

# Single Family Guaranty Business

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## Facing Strategic Crossroads June 27, 2005

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1. Is the housing market overheated?
  2. Are consumer changes in preference for adjustable rate vs. fixed rate mortgages cyclical or secular?
  3. Does Fannie Mae have a role/responsibility to stabilize the housing market?
  4. Does Fannie Mae have an obligation to protect consumers?

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## **The risk in the environment has accelerated dramatically.**

- Proliferation of higher risk alternative mortgage products
- Growing concern about housing bubbles
- Growing concerns about borrowers taking on increased risks and higher debt
- Aggressive risk layering

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## **Growth in adjustable rate mortgages (ARMs) continues at an aggressive pace.**

- Extensive menu of alternatives / options
- Increasing affordability concerns
- Emphasis on lowest possible payment
- Home being utilized more like an ATM

*Our competitive advantages today are in fixed rate mortgages.*

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**We are at a strategic crossroad....**

**We face two stark choices:**

- 1. Stay the Course**
- 2. Meet the Market Where the Market Is**

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## Stay the Course

- Maintain our strong credit discipline
- Protect the quality of our book
- Intensify our public voice on concerns
- Refrain from offering specific guidelines
- Preserve capital
- Test cyclical vs. secular

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**Alternatively, we could seek to ....**

**Meet the Market Where the Market Is**

- Meet current consumer and customer demands
- Participate in volume and revenue opportunity / current growth areas
- Accept higher risk and higher volatility of earnings

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## Possible Implications

### Stay the Course

- Lower volumes / revenues
- Slower book growth
- Continued market share decline
- Lower earnings
- Impact on key customer relationship

### Meet the Market

- Higher volume / revenues
- Faster book growth
- Slow down decline in market share
- Higher credit losses
- Increased exposure to unknown risks
- Potential increased earnings volatility



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## **Significant obstacles block our ability to pursue a “Meet the Market” strategy.**

- Lack of capabilities and infrastructure
- Lack of knowledge of the credit risks
- Lack of willingness to compete with the market on price
- Lack of a value proposition for subprime
- Lack of a conduit capacity and Regulatory concerns

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## **Realistically, we are not in a position to “Meet the Market” today.**

### **Therefore, we recommend that we:**

- Pursue a “Stay the Course” strategy and test whether current market changes are cyclical vs. secular:
  - Advocate public position
  - Be selectively opportunistic in pursuing business
  - See if consumer sentiment changes with flatter yield curve

### **While we:**

- Dedicate resources and funding to “underground” efforts to:
  - Develop a subprime infrastructure
  - Develop modeling capabilities for alternative markets
  - Develop a conduit capability

***Is there an opportunity to drive the market back to the 30-year FRM?***

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**If we do not seriously invest in these “underground” type efforts and the market changes prove to be secular, we risk:**

- Becoming a niche player
- Becoming less of a market leader
- Becoming less relevant to the secondary market

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# Management Team Discussion








# Single Family Facts and Data

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## First Half Performance and Observations

## Single Family Performance

### Corporate Objective Goals Scorecard Monthly Progress Report - May 2005

Maintain leadership and retain or grow our key accounts	
Address key competitive issues and maintain 30% MDO share	
Implement products and exceed target book growth of 1.75%	
Increase participation in subprime	
Use technology tools for process improvement and delivery preference	
Achieve the HUD goals	
Lead the market in minority lending and achieve targets	

- Satisfactory progress with customer retention. Holding our own against FRE
- Leakage to subprime and private label continues. We lack a value proposition to stem the tide in today's market
- Book growth negative year-to-date. Negative growth is expected for the full year
- Continue to work on value proposition and proposal to enter the subprime flow market
- On track
- On track
- Loss of market share to subprime, interest only, option ARMS, attracting mission borrowers relative to our "core" products

## Single Family Performance

2005 Divisional Goals (\$Bil)	
Lender Channel	\$383.2
Investor Channel	100.0
Dedicated Channel	16.0
<b>Total Business Volume</b>	<b>\$499.2</b>
Book Growth	1.75%
Gross Charged Fee	27.3 bps
Credit Losses	\$198 mil

*Inclusive of eBusiness.*

- Volume through May totaled \$188 billion and was \$11 billion (5.5%) behind plan
  - Full year estimate: \$491 billion (Q2 forecast)
- YTD book growth (estimated): minus 1.7 percent
  - Full year estimate: minus 0.6 percent
- YTD gross charge fee vs. plan: 26.2 bps vs. 26.8 bps
- YTD credit losses vs. plan: \$95.5 million vs. \$55.1 million
  - Current full year estimate (6/05): \$253 million

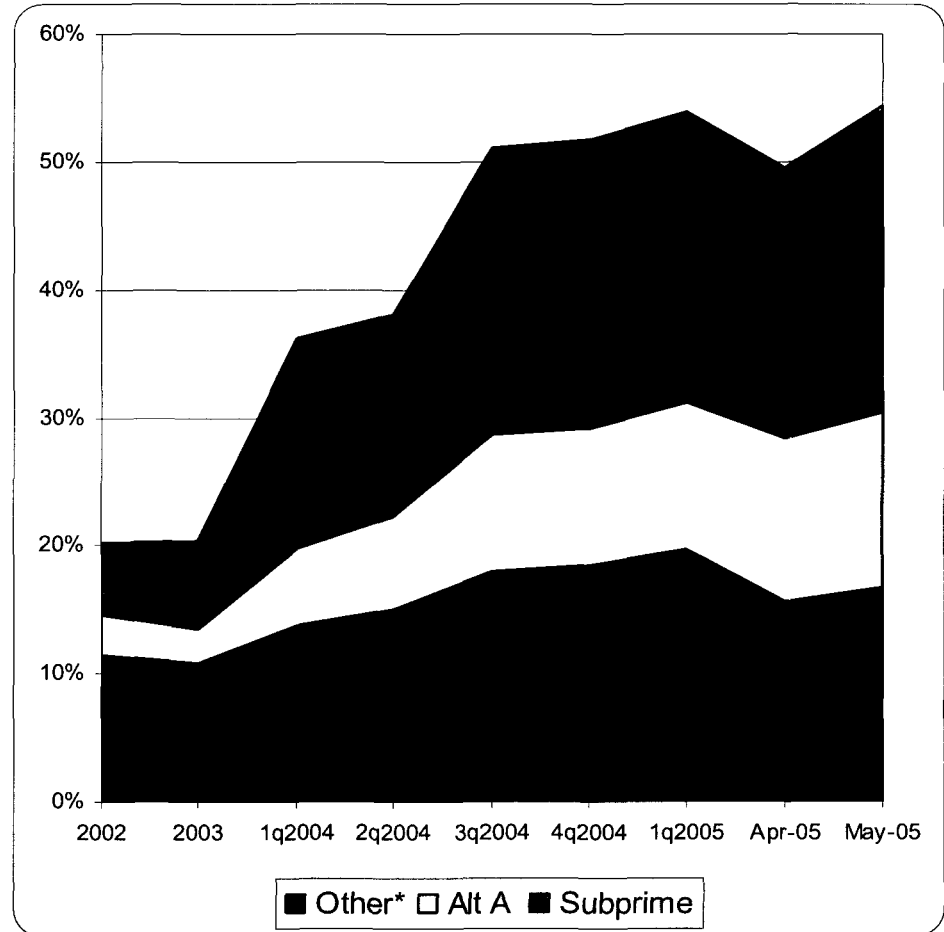
2005 HOUSING GOALS		MAY 2005 YTD ACTUAL
Low Mod (Affordable)	52.0%	55.5%
Special Affordable	22.0%	26.7%
Underserved	37.0%	41.3%
2005 SF PMM Sub Goal		
Low Mod (Affordable)	45.0%	45.48%
Special Affordable	17.0%	18.92%
Underserved	32.0%	32.49%
2005 MINORITY LENDING GOALS		
African American	5.4%	5.51%
Hispanic	11.6%	10.99%
<b>Total Minority</b>	<b>24.7%</b>	<b>23.78%</b>

- On the housing goals front we remain ahead of targets against all goal categories
- Our minority lending results through May are behind goal for Hispanic (10.99%) and total minority (23.78%)

## We continue to lose goals rich products to private label

- Much of the leakage to the private label market is from products with high minority concentrations
- The two product lines that are driving the majority of leakage to private label are Alt-A and Subprime
- In 2004, these product lines scored high relative to Fannie Mae's core products
  - Alt A: 30% total minority score
  - Subprime: 52% total minority score
- In addition, much of the Option ARM production is securitized in the private label market
  - Option ARMs: 37% estimated total minority score

