Financial Officer

This has been a very challenging year for OFHEO. Deteriorating conditions in the mortgage markets and at the Enterprises, the creation of the Federal Housing Finance Agency (FHFA) to supersede OFHEO as the regulator of the Enterprises, and ultimately putting Fannie Mae and Freddie Mac into conservatorship all served to tax the resources and energy of the agency like never before. Yet, despite all the challenges faced by the agency this year, OFHEO remained focused on maintaining a strong internal control environment that helped the agency in FY2008 to once again receive an unqualified audit opinion on its financial statements. This marks the eleventh straight year the agency has received a clean financial audit.

Senior management set the tone for the agency by continually reinforcing the need to maintain a strong internal controls environment. OFHEO's Executive Committee on Internal Controls (ECIC) met at least quarterly this past year to oversee internal controls throughout the agency. Managers worked hard to ensure that appropriate controls were in place over all relevant processes and systems and the ECIC concurred with management assurances on the effectiveness of OFHEO's internal controls.

OFHEO's record of achievement was enhanced this past year when in May the agency received the prestigious Certificate for Excellence in Accountability Reporting (CEAR) award for FY2007 from the Association of Government Accountants. This award represents the highest standard of federal fiscal accountability reporting. Only agencies receiving an unqualified opinion on their financial statements from an independent auditor are eligible to be considered for the CEAR. OFHEO was one of only 17 agencies to receive this recognition, and of the awardees, OFHEO had the smallest staff and budget.

Fiscal year 2009 will be a transition year. OFHEO will be in a wind-down mode as the new FHFA is fully "stood up." By law OFHEO will be abolished on July 29, 2009. FHFA will effectively absorb all of OFHEO's people and resources prior to its termination date. Staff and resources from the Federal Housing Finance Board will also be merged into FHFA. Going forward, some of the major challenges for FHFA will be to create new accounting, personnel, and IT systems to meet the needs of the new agency, and to do so with a continued commitment to effective internal controls over systems and processes.

I am confident that OFHEO's long record of excellence will be extended by FHFA.

Sincerely,

Mark Kinsey

Mark Kinsey
Chief Financial Officer

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
1700 G STREET NW WASHINGTON DC 20552 (202) 414-3801

OFFICE OF THE DIRECTOR

Federal Managers' Financial Integrity Act
Statement of Assurance
Fiscal Year 2008

The Office of Federal Housing Enterprise Oversight management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objective for the Federal Managers' Financial Integrity Act (FMFIA). OFHEO conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, OFHEO can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal controls.

In addition, OFHEO conducted its assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, OFHEO can provide reasonable assurance that its internal control over financial reporting as of June 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

In accordance with the requirements of FMFIA, OFHEO's financial management systems are substantially in compliance with the requirements for federal financial management systems as presented in A-127, Financial Management Systems as of September 30, 2008.

James B Lockhart III
James B. Lockhart III

10/23/08
Date

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

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

Mr. James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying balance sheets of the Office of Federal Housing Enterprise Oversight (OFHEO) as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended. These financial statements are the responsibility of OFHEO's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements." These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Office of Federal Housing Enterprise Oversight as of September 30, 2008 and 2007, and its net costs; changes in net position; budgetary resources; and custodial activities for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis (MD&A) section is not a required part of the basic financial statements of the Office of Federal Housing Enterprise Oversight but is supplementary information required by the Federal Accounting Standards Advisory Board and OMB Circular A-136, "Financial Reporting Requirements". We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the information and, accordingly, express no opinion on it.

In accordance with *Governmental Auditing Standards*, we have also issued a report dated October 31, 2008, on our consideration of the Office of Federal Housing Enterprise Oversight's internal control over financial reporting and a report dated October 31, 2008 on its compliance with certain provisions of laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards,* and, in considering the results of the audits, these reports should be read in conjunction with this report.

While this report is intended solely for the information and use of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, it is also a matter of public record, and its distribution is, therefore, not restricted.

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

October 31, 2008

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Certified Public Accountants and Consultants

Report of Independent Auditors on Internal Control

Mr. James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying balance sheets of the Office of Federal Housing Enterprise Oversight (OFHEO) as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended, and have issued our report thereon dated October 31, 2008. We conducted our audits in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements."

