



**Office of Federal Housing Enterprise Oversight
(OFHEO)**

NEWS RELEASE

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For Immediate Release

November 15, 2007

**OFHEO RELEASES 2007 PERFORMANCE AND
ACCOUNTABILITY REPORT**

Washington, DC – OFHEO Director James B. Lockhart today released the agency's 2007 Performance and Accountability Report (PAR). The report details OFHEO's operations and accomplishments as the safety and soundness regulator for Fannie Mae and Freddie Mac in the fiscal year ended September 30, 2007.

"I am pleased to submit this report detailing our operations, financial performance and the challenges ahead," said Lockhart. "This report comes at a time of great uncertainty in the U.S. housing markets, further underscoring the importance of the agency's mission, our accomplishments this past year and the need for legislative reform going forward."

For the tenth straight year, OFHEO received a clean audit opinion from the agency's external auditors and achieved numerous other accomplishments, detailed in the report:

- OFHEO continued to strengthen its operations and standards across all aspects of its supervision program. It published a major update to its Supervision Handbook, which outlines the agency's supervisory program to examine the Enterprises, and published three new examination guidances.
- The agency worked with other federal regulators and took proactive steps to help ease the impact of volatility in the mortgage markets, including implementing the subprime and nontraditional mortgage guidances.
- Oversight of remediation efforts at the companies proceeded but at the end of the reporting period neither Fannie Mae nor Freddie Mac had completed all of the items in their consent orders.
- In addition to OFHEO's continuous supervision and

examination, in FY 2007, OFHEO conducted 40 targeted examinations of the Enterprises including reviews of internal audit planning and guarantee fee pricing models.

- 94 percent of the Matters Requiring Attention (MRAs) in the examination process that were due were completed by the Enterprises and validated by OFHEO.
- OFHEO resolved the enforcement actions against former executives at Freddie Mac and filed a Notice of Charges against three former executives at Fannie Mae.
- The agency made significant progress on the President's Management Agenda (PMA) during FY 2007, including committing to five government-wide PMA initiatives.
- The agency's 2006 OMB Program Assessment Rating Tool (PART) assessment, published in February 2007, found that OFHEO has improved its effectiveness, and that the agency's key obstacle is the lack of legislation to strengthen its regulatory powers.
- OFHEO updated its Continuity of Operations (COOP) Plan, which identifies essential functions and alternate plans in an emergency.
- OFHEO published a Human Capital Strategic Plan and enhanced recruitment efforts in order to fill numerous vacancies and ensure a strong agency workforce.
- OFHEO launched a revamped and updated website with improved features and easier navigation.
- OFHEO published a Technology and Information Management Five-Year Strategic Plan.

The report provides a three-part summary of OFHEO's operations, progress toward achieving the agency's goals and a financial summary for FY 2007.

"As this report shows, this agency has accomplished much but the challenges facing OFHEO, Fannie Mae, Freddie Mac and all stakeholders in the nation's housing markets will continue in the year ahead," said Lockhart. "Enhanced supervision and the legislation needed to strengthen GSE oversight are crucial to prevent a recurrence of past problems and potentially more serious ones in the future."

The PAR report in PDF format follows.

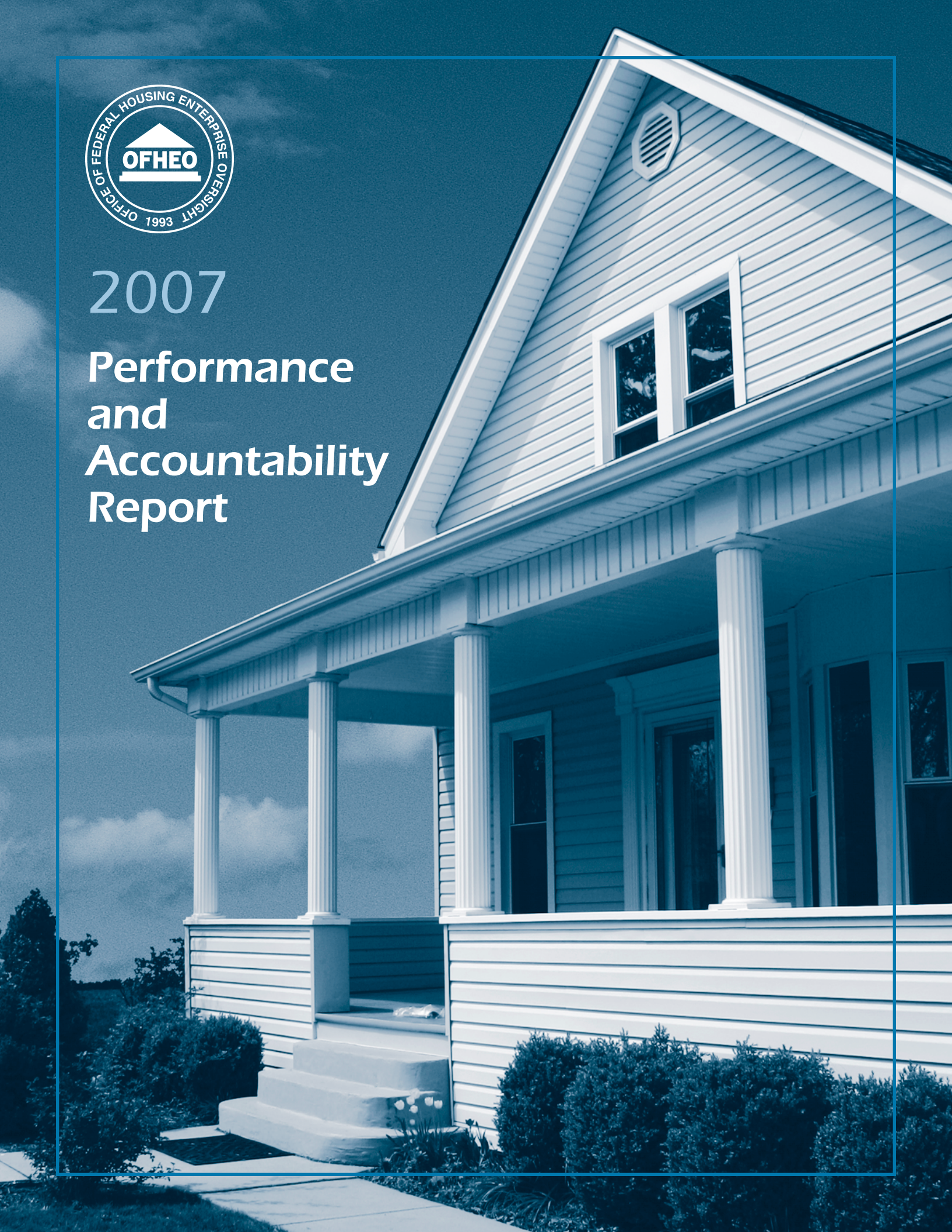
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OFHEO's mission is to promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.



2007

Performance and Accountability Report





OFHEO

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Office of Federal Housing Enterprise Oversight

2007

Performance and Accountability Report

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Message from the Director

On behalf of OFHEO's dedicated employees, it is a pleasure to submit this report which reviews our 2007 progress and accomplishments. For the tenth straight year, OFHEO received an unqualified opinion of our audited accounts. As detailed in this report, we also substantially achieved our performance goals. This report comes at a time of great uncertainty in the U.S. housing markets, further underscoring the importance of OFHEO's mission and the need for legislative reform.



Mission

OFHEO's primary mission is to ensure the safety and soundness of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac and promote housing and a strong national housing finance system. On a combined basis the GSEs own or guarantee \$4.7 trillion of mortgage debt, representing 40 percent of the total residential mortgages outstanding in the United States. Over the years, the Enterprises have been an important element in the growth of the mortgage market. Despite the Enterprises ongoing accounting, systems, internal control and risk management problems, and because of regulatory constraints placed upon them by OFHEO, the Enterprises were able to play a critical role in ensuring the liquidity in the conforming loan market during August and September. As a result, their mortgage market share grew to over 60 percent in the third quarter of 2007. The year 2007 also saw progress by the Enterprises toward correcting their problems, but more needs to be done. In addition, as their internal problems that have lasted for many years and this year's market turbulence and growing credit losses point out, there is a pressing need for a stronger regulator.

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 set for itself eight annual performance goals to reach these strategic goals and four annual performance goals to support its resource management strategy. To measure results in achieving goals, there were 34 performance measures for fiscal year 2007, 97 percent of which were achieved or substantially achieved.

Market Turmoil

Uncertainty and instability in the mortgage markets have captured the attention of OFHEO and the nation in the past year. Problems in the subprime and nontraditional mortgage markets have been especially troublesome for many homeowners. After a rapid three-year growth, beginning in the late fall of 2006, originations of subprime mortgages have declined, many of the top subprime lenders have left the business and delinquencies and foreclosures have risen dramatically. OFHEO has been monitoring developments closely and has taken several steps to enhance the Enterprises' ability to assist borrowers while still ensuring that Enterprise operations remain safe and sound. OFHEO worked closely with the federal banking regulators, the White House, the Treasury Department and the Department of Housing and Urban Development. OFHEO directed Fannie Mae and Freddie Mac to comply with interagency guidelines on nontraditional and subprime mortgages. The guidelines, developed by the federal banking agencies, are designed to reduce risks to borrowers and reduce future mortgage market volatility. By applying the guidelines to mortgages purchased directly by Fannie Mae and Freddie Mac and indirectly through their purchases of private-label mortgage-backed securities, the guidelines are being uniformly applied throughout most of the primary and secondary mortgage market.

The final months of fiscal year 2007 brought much discussion about the retained mortgage portfolio caps that OFHEO put in place in 2006 because of operational, risk management and financial reporting problems at the companies. OFHEO decided not to allow any major increases in the portfolios because of the ongoing operational risk, market risk and growing credit risk, which are primary safety and soundness concerns. However, OFHEO did provide additional flexibility to enhance the Enterprises' ability to purchase or securitize subprime mortgages, refinanced mortgages for borrowers with lower credit scores and affordable multifamily housing mortgages. This flexibility, along with their ongoing ability to securitize, sell assets and replace maturing assets, enables Fannie Mae and Freddie Mac to buy and securitize tens of billions per month in subprime rescue mortgages without further increasing the portfolio caps.

Enterprises' Remediation

OFHEO is focused on overseeing Fannie Mae and Freddie Mac's remediation of the problems that led to the portfolio caps in the first place. When OFHEO completed its special examinations at the Enterprises, each company was directed to address accounting, internal controls, risk management, governance and financial reporting problems. In 2007, both Enterprises continued to make progress, but neither company has completed all of the items identified in their consent orders. Both Enterprises expect to begin filing timely, audited financial statements in February 2008. OFHEO will lift the portfolio caps once they have fully resolved their pertinent safety and soundness issues. Subsequent to the lifting of the caps, OFHEO will also review the 30 percent additional capital requirement. These actions will create further need for enhanced regulator oversight from a stronger regulator as proposed in comprehensive GSE reform legislation currently pending before Congress.

Legislation

OFHEO has continued to strongly support enactment of legislative reform to strengthen GSE oversight. During the past year, the agency worked with the Bush Administration, Congress and interested parties on legislation that will provide bank regulator-like powers to a new GSE regulator overseeing Fannie Mae, Freddie Mac and the Federal Home Loan Banks. The House of Representatives passed, on a bipartisan basis, GSE regulatory reform legislation (H.R. 1427) in May 2007. It is a balanced bill that will strengthen the nation's housing finance system by enhancing oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. It is my hope that the Senate will complete its work on this important legislation soon.

Litigation

Litigation activities represented 25 percent of OFHEO's 2007 resources as the agency pursues administrative enforcement actions against former officers of Freddie Mac and Fannie Mae and responds to subpoenas in shareholder lawsuits. The agency filed a Notice of Charges against three former Fannie Mae executives in December 2006. Hearings are to begin in 2008. Hearings in a case against former Freddie Mac CEO Leland Brendsel began in October of 2007, which resulted in a consent order in November of over \$16 million that included fines to the U.S. government, income disgorgement and the dropping of claims against Freddie Mac for additional compensation.

Improved Supervision

Despite limitations with OFHEO's current statutory framework, the agency continued to strengthen its supervisory operations and standards and to review the Enterprises' risks and risk management throughout 2007. OFHEO completed its annual examinations of Fannie Mae and Freddie Mac, issued its Report to Congress two months earlier than required and monitored the progress each Enterprise made in resolving weaknesses and returning to timely financial reporting. In January 2007, OFHEO completed an updated Supervision Handbook improving the scope and transparency of the supervision program. In addition, OFHEO made improvements by establishing new groups for quality assurance and financial analysis.

President's Management Agenda

As OFHEO continues to monitor Fannie Mae and Freddie Mac's efforts to improve management practices, it is important that we also adopt best practices in managing ourselves. During 2007, OFHEO made management improvements consistent with the President's Management Agenda (PMA). Some of the major management accomplishments include a new Human Capital Strategic Plan, significant improvements in the pay-for-performance system, a new Information Technology

Strategic Plan, certification and accreditation of all major systems, and a new Continuity of Operations (COOP) plan. During the fiscal year, OFHEO made a commitment to embrace the five government-wide PMA initiatives and implement them according to the standards set by the Office of Management and Budget (OMB). Managing under the principles of the PMA, the agency has already made substantial progress in achieving efficiencies and producing results.

Program Data and Financial Performance

OFHEO's FY 2007 Performance and Accountability Report contains performance and financial data that are complete and reliable, with the exceptions noted in Chapter 2. The details of management assurances can be found in the Compliance with Laws and Regulations section in Chapter 1.

Conclusion

The challenges facing OFHEO, Fannie Mae and Freddie Mac and all stakeholders in the nation's housing market continue to grow. I remain impressed with the abilities and commitment of OFHEO's employees to accomplish the agency's important mission. The challenges will persist in fiscal year 2008 as credit conditions in the housing market continue to be a concern and as Fannie Mae and Freddie Mac continue their remediation efforts. Enhanced supervision of the Enterprises and the legislation needed to strengthen GSE oversight will be crucial to prevent a recurrence of past problems and the appearance of potentially more serious ones in the future.

A handwritten signature in blue ink that reads "James B. Lockhart III". The signature is written in a cursive style with a double underline at the end.