Private Label Market Shares of MBS Issuance

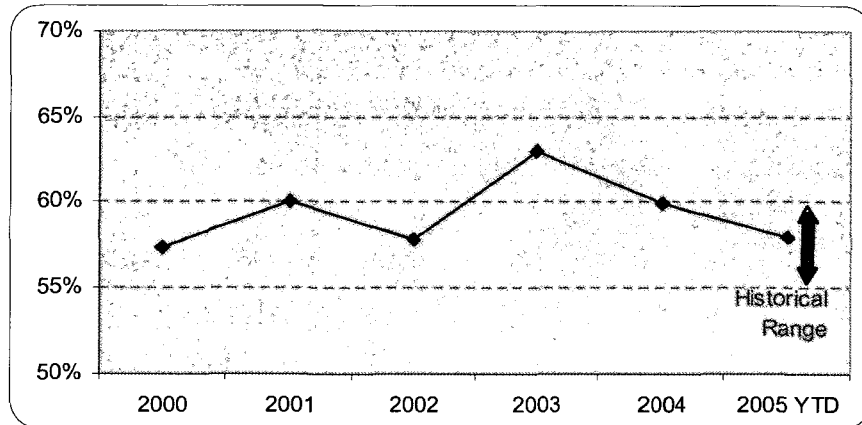


\* Other includes Option Arms

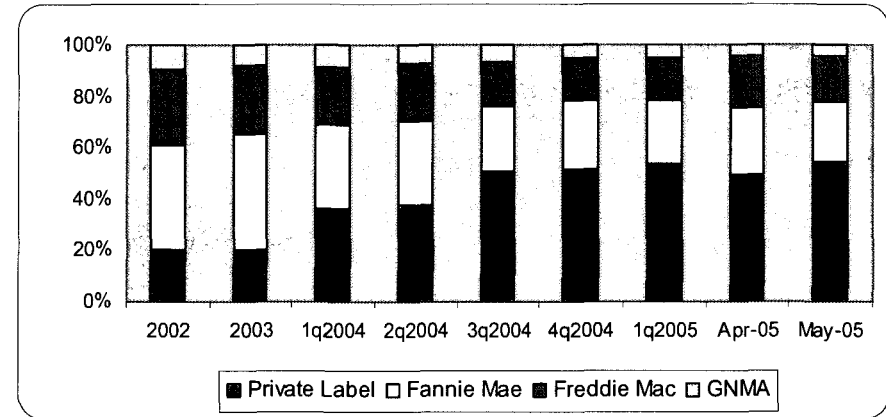


Even with tough competition and widening MBS/PC price spreads, Fannie Mae has still maintained share levels versus Freddie Mac in the historical range (55% - 60%)

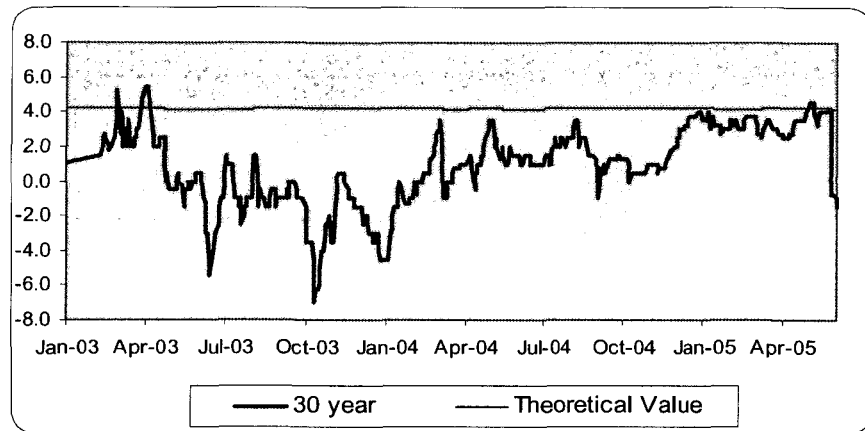
**Fannie vs. Freddie**



**Entire Securities Market**



**MBS/PC Price Spreads**



- Despite Fannie/Freddie price spreads being at high levels during the past 6 months, the Fannie/Freddie share has remained in the historical range
- However, both GSE's continue to see significant share loss to the private label market

# Our competitive advantages in our core competencies continue to erode

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**1 YEAR AGO....**  **TODAY....**

## **Core Competencies**

Credit risk management

Capital advantage

Low cost producer

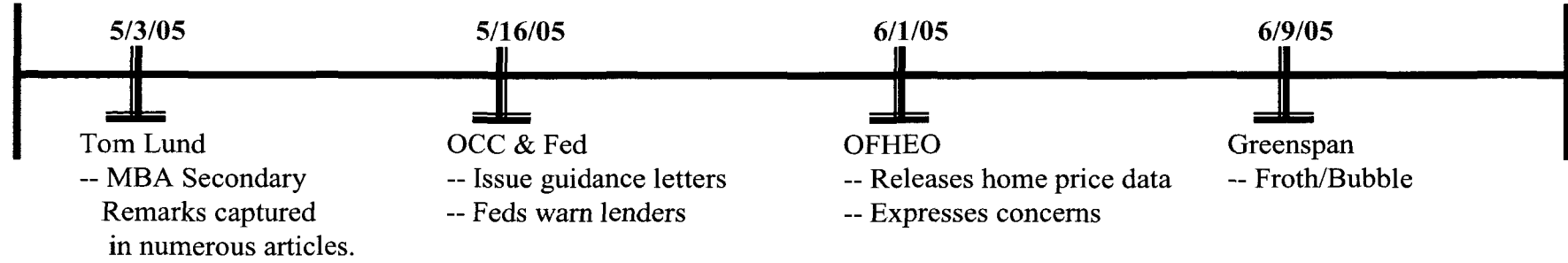
Customized value approach

Liquidity premium

DU/DO Technology

- Our insular view prevents us from taking credit risks in areas unfamiliar to us.
- Our capital advantage has been lost to collateralized debt obligation issuers and hedge funds. Basel II will further erode our advantage.
- Our pricing is uncompetitive. According to our models, market participants today are not pricing legitimately for risks.
- We don't have a value proposition to compete in today's market (lack of conduit capability).
- Premium still exists with respect to our 30-year TBA security; No liquidity premium for non-fixed rate product.
- DU/DO remain the leading automated underwriting systems in the market. Continued investment is required to ensure we do not lose our competitive advantages in this area.

## Our public position on risk concerns has been gaining momentum



### Articles of Interest

Source: Google

	# of Articles: (Jan – April)	# of Articles: (May – June 22, 2005)
■ Housing Bubble	932	1,248
■ Interest Only	315	1,213
■ Housing Affordability Concerns	86	746
■ Greenspan and Housing Concerns	187	598
■ OFHEO and Housing Concerns	12	28
■ OCC and Housing Concerns	18	17
■ Option ARMs	20	10

Since early May, we estimate that over 3,500 articles have appeared in various publications on the topics listed above. This compares with an estimated 1,200 articles on these topics in the four months prior.

Our customer's and other market participant's attitudes towards layered featured products varies across a broad spectrum

<p><b>Cautious</b>  <b>Longer Term View</b>  <b>Constrained</b></p>	<p><b>Slower to Move</b>  <b>Reluctant Follower</b>  <b>Tighter Credit Box</b></p>	<p><b>Production Focused</b>  <b>Meet the Market</b>  <b>Move Fast</b></p>
<p><b>Wells</b>  <b>Citi</b>  <b>ABN</b>  <b>Suntrust</b>  <b>Wachovia</b>  <b>HSBC</b>  <b>USAA</b>  <b>Irwin</b>  <b>Community Banks</b>  <b>Credit Unions</b></p>	<p><b>Chase</b>  <b>PHH</b>  <b>First Horizon</b>  <b>BofA</b>  <b>GMAC</b>  <b>Flagstar</b>  <b>OSB</b>  <b>Builder Mtg Corps</b></p>	<p><b>CHL</b>  <b>WaMu</b>  <b>World</b>  <b>Greenpoint</b>  <b>Indy Mac</b>  <b>Street Aggregators</b>  <b>Independent Mtg Bankers</b>  <b>Brokers</b>  <b>Realtors</b>  <b>Subprime Originators</b></p>

The market outlook for the year continues to change, driven by lower than expected interest rates and other market dynamics

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	2005 Plan	Q2 2005 Forecast
30-Year FRM	6.00%	5.64%
FRM-ARM Spread	1.35%	1.22%
SF Mortgage Originations (\$Bil)	2,146	2,671
Refinance Share (% of volume)	39.5%	47.4%
ARM Share	29.2%	31.4%
SF 1st Lien MDO (\$Bil)	7,704	7,923
SF 1st Lien MDO Growth	8.3%	9.8%
FNM HPI (% change from year ago)	3.4%	6.5%

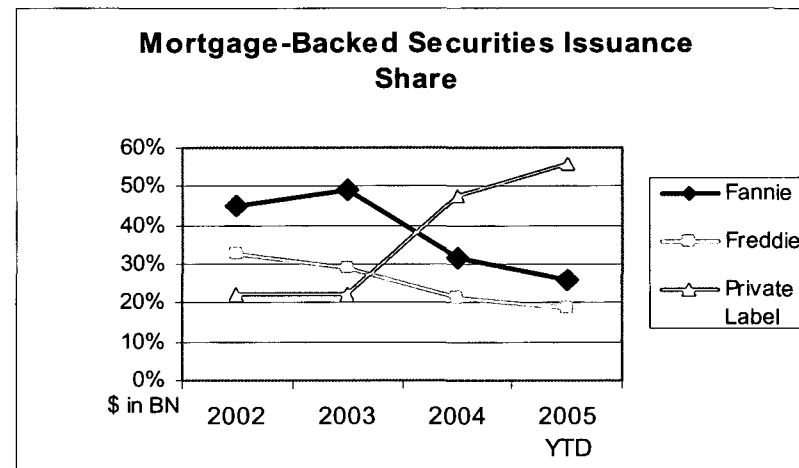
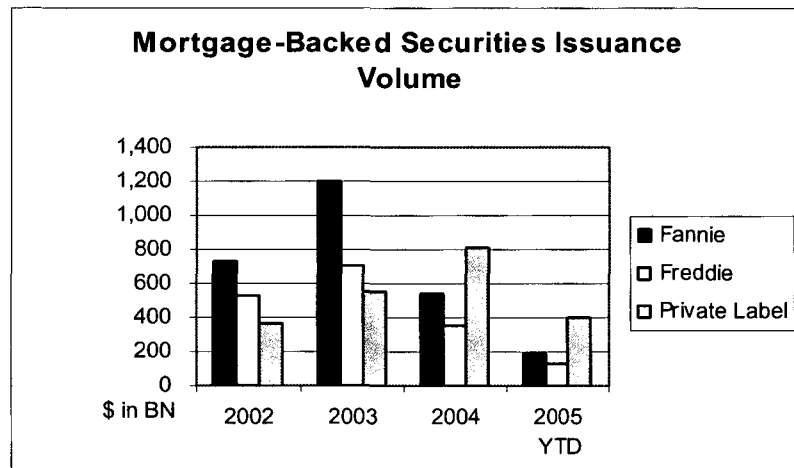
Fannie Mae 2005 Plan and Q2 2005 Forecast