In planning and performing our audits, we considered the Office of Federal Housing Enterprise Oversight's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. We obtained an understanding of the design effectiveness of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of OFHEO's internal controls. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. Our audits were not for the purpose of expressing an opinion on the effectiveness of OFHEO's internal control. Accordingly, we do not express an opinion on the effectiveness of OFHEO's internal control.

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

Our consideration of internal control was for the limited purpose described in the preceding paragraphs and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we noted no matters involving the internal control and its operation that we considered to be significant deficiencies or material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Office of Federal Housing Enterprise Oversight in a separate letter dated October 31, 2008.

While this report is intended solely for the information and use of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, it is also a matter of public record, and its distribution is, therefore, not restricted.

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

October 31, 2008

DJHPM

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

Certified Public Accountants and Consultants

Report of Independent Auditors
on Compliance with Laws and Regulations

Mr. James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying balance sheets of the Office of Federal Housing Enterprise Oversight (OFHEO) as of September 30, 2008 and 2007, and the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended, and have issued our report thereon dated October 31, 2008. We conducted our audits in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements."

The management of the Office of Federal Housing Enterprise Oversight is responsible for complying with laws and regulations applicable to OFHEO. As part of obtaining reasonable assurance about whether OFHEO's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Office of Federal Housing Enterprise Oversight.

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

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

While this report is intended solely for the information and use of the management of the Office of Federal Housing Enterprise Oversight, OMB and Congress, it is also a matter of public record, and its distribution is, therefore, not restricted.

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

October 31, 2008

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Balance Sheets

As of September 30, 2008 and 2007

(Dollars in Thousands)

	2008	2007
Assets		
Intragovernmental		
Fund Balance with Treasury - Note 3	$ 20,830	$ 25,387
Total Intragovernmental	20,830	25,387
Accounts Receivable - Note 4	501	-
Property, Plant & Equipment, Net - Note 5	4,987	8,718
Total Assets	**$ 26,318**	**$ 34,105**
Liabilities		
Intragovernmental		
Other Liabilities		
Accrued Benefits	$ 347	$ 245
Due To Department of Labor	1	-
Due To Treasury	5,530	5
Total Other Liabilities	5,878	250
Total Intragovernmental - Note 6	5,878	250
With the Public		
Accounts Payable	811	1,453
Other Liabilities		
Accrued Payroll	1,746	1,321
Annual Leave	3,907	3,061
Deferred Rent	186	196
Total Other Liabilities	5,839	4,578
Total With the Public - Note 6	6,650	6,031
Total Liabilities	**12,528**	**6,281**
Net Position		
Unexpended Appropriations - Note 1.K	12,897	22,363
Cumulative Results of Operations - Note 1.K	893	5,461
Total Net Position	**$ 13,790**	**$ 27,824**
Total Liabilities and Net Position	**$ 26,318**	**$ 34,105**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Statements of Net Cost

for the Years Ended September 30, 2008 and 2007

(Dollars in Thousands)

	2008	2007
Program Costs		
Program Costs – Note 8	$ 75,379	$ 68,082
Net Cost of Operations	**$ 75,379**	**$ 68,082**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Statements of Changes in Net Position

for the Years Ended September 30, 2008 and 2007

(Dollars in Thousands)

	2008	2007
Cumulative Results of Operations		
Beginning Balance	**$ 5,461**	**$ 8,760**
Budgetary Financing Sources Appropriations Used	69,169	63,209
Other Financing Sources Imputed Financing	1,642	1,574
Total Financing Sources	70,811	64,783
Net Cost of Operations	(75,379)	(68,082)
Net Change	(4,568)	(3,299)
Cumulative Results of Operations	**893**	**5,461**
Unexpended Appropriations		
Beginning Balance	**22,363**	**19,475**
Budgetary Financing Sources		
Appropriations Received	66,000	66,150
Appropriation Transfer Out - Note 1.L	(6,175)	-
Other Adjustments	(122)	(53)
Appropriations Used	(69,169)	(63,209)
Total Budgetary Financing sources	**(9,466)**	**2,888**
Unexpended Appropriations	**12,897**	**22,363**
Net Position	**$ 13,790**	**$ 27,824**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Statements of Budgetary Resources

for the Years Ended September 30, 2008 and 2007

(Dollars in Thousands)