Director

Management's Discussion & Analysis

OVERVIEW

The Office of Federal Housing Enterprise Oversight (OFHEO) issues a Performance and Accountability Report (PAR) to improve transparency and 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) 2007:

Chapter One: Management's Discussion and Analysis

- ▲ *Explains OFHEO's purpose and structure*
- ▲ *Provides highlights of the year's accomplishments*
- ▲ *Describes challenges the agency faces*
- ▲ *Summarizes OFHEO's performance*
- ▲ *Presents a financial summary for FY 2007*

Chapter Two: Performance Section

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

Chapter Three: Financial Section

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

About OFHEO

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent entity within the Department of Housing and Urban Development (HUD) by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*). The agency is headed by a Director appointed by the President for a five-year term. James B. Lockhart III was nominated and appointed as Acting Director by President George W. Bush in May 2006, and was confirmed as the Director of OFHEO by the U.S. Senate in June 2006.

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), Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation). OFHEO works to ensure the capital adequacy and financial safety and soundness of these two GSEs, also known as the Enterprises. Although appropriated by Congress, OFHEO is funded through assessments on Fannie Mae and Freddie Mac and its operations represent no direct cost to the taxpayer.

OFHEO's Organizational Structure

OFHEO is led by the Director, who sets the direction for OFHEO to achieve its mission of ensuring the safety and soundness of Fannie Mae and Freddie Mac. At the end of the fiscal year, OFHEO had a staff of 236 employees. In addition, OFHEO is actively recruiting to fill over 40 vacancies. The large percentage of vacancies is primarily a function of uncertain funding in 2007 caused by a continuing

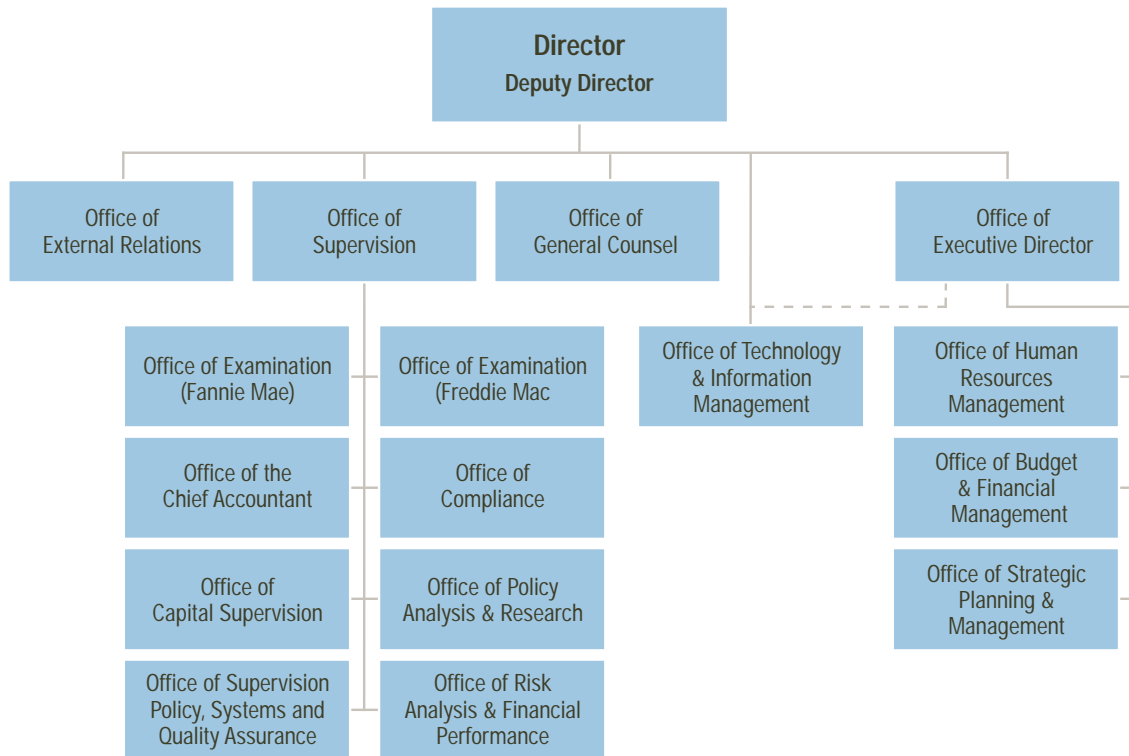


Figure 1 – Organization Chart for OFHEO

resolution. OFHEO's operations are structured efficiently to accomplish its mission with a relatively small staff. Its component offices have specific responsibilities and work together to ensure effective oversight of Fannie Mae and Freddie Mac.

OFHEO's Office of Supervision is responsible for the agency's examinations of the Enterprises, identification of matters requiring attention or enforcement, compliance efforts, capital adequacy determinations, and policy and research functions. The Director of the Office of Supervision coordinates and oversees a wide range of supervision activities through the efforts of eight component offices (see Figure 1), including two new offices established in FY 2007. The Office of Supervision Policy, Systems and Quality Assurance was established early in the year to implement a quality assurance program for the agency's examinations and supervision process. The Office of Risk Analysis and Financial Performance, established at the same time, was created to monitor trends and analyze both market data and the Enterprises' financial performance in support of the supervision and oversight process.

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 the General Counsel is also responsible for coordinating enforcement actions through the courts with the Department of Justice.

The Office of External Relations works with OFHEO's external stakeholders to ensure effective communication by responding to public, media and congressional inquiries and releasing pertinent information to the public.

The Office of the Executive Director is responsible for OFHEO-wide management and oversight of all administrative matters. The Office of the Executive Director coordinates its component offices – with responsibilities that include human capital management, budget and financial management, and strategic planning and management – in support of the entire agency.

The Office of Technology and Information Management is responsible for ensuring the integrity, confidentiality and availability of OFHEO's information systems and assets. The office is also responsible for developing information systems, providing support to OFHEO employees on information technology systems and maintaining information security.

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

Congress established Fannie Mae and Freddie Mac to perform an important role in the nation's housing finance system – to provide liquidity and stability to the secondary mortgage market including activities that support affordable housing for low- and moderate-income families. The Enterprises provide liquidity (ready access to funds on reasonable terms) to the thousands of banks, savings and loans, and mortgage companies that make loans to finance housing. Fannie Mae and Freddie Mac buy mortgages from lenders and either hold these mortgages in their portfolios or package the loans into mortgage-backed securities (MBS) that are sold to the public. The Enterprises also buy for their portfolio their own, other agency and private-label MBS. Lenders use the cash raised by selling mortgages to the Enterprises to engage in further lending. The Enterprises' purchases help ensure that individuals and families who buy homes and investors who purchase apartment buildings and other multifamily dwellings have a continuous, stable supply of mortgage money.

By packaging mortgages into MBS and guaranteeing the timely payment of principal and interest on the underlying mortgages, Fannie Mae and Freddie Mac attract to the secondary mortgage market investors who might not otherwise invest in mortgages, thereby expanding 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 threaten the economy. Further, a majority of the mortgages purchased by Fannie Mae and Freddie Mac finance dwelling units that are affordable to low- and moderate-income households, or are located in geographic areas that the Department of Housing and Urban Development has designated as underserved. The Enterprises' support for mortgage lending that finances affordable housing reduces the cost of such borrowing. At the end of the third quarter of 2007, they had \$3.2 trillion in MBS held by others and \$1.4 trillion in their retained mortgage portfolios. Their combined market share of residential mortgage debt outstanding was 40 percent at the end of the second quarter of 2007.

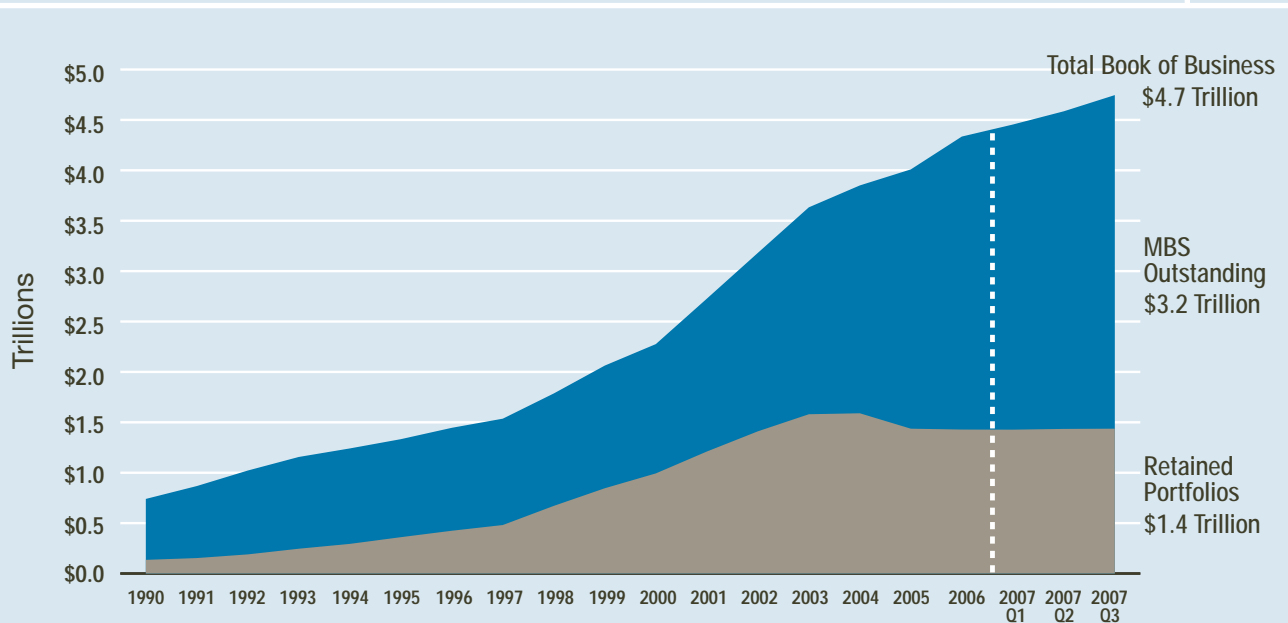
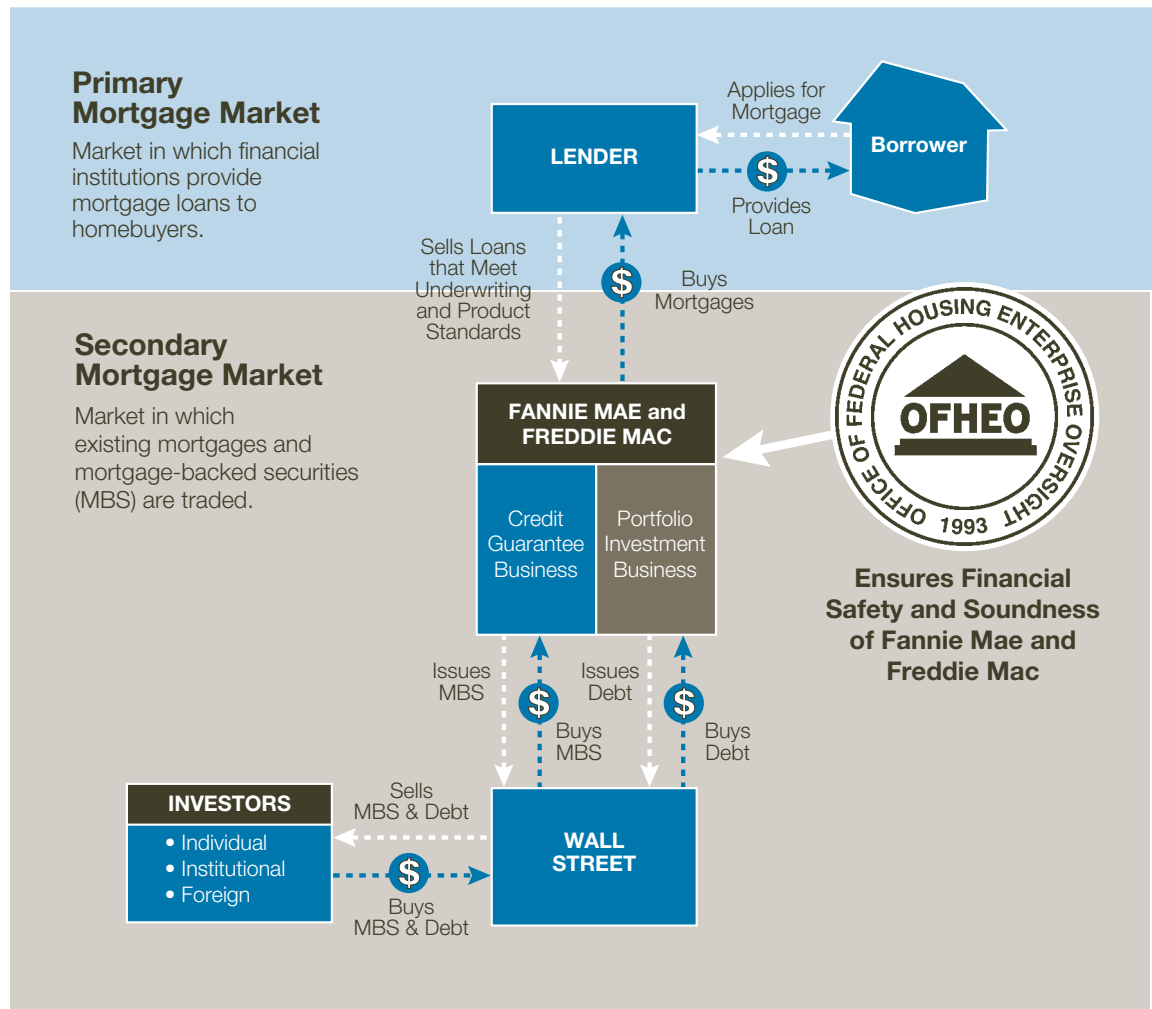


Figure 2 – Enterprises' Combined Total Book of Business, 1990 – 2007Q3

Figure 3 – OFHEO’s Oversight Role



Performance Highlights

OFHEO Enhances Oversight of the Enterprises

During FY 2007, OFHEO has made significant enhancements to its oversight and supervision of the Enterprises. The agency has improved its examination process and issued new guidances.

To enrich its ongoing examination of the Enterprises in FY 2007, OFHEO began a concerted effort to conduct “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. 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 FY 2007, as a complement to continuous supervision activities, OFHEO conducted 40 targeted examinations including reviews of an Enterprise’s internal audit planning process and guarantee fee pricing models. As part of the examination process, OFHEO also identified numerous problems that each Enterprise needed to correct. The Enterprises and OFHEO agreed to a

time frame for the corrections to be made and OFHEO closely monitored these Matters Requiring Attention (MRAs). In FY 2007, 94 percent of the MRAs that were due were completed by the Enterprises and validated by OFHEO.

In January 2007, OFHEO published a revised and updated Supervision Handbook. 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 this year.