# Single Family Facts and Data

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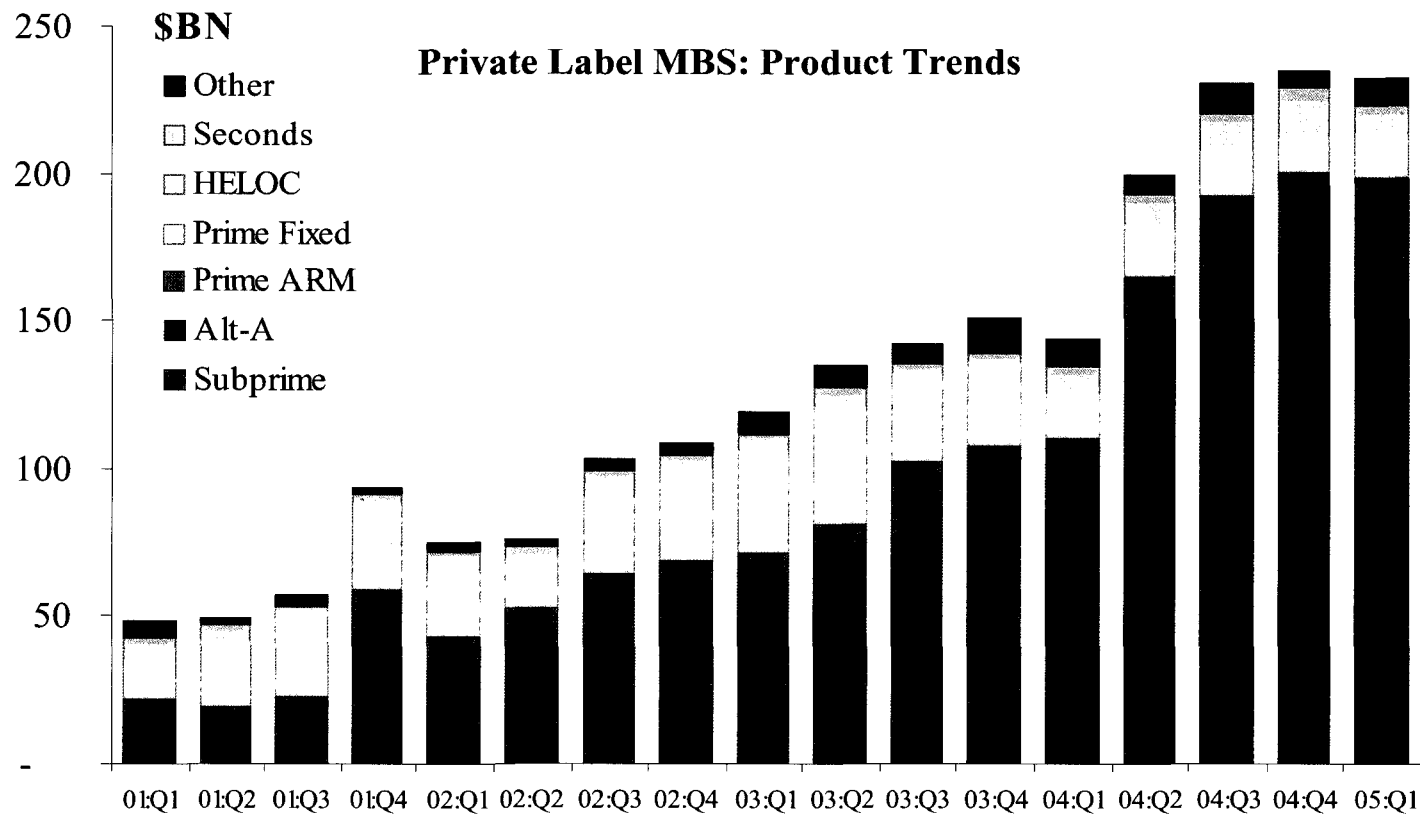
## Private Label and Subprime Market Trends

# Private Label Trends



- Private label market continues to be a significant source of liquidity to lenders. \$401 billion of private label securities have been issued in 2005 through May.
- In 2004, Private Label volume surpassed Fannie Mae volume for the first time, with total Private Label issuance of \$809 billion versus Fannie Mae issuance of \$537 billion.
- Fannie Mae is still the largest single issuer of MBS. Freddie Mac was the second largest issuer with \$358 billion, and Countrywide ranked third at \$114.5 billion.

# Private Label Trends



Source: Corporate Development, Inside MBS & ABS

- Growth in PL has been driven by increases in:
  - Subprime
  - Alt-A
  - ARM production
- Common theme across these products: housing affordability and flexible guidelines

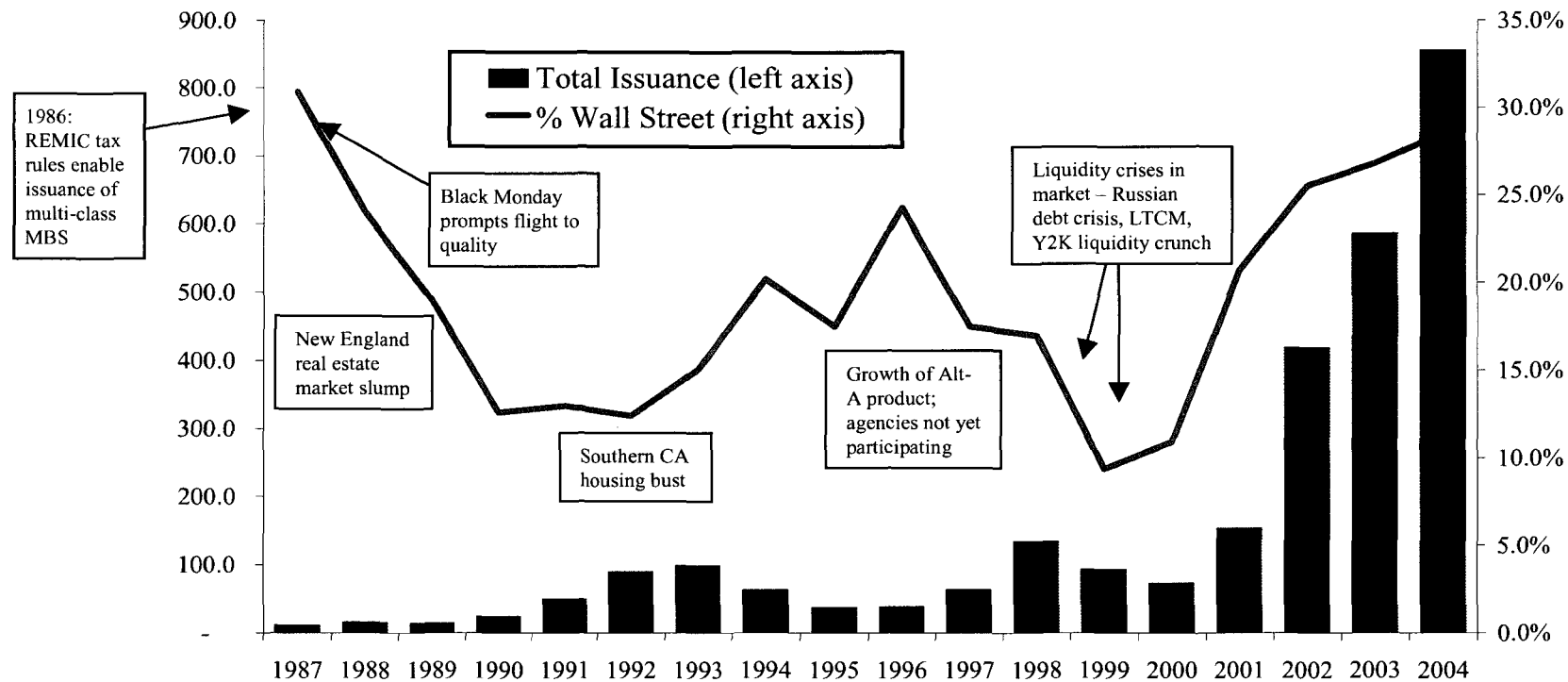


## Private Label Trends – Wall Street Presence

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- Wall Street firms playing an increasingly large role as aggregators of mortgage product.
- Wall Street share of private label issuance has doubled in the past three years (as of 2004 year-end).
- Many Wall Street players are pursuing vertical integration to develop consistent source of product:
  - Lehman originated \$43B in Correspondent and Broker originations in 2004.
  - Bear Stearns launched a Broker division in early 2005.
  - Firms making significant front end technology investments, including developing proprietary AU systems.