	2008	2007
Budgetary Resources		
Unobligated Balance, Beginning	$ 122	$ 53
Recoveries of Prior Year Obligations - Note 10	2,908	1,409
Budget Authority:		
Appropriation	66,000	66,150
Non-Expenditure Transfer - Note 1.L	(6,175)	-
Permanently Not Available Pursuant to P.L. 102-550 - Note 11	(122)	(53)
Total Budgetary Resources	**$ 62,733**	**$ 67,559**
Status of Budgetary Resources		
Obligations Incurred - Note 9	$ 59,450	$ 67,437
Unobligated Balance Not Available	3,283	122
Total Status of Budgetary Resources	**62,733**	**67,559**
Change in Obligated Balance		
Obligated Balance, Beginning	25,260	22,187
Obligations Incurred	59,450	67,437
Gross Outlays	(69,284)	(62,955)
Recoveries	(2,908)	(1,409)
Obligated Balance, Ending	12,518	25,260
Net Outlays		
Disbursements	69,284	62,955
Net Outlays	**$ 69,284**	**$ 62,955**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Statements of Custodial Activity

for the Years Ended September 30, 2008 and 2007

(Dollars in Thousands)

	2008	2007
Revenue Activity		
Sources of Cash - Note 15		
Fines Assessed	$ 5,025	$ -
FOIA Fees Collected	4	5
Total Cash Collections	5,029	5
Accrual Adjustment	501	-
Total Custodial Revenue	**5,530**	**5**
Disposition of Collections		
Due to Treasury - Note 15	5,530	5
Total Disposition of Collections	**5,530**	**5**
Net Custodial Activity	**$ 0**	**$ 0**

The accompanying notes are an integral part of these statements.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Notes to the Financial Statements

(Dollars in Thousands)

NOTE 1 • SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent office within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (title XIII of P.L. 102-550). OFHEO is responsible for the regulatory oversight of Fannie Mae and Freddie Mac (Enterprises), including conducting annual and special examinations as well as determining whether the Enterprises are operating in a safe and sound manner and adequately capitalized.

B. Basis of Presentation

OFHEO is not directly subject to the requirements of the Chief Financial Officer's (CFO) Act or the Accountability of Tax Dollars Act of 2002 to prepare audited financial statements. OFHEO is a component of HUD, and HUD is subject to both of these laws. OFHEO's principal statements were prepared from its official financial records and general ledger in accordance with generally accepted accounting principles (GAAP) and follow the presentation guidance established by the Office of Management and Budget (OMB) Circular A-136 "Financial Reporting Requirements." These financial statements are in addition to financial reports prepared by OFHEO, pursuant to OMB directives, which are used to monitor and control budgetary resources.

C. Basis of Accounting

Transactions are recorded on both an accrual and budgetary basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of Federal funds. OFHEO complies with the U.S. Standard General Ledger and conforms to GAAP for Federal entities as prescribed by the standards set forth by the Federal Accounting Standards Advisory Board (FASAB). FASAB is recognized by the American Institute of Certified Public Accountants (AICPA) as the body designated to establish GAAP for Federal entities.

D. Use of Estimates

Estimates are used by OFHEO in determining the amounts to be reported for services provided by contractors that have not yet been billed to the agency at September 30. An accounts payable is recorded based on these estimates. Estimates are also used in determining the amount of salaries and benefits earned but unpaid at September 30. An accrued payroll liability is recorded for this amount.

E. Earmarked Funds

FASAB's Statement of Federal Financial Accounting Standard (SFFAS) #27 "Identifying and Reporting Earmarked Funds" establishes certain disclosure requirements for funds defined as "earmarked." SFFAS #27 states that "(e)armarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues."

The standard also presents three required criteria for an earmarked fund. Based on the standard's criteria and in consultation with OMB, OFHEO determined that it has no earmarked funds.

NOTE 1, continued

F. Funds with the U.S. Treasury

Each year Congress enacts a "no-year" appropriation to fund OFHEO's operating costs. The appropriation is paid by an annual assessment from Fannie Mae and Freddie Mac and not with taxpayer funds. OFHEO receives an appropriation warrant from the U.S. Treasury (Treasury) General Fund each year and fully offsets the General Fund warrant with money collected from the Enterprises.

