Mortgage Market Note

U.S. Treasury Support for Fannie Mae and Freddie Mac

January 20, 2010

MORTGAGE MARKET NOTE 10-1 (UPDATE OF MORTGAGE MARKET NOTES 09-1 AND 09-1A)

I. Introduction

The Housing and Economic Recovery Act of 2008 (HERA) authorized the Secretary of the Treasury to support Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs) by purchasing obligations and other securities from those government-sponsored enterprises (collectively, the housing GSEs). HERA gave the Secretary broad authority to determine the conditions and amounts of such purchases.

On September 7, 2008, the Treasury Department exercised that authority by initiating individual Senior Preferred Stock Purchase Agreements (SPAs) through the Federal Housing Finance Agency (FHFA) as conservator with Fannie Mae and Freddie Mac (the Enterprises). In addition, the Treasury Department established two special facilities to purchase obligations of the housing GSEs: one to purchase GSE-guaranteed mortgage-backed securities (the GSE MBS Purchase Facility) and the other to purchase GSE debt (the GSE Credit Facility). The programs established by the Treasury Department under HERA were intended to improve investor confidence in the ability of each housing GSE to continue to provide liquidity to mortgage markets and to meet its obligations. Investor confidence is essential to liquid and well-functioning mortgage markets, which in turn benefit homeowners and qualified mortgage borrowers by lowering borrowing costs and supporting home prices.

On May 6, 2009, amendments were made that, relative to the initial agreements, doubled the Treasury commitment to each Enterprise, increased the maximum size of each Enterprise's retained mortgage portfolio, and allowed each Enterprise to increase its indebtedness. On December 24, 2009, the Treasury Department announced further amendments to the SPAs which included additional financial support for each Enterprise through the end of

2012 and changes to the limits on their retained mortgage portfolios. Also on December 24, the Treasury also confirmed the expiration of the GSE MBS Purchase Facility and the GSE Credit Facility.

The Federal Reserve also has supported the Enterprises and the mortgage markets. On November 25, 2008, the Federal Reserve announced it would purchase $100 billion of debt issued by the housing GSEs and $500 billion of MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. On March 18, 2009, the Federal Reserve increased those commitments to $200 billion for the purchase of housing GSE debt and $1.25 trillion for the purchase of MBS. On November 4, 2009, the Federal Reserve reduced its commitment to purchase GSE debt to $175 billion. The Federal Reserve expects that its purchases of both GSE debt and MBS will extend through March 2010.

This Mortgage Market Note answers three basic questions about the SPAs:

- What do they do?
- How do they work? and
- When do they expire?

In addition, this Mortgage Market Note answers the following questions about the expired GSE Credit Facility and GSE MBS Purchase Facility:

- What did they do?
- When did they expire?

II. Senior Preferred Stock Purchase Agreements

What they do

The SPAs are the cornerstone of the financial support that the Treasury is providing to Fannie Mae and Freddie Mac. The SPAs effectively provide a very long-term federal guarantee to existing and future debtholders. As amended on December 24, 2009, each SPA commits the Treasury to provide additional support to each Enterprise through the end of 2012 in exchange for senior preferred shares. Treasury's financial commitment now equals the greater of $200 billion or $200 billion plus cumulative net worth deficits experienced during 2010, 2011, and 2012, less any surplus remaining as of December 31, 2012. Treasury's commitment protects the credit interests of all holders of the

Enterprises' senior and subordinated debt and MBS with no expiration date.

How they work

The SPAs effectively guarantee senior and subordinated debt and Enterprise-guaranteed MBS by ensuring the solvency of each Enterprise. If an Enterprise's liabilities exceed its assets under generally accepted accounting principles, the Treasury must provide sufficient cash capital to eliminate that deficit in exchange for senior preferred stock. The SPAs legally bind the U.S. government, through the Department of the Treasury, to provide the necessary capital under the stated conditions. The FHFA is responsible for determining the net worth position of each Enterprise and whether the Treasury's obligation has been triggered.