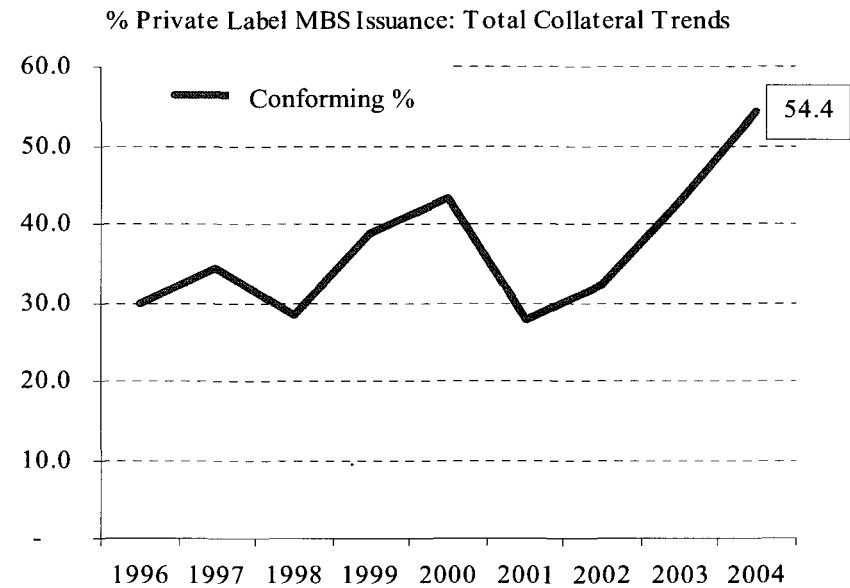
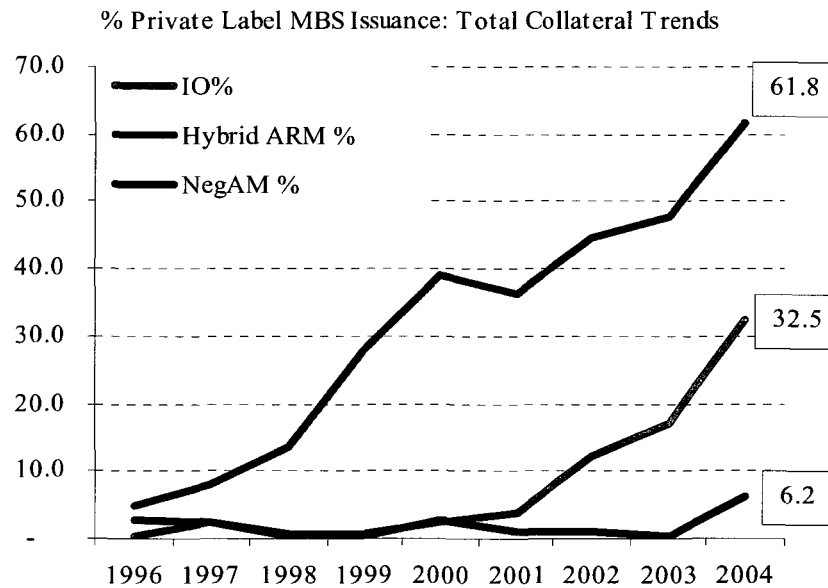
# Wall Street Issuance Trends – Cyclical or Secular?



- 1999-2001 – Wall Street presence in Private Label Issuance declines during (a) the consolidation of many subprime lenders, and (b) the increased presence of the Agencies in the Alt-A market.
- 2002-2005 – Wall Street participation increases measurably; and the street indicates that they are intent on having a lasting presence.
  - “They all want to be like Lehman Brothers... Lehman has a huge pipeline and everyone’s coveting it.” – Subprime Lender
  - CSFB has ambitious 2005 goals and is positioning itself to continue integrating downstream – exploring acquiring a servicer in 2005. (5/05 - CSFB 9<sup>th</sup> Private Label Issuers Conference)
  - Morgan Stanley is seeking “to build a brand and a reputation” for their securitization program and to show that they are “not just an opportunistic bond shop.” (4/05 – Origination News)
  - On Bear’s new broker platform: “Our pitch [is] that the broker’s getting capital market execution because he’s dealing direct with Wall Street.”

## Private Label Trends – Products and Risk Appetite

- Primary market originations of products outside Fannie Mae’s traditional risk appetite are on the rise. This means lenders have to turn to aggregators / private label as an outlet.



Source: UBS Mortgage Research: *Market Strategist*, May 31, 2005

- Strong growth of innovative products (Interest Only ARMs, “Pay Option” ARMs)
- Steady growth in share of Private Label market with conforming loan balances

## Private Label Trends – Products and Risk Appetite

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- Private label securities increasingly include a significant amount of conforming balance product. Reasons include:
  - Our tough anti-predatory lending guidelines preclude us from taking certain loans
  - Our risk appetite is tighter than the market's, especially regarding IO's and Option ARMs
  - Pricing / All-in execution
  - “Spillover” effect – lenders may prefer to sell product all in one place for convenience or execution reasons
  - Difficulty of hedging spread risk on ARMs: Many smaller lenders need best efforts flow execution and servicing released bids, which we don't offer with Alt-A and IO

# Private Label Trends – Products and Risk Appetite

## Private Label Securities Collateral Characteristics

Deals Issued April 2004 - Jan 2005

Prime Fixed & Prime ARM Deals --> These two categories represented 27% of all private label securitizations in 2004													
	\$ UPB (BB)	% Total UPB	Avg Loan Size	WA FICO	% FICO < 620	WA LTV	WA CLTV	% Investor	% Cashout	% CA	% Low/No Doc	% IO	% Option ARM
Total Collateral	116.1	100%	433,987	733	0.6%	69.1	85.6	2%	22%	48%	48%	48%	13%
Conforming Balance	22.1	19%	215,269	728	1.1%	73.3	92.5	7%	22%	26%	42%	73%	6%
Within FM Risk Appetite	20.0	17%	214,355	732	0.2%	73.1	92.4	7%	2%	25%	40%	79%	0%
Outside FM Risk Appetite	2.1	2%	225,742	683	10%	75.5	94.1	12%	42%	37%	55%	13%	60%

Alt-A Deals --> This category represented 20% of all private label securitizations in 2004													
	\$ UPB (BB)	% Total UPB	Avg Loan Size	WA FICO	% FICO < 620	WA LTV	WA CLTV	% Investor	% Cashout	% CA	% Low/No Doc	% IO	% Option ARM
Total Collateral	109.3	100%	252,548	711	1.2%	74.8	93.3	18%	30%	45%	67%	51%	12%
Conforming Balance	63.1	58%	182,392	710	1.5%	76.4	95.6	24%	28%	32%	63%	48%	11%
Within FM Risk Appetite	39.6	36%	181,273	723	0.6%	75.7	95.8	24%	21%	31%	56%	60%	0%
Outside FM Risk Appetite	23.5	22%	184,307	688	3.2%	77.5	95.3	24%	40%	34%	75%	28%	28%

Notes:

Data Source: Loan Performance database.

"Prime FRM" "Prime ARM" and "Alt-A" deal classifications are defined by the issuer as reflected in LP database.

"FM Current Risk Appetite" reflects typical FM eligibility criteria on bulk deal business for an average customer.

Loans without reported FICO scores were excluded from the data set.

All loans are in first lien position; WA CLTV = weighted average combined LTV of first lien plus any subordinate lien(s)

# Fannie Mae vs. Market View: IO & Option ARM

## Countrywide Recent Bid Profile Interest Only and Option ARMs

Collateral Profile	WAC	WAM	LTV	FICO	ACI	% Low Doc
IO ARM (Std MI)	6.00	359	79.5	727	622	79.6
Pay Option ARM (Std MI)	1.60	359	75.8	721	626	65.1

## Fannie Mae vs. Rating Agencies

	IO ARM		Pay Option ARM		
	FM	S&P	FM	S&P - Old	S&P - New
AA Sizing (Fannie Stress)	7.5	3.7	8.5	5.5	6.7
B Sizing (Expected Loss)	1.8	0.4	2.2	0.6	0.8

## Fannie Mae vs. MI Companies

	IO ARM	Pay Option ARM
Fannie Mae Value of CE	31.3	44.1
MI Cost for CE	18.7	28.9
MI Execution Benefit	12.6	15.2
Enhancement Levels	2.35% stop-loss, 0.55% deductible	3.85% stop-loss, 0.65% deductible

## Market Pricing

	With Credit Enhancement		No Credit Enhancement	
	IO	Pay Option	IO	Pay Option
Competitive Gfee (Charge Fee)	54.0	55.0	54.0	55.0
Gross Model Fee (includes CE cost)	54.5	63.4	105.9	110.2
GAP	-0.5	-8.4	-51.9	-55.2

### Notes:

Average Investor Channel charge fee for IO product is 49 bps

Pay Option charge fees reflect recent Countrywide bids vs. private label market.