Law requires that OFHEO return to the Enterprises unobligated funds as of the end of the fiscal year by crediting the next year's assessment. It is important to understand how the crediting provision functions with the "no-year" fund designation. "No-year" funds are available for obligation without fiscal year limitation. Rules for "no-year" funds essentially remove all statutory limits as to when the funds may be obligated and expensed, and funds remain available for their original purpose until expended. The mandated crediting provision for unobligated funds acts as a restriction to the "no-year" designation. Consequently, when OFHEO closes its books each fiscal year, it accounts for budgetary resources not obligated as of the end of that fiscal year (September 30). OFHEO reduces the following year's annual assessment by the amount of the unobligated balance from the prior year. The cash is retained in the OFHEO fund and it supplements the new assessment to fully cover the total amount appropriated for the new operating year.

Included in the fund balance with Treasury at September 30, 2008 are civil penalties that had been levied against the Enterprises with OFHEO designated as the collecting agency. These penalty collections were not available for OFHEO's use, and they were designated as Treasury money when collected by OFHEO. There were no civil penalties in fiscal year 2007. OFHEO also collects fees for processing Freedom of Information Act (FOIA) requests. Similar to the civil penalties, FOIA fees are not available for OFHEO's use. As part of Treasury's year-end closing process, the fund balance for these types of collections are swept into its General Fund.

The amounts collected for civil penalties and FOIA request fees are classified as nonbudgetary fund balance and are considered nonentity assets.

OFHEO cash receipts and disbursements are processed by Treasury. With the exception of the amounts collected for civil penalties and FOIA requests and the unobligated balance not available at year-end, the fund balance with Treasury represents assessment money available to pay current liabilities and to finance authorized purchase obligations.

G. Accounts Receivable

OFHEO records an accounts receivable when amounts are due from civil penalty assessments or from individuals requesting FOIA services. There existed an accounts receivable balance at September 30, 2008; there was none at September 30, 2007. No accounts receivable was estimated as uncollectible.

H. Property and Equipment

OFHEO's property and equipment is recorded at cost and is depreciated using the straight-line method over the estimated service lives of the assets. Service lives have been established as three years for most computer-related systems and up to 15 years for other equipment. Leasehold improvements are depreciated over the remaining term of the lease agreement. OFHEO has an established capitalization threshold of $5,000 to conform to the materiality approach for the accounting that supports OFHEO's independent financial statements. Other property items, normal repairs and maintenance are charged to expense as incurred.

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

I. Liabilities

Liabilities represent the amount of funds that are likely to be paid by OFHEO as the result of a transaction or an event that has already occurred.

NOTE 1, continued

OFHEO reports its liabilities in the financial statements under two categories: Intragovernmental and With the Public. Intragovernmental liabilities represent funds owed to another Federal agency. Liabilities With the Public represent funds owed to any entity or person that is not a Federal agency, including private sector firms and federal employees. Each of these categories may include liabilities that are covered by budgetary resources and liabilities not covered by budgetary resources.

Liabilities covered by budgetary resources are liabilities that are funded by a current appropriation or other funding source. These consist of accounts payable and accrued payroll and benefits. Accounts payable represent amounts owed to another entity for goods ordered and received and for services rendered by other than employees. Accrued payroll and benefits represent payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year.

Liabilities not covered by budgetary resources are liabilities that are not funded by any current appropriation or other funding source. These liabilities consist of accrued annual leave, deferred rent and the amounts due to Treasury for collections and accounts receivable of civil penalties and FOIA request fees. Annual leave is earned throughout the fiscal year and is paid when leave is taken; the accrued liability for annual leave represents the balance earned, but not yet taken. The Department of Labor (DOL) is the central paying agent for all workers' compensation claims filed under the Federal Employees Compensation Act (FECA). Accrued FECA represents the amount OFHEO is to reimburse DOL for claims paid to OFHEO employees. OFHEO has one unpaid FECA claim as of September 30, 2008; none existed at September 30, 2007. No liability is recorded for future worker's compensation as of September 30, fiscal years 2008 and 2007, as OFHEO's methodology for estimating this future workers' compensation as prescribed by DOL determined that the liability would be negligible. Deferred rent is the difference at year-end between the sum of monthly cash disbursements paid to date for rent and the sum of an average monthly rent calculated based on the term of the lease. This determination and recording of deferred rent is applicable only to the lease agreement on the property at 1750 Pennsylvania Ave that commenced in 2005 (see Note 7 – Operating Leases).