In November 2006, OFHEO published three new examination guidances—corporate governance, compensation practices and accounting practices—that outline the safety and soundness standards the agency uses to evaluate the Enterprises. Guidances are made available on the OFHEO website and add transparency and clarity to the supervision process. These guidances were designed to prevent a recurrence of the problems identified in the special examinations of Fannie Mae and Freddie Mac by addressing the responsibilities and conduct of Enterprise boards and senior management with regard to compensation, risk management, internal controls and accounting.

OFHEO published proposed guidance on the conforming loan limit in June 2007 and solicited comments from the public and industry stakeholders. The conforming loan limit is the maximum size loan that the Enterprises can buy from lenders. OFHEO's guidance outlines the process for calculating the conforming loan limit, including procedures for years in which house price levels decline. After considering comments on the proposed guidance, in October 2007, the agency published in the *Federal Register* a revision to the proposed guidance for comment. More information on the conforming loan limit can be found on OFHEO's website.

OFHEO Takes Action on Nontraditional and Subprime Lending

Foreseeing the deterioration in the housing finance market, particularly the subprime mortgage market, OFHEO has sought proactive ways to both help stabilize the market and prevent similar problems in the future. The feature on the subprime mortgage market in 2007 on page 13 provides further details on the recent market disruption.

Fannie Mae and Freddie Mac have played a large role in the subprime market through the purchase of AAA-rated private-label mortgage-backed securities (MBS) backed by subprime mortgages. As of June 30, 2007, they held \$170 billion of these securities. Although the value of private-label MBS has declined, the Enterprises are still expecting minimal losses because they invested almost exclusively in the highest credit quality (AAA) tranches. To a smaller extent, the Enterprises also buy and hold subprime mortgages directly. OFHEO has continued to encourage Fannie Mae and Freddie Mac to purchase safe and sound rescue mortgages—loans that enable qualified borrowers who are in trouble or risk foreclosure to refinance their mortgage loans facing high resets in interest rates. These rescue loans typically also require the homeowner to receive training or credit counseling. Along with the other federal financial institution regulators, OFHEO encourages loan modifications rather than foreclosures, whenever possible.

The Enterprises committed that in the next few years they will purchase refinanced loans of more than \$40 billion made to current subprime borrowers. Over time, these purchases should help reduce some of the distress in the subprime market. Through normal runoff from loan prepayments and amortization, securitization and the portfolio cap flexibility granted on September 19, 2007, Fannie Mae and Freddie Mac have the ability to help finance tens of billions of new or refinanced subprime loans each month, while maintaining a strong presence in the secondary market for prime mortgages. The Enterprises have regular and special programs that may provide attractive alternatives for some subprime borrowers exposed to payment shock. OFHEO has been monitoring the Enterprises closely to ensure that they make and manage these purchases in a safe and sound manner.

OFHEO has taken several actions to protect borrowers and ensure that the Enterprises are buying quality loans. In December 2006, OFHEO directed Fannie Mae and Freddie Mac to comply with the *Interagency Guidance on Nontraditional Mortgage Product Risks* issued by the bank regulators in September 2006. Additionally, at OFHEO's request, the Enterprises each notified their mortgage originators that after September 13, 2007, they would only buy mortgages that comply with the guidance, which includes:

- ▲ an evaluation of the borrower's ability to pay the mortgage loan at the fully-indexed rate, assuming a fully amortizing repayment schedule;
- ▲ limitations on reduced documentation requirements for such mortgages;
- ▲ limitations on risk-layering without compensating factors;
- ▲ a focus on improved consumer disclosure; and
- ▲ strengthened portfolio and risk management practices.

OFHEO also required the Enterprises to follow the *Interagency Statement on Subprime Mortgage Lending*, which was issued in final form by the bank regulators in June 2007. The statement primarily focuses on adjustable-rate loans that have low initial rates and then move to higher interest rates after just a few years, causing payment shock for the borrower. The statement advises that underwriting standards should qualify potential borrowers not at an artificially low initial or teaser rate, but at the fully-indexed, fully-amortized rate. In addition, the guidance cautions against the use of "stated income" and low-documentation subprime loans and recommends limitations on the length of time in which a prepayment penalty applies. Both Fannie Mae and Freddie Mac announced their compliance with the statement through communications to their dealers and sellers. The Enterprises also announced, at OFHEO's direction, that they would apply this guidance not just to the mortgages that they purchase directly, but also to any mortgages that underlie private-label MBS that they may purchase. In this way, OFHEO and the Enterprises will ensure that these guidelines will be implemented for both regulated and nonregulated mortgage lenders.

Subprime Mortgage Market

Over the past year, the \$1.2 trillion subprime mortgage market has suffered severe turbulence and uncertainty. Subprime mortgages are made to borrowers who have impaired credit. As the volume of subprime loans tripled from 2002 to 2006, the most prevalent type of subprime mortgage loan shifted from fully amortizing loans to nontraditional products, including lower teaser rate, interest-only or negative amortization loans. The shift in loan products compounded by the effects of weakened underwriting standards in the mortgage industry and weaker housing markets across the nation severely affected the ability of some homeowners with subprime loans to keep up with their mortgage payments, refinance or sell their homes to pay off the loan. As a result, serious delinquencies—loans 90 days past due or already in foreclosure proceedings—have risen from 5.8 percent in the second quarter of 2005 to 9.3 in the second quarter of 2007. The percentage of subprime loans in foreclosure has almost doubled in that same period, from 3.3 percent to 5.5 percent. Many subprime lenders have folded, many subprime MBS have been downgraded and some subprime hedge funds have been restructured or liquidated. Expectations are that the problems in the subprime market will continue over time as many hundreds of thousands of teaser adjustable-rate subprime mortgage loans reach their payment reset dates.

A variety of factors contributed to a relaxation of credit discipline that ultimately led to the drop in mortgage market liquidity in August 2007. Subprime mortgages originated in 2005, 2006 and the first half of 2007 were poorly underwritten, as often occurs at the end of a credit cycle, and their poor performance is weighing heavily on the market. Many of those loans were adjustable-rate mortgages and consumers who obtained them apparently did not understand the extent to which their monthly payments would increase or believed that house price appreciation would allow them to refinance at a lower rate before their rate changed. Mortgage securitizers that issued private-label MBS backed by subprime loans, mortgage lenders and rating agencies focused on maintaining origination volume, rather than the quality of loans. Secondary market investors performed insufficient due diligence on many private-label MBS. Investors in those securities relied too heavily on credit ratings to assess the credit risk of the securities and often underestimated the market risk. In addition, there was a significant rise in the incidence of fraud in mortgage lending in 2006 and the first half of 2007.

Since the late fall of 2006, originations of subprime mortgages have declined sharply, with many of the top subprime lenders exiting the origination business. Subprime originations in the first half of 2007 were down nearly 50 percent from 2006 levels. More regulatory scrutiny, rising delinquencies associated with slower appreciation of, or outright declines in, house prices and diminished investor appetite for subprime mortgages were major factors contributing to that decrease. As a result, in the third quarter of 2007, issuance of subprime MBS fell 63 percent compared to the previous quarter and since the fourth quarter of 2006, private-label securitizations have declined 74 percent. Originations of other mortgages have also declined with the housing slowdown, but far less than subprime loans.

Remediation Continues at Fannie Mae and Freddie Mac

As a result of the special examinations of Fannie Mae and Freddie Mac, each Enterprise was required to make specific changes and improvements to its practices and operations through consent orders they entered into with OFHEO. Each Enterprise developed a remediation plan outlining these changes and the time frame for making them. OFHEO has been monitoring the Enterprises' implementation of the consent orders for the last several years. In FY 2007, both Enterprises continued to make consistent progress, but neither Enterprise has completed all the items.

Freddie Mac's agreement with OFHEO in December 2003 required 29 specific improvements, including improvements to its accounting and internal controls to produce timely, audited financial statements. Except for the separation of the CEO and Chairman of the Board positions, Freddie Mac is in satisfactory compliance with its consent order. Freddie Mac has presented a transition plan to address the separation of positions. In FY 2007, Freddie Mac published its 2006 financial statements and made progress in 2007 by issuing quarterly (but not timely) financial results. Major challenges in 2008 include becoming a timely filer, a registrant with the Securities and Exchange Commission (SEC) and compliant with Sarbanes-Oxley and completion of their comprehensive remediation plan.

OFHEO employees attend the annual Office of Supervision conference in November 2006.



Fannie Mae's agreement with OFHEO in May 2006 outlined 81 specific improvements, including steps to resolve accounting, internal control, corporate governance and risk management weaknesses. Fannie Mae is in compliance with 88 percent of items contained in the consent order and continues to work on the remaining items. Fannie Mae has also made progress on restatements. In December 2006, Fannie Mae restated financial results for 2002 and 2003 and

revised financial results for 2004. The Enterprise also issued financial results for 2005 and 2006 this year and plans to begin quarterly reporting for 2007 before year-end 2007. Both Enterprises have stated that they expect to publish timely, audited financial 2007 annual reports in February 2008.

In 2004, OFHEO entered into agreements with both Enterprises to hold 30 percent more capital than the minimum requirement and, in 2006, to limit the growth of their portfolios until their operational problems are resolved and they have achieved timely reporting of financial results. In September 2007, OFHEO modified the portfolio limits to provide them additional flexibility with an expectation that each Enterprise would use its flexibility to provide greater assistance to subprime borrowers. A more detailed discussion of the portfolio caps can be found in the feature on Enterprise portfolio limits on page 18.

OFHEO Sends 2007 Annual Report of Examination to Congress

OFHEO delivered its annual Report to Congress on the condition of the Enterprises in April 2007, two months ahead of schedule. OFHEO is unique among regulators as it is required by law to make public its examination findings. The report details the agency's annual examination conclusions and regulatory oversight of Fannie Mae and Freddie Mac for the calendar year 2006. The April report concluded that although both Enterprises have made reasonable progress, they remain a significant supervisory concern. OFHEO also concluded that while both Enterprises made progress toward correcting their problems, especially in systems, controls and financial reporting, such corrections took significantly more time and money than either the company or OFHEO anticipated.

The 2007 annual Report to Congress is on OFHEO's website, www.ofheo.gov.

OFHEO Pursues Litigation Against Former Enterprise Executives

OFHEO continued to pursue administrative enforcement actions against former officers of Freddie Mac and Fannie Mae arising from its special examinations.

In December 2003, OFHEO issued a Notice of Charges against former Freddie Mac CEO Leland Brendsel and CFO Vaughn Clarke. The charges described their improper management of earnings and sacrifice of risk management that led to the company's restatement. In September 2007, OFHEO entered into a consent order with former CFO Vaughn Clarke. The Administrative Law Judge began the hearing in October 2007 on the charges against Mr. Brendsel. In November, OFHEO issued a consent order that totaled \$16.4 million, including payments to the U.S. government, income disgorgement and the dropping of claims against Freddie Mac for additional compensation.

In December 2006, OFHEO filed a Notice of Charges against three former Fannie Mae executives, former Chairman and CEO Franklin D. Raines, former Chief Financial Officer J. Timothy Howard and former Controller Leanne Spencer. The charges describe how the individuals manipulated earnings to maximize their bonuses, while neglecting accounting systems and internal controls, misapplying more than 20 accounting principles and misleading the regulator and the public from 1998 to 2004. The Administrative Law Judge has set a formal hearing for 2008.

During FY 2007, OFHEO was subpoenaed in a federal district court case involving shareholder lawsuits against Fannie Mae and certain former executive officers. While OFHEO is not a party in the case, the individual respondents in this multi-district litigation (consolidated in the District of Columbia) have sought extensive discovery of information from OFHEO. The Department of Justice represents OFHEO before the court.



OFHEO releases its 2007 annual Report to Congress on the condition of the Enterprises and OFHEO's regulatory oversight during the year.



“Congress needs to get them [the GSEs] reformed.” President Bush discusses the need for GSE reform in an August 9, 2007 news conference.

Legislation to Strengthen Enterprise Oversight

The House of Representatives passed GSE regulatory reform legislation (H.R. 1427) on May 22, 2007. The Senate is working on GSE regulatory reform. OFHEO continued to support reform legislation by working with the Administration, Congressional Members and staff on issues related to legislative proposals. The Director has given many press interviews and has addressed various groups with interests in the housing and mortgage finance industry to explain the need for statutory change and its possible effects and to gather their input. The agency responded to numerous media inquiries about the legislation.

Key elements of GSE regulatory reform include:

- ▲ All of the housing GSEs—Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks (FHLBs)—would be supervised by a single, new and stronger regulator. Comptroller General David Walker stated in Senate testimony that “[A] single housing GSE regulator could be more independent, objective, efficient and effective than separate regulatory bodies and could be more prominent than either one alone. We believe that valuable synergies could be achieved and expertise in evaluating GSE risk management could be shared more easily within one agency.”
- ▲ The new regulator would have regulatory, supervisory and enforcement powers equivalent to those of bank regulators. As there is little discipline provided by the credit markets to the Enterprises, receivership powers are a key bank regulator power that OFHEO needs.
- ▲ HUD’s mission and new product authority for Fannie Mae and Freddie Mac would be transferred to the new regulator.
- ▲ The new regulator would have independent litigating authority and be nonappropriated.
- ▲ A new regulator would have the flexibility and authority to adjust both the risk-based and minimum capital requirements through an open regulatory process, which would be supplemented with the ability to respond quickly to changing conditions.
- ▲ Specific statutory guidance would be provided by Congress to ensure that the regulator can promulgate a regulation to focus the Enterprises’ portfolios on their charter missions of supporting affordable housing and contributing to the stability and liquidity of the secondary mortgage markets. At the same time, the regulator would ensure the Enterprises’ safety and soundness by considering all relevant risk factors to their shareholders and secondary housing finance markets.

OFHEO remains committed to working with Congress to enact GSE Reform legislation that would create a stronger regulator for Fannie Mae, Freddie Mac and the FHLBs.

OFHEO Works to Combat Mortgage Fraud

Following litigation involving mortgage fraud against Fannie Mae brought in 2004, OFHEO examiners undertook a detailed review of areas needing improvement in the controls and operating systems that permitted such a fraud attempt against the Enterprise.

In FY 2005, with assistance from members of the President's Corporate Fraud Task Force, OFHEO published a regulation for mortgage fraud reporting that required of the Enterprises ongoing employee training, internal reporting improvements and enhanced mortgage fraud detection regimes. As defined in OFHEO's regulation, 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.