Freddie Mac recently offered WAMU a mid-30's gfee for high quality Option ARMs

- Fannie Mae's view of risk is significantly different than other market participants
- S&P recently came out with more punitive criteria for Option ARMs
- MI companies price the expected and stress loss levels differently than Fannie Mae
- We need to obtain credit enhancement on the entire loan pool in order to achieve relatively gap neutral model fees

# Fannie Mae vs. Market View: Subprime

## Countrywide Recent Bid Profile Subprime Market

Collateral Profile	WAC	WAM	LTV	FICO	ACI	DTI
ARM (Charter MI)	7.1	359	78.3	604	561	41.1

### Fannie Mae v.s. Rating Agencies

	Subprime	
	FM	S&P
AA Sizing (Fannie Stress)	12.0	12.6
B Sizing (Expected Loss)	3.1	2.0

### Fannie Mae v.s. MI Company

	Subprime with Deep CE
Fannie Mae Value of CE	176.0
MI Cost for CE	101.0
MI Execution Benefit	75.0
Enhancement Levels	15.0% stop-loss, 1.50% deductible, Charter Primary

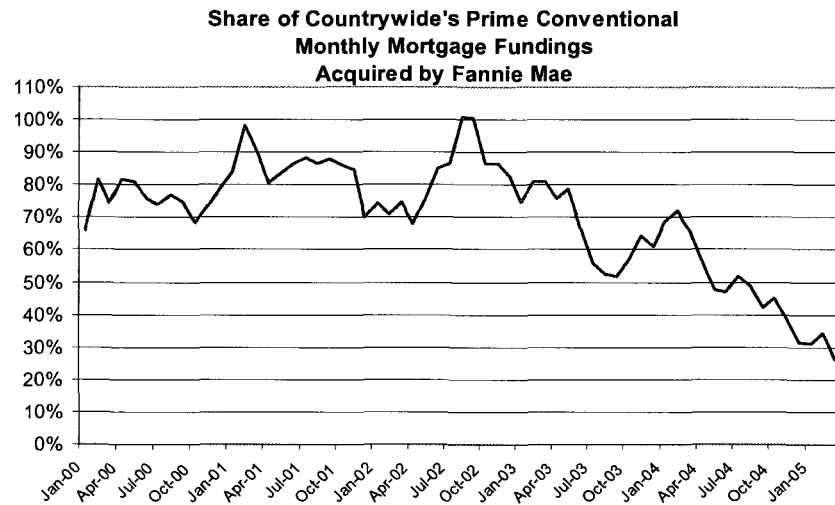
### Competitive Alternatives

	Subprime	
	With Deep CE	With Charter Min MI Only
Competitive Gfee	130.0	130.0
Gross Model Fee (includes CE cost)	195.0	277.0
GAP	-65.0	-147.0

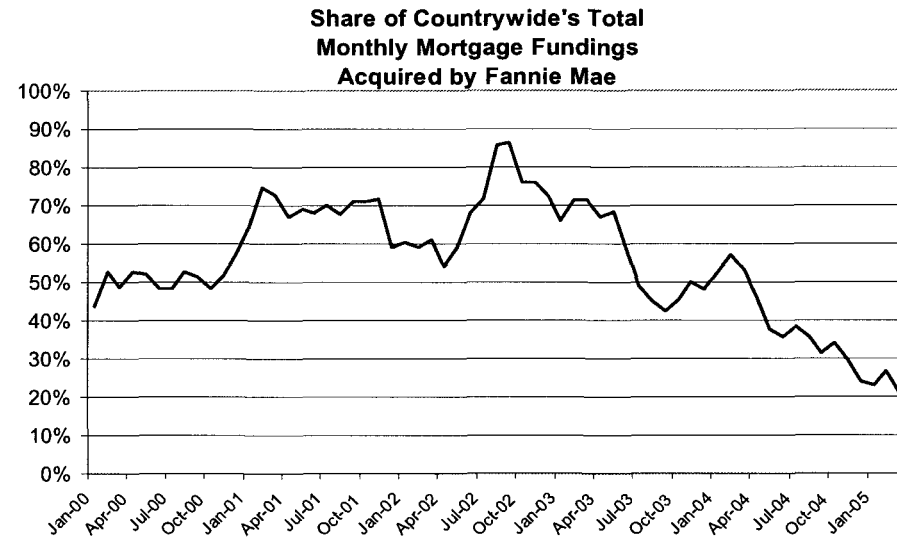
- Our view of risk for subprime product is more in line with Rating Agencies
- MI companies price the expected and stress loss levels differently than Fannie Mae
- Our execution still significantly off current market levels – market competitive g-fees would result in significant negative gap, even with credit enhancement

# Private Label Trends – Products and Risk Appetite

- This trend is increasingly costing us business with our largest customer:



<sup>1</sup>Fannie Mae acquisitions of conventional, first-lien mortgages from Countrywide as a share of Countrywide fundings of prime, conventional, first-lien mortgages.



<sup>2</sup>Fannie Mae acquisitions of mortgages from Countrywide as a share of Countrywide mortgage fundings.



# Private Label Trends – Products and Risk Appetite

## Countrywide Loan Production

Q1-2005

\$ in millions

PRODUCT	Total Countrywide Loan Production	% Total Production	\$ UPB Sold to Fannie	% Sold to Fannie
30 FRM	\$11,218	38.9%	\$5,354	47.7%
15 FRM	2,985	10.3%	2,379	79.7%
FRM ALT-A	4,340	15.0%	646	14.9%
AMORTIZING ARM ALT-A	600	2.1%	403	67.2%
INTEREST ONLY ARM	2,811	9.7%	1,920	68.3%
PAY OPTION ARM	6,889	23.9%	-	0.0%
<b>TOTAL PRODUCTION</b>	<b>\$28,843</b>	<b>100.0%</b>	<b>\$10,702</b>	<b>37.1%</b>

## Pay Option ARM Drill Down Potential Eligibility Criteria

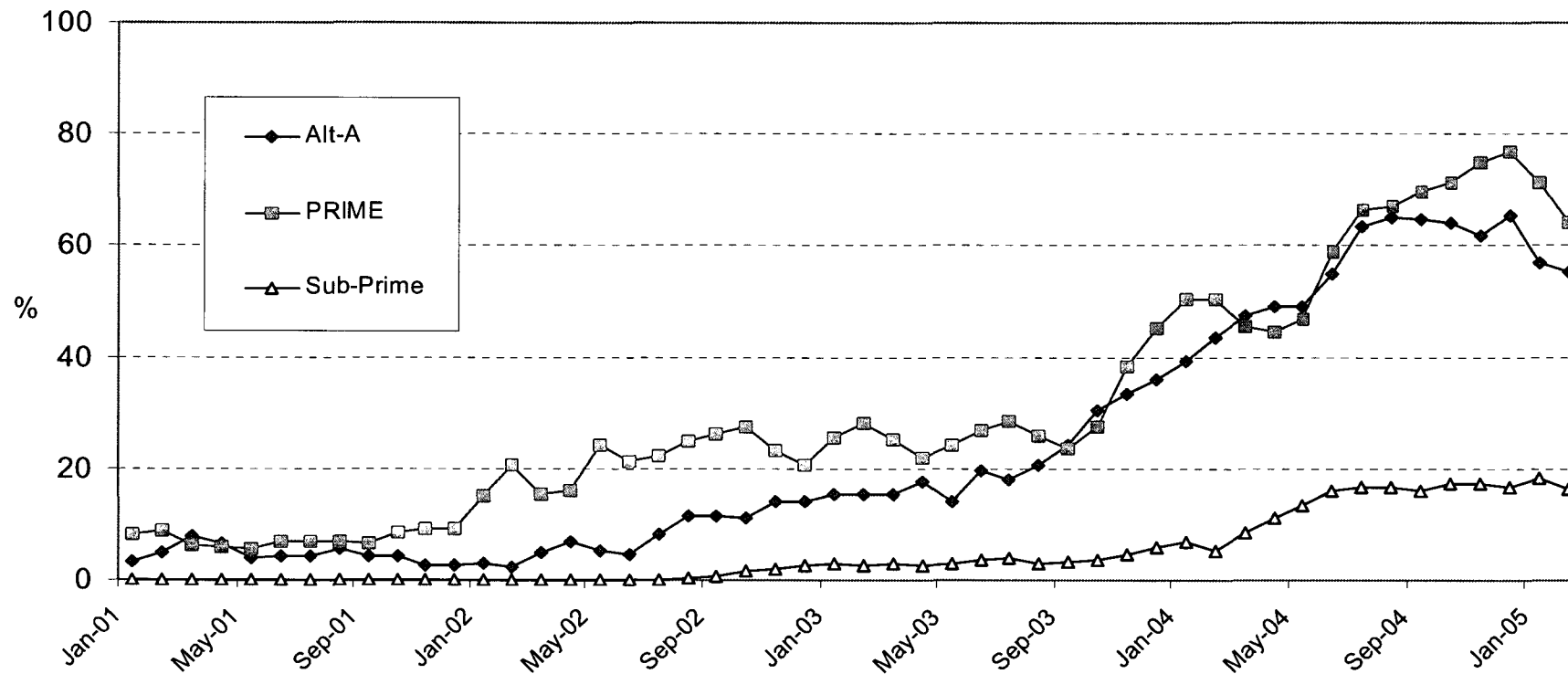
Pay Option	Tight Eligibility Bucket	Broader Eligibility Bucket	Not Eligible
<b>Total UPB</b>	\$2,412	\$5,670	\$1,219
% Investor	22.1	21.6	30.3
% Cashout	38.9	41.8	44.1
% Single-Family	79.8	79.7	69.3
% Full Doc	46.1	36.1	33.6
% with Subordinate Liens	21.2	23.3	27.6
wa Debt Ratio	35.4	35.6	45.0
wa FICO	744.1	721.4	669.1
wa MTMLTV	70.7	73.1	78.3
CreditWorks Model Fee	76	101	219
Gross Model if Credit Enhanced	52	62	n/a
Est Market Price (Charge Fee)	25	50	55

### Notes:

- Does not include subprime, second, or government loans.
- Eligibility buckets reflect potential offering to Countrywide for Option ARM product under a forward commitment.
- Tight eligibility bucket could be extended to other lenders on a bulk basis.
- "Not Eligible" category on Option ARMs reflects loans outside our credit risk appetite and/or borrower appropriateness framework.
- Debt ratio (back ratio) estimated from a one-month sample and only includes Full Doc loans.
- Countrywide data file did not include loans sold to Freddie; figures are grossed up assuming a 20% FR share based on Q1 actuals.