J. Retirement Plans

OFHEO participates in the retirement plans offered by the Office of Personnel Management (OPM) and does not maintain any private retirement plans. All full time, permanent employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS).

OFHEO expenses its contributions to the retirement plans of covered employees as the expenses are incurred. OFHEO is reporting imputed (unfunded) costs with respect to retirement plans, health benefits and life insurance pursuant to guidance received from OPM. These costs are paid by OPM and not by OFHEO. Disclosure is intended to provide information regarding the full cost of OFHEO's program in accordance with GAAP.

K. Net Position

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

1) Unexpended Appropriations, consisting of undelivered orders and unobligated balances of OFHEO's funds.

2) Cumulative Results of Operations, consisting of:

   a. Invested capital, which represents OFHEO's investment in property and equipment, net of accumulated depreciation. Increases to invested capital are recorded when assets are acquired with direct appropriations and decreases are recorded as a result of depreciation and disposition of capital assets.

   b. Future funding requirements, which represent funds required to pay for accrued annual leave, accrued FECA and deferred rent. The expense for these accruals is not funded from current assessments, but will be funded from future assessments as the expenses are incurred.

NOTE 1, continued

L. Creation of New Agency

On July 30, the President signed into law the Housing and Economic Recovery Act of 2008, Pub. L. 110-289, 122 Stat. 2654 (HERA), which amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 and the Federal Home Loan Bank Act (1992 Act). One of the provisions of HERA created the Federal Housing Finance Agency (FHFA), which is empowered with regulatory oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks (collectively, regulated entities). The formation of this new agency comprises the transfer of personnel, property, and program activities of the Office of Federal Housing Enterprise Oversight (OFHEO); the Federal Housing Finance Board (FHFB), and certain employees and activities of the Department of Housing and Urban Development (HUD) related to the regulation of the housing mission of Fannie Mae and Freddie Mac.

Specifically, (1) the transfer of FHFA and OFHEO employees is to be accomplished no later than one year after enactment of HERA, and the transfer of the certain HUD employees will take place after such employees are identified for transfer; (2) the funds of both OFHEO and FHFB became funds of FHFA upon enactment of HERA; (3) FHFA may use the property of OFHEO and FHFB to facilitate the transfer of functions and such property is transferred to FHFA upon abolishment of FHFB and OFHEO. OFHEO and FHFB continue to exist for the sole purpose of winding up their affairs until they are abolished one year after enactment of HERA.

As noted above, upon enactment of HERA, the funds of both OFHEO and FHFB are treated as amounts received from assessments by FHFA of the regulated entities. These funds may be used to provide for reasonable expenses (including administrative and start-up costs) of FHFA, and for use by FHFA in the windup of the affairs of OFHEO and FHFB. As a practical matter, funds from OFHEO and FHFB were kept in their respective Treasury funds. Also, a simplified accounting structure was created for FHFA within OFHEO's accounting system to segregate and track the non-personnel expenses for FHFA. At the end of FY2008 OFHEO transferred $6.175 million and FHFB transferred $81 thousand of assessment collections to FHFA to fund the non-personnel obligations incurred by FHFA during the August to September period.

OFHEO's transfer of $6.175 million is reflected in the Balance Sheet, the Statement of Changes in Net Position and in the Statement of Budgetary Resources. These non-personnel obligations are comprised of $6.038 million for the regulation of Fannie Mae and Freddie Mac, including $5.5 million for legal services related to the Enterprises' conservatorships, and $.137 million for start-up and overhead costs. FHFA incurred $1.010 million in personnel costs from OFHEO related to FHFA activities. These personnel costs were paid directly from OFHEO's fund as they were incurred.

Under the authority of the 1992 Act, as amended by HERA, FHFA placed Fannie Mae and Freddie Mac under conservatorship on September 6, 2008, to stabilize the two entities with the objective of maintaining normal business operations and restoring safety and soundness. FHFA, as conservator, assumed the power of board and management. As conservator, FHFA appointed a Chief Executive Officer for each enterprise and new boards of directors are being formed. FHFA delegated to the Enterprises certain business and operational authority. FHFA personnel monitor the operations of the enterprises..