In FY 2006, OFHEO signed an agreement with the Treasury Department's Financial Crimes Enforcement Network (FinCEN) to share information provided by the Enterprises. FY 2007 was the first full year of Enterprise reporting and OFHEO's sharing of information with the Treasury Department. Based on reporting by the Enterprises, OFHEO has filed several hundred suspicious activity reports with FinCEN. OFHEO also works closely with law enforcement around the country on matters involving cases of suspected mortgage fraud reported by the Enterprises. OFHEO participates regularly with the Department of Justice Mortgage Fraud Working Group. OFHEO continues to provide public outreach and has raised concerns that the subprime lending problems of 2007 may prove to be rife with fraudulent activities.

New Features Expand OFHEO's Quarterly House Price Index

OFHEO continued to upgrade its House Price Index (HPI) reports, a quarterly measure of house price trends within and across all 50 states and the District of Columbia. In FY 2007, OFHEO expanded HPI features and data provided to the public, including the publication of additional purchase-only indexes to augment the standard all-transactions HPI. Purchase-only indexes are now available for each of the nine Census Divisions and every state and Washington, DC. OFHEO also added a new feature with its quarterly HPI report that details the share of cash-out refinancings that are used in the HPI. The new data provide users with a better understanding of the sources of divergence between OFHEO's standard HPI and the purchase-only indexes.

Also during the fiscal year, OFHEO supplemented release materials with in-depth highlights exploring various topics of interest, including the difference between home price appreciation in rural and urban areas, price trends in close-in city suburbs to those in outlying communities, the effect of refinance appraisal data and purchase-only numbers and an analysis of the monthly house price indexes. OFHEO published a research note in FY 2007 exploring the differences between OFHEO's HPI and the S&P/Case Schiller index, which is a publicly available alternative house price index introduced in 2006.

OFHEO originally developed and uses the HPI to establish quarterly capital standards for the Enterprises. Television, radio and newspaper interviews frequently supplement release of the quarterly reports, which are widely used by government, industry, consumer groups and the public as a resource on house price information.

OFHEO Improves Management Effectiveness

During FY 2007, OFHEO strengthened its infrastructure and support services and made the agency more results-oriented. Key among OFHEO's FY 2007 accomplishments were completing an updated Technology and Information Management Strategic Plan and issuing its first Human Capital Strategic Plan, setting OFHEO's direction for the future. The agency made improvements in its individual performance management system, creating a more transparent connection between employee performance and agency goals. OFHEO revamped its Investment Review Board (IRB) to improve how it plans, manages and monitors IT investments. The new Executive Committee on Internal Controls has created a focal point for agency-wide oversight and monitoring of improvements in the effectiveness and efficiency of agency operations. OFHEO also made other business process improvements in its support areas, including instituting a new electronic time and attendance system, improving coordination of budget development tied to performance results, completing certification and accreditation of all its major systems and updating its Continuity of Operations (COOP) plan. OFHEO received clean audit opinions on both its financial statements and its information security

Enterprise Portfolio Limits

Fannie Mae and Freddie Mac support the liquidity and stability of the mortgage markets by buying, selling and securitizing more than \$100 billion of mortgages per month. The Enterprises buy mortgages and MBS, hold them in their own portfolios and fund them by issuing debt. The Enterprises' portfolio holdings chiefly comprise their own MBS, other issuers' private-label MBS, and whole loans. Figure 4 shows the Enterprises' retained mortgage portfolios as of September 30, 2007. Actual mortgage loans (whole loans) comprise 42 percent of Fannie Mae's retained mortgage portfolio and 10 percent of Freddie Mac's. Thus, 58 percent of Fannie Mae's retained mortgage portfolio, and 90 percent of Freddie Mac's retained mortgage portfolio consist of mortgage-backed securities. In fact, combined, the Enterprises own about 18 percent of all of their MBS that are outstanding and almost 50 percent of their portfolios are MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae (the Government National Mortgage Association).

The Enterprises' retained mortgage portfolios pose not only credit risk but also significant interest rate and operational risks. Since Fannie Mae and Freddie Mac still have significant systems, operational, internal control, accounting and risk management challenges, in 2006 OFHEO entered into separate agreements with each Enterprise to cap its retained mortgage portfolio. Portfolio caps are limits on the total dollar amount of mortgage assets Fannie Mae and Freddie Mac may hold on their balance sheets. The agreements were established to limit the size of the portfolios (but not to limit Enterprise securitization of mortgages) as the Enterprises remediate existing safety and soundness issues. Fannie Mae's portfolio cap, established by a consent order in May 2006, was fixed at \$727.7 billion. The Freddie Mac portfolio cap, established by a voluntary agreement between Freddie Mac and OFHEO, allows two percent annual growth (0.5 percent quarterly). For the third quarter of 2007, the Freddie Mac cap would have been \$728.1 billion without the changes below.

In September 2007, OFHEO modified the portfolio caps for both Enterprises in order to provide additional flexibility to help them make purchases of subprime mortgages that would help

program. As a capstone to its commitment to follow the PMA principles, OFHEO initiated a process to formally participate in the program and be rated on its condition and progress beginning in October 2007.

Promoting Diversity at OFHEO

In FY 2007, OFHEO launched a reinvigorated agency-wide diversity program. Twenty-six volunteers, over 10 percent of OFHEO's workforce, formed the OFHEO Diversity Council with the goal of enhancing outreach efforts, leadership development and retention of a diverse workforce, and increasing awareness and acceptance of the many characteristics and backgrounds represented at OFHEO. The Diversity Council began to develop a strategic plan, worked with OFHEO's Office of Human Resources Management on outreach to recruit from underrepresented communities and named October 2007 Diversity Month at the agency. The Council plans a variety of educational and cultural programs to celebrate diversity. OFHEO's diversity is a critical link in meeting the agency's mission by making diversity an organizational strength that contributes to achieving results. In FY 2007, 47 percent of applicants for vacant positions and 40 percent of applicants hired self-identified as minorities.

subprime borrowers avoid foreclosure and affordable multifamily mortgages. OFHEO set a new portfolio cap for both Enterprises of \$735 billion based on the unpaid principal balance of the loans and securities in their portfolios instead of the Generally Accepted Accounting Principles (GAAP) value, which is less stable. The new limit is based on the average of monthly closing balances instead of the quarter-end value, which also provides a more stable figure. OFHEO also allowed Fannie Mae the same moderate increases that Freddie Mac had agreed to—two percent annual growth and not more than 0.5 percent per quarter. In addition, for the fourth quarter of 2007, OFHEO allowed a one percent increase.

The portfolios are not static. Each month, borrowers make principal payments that reduce their loan balances and some borrowers prepay their mortgages. At the same time, each month the Enterprises are selling investments and buying new mortgages and MBS within the cap limits. As a result, the Enterprises in combination have the ability to make \$20 to \$30 billion in new portfolio investments each month. Importantly, the portfolio caps do not apply to the Enterprises' off-balance sheet securitization activities, except when they purchase their own MBS for their retained portfolios. Under the agreements, OFHEO will lift the restrictions on an Enterprise's portfolio level depending on the safety and soundness issues at that time, once it files accurate, audited financial statements in a timely manner.

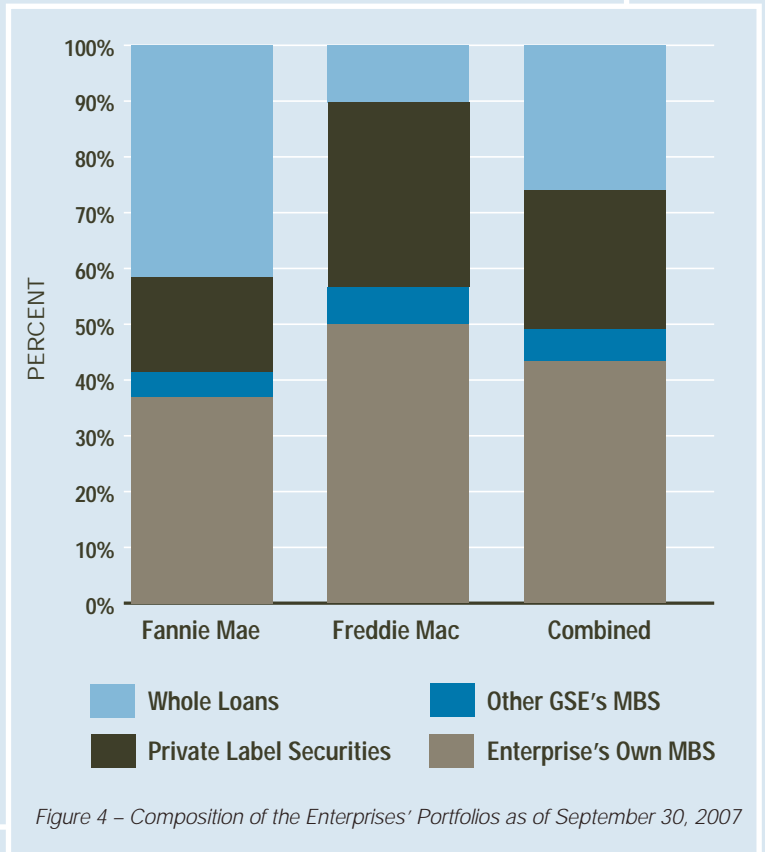


Figure 4 – Composition of the Enterprises' Portfolios as of September 30, 2007

Management Challenges

Maintaining Effective Regulatory Oversight

Currently, Fannie Mae and Freddie Mac are working to improve their internal controls, compliance with accounting standards, risk management, financial reporting, data quality, systems, executive leadership and governance. The Enterprises are making improvements while still facing the demands of the dynamic markets in which they operate, filling critical management and staff positions and working to change the cultures of their organizations. OFHEO will continue to be challenged to ensure that the Enterprises meet the commitments made in their agreements with OFHEO. OFHEO must proactively work with the Enterprises to ensure that they make the needed corrections and improvements. OFHEO believes both Enterprises still have a significant amount of work to do before their critical problems are corrected.

Monitoring Changing Mortgage Market Conditions

The mortgage market and housing market deteriorated significantly in 2007. Changes in the market include a slowdown of house price appreciation (see feature on house price changes on page 21), home building and home purchase activity, and an increase in defaults and foreclosures caused by poor lending decisions, particularly in the subprime market. The mortgage markets have begun to recognize the increase in expected losses due to credit risk. Substantial market corrections in pricing have taken place.

The Enterprises are not immune from the effects of declining house prices and general deterioration of credit conditions in the housing market. Thus, the weakening of housing markets during 2007 combined with the sheer size of the Enterprises' exposure to the market raises concerns despite the Enterprises' good track record in managing credit risk. Both Enterprises have announced that they expect to have much larger credit losses in 2007 and 2008 than in 2006. Other financial institutions that are counterparties to the Enterprises in the sharing of risk are facing losses in the current market environment. Should the counterparties' financial strength or operational capabilities weaken further, the Enterprises could suffer drains on their capital.

Both Enterprises are beginning to support rescue loan programs, through which qualified subprime borrowers may be able to refinance certain loans on more favorable terms. OFHEO will continue to oversee the Enterprises monitoring of credit conditions and review their capital adequacy.

Maintaining Capacity to Strengthen Supervision and Address Emerging Risks

OFHEO continues to strengthen its supervisory standards and operations, including reviewing the Enterprises' risks and risk management on a continuous basis despite limitations presented by OFHEO's current statutory framework for regulation. Through continuous monitoring, research and analysis and risk-based examinations, OFHEO identifies issues that warrant additional attention and

House Price Changes in 2007

House prices have decelerated in the last year. OFHEO's House Price Index (HPI) reported price growth of 3.2 percent for the U.S. as a whole between the second quarter of 2006 and the second quarter of 2007, down sharply from the 10.0 percent price increase over the preceding four quarters.

Prices in the most recent year were weakest in the Midwest, parts of the Northeast and in many areas of the country that exhibited the high appreciation during the housing boom. Prices fell by roughly 1.5 percent in California and Nevada, a stark contrast to appreciation rates that averaged more than 16 percent during the preceding four years. Besides Nevada and California, other states that exhibited price declines were Michigan, Massachusetts and Rhode Island.

Appreciation remained relatively robust in parts of the Rocky Mountain states and the Pacific Northwest. Double-digit price growth was observed in Utah and Wyoming, states that previously showed relatively modest appreciation. Rates of appreciation were also high in Washington, Montana, New Mexico and Idaho, ranging from between 8.4 and 9.1 percent. Figure 5 shows the house price changes for all 50 states.

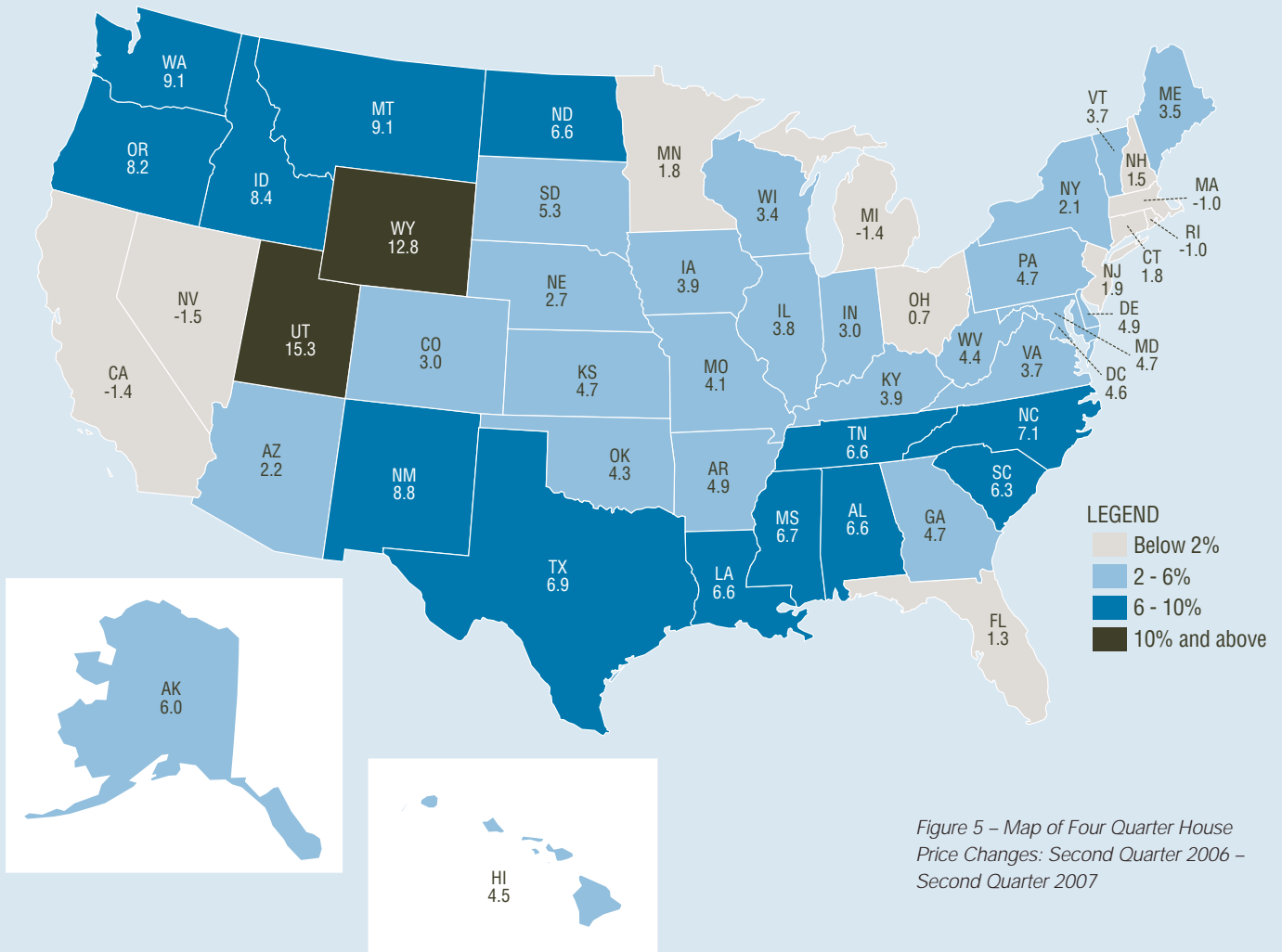


Figure 5 – Map of Four Quarter House Price Changes: Second Quarter 2006 – Second Quarter 2007

explores them further through targeted examinations. OFHEO is strengthening its oversight with lessons learned from prior examinations by proactively issuing additional guidances and establishing a quality-assurance function.