# Interest Only / Option ARMs Dominate Prime & Alt-A Private Label Deals

## IO/ Option ARM Share of Private Label Deals



Source: UBS Mortgage Research 6-7-05 Mortgage Strategist

Many of the current products in the market today provide for a low payment with increased payment shock over time

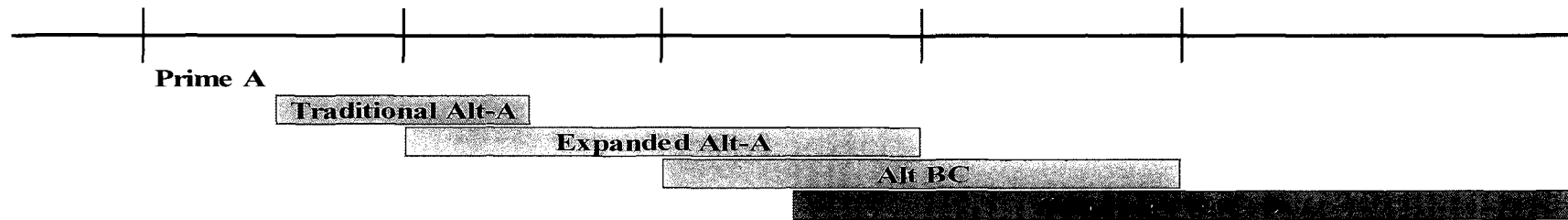
<b>Loan Type</b>	<b>Start Rate</b>	<b>P &amp; I Payment (Initial)</b>	<b>P &amp; I Payment (First Adjustment)</b>	<b>P &amp; I Payment (Maximum Adjustment)</b>	<b>Qualifying Max. Loan Amount</b>
<b>Option ARM (w/ Neg. Amortization)</b>	1.00%	\$125	\$876	\$1,912	\$285,714
<b>3/1 IO ARM</b>	5.00%	\$625	\$904	\$1,436	\$300,000
<b>5/1 IO ARM</b>	5.13%	\$641	\$992	\$1,376	\$292,683
<b>30-Yr. Fixed Rate (w/ 2/1 buydown)</b>	4.25%	\$738	\$826	\$916	\$254,096
<b>30-Yr. IO Fixed Rate</b>	6.00%	\$750	\$1,266	\$1,266	\$250,000
<b>5/30 IO (35-Yr.)</b>	6.13%	\$766	\$911	\$911	\$244,898
<b>40-Yr. Fixed Rate</b>	5.75%	\$799	\$799	\$799	\$234,571
<b>5/1 ARM</b>	5.00%	\$805	\$900	\$1,252	\$232,852
<b>30-Yr. Fixed Rate (Approve)</b>	5.63%	\$863	\$863	\$863	\$217,143

Assumptions: a) \$150K loan amount. b) Start Rates based on posted lender pricing. Rates at adjustment assume current index value for the loan type. Option ARM teaser rate of 1% on IO fixed for one year, then moves to 5.25% until first rate adjustment. c) Qualifying max loan amount for all loan types assumes the borrower made \$60K and utilizes a 25% qualifying ratio. d) Option ARM qualifying rate of 5.25%. All other loan types qualified at starting payment rate.

# Subprime Market Trends

- Market is evolving into a product continuum

(\$ in Millions)



- Trends towards integration of prime and subprime players:
  - New Century/RBC Acquisition in May 2005
  - Countrywide #1 issuer of subprime and Alt A; #3 issuer in Prime ARM securities in 2004
  - Ameriquest making significant marketing efforts aimed at broad customer base
  - To date, we have not seen any players integrate platform and sales process
- Profit margins in subprime shrinking but are still significantly higher than for prime mortgages

# Subprime Market Trends

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## Key Drivers of Growth in Subprime:

- **Broker driven sales process:**
  - Subprime generates higher margins and more approvals
- **Greater flexibility results in borrower ability to qualify for larger loan:**
  - Calculation of income (subprime more flexible on income sources)
  - Higher debt ratios
  - Appraisal values (subprime typically exhibits higher appraisal bias)
- **Mortgage Insurance Avoidance:**
  - Subprime lenders moving up the credit spectrum results in higher LTV's
  - For marginal borrowers, a subprime loan often costs less than a conventional loan once the MI payment is factored in
- **Ability of lenders to transfer risk to capital markets / monetize entire cash flow stream:**
  - Strong CDO demand for subordinate bonds means lenders have a steady investor source for riskiest credit
  - Ability to sell off residual cash flows in form of Net Interest Margin (NIM) bonds means lenders can realize more proceeds upfront and reduce exposure to future income fluctuations

# Single Family Facts and Data

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## Home Price Growth and Credit Concerns

# Home Price Growth Remains Strong

Region	Annualized HP Growth from TB-RTI* up to 2005Q1		
	Last 1 yr	Last 2 yrs	Last 5 yrs
West South Central	4.7%	3.7%	3.4%
West North Central	6.4%	6.3%	7.3%
East South Central	6.6%	5.3%	3.7%
East North Central	6.8%	5.9%	5.4%
New England	10.9%	10.9%	12.3%
Middle Atlantic	14.6%	13.9%	12.3%
Mountain	22.5%	16.8%	9.4%
South Atlantic	22.7%	17.7%	11.8%
Pacific	22.8%	21.3%	15.5%
US	14.6%	12.7%	9.9%

\*TB-RTI: A new home price index estimation methodology that uses data only from purchase transactions.

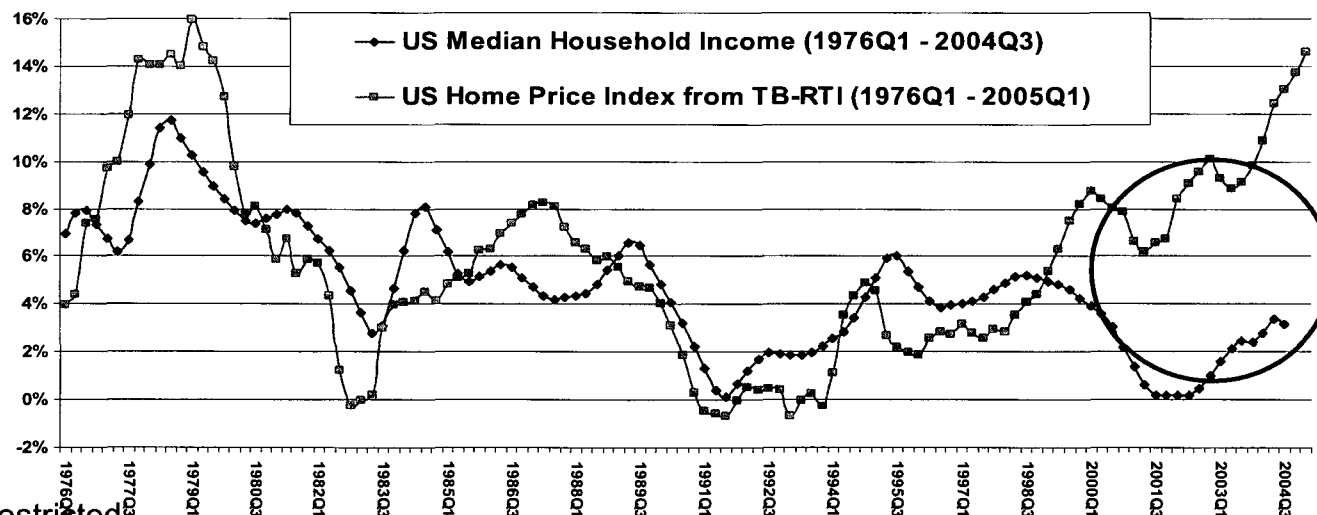
## US Housing Market continues with its recent trend:

- High growth rate and high dispersion across geographic locations
- Some observed slowing of growth rates (Southern CA, Las Vegas), but most remain above long-term trend