M. Comparative Data

Certain 2007 line items in the Balance Sheet have been reclassified to conform to the current year's presentation.

NOTE 2 • NON-ENTITY ASSETS

Assets that are classified as non-entity are the portion of fund balance with Treasury represented by collections of civil penalties and FOIA request fees and the accounts receivable due from a civil penalty and FOIA requests. Those non-entity asset balances consist of the following as of September 30, 2008 and 2007:

	2008	2007
Fund Balance - Intragovernmental	$ 5,029	$ 5
Accounts Receivable - With the Public	501	-
Total Non-entity Assets	$ 5,530	$ 5

NOTE 3 • FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of the following as of September 30, 2008 and 2007:

	2008	2007
Fund Balances:		
Appropriated Funds	$ 15,801	$ 25,382
Other	5,029	5
Total	$ 20,830	$ 25,387
Status of Fund Balances:		
Unobligated Balance		
Unavailable	$ 3,283	$ 122
Obligated Balance	12,518	25,260
Non-Budgetary	5,029	5
Total	$ 20,830	$ 25,387

NOTE 4 • ACCOUNTS RECEIVABLE

Accounts Receivable balances consist of the following as of September 30, 2008 and 2007:

	2008	2007
Civil Penalty Asssessment Due	$ 500	$ -
FOIA Fee Due	1	-
Accounts Receivable Public	$ 501	$ -

NOTE 5 • PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment balances as of September 30, 2008

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Equipment	$ 11,515	$ 10,451	$ 1,064
Leasehold Improvements	6,849	5,750	1,099
Internal-Use Software	25,088	22,264	2,824
Total	$ 43,452	$ 38,465	$ 4,987

Property, Plant and Equipment balances as of September 30, 2007

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Equipment	$ 12,107	$ 9,135	$ 2,972
Leasehold Improvements	6,366	4,150	2,216
Internal-Use Software	23,449	19,919	3,530
Total	$ 41,922	$ 33,204	$ 8,718

The internal use software application included in the current net book value is OFHEO's automated supervisory tool (xWorks). The Risk-Based Capital (RBC) software was fully depreciated in FY2005 and FIMS was fully depreciated in FY2008.

NOTE 6 • LIABILITIES COVERED AND NOT COVERED BY BUDGETARY RESOURCES

Liabilities Covered and Not Covered by Budgetary Resources balances consist of the following as of September 30, 2008 and 2007:

	2008			2007		
	Covered	Not Covered	Total	Covered	Not Covered	Total
Intragovernmental						
Other Liabilities:						
Accrued Benefits	$ 347	$ -	$ 347	$ 245	$ -	$ 245
Due to DOL	-	1	1	-	-	-
Due to Treasury	-	5,530	5,530	-	5	5
Total Other Liabilities	$ 347	$ 5,531	$ 5,878	$ 245	$ 5	$ 250
Total Intragovernmental	$ 347	$ 5,531	$ 5,878	$ 245	$ 5	$ 250
With the Public						
Accounts Payable	$ 811	$ -	$ 811	$ 1,453	$ -	$ 1,453
Accrued Payroll	1,746	-	1,746	1,321	-	1,321
Annual Leave	-	3,907	3,907	-	3,061	3,061
Deferred Rent	-	186	186	-	196	196
Total Other Liabilities	1,746	4,093	5,839	1,321	3,257	4,578
Total With the Public	$ 2,557	$ 4,093	$ 6,650	$ 2,774	$ 3,257	$ 6,031
Total Liabilities	$ 2,904	$ 9,624	$ 12,528	$ 3,019	$ 3,262	$ 6,281

All "Other Liabilities" are considered current, except for the deferred rent.

NOTE 7 • OPERATING LEASES

1700 G Street NW

OFHEO has an occupancy lease with the Office of Thrift Supervision (OTS) at 1700 G Street NW, Washington, DC, that covers office space and building services, including utilities, security guards, janitorial services, mail delivery, use of the loading dock, garage parking and building operation and maintenance. The initial term of the lease was for five years beginning in 1993, with the option to renew for three 5-year terms. OFHEO has exercised the second of the three option terms.