The ongoing supervision should place OFHEO in a good position to identify and address emerging problems in a timely fashion. However, the size and complexity of the Enterprises' business activity, the scope of their remediation activities which have cost several billions of dollars, the changing dynamics of the mortgage markets and the status of the Enterprises' internal controls and financial reporting continue to present challenges for their regulator. While OFHEO's resources and staff have increased over time, the competition for highly skilled and experienced staff in technical fields continues to challenge OFHEO to recruit 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. OFHEO must invest in its staff so they can stay abreast of the changes in their fields and reinforce the agency's knowledge base.

Investing in staff and planning new hires is cumbersome as OFHEO is the only financial institution regulator appropriated by Congress even though the agency is fully funded by the Enterprises. For 14 of OFHEO's 16 years of existence the agency started the year with a continuing resolution, including 2007 and now 2008. In May 2007, OFHEO received additional funding in the Iraq War Supplemental Appropriation. OFHEO enters 2008 with more than 40 vacancies, representing 17 percent of the current workforce, primarily in the supervision area. The proposed legislation would remove OFHEO from the appropriations process and therefore allow OFHEO to grow with its supervisory work.

Strengthening Capital Standards and Capital Oversight

OFHEO continues to review and strengthen its capital oversight. OFHEO monitors the Enterprises' capital weekly, makes capital classifications quarterly and conducts an ongoing review to verify and validate the data used in capital calculations. OFHEO has placed a 30 percent capital surcharge on the minimum capital requirement for each Enterprise to account for serious deficiencies in its operations that were identified through OFHEO's special examinations. In addition, OFHEO has embarked on a significant review of the risk-based and minimum capital standards and will continue to identify proposed changes that would strengthen the standards to better account for risk. Some improvements will require changes to the law. The current law requires the Enterprises to maintain low regulatory minimum capital levels at about half of what large banks must maintain in order to be classified as well capitalized. As shown in Figures 6 and 7, below, the risk-based capital (RBC) standard has been constrained by the 1992 law and is much lower and more volatile than the minimum capital requirements. In particular, Fannie Mae's 2007 capital requirements display a significant anomaly as the RBC requirement fell despite the deteriorating mortgage market conditions. OFHEO and the Enterprises are developing better risk-based, also called economic capital, models.

Enhancing Authorities

OFHEO's ability to ensure the safety and soundness of the Enterprises will continue to be constrained unless Congress acts to reform the regulatory structure for overseeing the Enterprises. Without additional authorities, OFHEO will have to rely on consent orders and other voluntary agreements with the Enterprises or cumbersome enforcement proceedings to effect change, and may not be able to act quickly enough to help prevent future problems. As the Enterprises finish their remediation processes in 2008 and these constraints are lessened, it is critical that legislation is in place to prevent a recurrence of past problems. The authorities that need to be created are wide-ranging— independent litigating authority, receivership authority and better enforcement powers (including employee and director malfeasance penalties), independent funding authority, capital authority, new product and mission authority, and explicit authority to set portfolio growth limits. These authorities would provide OFHEO with the tools and resources necessary to keep up with the growth and complexity of the Enterprises, address systemic risk and provide growth constraints in lieu of market discipline. This comprehensive approach to strengthen the regulator in turn strengthens the Enterprises' credibility and lessens the uncertainties they, their shareholders and the mortgage markets face.

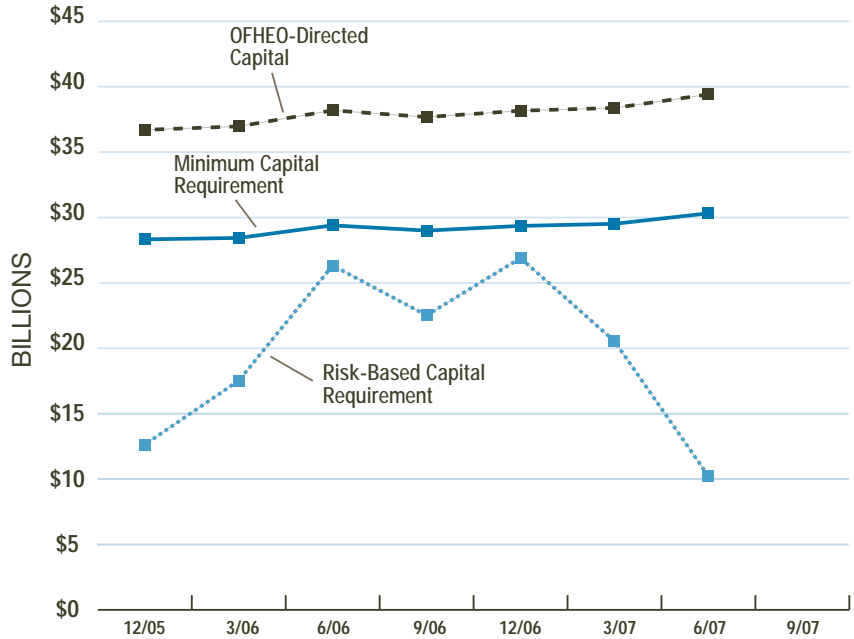


Figure 6 – Fannie Mae Capital Requirements for FY 2006 - 2007

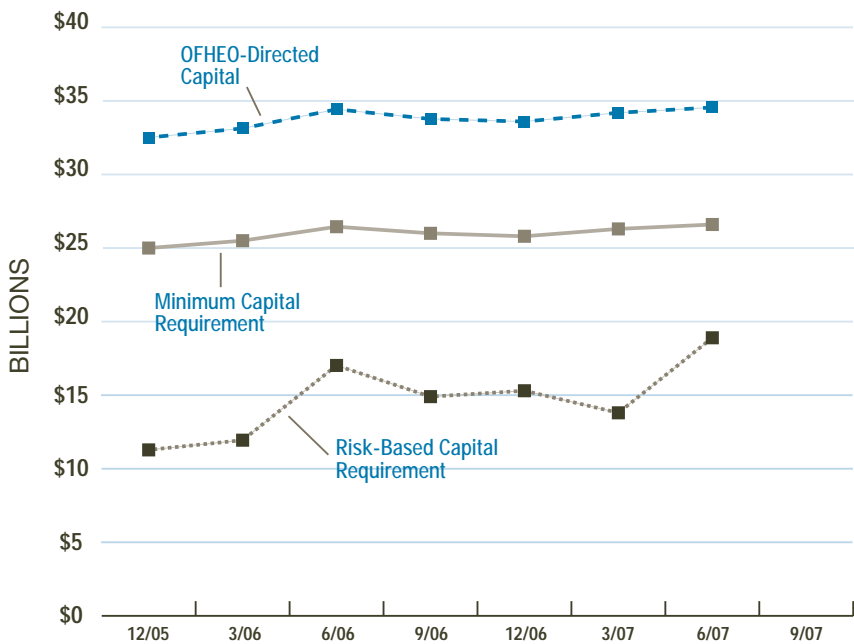


Figure 7 – Freddie Mac Capital Requirements for FY 2006 - 2007

Creating a New Regulatory Agency if Legislation is Enacted

Both houses of Congress are actively considering legislation to combine the two agencies regulating housing government-sponsored enterprises—OFHEO and the Federal Housing Finance Board (FHFB)—into a single entity with all the powers and responsibilities of other financial institution regulators. The FHFB is responsible for the oversight of the 12 Federal Home Loan Banks across the nation, which have over a trillion dollars in assets. GSE mission oversight functions of the Department of Housing and Urban Development also would be transferred to the new entity. If this legislation is enacted, the agency will face policy-related, people-related and systems-related challenges similar to those that confront private companies in mergers. These challenges include increased attention to the similar and different approaches and standards used to supervise Fannie Mae and Freddie Mac on the one hand and the Federal Home Loan Banks on the other. Administratively, the new agency will need to merge information technologies and systems, financial and human resources functions and agency cultures to meet the needs of the new entity.

Maintaining OFHEO's Information Technology Infrastructure, Security and Preparedness

OFHEO uses technology to accomplish its supervision mission. At OFHEO, technology is used to support the regulation of capital adequacy at the Enterprises and to enhance regulatory oversight with efficient systems and tools. OFHEO also relies on technology to ensure an efficient infrastructure to support supervision (including examinations, capital classification, modeling, research and analysis) and the underlying administrative functions. The technological sophistication of the Enterprises' operations and products requires equivalent sophistication at OFHEO. In addition, OFHEO uses its information technology resources through the agency website to provide transparency about the supervision process and relevant and useful information regarding the Enterprises and mortgage market to the public. OFHEO will continue to be challenged to maintain the robustness and versatility of its IT infrastructure while ensuring appropriate security for the data and information OFHEO needs to do its job. The agency has begun to implement a plan to secure, restrict access to and reduce the use of personally identifiable information and has implemented a robust monitoring system to help ensure appropriate information security. OFHEO will be challenged to complete the changes and improvements required as part of the PMA's E-Government initiative. OFHEO is also charged to ensure the continuity of its operations to be prepared for a possible disruption from external sources or events and to integrate its emergency preparedness plans with those of each Enterprise.

Carrying Out our PART Improvement Plan

The agency's 2006 OMB Program Assessment Rating Tool (PART) assessment published in February 2007, found that OFHEO has improved its effectiveness at identifying and addressing significant and systemic issues at the Enterprises that need attention. OFHEO received an overall rating of "Adequate" at that time. 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. The key obstacle is the

lack of legislation to strengthen OFHEO's regulatory powers. Since OFHEO and OMB completed the PART review in 2006, OFHEO continued to make progress on its PART improvement plan, including rating Enterprise performance with bank-like risk measures. OFHEO has begun to work with the new performance measures categorizing the Enterprises' condition, and the results are included in this Performance and Accountability Report. OFHEO is measuring the results of its work with these outcome measures; many external influences, including the actions of the Enterprises and Congress, affect these measures. OFHEO will continue to be challenged by these external factors to improve its regulatory program. As discussed in prior sections of this report, OFHEO is working with the Administration and Congress to address changes that would fix the identified weaknesses.

Pursuing Litigation Related to Special Examinations

As a consequence of its findings in the special examinations of each Enterprise, OFHEO has been pursuing litigation against former executives of Freddie Mac and Fannie Mae through its enforcement authorities. OFHEO entered into consent orders with former CFO Vaughn Clarke and CEO Leland Brendsel in September and November 2007, respectively, resolving the Freddie Mac enforcement action. OFHEO expects that the Fannie Mae enforcement action will be completed through the administrative phase by 2009. Opportunities are available for appeal, and the Department of Justice will represent OFHEO in any appeal to the D.C. Circuit Court. In 2007 these litigation activities represented 25 percent of OFHEO's resources, and the agency's FY 2008 budget includes significant resources for this litigation. In the past, OFHEO has sought supplemental appropriations to cover these costs as they arise and will continue to be challenged by the changing costs and the logistics of procurement, staffing and document management until these cases are settled. Figure 8 shows the percentage of litigation-related obligations to total obligations for the last five years.

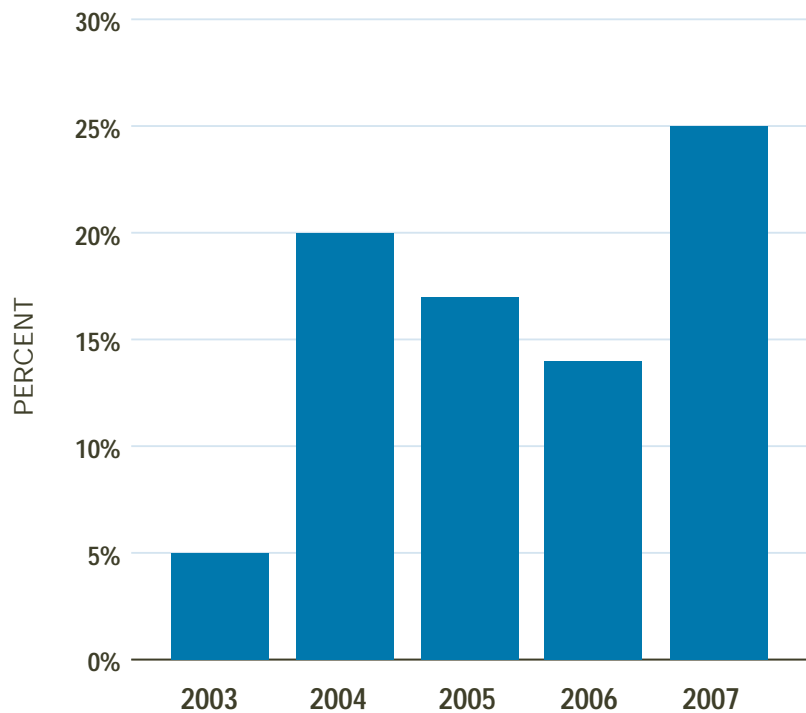


Figure 8 – Percent of Litigation-Related Obligations to Total Obligations for FY 2003 - 2007

PERFORMANCE SUMMARY

Strategic Planning at OFHEO

OFHEO uses strategic planning and performance planning to set long-term and annual goals and monitors progress throughout the year to produce results. The second chapter of this report describes in greater detail OFHEO's results and efforts to achieve its FY 2007 performance goals.