## Home price growth has significantly outpaced income growth:

- Affordability is at historical lows in some markets

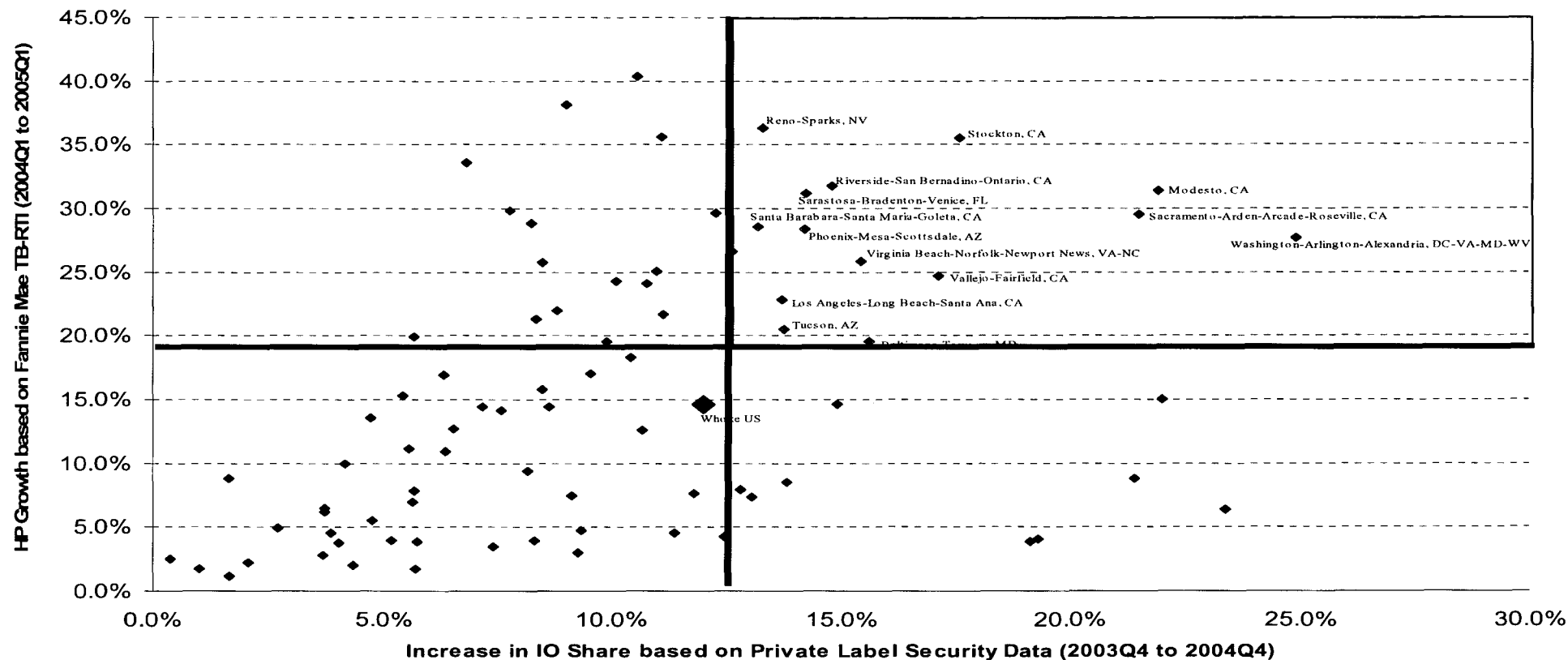
US Income Growth vs. Home Price Growth



# Local Market Focus – I/O Share

Many of the MSAs that experienced a high annual IO share increase (in excess of 13%) were MSAs that also experienced high home price growth (in excess of 19%) in the last year.

**Increase in Interest-Only (IO) Share Vs. HP Growth among top 100 MSAs**



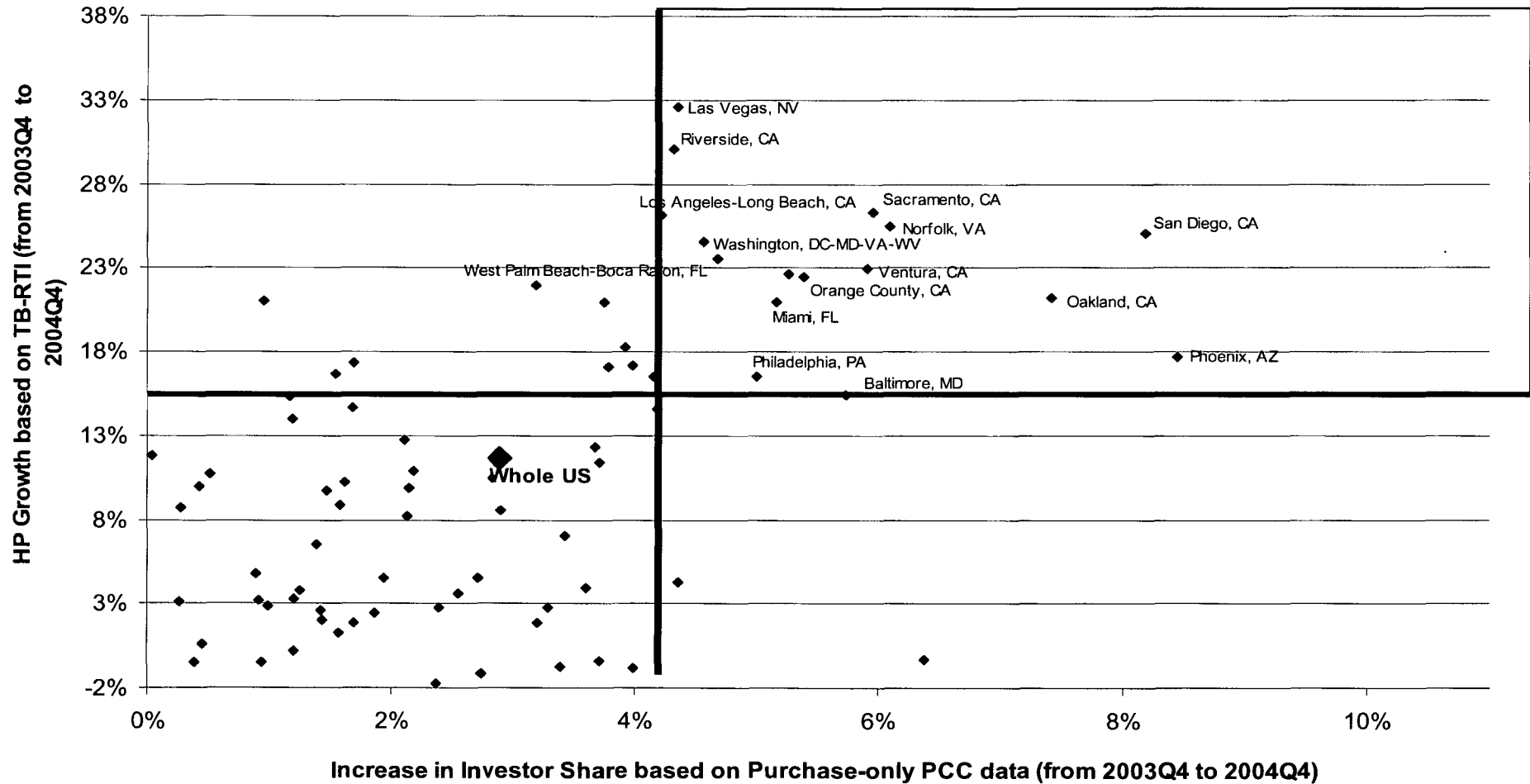
Source: Private Label Purchase Loan Dataset (Economics and Mortgage Market Analysis) & Credit Finance



# Local Market Focus – Investor Share

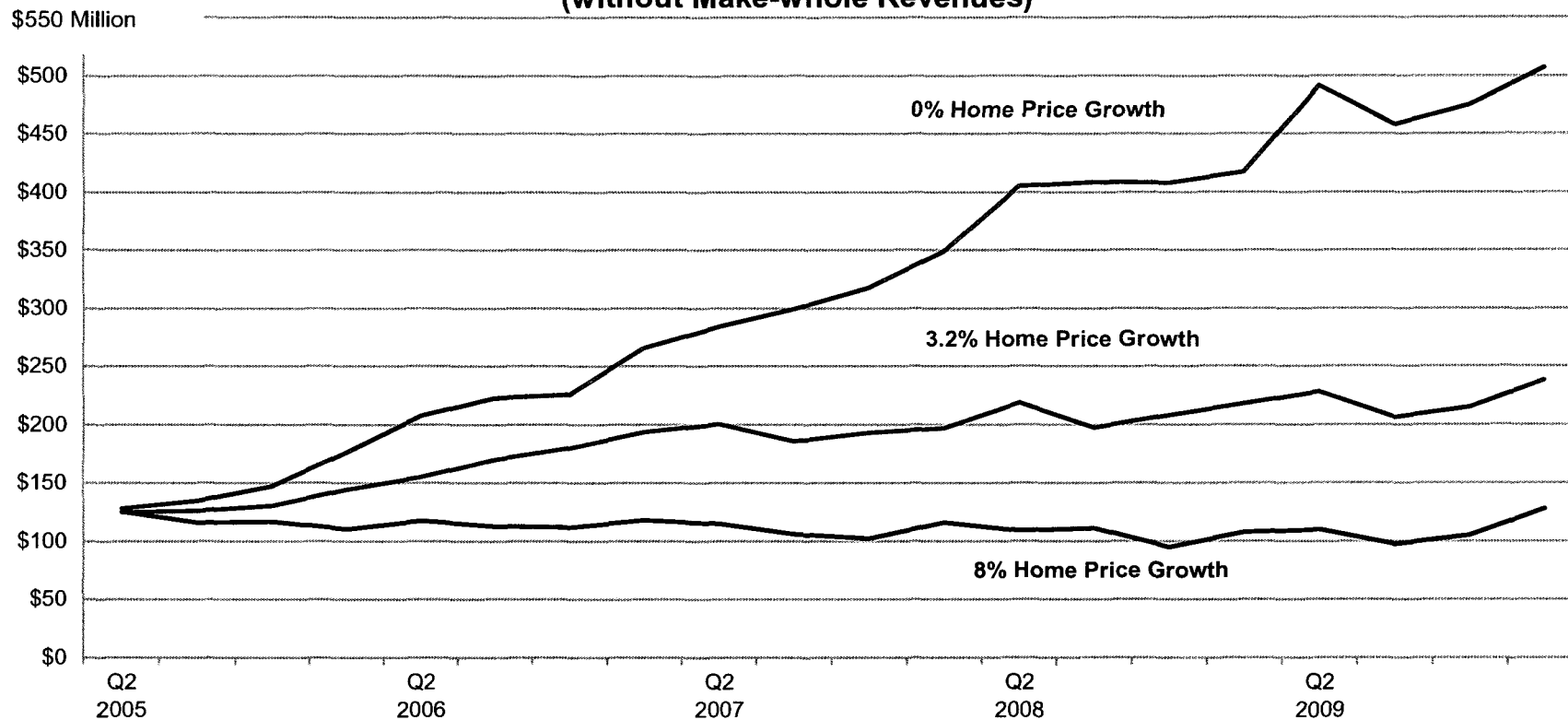
During the last year, many of the MSAs that experienced a high annual increase in investor share (in excess of 4%) were MSAs that also experienced high home price growth (in excess of 15%).