OFHEO may terminate the lease agreement with OTS in whole or in part. In the event of a termination at OFHEO's discretion, OFHEO would be required to pay two months rent. If either party ceases to exist or merges with another entity by operation of law, either party may terminate the rental agreement. In the event of termination under this provision,

NOTE 7, continued

neither party is liable for further costs, fees, damages or other monies due to the termination, except for payments through the date of termination. Because of this termination clause, no deferred rent is established for this lease, nor is disclosure of minimum future lease payments required under Financial Accounting Standard Board Statement #13. If OFHEO continues renting up to the expiration date of its current option term ending November 2008, lease payments for fiscal year 2009 are estimated to be $0.8 million.

1750 Pennsylvania Avenue NW

In FY2005, OFHEO obtained additional rental space at 1750 Pennsylvania Avenue NW, Washington, D.C., through a private-sector sublessor. The expiration date of the lease is March 30, 2011. If the primary lease would terminate earlier than the expiration date, the sublease would then also terminate. A deferred rent liability is established for this lease.

Under existing commitments, the future minimum lease payments through FY2011 are as follows:

Fiscall Year Ending September 30,	1750 Penn Ave NW
2009	$ 944
2010	981
2011	505
Total Future Minimum Lease Payments	$ 2,430

1 Lease runs through March 2011.

Total rent expenses on the two leases for the years ended September 30, 2008 and 2007 were approximately $5.3 million and $5.1 million, respectively.

NOTE 8 • PROGRAM COSTS

Program costs are distributed into two categories: Intragovernmental and With the Public. Intragovernmental costs are a result of OFHEO contracting with other federal agencies for goods and/or services, such as rent paid to OTS, payroll processing services received from the Department of Agriculture and imputed financing costs for post-retirement benefits with the Office of Personnel Management. With the Public costs include expenditures for contracts with the private sector for goods or services, payments for employee salaries, depreciation, annual leave and deferred rent expenses. The cost for the years ended September 30, 2008 and 2007 were:

	2008	2007
Intragovernmental	$ 14,135	$ 13,036
With the Public	61,244	55,046
Total Program Costs	$ 75,379	$ 68,082

NOTE 9 • APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

	2008	2007
Direct Obligations - Category B	$ 59,450	$ 67,437

All obligations incurred are characterized as OMB Category B obligations (i.e., not apportioned by fiscal quarter) as reported on the Statements of Budgetary Resources for the years ended September 30, 2008 and 2007 were:

NOTE 10 • ADJUSTMENTS TO BEGINNING BALANCE OF BUDGETARY RESOURCES

In addition to its appropriation, OFHEO received from OMB a reapportionment of prior year funds resulting from recoveries of prior year obligations. OFHEO requested and received the authority to reobligate these prior year funds in fiscal years 2008 and 2007.

NOTE 11 • LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

The 1992 Act states that any balance that remains unobligated at the end of the fiscal year must be returned to the Enterprises as a credit against the next year's assessment.

NOTE 12 • EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES (SBR) AND THE BUDGET OF THE U.S GOVERNMENT (BUDGET)

The financial statements for FY2008 are published before the 2008 U.S. Budget actual figures are available. Therefore, a reconciliation between the SBR and the Budget is prepared for FY2007. OFHEO has no differences between the SBR and the U.S. Government Budget for FY2007. OFHEO routinely reconciles financial data reported throughout the entire reporting process to ensure consistency.

	2007 SBR (In Millions)	2007 Budget (In Millions)
New Budget Authority	$ 66	$ 66
Resources from Recoveries	1	1
Total Budgetary Resources	$ 67	$ 67
Change in Obligated Balance		
Obligated Balance, start of year	$ 22	$ 22
New Obligations	67	67
Outlays	(63)	(63)
Recoveries	(1)	(1)
Obligated Balance, end of year	$ 25	$ 25
Gross Outlays	$ 63	$ 63

NOTE 13 • UNDELIVERED ORDERS AT THE END OF THE PERIOD

Undelivered orders are funds that have been obligated for goods or services yet to be received. The balances outstanding at September 30, 2008 and 2007 were:

	2008	2007
Undelivered Orders	$ 9,613	$ 22,240

NOTE 14 • RECONCILIATION OF BUDGET TO NET COST OF OPERATIONS

SFFAS # 7 "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting" requires that a reconciliation be presented to explain the relationship between budgetary resources obligated during the period and the net cost of operations.