In FY 2006, OFHEO established a new 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, four annual performance goals to support its resource management strategy and a total of 34 performance measures. OFHEO's FY 2007 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 of its performance goals in FY 2007. During the year, OFHEO strengthened its supervisory program while addressing the issues identified at both Enterprises through special examinations and monitoring progress on remediation plans and agreements at both Enterprises. OFHEO continued to work with the Administration and Congress to support legislation to strengthen regulatory oversight. OFHEO continued to provide useful information and analysis to the public throughout the year, including the media and investor-analyst communities. OFHEO also worked with other federal agencies on various issues throughout the year. The table on pages 27 and 28 shows the agency's performance goals for each strategic goal and selected accomplishments. 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 were met. A complete discussion of OFHEO's annual performance goals and measures can be found in the Performance Section of this report.

Performance Goals for FY 2007

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.

- ▲ Completed annual examinations at both Fannie Mae and Freddie Mac, including 40 targeted examinations.
- ▲ Rated the safety and soundness of both Enterprises based on CAMELSO standards and five risk assessment categories.
- ▲ Monitored the remediation efforts of the Enterprises. Both Fannie Mae and Freddie Mac have made considerable progress, yet have substantial work to do to correct their internal controls and accounting problems.



GOAL 1.2

Ensure the Enterprises are adequately capitalized.*

- ▲ Ensured that both Fannie Mae and Freddie Mac were adequately capitalized for the first three quarters of the year and maintained a mandatory capital surplus 30% over the regulatory minimum capital levels.
- ▲ Completed planned project milestones to improve measures of capital adequacy.



GOAL 1.3

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

- ▲ Monitored each Enterprises' progress in making the improvements outlined in their consent orders with OFHEO. 90% of these items were completed and validated as sustainable by OFHEO.
- ▲ Identified during the examination process specific areas and items for each Enterprise to address and tracked their progress. 94% of these items were completed and validated by OFHEO.



GOAL 1.4

Strengthen regulatory infrastructure to enhance the supervision of the Enterprises.

- ▲ Implemented a quality assurance program for OFHEO to help ensure the quality of OFHEO's supervision activities.
- ▲ Began to develop an Enterprise call report.
- ▲ Published guidance on corporate governance, compensation practices and accounting practices.
- ▲ Proposed new guidance for calculating the conforming loan limit and solicited public comment.

* Data for the quarter ending September 30, 2007, will be available by December 30, 2007.

Performance Results Key: Goal Fulfillment



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



GOAL 2.1

Support efforts to strengthen OFHEO's authorities.

- ▲ Provided public information about the need for legislation to strengthen the regulation of Fannie Mae and Freddie Mac, including testimony, speeches, public forums, and media interviews.
- ▲ Responded to Congressional inquiries in a timely manner and provided technical assistance in support of H.R. 1427, The Federal Housing Finance Reform Act of 2007, which passed the House of Representatives on May 22, 2007.
- ▲ Delivered presentations to senior management of Fannie Mae and Freddie Mac on the sources of the systemic risk of the Enterprises and how reducing the size of their retained mortgage portfolios would reduce that risk.

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.

- ▲ Issued two months early OFHEO's annual Report to Congress describing the findings of the calendar year 2006 examinations of both Enterprises. OFHEO is unique among regulators, as it is required by law to make public its examination results and conclusions.
- ▲ Issued quarterly House Price Index, developed new purchase-only index and issued monthly house price appreciation for the past two-and-a-half years.
- ▲ Developed a housing statistics section on the new OFHEO website that provides useful information to the consumer.
- ▲ Published five working papers, three research papers and a mortgage market note, all of which provide useful information to the public and industry on issues and developments related to the Enterprises or the secondary mortgage market.



GOAL 3.2

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

- ▲ Launched new OFHEO website. Survey of users found that about 94% found the information on OFHEO's website valuable.
- ▲ Met at least quarterly with industry stakeholders, including trade associations, industry representatives and housing advocacy groups to discuss the proposed legislation, market developments and related issues.
- ▲ Started a new series of public information documents called *Mortgage Market Notes* to clarify policy issues.



GOAL 3.3

Cooperate with other Federal agencies on mortgage markets and the nation's housing finance system and regulatory issues.

- ▲ Worked with other federal agencies by responding to their requests for information and participating in task forces and other interagency efforts on regulatory issues. Cosponsored a financial regulator forum on subprime mortgages.
- ▲ OFHEO management met regularly with counterparts in HUD to discuss shared data, reports and information relating to the Enterprises and market developments.
- ▲ Joined other regulators in implementing nontraditional and subprime mortgage guidance.

Performance Results Key: Goal Fulfillment

Fully Achieved

Substantially Achieved

Not Achieved

Managing OFHEO's Resources

OFHEO's management philosophy reflects the government-wide management goals outlined in the President's Management Agenda (PMA). OFHEO's focus on human capital management, effective information technology resource management and strong program controls, including integrating financial systems, form the critical foundation achieving its strategic goals. OFHEO identified four performance goals indicative of an effective support infrastructure.

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.

- ▲ Published OFHEO's first Human Capital Strategic Plan which provides a vision and structure for future workforce and succession planning.
- ▲ Completed an agency-wide competency analysis review for technical competencies for mission-critical occupations and leadership.
- ▲ Conducted an agency-wide employee survey, using the survey questions established by OPM for the annual employee survey.
- ▲ Revised the employee performance appraisal review system to clearly link individual results to the agency's goals.
- ▲ Implemented recommendation from Government Accountability Office (GAO) based on their review of pay comparability and performance management at 10 federal financial regulatory agencies.



GOAL 4.2

Provide effective information resource management services to OFHEO managers and staff to support the goals of the agency.

- ▲ Published five-year strategic plan for information technology. This plan allows the agency to stage and upgrade the information technology that is appropriate for the work planned each year.
- ▲ Completed all projects planned for FY 2007 in the Information Technology Five-Year Strategic Plan.
- ▲ Certified and Accredited all major systems in the agency.
- ▲ Revamped the OFHEO Investment Review Board.
- ▲ Maintained 97% availability of OFHEO's network for use by the staff.



GOAL 4.3

Maintain a strong internal control and risk management program.

- ▲ Received an unqualified audit opinion on its FY 2007 financial statements.
- ▲ No significant weaknesses identified in OFHEO's FY 2007 independent review of information security.
- ▲ Received a positive audit report on the Delegated Examining Unit.



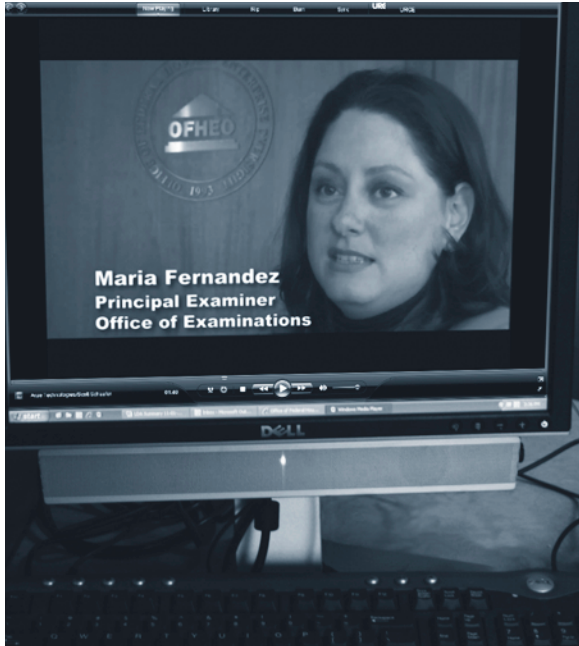
GOAL 4.4

Ensure the continuity of OFHEO's business functions.

- ▲ Completed revision and update to OFHEO's Continuity of Operations plan to be consistent with Federal Protective Circular 65 and other federal guidance.

Performance Results Key: Goal Fulfillment

- Fully Achieved
- Substantially Achieved
- Not Achieved



OFHEO launches a new recruitment video on its website to inform potential job candidates about the advantages of working for the agency.

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 committed to excellence in management practices, continuous improvement, increasing efficiencies throughout the agency and achieving results. OFHEO has been making management improvements over the past several years consistent with the PMA principles. During FY 2007, OFHEO committed to embrace the five government-wide PMA initiatives and implement them according to the standards set by OMB. OFHEO established "Proud to Be" plans for all five initiatives and set specific goals for 2008 and 2009 to achieve "green" status. In the next few years, OFHEO's status on these PMA initiatives will be assessed against the same criteria applied by OMB to scorecard agencies. Through this assessment process, OFHEO will share its results, successful practices and benchmarks with other federal agencies. 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 FY 2007, OFHEO took tangible steps to move toward the "green" status outlined by OMB for all five initiatives. Because OFHEO has been managing under the principles of PMA and implementing government-wide mandates in the past several years, OFHEO has already made substantial progress toward gaining efficiencies, better alignment with agency goals and achieving results.

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.

- ▲ In FY 2007, OFHEO published a Human Capital Strategic Plan that provides a vision and structure for future work force and succession planning, leadership and knowledge management, a results-oriented performance culture and talent management.

- ▲ 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 conducted an agency-wide competency analysis to identify mission-critical, technical competency gaps in key positions and identify leadership competency gaps for managers and executives.
- ▲ OFHEO began to create a formal leadership development program for its executives and managers.
- ▲ OFHEO has a merit-based performance rating and merit-based pay systems.
- ▲ OFHEO revised its performance management system to incorporate a more direct link between the agency's strategic and performance plans and individual performance.
- ▲ OFHEO developed an executive-level pay plan and classification system.

Competitive Sourcing. 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.

- ▲ OFHEO contracts for many services and commercial activities. Instead of hiring permanent personnel, whenever it was cost-effective, OFHEO obtained significant computer systems support and litigation services through contracts. OFHEO also used the other federal agencies' services for payroll, background security adjudication, relocation, executive development, travel, systems certification and accreditation and independent review of computer security.
- ▲ OFHEO completed the annual Fair Act report, an inventory of commercial and inherently governmental activities performed by the agency, which is posted on the agency's web site at www.ofheo.gov.

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.

- ▲ OFHEO received an unqualified audit opinion on its FY 2007 financial statements from its external auditor with no material weaknesses reported. OFHEO has received clean audit opinions for 10 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 FY 2007, OFHEO commissioned an “Agreed-Upon Procedures” review of internal controls relating to two specific systems and plans a full internal controls audit within the next year.
- ▲ OFHEO’s financial accounting system is compliant with Financial Systems Integration Office (FSIO) standards.

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 Web to help citizens find information and obtain services. OFHEO relies heavily on information technology to complete the work needed to achieve its goals.

- ▲ OFHEO issued a new Five-Year Information Technology Strategic Plan.
- ▲ OFHEO launched a revamped and updated website to make it easier for the public to access information, including a new housing statistics section.
- ▲ OFHEO completed the process of certifying and accrediting all of its major information systems.
- ▲ OFHEO changed the organizational reporting structure of its information technology program so that the Chief Information Officer reports to the OFHEO Director.
- ▲ OFHEO revamped its Investment Review Board 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 and began automating the performance evaluation process.
- ▲ 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.

- ▲ 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 received a rating of “Adequate” in OMB’s review of the program using the PART during 2006.
- ▲ OFHEO developed its 2009 performance budget using an interactive, integrated process through which the Director and senior managers reviewed performance expectations and budget decisions.

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 results of this assessment are publicly available from www.expectmore.gov. The PART assessment noted that the program had significantly improved effectiveness, but needed to adopt bank regulator-like risk rating measures. OFHEO adopted a CAMELSO (capital adequacy, asset quality, management, earnings, liquidity, sensitivity to market risk and operational risk) measure and a related risk assessment measure for 2007 and progress on achieving them is included in this report. OFHEO’s PART assessment also identifies limited statutory authority as a restriction on the program’s effectiveness. The PART improvement plan calls 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 PART assessment also noted that there were no independent program evaluations of OFHEO in recent years, which OFHEO will address in 2008.

FINANCIAL SUMMARY

Fiscal Year 2007 Financial Results

As mandated by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, OFHEO receives its funding through assessment collections from Fannie Mae and Freddie Mac. Congress sets the appropriated funding level; however, no taxpayer funds are 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.

In FY 2007, OFHEO’s appropriation was for \$66.2 million in budget authority, which included a supplemental appropriation of \$6.2 million for increased costs of examination, supervision and capital oversight of the Enterprises. During FY 2007, OFHEO recovered \$1.4 million in unspent prior obligations, bringing the total budgetary resources to \$67.6 million. The agency obligated all but \$122,000 of that amount. Budgetary resources increased \$7.0 million between FY 2006 and FY 2007.

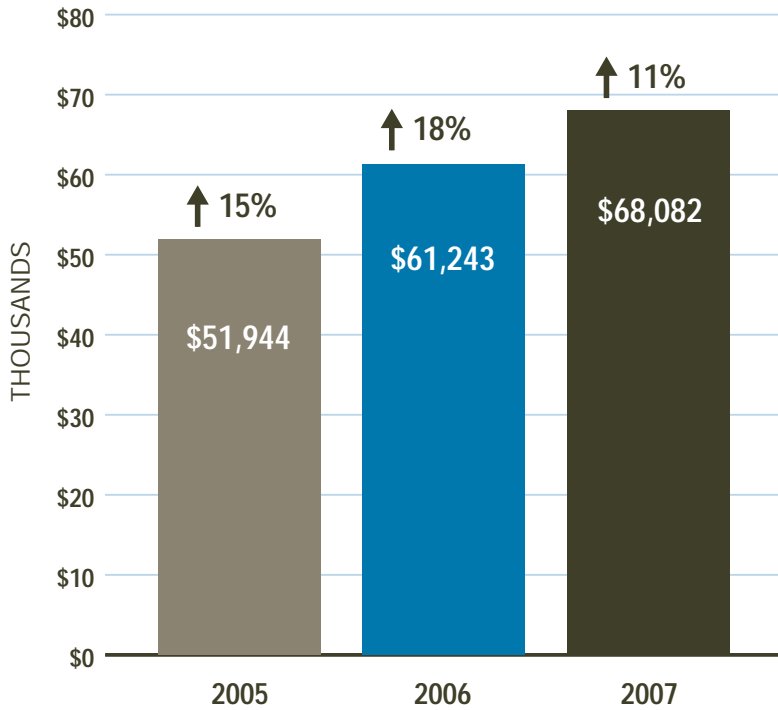


Figure 9 – OFHEO Net Costs, FY 2005 – 2007

The total budgetary resources for FY 2006 included the appropriation of \$60.0 million and \$0.6 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 expenses 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 increased in FY 2007 over FY 2006 by \$6.8 million or 11.2 percent, as reflected in the Statements of Net Cost for the Years Ended September 30, 2007 and 2006. Figure 9 reflects the net change in cost of operations from FY 2005 to FY 2007. The increase in net cost from FY

2006 to FY 2007 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 FY 2007, as goods and services were received.