In return for the support provided through the SPAs, Fannie Mae and Freddie Mac provided certain compensation to the Treasury and accepted various restrictions. The compensation to the Treasury initially included the issuance by each Enterprise of $1 billion in senior preferred stock and warrants for the purchase of common stock representing 79.9 percent of its outstanding common stock. The Treasury receives annual dividends on the senior preferred stock of 10 percent if paid in cash or 12 percent if paid in additional senior preferred stock. In addition, beginning January 1, 2011, the Treasury is entitled to receive from each Enterprise a commitment fee as compensation for the explicit support provided by the SPA.

The SPAs also restrict each Enterprise from issuing debt in excess of 120 percent of the amount of mortgage assets it is permitted to own.[1] Further, each Enterprise's retained mortgage portfolio may not exceed $900 billion as of December 31, 2009. In subsequent years, the maximum retained mortgage portfolio will decline by 10 percent per year from $900 billion until it reaches $250 billion, which would occur in 2022.[2] As of October 31, 2009, both Enterprises' retained portfolios were below the 2010 maximum of $810 billion with Fannie Mae holding retained mortgage assets of $771 billion and Freddie Mac holding retained mortgage assets of $770 billion.

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[1] These debt and portfolio limits were set in amendments to the SPAs formalized on May 6, 2009. The May 6 amendments also doubled the Treasury commitment to each Enterprise from $100 billion to $200 billion. The Treasury had announced that increase on February 18, 2009.

[2] The portfolio limits over subsequent years were set in amendments to the SPAs formalized on December 24, 2009.

When they expire

The Treasury's commitment to provide capital to an Enterprise pursuant to their SPA has no set expiration date. That commitment terminates only when one of the following events occurs:

- The Treasury has provided the full commitment of the greater of $200 billion or $200 billion plus cumulative net worth deficits experienced during 2010, 2011, and 2012, less any surplus remaining as of December 31, 2012.
- The Enterprise liquidates its assets. In the event of such a liquidation, the Treasury will fund any capital deficiency up to its commitment under the SPA. After that final funding, the funding commitment in the SPA would terminate.
- The Enterprise has repaid, defeased, or made other provision for all its mortgage guarantee obligations and debts.

The Justice Department has issued an opinion that each SPA creates a binding obligation on the United States to provide the financial backstop set forth therein, without time limit, for the duration of the SPA and the liabilities protected by the SPA.[3] Thus, the Treasury's commitment to provide capital to Fannie Mae and Freddie Mac is enforceable in federal court by the action of holders of debt issued or MBS guaranteed before or during the term of the commitment. The effective guarantee of Fannie Mae and Freddie Mac debt and MBS will continue as long as those instruments are outstanding.

III. GSE Credit Facility

What it did

The GSE Credit Facility ensured that all three of the housing GSEs had access to financing from the Treasury through the worst of the crisis. Through this facility, the Treasury stood ready to provide secured funding on an as-needed basis. The facility ensured that a lack of access to funding in the open market would not prevent a housing GSE from conducting its business, including making timely payment of interest and principal on senior or subordinated debt obligations.

[3] See http://www.usdoj.gov/olc/2008/treasury-gse-ltr-opinion.pdf.

When it expired

The facility was not used and expired December 31, 2009.

IV. GSE Mortgage-Backed Securities Purchase Facility

What it did

The GSE MBS Purchase Facility provided a mechanism through which the Treasury could make unlimited purchases in the open market of MBS guaranteed by Fannie Mae and Freddie Mac. Such purchases were intended to help improve the liquidity and stability of the secondary market for U.S. residential mortgages, which, in turn, improved the availability of mortgage credit to homebuyers, mitigated upward pressures on mortgage rates, and supported home prices through the worst months of the crisis.

The Treasury purchased about $220 billion in Enterprise MBS from September 2008 through the December 2009.

When it expired

The Treasury authority to make new purchases through the facility expired on December 31, 2009. However, the Treasury continues to hold a portfolio of Enterprise MBS purchased through the facility.

More Information
(Active web link below)

[Current data on Treasury and Federal Reserve Purchase Programs for GSE and Mortgage-Related Securities]