Liabilities not covered by budgetary resources reported on the Balance Sheet consist of collections of a civil penalty and FOIA fees due to Treasury, accrued annual leave and deferred rent. The changes between the year-end balances of accrued annual leave and deferred rent are reflected in the above reconciliation under the category "Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Periods." The change in these balances is commonly referred to as unfunded expense.

The liabilities established for the collections of the civil penalty and FOIA request fees are considered custodial activities and do not impact the reconciliation.

	2008	2007
Resources Used to Finance Acitivies:		
Budgetary Resources Obligated		
Obligations Incurred	$ 59,450	$ 67,437
Recoveries	(2,908)	(1,409)
Net Obligations	56,542	66,028
Other Non-Budgetary Resources Imputed Financing	1,642	1,574
Net Other Non-Budgetary Resources	1,642	1,574
Total Resources Used to Finance Activities	**$ 58,184**	**$ 67,602**
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods or Services Ordered but not Provided	12,627	(2,818)
Resources that Finance the Acquisition of Assets	(2,422)	(3,279)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**10,205**	**(6,097)**
Total Resources Used to Finance the Net Cost of Operations	**$ 68,389**	**$ 61,505**
Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period		
Annual Leave	846	757
Deferred Rent	(9)	25
Depreciation and Revaluation of Assets	6,153	5,795
Total Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period	**$ 6,990**	**$ 6,577**
Net Cost of Operations	**$ 75,379**	**$ 68,082**

NOTE 15 • CUSTODIAL ACTIVITIES

The $5.025 million of fines assessed presented on the Statement of Custodial Activity in FY2008 represent collections on civil penalties assessed against former Fannie Mae executives ($3.025 million) and a Freddie Mac executive ($2.0 million) as part of the settlements with OFHEO regarding accounting improprieties uncovered in separate examinations. A liability Due to Treasury is reported by OFHEO at September 30, 2008 for the amount of the penalties collected.

The $0.5 million accrual adjustment represents the amount remaining to be paid as part of the settlement terms with the former Freddie Mac executive. A liability Due to Treasury is reported by OFHEO at September 30, 2008 for the amount of the penalty due to be collected.

OFHEO also collects fees for services provided in response to FOIA requests. These fees also are not available for OFHEO's use. A liability Due to Treasury is reported by OFHEO at September 30, 2008 and 2007 for the amount of fees collected and owed.

Glossary

Alt-A Mortgage – Generally a loan with less than standard documentation, especially of borrower income or assets, but sometimes also includes loans with credit defects or other deviations from standard underwriting standards.

Conforming Jumbo Mortgage – New, temporary conforming loan limit greater than $417,000 for one-unit properties in some areas, established under the Economic Stimulus Act of 2008.

Conservatorship – Statutory process designed to stabilize troubled institutions with the objective of maintaining normal business operations and restoring their safety and soundness.

Deed-in-Lieu – The borrower gives the deed (property ownership) to the servicer to fulfill his/her obligation to repay the debt. In exchange for delivering the deed, the borrower avoids a deficiency judgment.

Enterprise – Fannie Mae or Freddie Mac.

Foreclosure – A legal process dictated by state law in which the mortgaged property is sold to payoff the mortgage of the defaulting borrower.

GAAP net worth – The amount by which a company's assets exceed its liabilities as determined by generally accepted accounting principles (GAAP).

Golden parachute payment – Payment to an executive leaving a company based on an agreement that guarantees lucrative severance benefits if control of the company changes hands.

Loan Modification – A change or changes to the original mortgage terms, which may include a change to the product (adjustable rate to a fixed-rate product), interest rate, term and maturity date, amortization term, and amortized balance.

Prime Mortgage – A mortgage with a FICO credit score that is 660 or above.

Senior Preferred Stock – Capital stock owned by the Treasury Department, which pays specific dividends before preferred stock or common stock dividends. In the event of a liquidation, senior preferred stock takes precedence over preferred and common stock.

Serious Delinquency – A mortgage that has not received any payments in 90 days.

Subprime Mortgage – A mortgage made to a borrower with impaired credit.

Index of Figures and Features

Figures

Features

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