**Increase in Investor Share vs. HP Growth among top 100 MSAs**



# High home price growth tends to reduce credit losses

**Forecasted Credit Losses Under Alternative National Home Price Growth Scenarios (without Make-whole Revenues)**



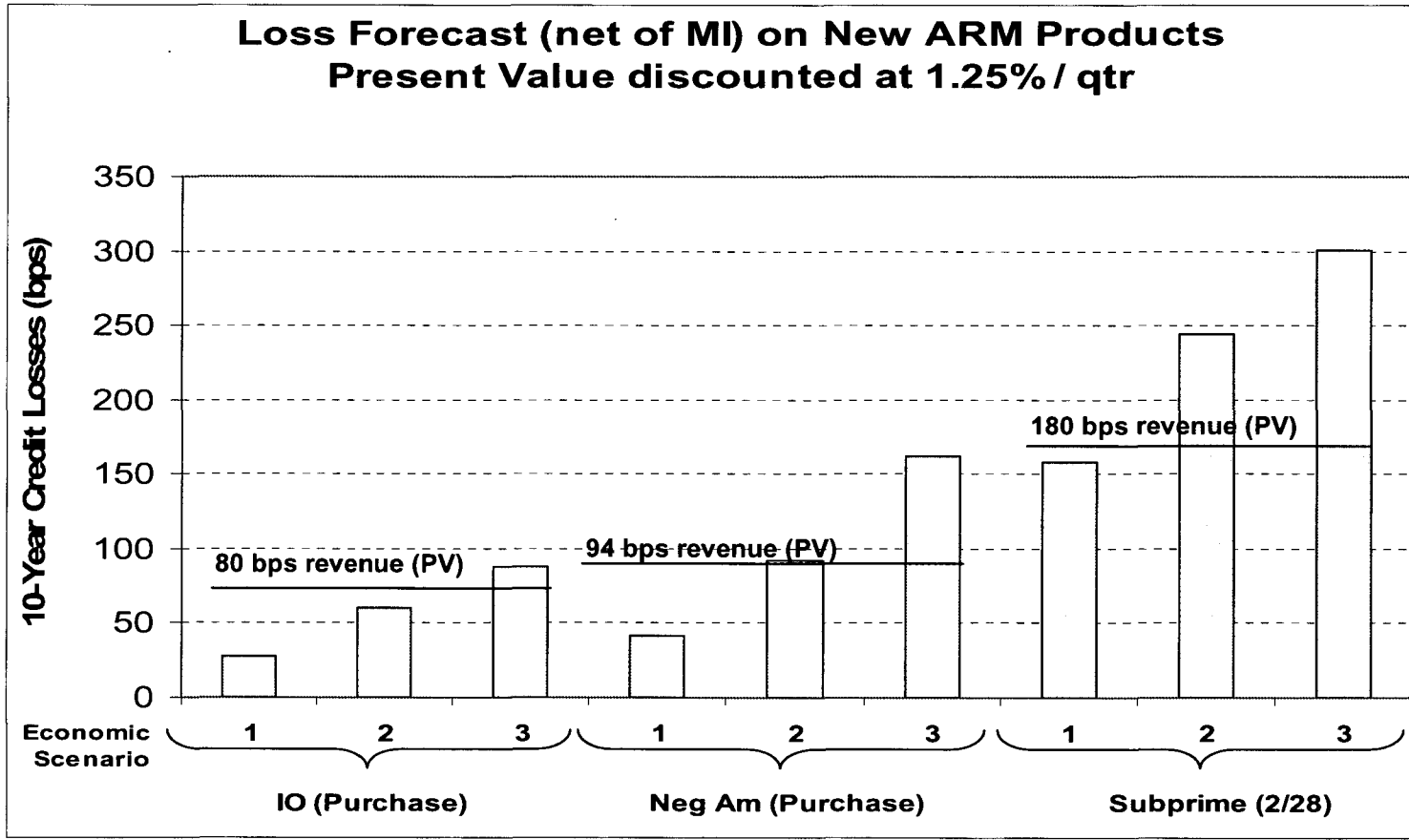
Source: 2005Q2 Loss Forecast Model (LFM) production runs.  
 All loss figures are as of default date and include charge-off, foreclosed property expense, and foregone interest.

Fannie Mae

Proprietary and Confidential

# Credit losses on new ARM products would vary under different economic scenarios

- Losses were forecast on new ARMs in three different economic scenarios:**
1. Corporate Forecast: House prices up 3-4% annually, interest rates up 1% in 1st 5-years
  2. Housing Recession in overpriced regions, interest rates increase 1.1% in 1st 5-years
  3. Housing Recession in overpriced regions, interest rates increase 5% in 1st 5-years



# Single Family Facts and Data

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## Emerging Products and Product Definitions

# Emerging Products: Market View and Fannie Mae Participation

	2003				
	ARM	Low & No Doc	Investor	2nd Home	IO ARMs
	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)
Prime Conventional Conforming	18.2%	16.7%	6.5%	5.1%	NA
Subprime	80.6%	42.8%	7.2%	1.3%	9.1%
Alt-A	44.0%	65.0%	18.1%	3.9%	25.1%
FNM Participation	13.9%	8.5%	5.5%	5.5%	1.1%
% FNM Participation via Inv. Chan	28.7%	77.7%	26.2%	9.0%	47.7%

	2004				
	ARM	Low & No Doc	Investor	2nd Home	IO ARMs
	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)	(Share of \$ Volume)
Prime Conventional Conforming	30.8%	22.3%	8.1%	6.5%	NA
Subprime	88.1%	44.8%	7.5%	1.5%	23.9%
Alt-A	71.1%	57.6%	18.2%	4.7%	50.3%
FNM Participation	24.9%	10.1%	5.6%	7.0%	7.6%
% FNM Participation via Inv. Chan	33.6%	80.6%	40.9%	14.8%	71.7%

In 2003, IO ARMs accounted for just 1.1% of FNM's purchase money mortgage acquisitions. In 2004, they accounted for 7.6%

Source: Economics and Mortgage Market Analysis using Loan Performance.

- Shares of ARMs, Investor and Low Doc products have increased from 2003 to 2004 as measured by purchase money mortgage originations.
  - FNM product shares of ARM, I/O, Low Doc are trailing behind market share.
  - Investor Channel is driving I/O and Low Doc volume.
- Alt A and Subprime are more concentrated in these products.

## Product Definitions

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- **Interest Only** - A mortgage in which the borrower makes monthly payments for a specified period that cover only the interest due on the loan. During the Interest Only period, the outstanding principal balance of the loan does not decline. After the initial interest only period, the monthly payment is increased to an amount sufficient to fully amortize the outstanding balance over the remaining term of the loan.
- **Hybrid ARM** - A mortgage loan that has an initial fixed rate period, after which the mortgage loan converts to an adjustable rate. An example of a Hybrid ARM is a 2/28 mortgage loan. This is a 30 year adjustable mortgage program, except that the first interest rate adjustment does not occur until 2 years into the loan. Once the loan converts to an ARM, the interest rate adjusts periodically (typically monthly, semi-annually or annually) based on a particular interest rate index (e.g., LIBOR, 1-Yr Treasury).
- **Negative Amortization Adjustable-Rate Mortgage (Neg Am)** - An adjustable rate mortgage that provides for a fixed monthly payment even if the interest rate on the loan changes. Typically, the interest rate on a neg am loan adjust monthly, while the payment stays fixed for a year. If the interest rate increases in a given month such that the monthly payment is insufficient to cover both principal and interest then due, the interest shortage is added to the unpaid principal balance of the mortgage to create "negative" amortization. Most neg am loans have a cap on the maximum amount that can be added to the loan balance over the life of the loan.
- **Option ARM** - An adjustable rate mortgage that gives the borrower various payment options each month. In a typical Option ARM, borrowers have the option to make a minimum payment, which could result in negative amortization if the minimum payment is not enough to cover interest due (similar to the minimum payment on a credit card). They also have the option to make interest-only payments or fully amortizing payments. The expanded payment options give the borrower more leeway to qualify for a mortgage. The 12 month Treasury Average (MTA) is the most common index used with option ARM loans; however, some lenders also offer LIBOR, the 1-Year Treasury Bill, and the 11<sup>th</sup> District Cost of Funds (COFI) as indices.