Human Capital Cost. Payroll expenses rose \$5.1 million, or 17 percent, from FY 2006 to \$35.1 million during FY 2007. The increase in net cost is primarily associated with incurring the full year cost in FY 2007 for the 26 Full-Time Equivalents (FTE) added in FY 2006 plus the six new FTE in FY 2007. Other factors contributing to the increase include merit pay for a larger FTE base and \$0.6 million rise in benefits for the greater number of participants and higher benefits costs.

Continuous Supervision Costs and Related Litigation Cost. Net cost rose more than \$1.5 million, or 15 percent, from FY 2006 to \$11.9 million for contract legal and document management services, and expert witnesses supporting the Freddie Mac and Fannie Mae continuous supervision and litigation costs.

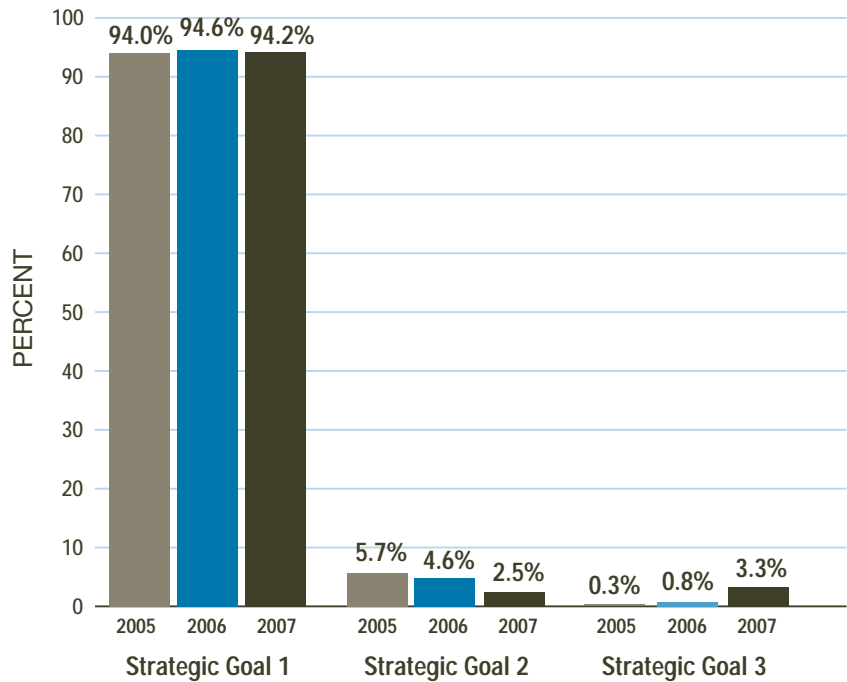
Other Factors. A number of expenses, such as rent, administrative support systems and information technology purchases increased by smaller amounts in 2007. Depreciation expense was \$1.5 million, or 35 percent, higher in FY 2007 because of software development for the automated supervisory tool (xWorks), and equipment purchases to support internal software.

During FY 2007, OFHEO continued to focus on hiring and retaining staff to ensure effective oversight of the Enterprises. FTE rose from 224 in FY 2006 to 230 at the end of FY 2007, an increase of two percent. Total FTE for 2007 were 26 lower than budgeted primarily due to delayed hiring caused by the continuing resolution.

Unqualified Audit Opinion for Fiscal Year 2007

For FY 2007, 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 FY 1998. No material weaknesses were noted in internal controls or any noncompliance with laws and regulations.

OFHEO contracted for two “Agreed-Upon Procedures” reviews of both internal controls and change management controls associated with the agency’s new web-based time and attendance system, Kronos, and with its Financial Information Management System (FIMS) and its new automated internal controls program, Applimation. No material control weaknesses were identified in either of these two reviews.



* FY 2007 was the first year OFHEO operated under its FY 2006-2011 Strategic Plan, issued September 30, 2006. In FY 2005 and 2006, OFHEO operated under the Strategic Plan it adopted at the end of 2003.

Figure 10 – OFHEO Obligations by Strategic Goal, FY 2005 – 2007*

Compliance with Appropriation Mandate

OFHEO is in compliance with language in OFHEO’s FY 2007 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 10 demonstrates that, during FY 2007, OFHEO used 94.2 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 FY 2007 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 2007, the ECIC was composed of the Executive Director who served as the Chair, the Director of Supervision, the General Counsel and the Deputy Director. 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 assessment of Internal Controls has been further strengthened by the purchase and installation of the Applimation system in FIMS to track internal controls. 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.

During FY 2007, 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, 2007. This assurance can be found in the third chapter of this report and meets the reporting requirement for internal controls in the Federal Managers Financial Integrity Act of 1982 (FMFIA).

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 Financial Information Management System (FIMS), the core accounting and financial system to which OFHEO converted in FY 2005, 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. During FY 2007, OFHEO streamlined accounting processes by completing an electronic interface between Bank of America purchase credit card charges and FIMS.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT

Title III of the Electronic Government Act of 2002, entitled 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 FY 2007. OFHEO’s report showed that the agency improved its overall security posture with respect to safeguarding its information assets and systems, including the completion of certification and accreditation for all major systems. Specific recommendations in the report included developing comprehensive security policies, enhancing Plans of Action and Milestones to address security-related weaknesses for systems, improving information technology contingency plans, undertaking a review to validate and document system configurations and addressing specific technical deficiencies for OFHEO’s information systems that were noted during the review.

During FY 2007, OFHEO changed the organizational reporting structure of its information security program to be compliant with FISMA, and addressed operational aspects of the security program by hiring a dedicated Chief Information Security Officer who reports to the Chief Information Officer, hiring additional information security staff for the program and developing an Information Technology Security Strategic Plan. OFHEO also developed policies to address incident response and personally identifiable information based on OMB guidance, implemented systems life-cycle development guidance that incorporates security controls into new system development and provided an 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 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 and established through proper requisition and procurement processes. There were zero erroneous payments issued by OFHEO in FY 2007.

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 FY 2007, the dollar amount subject to prompt payment was \$20.2 million, a decrease of 11 percent over \$22.7 million in FY 2006. The amount of interest penalty paid in FY 2007 was \$11 or 0.00006 percent of the total dollars disbursed. This compares to the \$13,702 interest penalty paid in FY 2006 at 0.06 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.

Performance Section

OVERVIEW

OFHEO'S 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.



Each year, OFHEO develops outcome-based performance goals that lead to the accomplishment of the strategic goals. OFHEO's performance goals reflect key program areas and challenging yet achievable targets. Each performance goal has at least one corresponding performance measure that may be outcome- or output-based. 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.

Figure 11 – OFHEO's Goal Hierarchy

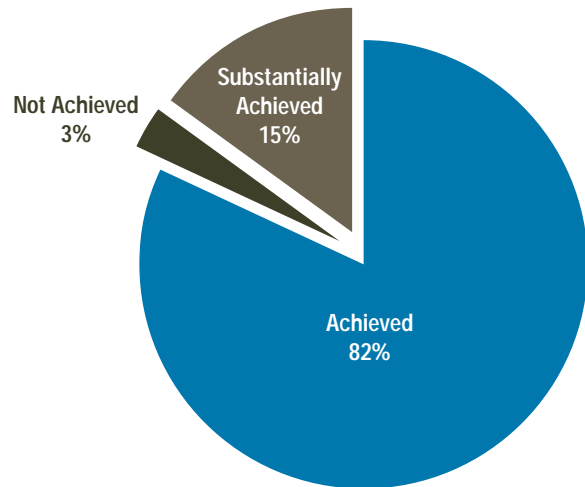
Managing and Measuring Performance

OFHEO accomplishes its mission primarily by conducting examinations of the Enterprises, monitoring their progress in completing their remediation plans, assessing their capital adequacy, conducting research and analysis about the Enterprises and the housing markets and working towards regulatory reform. OFHEO's regulatory framework supports these functions. The OFHEO Annual Performance Budget describes how OFHEO achieves its goals. However the best measure of OFHEO's overall performance is whether its actions result in safe and sound operations and adequate capital levels at each Enterprise.

Over the course of the year, OFHEO managers reported their progress in achieving the performance goals and then met with the Director to review status and accomplishments each quarter. Through weekly meetings, senior management was 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 litigation and disruptions in the subprime and nontraditional mortgage markets.

Most of OFHEO's performance indicators reflect data and milestones internal to the agency, with the exception of data used as input to the capital calculations. The performance information reported in this Performance and Accountability Report is complete and reliable, with exceptions related to capital classifications (described under Performance Goal 1.2). Figure 12 shows OFHEO's achievement of performance measures for FY 2007 compared to FY 2006.

2007 Performance Measures



2006 Performance Measures

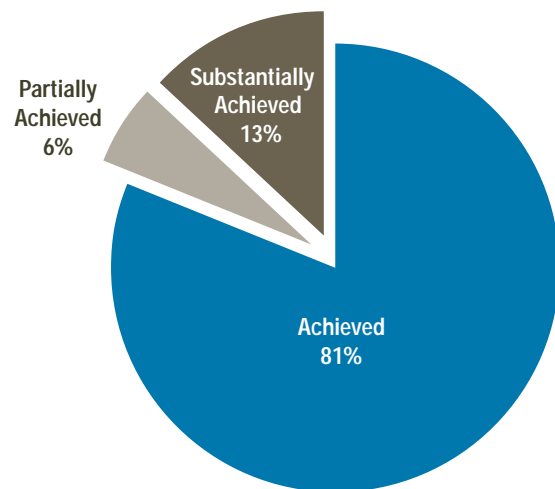


Figure 12 – Performance Measures Achieved in FY 2007 and FY 2006

STRATEGIC GOAL 1

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






OFHEO Director of Supervision Len Reid speaks about the agency's enhanced supervision and oversight at a conference for the Office of Supervision in November 2006.

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 is 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. OFHEO currently considers both Enterprises to be significant supervisory concerns. 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, skills and expertise OFHEO acquires through its examinations and the insights gained from its research and analysis 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.

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

GOAL 1.1		Ensure the Enterprises comply with safety and soundness standards.
MEASURE 1.1(1)	Percentage of Enterprises with CAMELSO ratings of 1, 2 or 3.	100%
	2007 PERFORMANCE At the end of the calendar year 2006 examination, OFHEO determined that both Enterprises had CAMELSO ratings at 3 or higher.	
MEASURE 1.1(2)	For both Enterprises, the percentage of OFHEO's five risk assessment categories with an acceptable risk/risk management profile.	80% for both Enterprises
	2007 PERFORMANCE OFHEO's five risk assessment categories are: governance, market risk, credit risk, operational risk and model risk. At the end of the calendar year 2006 examination, both Fannie Mae and Freddie Mac had acceptable risk profiles in four of the five areas and had one area with high quantity of risk and weak risk management.	
MEASURE 1.1(3)	Average number of days to issue report of examination to Enterprise Boards of Directors and meet with them after field work is complete.	120 days
	2007 PERFORMANCE OFHEO's calendar year 2006 examination was completed on time and the Enterprises' Boards of Directors were briefed on OFHEO's findings and conclusions as quickly as possible afterwards, within an average of 71 days.	

Prior Year Performance

2006 	Both Enterprises continue to pose supervisory concern including internal controls and accounting problems. Both Enterprises have remedial plans in place to address Special Examination findings and OFHEO continued to identify other issues requiring attention. Although both Enterprises have responded to OFHEO's concerns they have 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 continued 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 FY 2003. In FY 2004, OFHEO identified safety and soundness concerns at Fannie Mae and took remedial action.

Performance Results Key: Goal Fulfillment

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

2006 Performance Discussion for Goal 1.1

Overall

During the year, OFHEO completed its calendar year 2006 annual examination of Fannie Mae and Freddie Mac and the agency began its calendar year 2007 annual examination. OFHEO found the Enterprises financially sound for calendar year 2006, but both remained significant supervisory concerns. OFHEO summarized its findings and conclusions about the 2006 examination in the annual Report to Congress, issued in April 2007. OFHEO presents its 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. FY 2007 marks the first year that OFHEO gave a formal numerical rating to each Enterprise based on its condition. Both Enterprises were rated at three or better on a five-level scale, where five is the weakest and one is the strongest CAMELSO score. This rating is consistent with the results of the risk profile measure, the second measure of the Enterprises' condition that OFHEO used to complement the numerical rating. Of the five categories of risk that OFHEO monitored and tracked throughout the year—governance, market risk, credit risk, operational risk and model risk—each Enterprise had an acceptable risk management profile for four of the five categories. In one of the five categories, both Fannie Mae and Freddie Mac had a high quantity of risk and weak risk management.

During the year, OFHEO monitored the progress that each Enterprise made in resolving weaknesses and returning to timely, audited 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). OFHEO's continuous supervision included assessment of the strengths and weaknesses of the Enterprises' risk management capabilities, risks associated with subprime and nontraditional mortgages, and the impact on the Enterprises of market events, as well as the Enterprises' market risks. Given the rapid negative changes in the mortgage markets in the last half of the year, credit risk has emerged as a major risk for both Enterprises.

Throughout the year, as OFHEO identified deficiencies in the Enterprises' operations, these were communicated with each Enterprises' management and Boards of Directors as appropriate. The conclusions of the annual examination were shared with the Boards before being published in the annual Report to Congress. Timely communication with the Boards is an OFHEO performance measure. Both Enterprises made progress towards correcting their problems, especially in systems, controls and financial reporting. OFHEO's annual Report to Congress, found on the website at www.ofheo.gov, describes in more detail the agency's findings and the Enterprises' progress and condition.

Fannie Mae

OFHEO's examination of Fannie Mae for calendar year 2006 concluded that Fannie Mae has devoted substantial effort to making progress toward correcting deficiencies, however, the Enterprise still has significant issues to resolve related to data, systems, controls and risk measurement and management. Fannie Mae has built the foundation to address deficiencies, but all the corrective programs are not yet completed. The Enterprise also has weaknesses in several areas of credit risk management, some deficiencies in interest-rate risk measurement and strong asset quality. OFHEO found that Fannie Mae's operations had significant control deficiencies that adversely impacted risk management and the Enterprise's expansion into new products.

OFHEO recommended that the Board carefully oversee Fannie Mae's project management, management communications, interest rate risk, management reporting, infrastructure improvements and internal controls.



Freddie Mac

OFHEO's examination of Freddie Mac for calendar year 2006 concluded that Freddie Mac had made significant efforts to address internal control weaknesses, but that several key initiatives had not made progress as planned. Freddie Mac had established plans to take corrective actions, but needed to complete those plans. OFHEO also found that the Enterprise needed to address improvements to systems capabilities and information processing controls, to implement re-engineered business processes and to make cultural and organizational improvements in order to improve internal controls.

OFHEO recommended that the Board carefully oversee Freddie Mac's internal controls, information technology, credit risk management, corporate-wide change management and risk oversight functions. Subsequently, Freddie Mac made changes and additions to Board committees and subcommittees.

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 related to supervision activities are collected in OFHEO's automated supervisory tool and reviewed by quality assurance staff and OFHEO management. CAMELSO ratings and standards for each risk category in the risk profile measure are based on criteria outlined in OFHEO's Supervisory Handbook, which is available to the public on the OFHEO website www.ofheo.gov.

GOAL 1.2		Ensure the Enterprises are adequately capitalized.
MEASURE 1.2(1)	The Enterprises meet OFHEO's determination of capital adequacy.	Meet quarterly
	2007 PERFORMANCE Freddie Mac: classified as adequately capitalized each quarter. ¹ Fannie Mae: classified as adequately capitalized each quarter. ^{1,2}	
MEASURE 1.2(2)	Complete planned enhancements to the standards against which the Enterprises are measured.	Meet quarterly milestones
	2007 PERFORMANCE 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. OFHEO completed projects to better account for the full range of Enterprise risks, including better measurement of operational risk and using market value approaches.	

Prior Year Performance

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 three 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 all four quarters.

¹The data for the quarter ending September 30, 2007, will be available in December 2007.

²Fannie Mae's capital classification is based on Fannie Mae's best estimates of its financial condition, as certified and represented as true and correct to the best of Fannie Mae management's belief and knowledge. The classification remains subject to revision during Fannie Mae's reaudit and accounting restatement process.

2007 Performance Discussion for Goal 1.2

For the first three quarters of FY 2007, both Fannie Mae and Freddie Mac were adequately capitalized and both maintained a 30 percent minimum capital surplus as required by OFHEO, as well as self-imposed additional requirements. OFHEO is statutorily required to determine capital adequacy of the Enterprises on the basis of both minimum and risk-based capital standards. Figures 13 - 16 show each Enterprise's capital levels in comparison to their requirements.

Fannie Mae and Freddie Mac are required to maintain the 30 percent surplus over their minimum capital requirement because of uncertainties in their financial statements and operational weaknesses identified. OFHEO continues to hold weekly capital assessment meetings with both Enterprises to closely monitor its capital position, as they work to produce timely financial statements. Fannie Mae’s capital classifications during FY 2007 remain subject to revision based upon results from the Enterprise’s re-audit and accounting restatement process.

OFHEO publishes the OFHEO-directed, minimum and risk-based capital requirements for each Enterprise on its website, www.ofheo.gov. Data on the Enterprises’ capital for the quarter ending September 30, 2007, will be disclosed at the end of December 2007.

During FY 2007, OFHEO focused on improving the capital standards to better account for the full range of Enterprise risks, including better measurement of operational risk and using market value approaches. OFHEO also continued developing additional measures of capital adequacy during the year. OFHEO completed a Capital Oversight Plan that outlines an overall strategy and describes the approach the agency will take to ensure that both the risk-based and minimum capital requirements are robust, up-to-date and account appropriately for

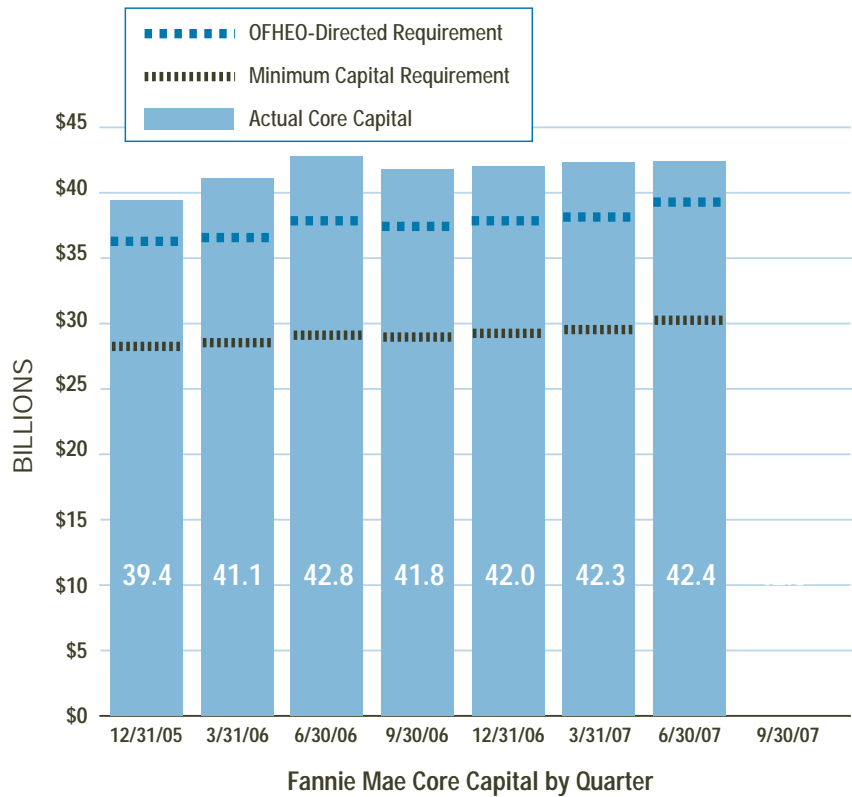


Figure 13 – Fannie Mae Minimum and OFHEO-Directed Capital, FY 2006 – 2007

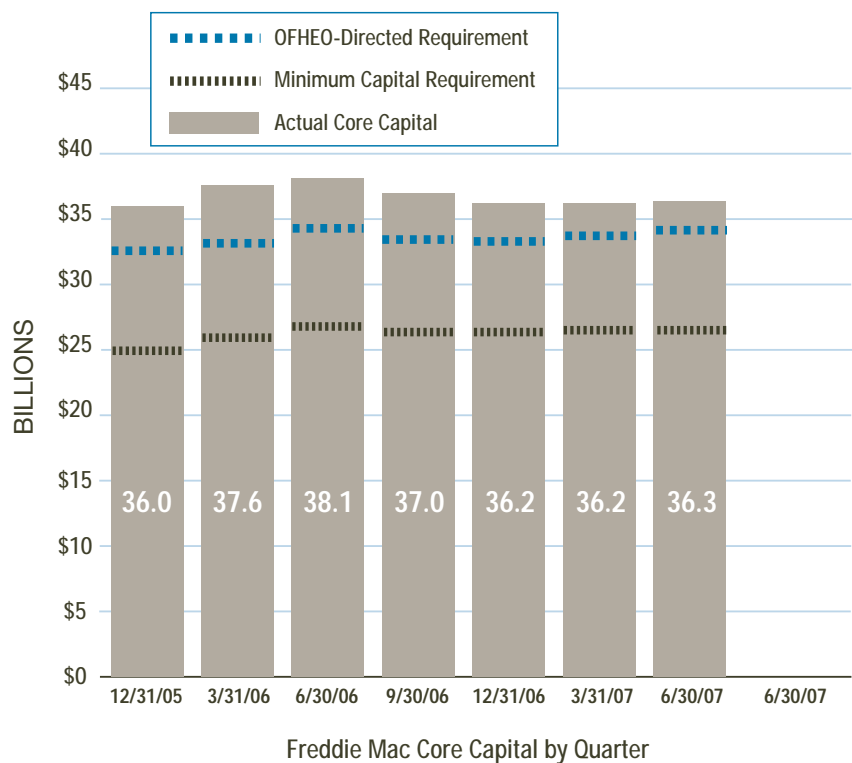


Figure 14 – Freddie Mac Minimum and OFHEO-Directed Capital, FY 2006 – 2007

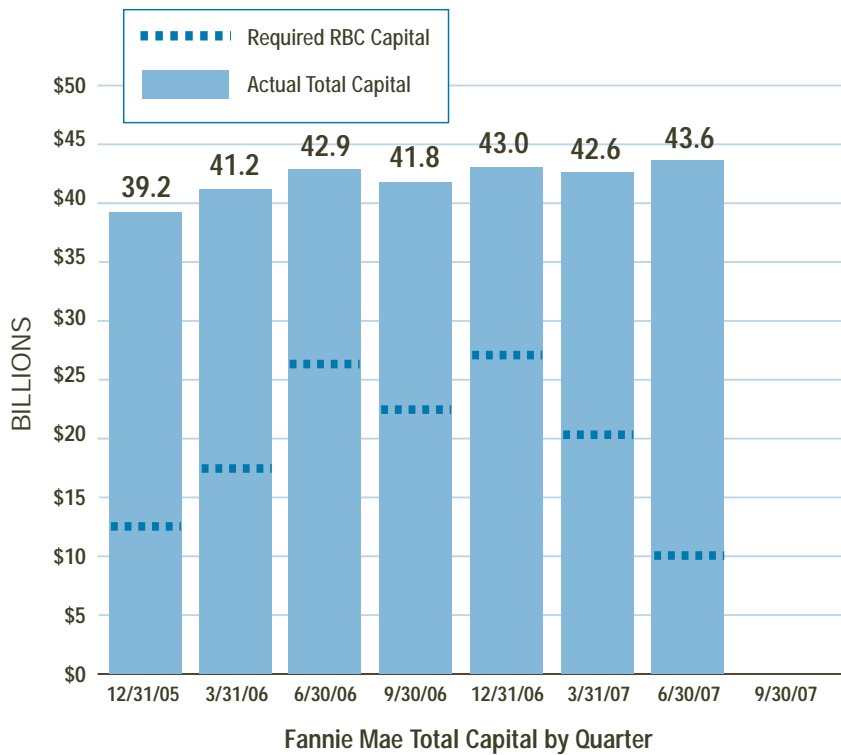


Figure 15 –Fannie Mae Risk-Based Capital Requirements, FY 2006 – 2007

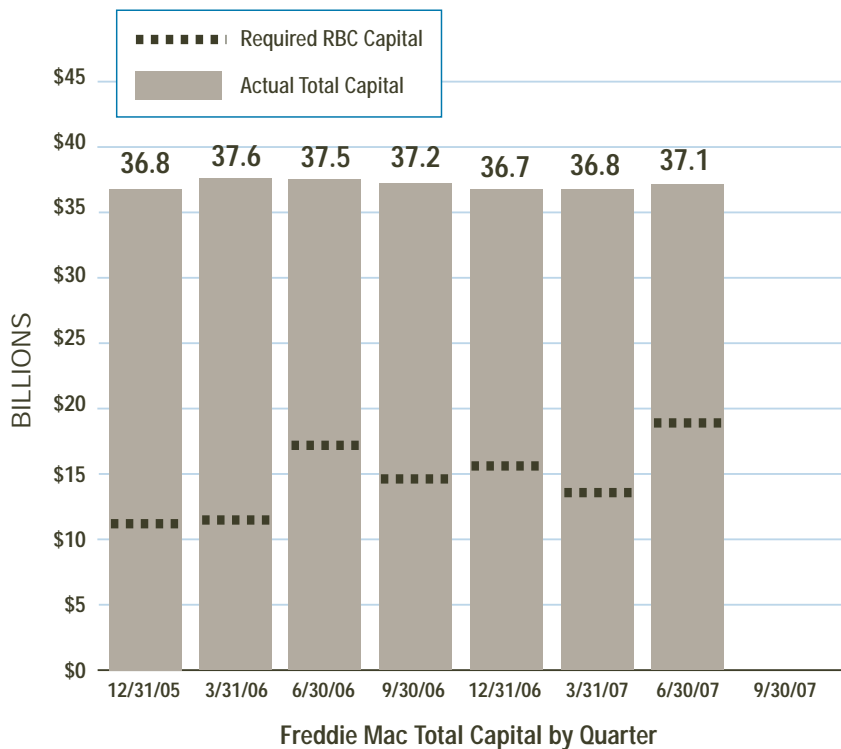


Figure 16 –Freddie Mac Risk-Based Capital Requirements, FY 2006 - 2007

market, credit, operational and systemic risk. The plan also identifies the limitations of the current regulatory structure and offers options to address them.

In FY 2007, OFHEO undertook six projects to develop a new framework for capital oversight focusing on new approaches to the risk-based capital requirement while revising the existing model. The new risk-based models include separate models for market, credit and operational risks. OFHEO is also addressing issues related to the appropriate measure of available capital, including the use of a fair value of equity.




Completeness and Reliability of Performance Data

The data for this performance goal are complete for the first three quarters of the fiscal year and has some limitations in reliability for Fannie Mae in the second and third quarters. Data for the quarter ending September 30, 2007, will be available in December 2007. This data will be available on OFHEO’s website at that time. OFHEO will include all four quarters of data in its annual Report to Congress in April 2008 and subsequent agency performance budgets and reports.

Each quarter senior officers of each Enterprise transmit their data and attest to its completeness and accuracy. For the risk-based capital standard, OFHEO uses data

validation protocols to ensure the consistency and integrity of the data received. However, because of the internal control problems related to financial reporting, quarterly capital classifications for quarters in FY 2007 were made using Enterprise data that is subject to revision.

As each Enterprise has made progress on restating its financial results, OFHEO has reassessed their capital levels for the appropriate quarters based on the new data. In FY 2007, OFHEO reassessed Fannie Mae’s capital levels based on resubmitted data for all four quarters in the calendar years 2002, 2003 and 2005 and the first three quarters in 2004. OFHEO reaffirmed Fannie Mae’s classification of adequately capitalized for the four quarters in calendar year 2005 and reclassified Fannie Mae as significantly undercapitalized for the four quarters in calendar years 2002, 2003 and 2004. During the fiscal year, OFHEO also reassessed Freddie Mac’s capital levels based on resubmitted data for the first three quarters of calendar year 2006 and reaffirmed that the Enterprise was adequately capitalized for those time periods.

GOAL 1.3		Ensure the Enterprises comply with applicable laws, regulations and directives, including executive compensation, corporate responsibility and disclosure.
MEASURE 1.3(1)	Any identified instances of non-compliance with laws, regulations or directives are resolved to OFHEO’s satisfaction.	100%
	2007 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. Filed notice of charges against three former Fannie Mae executives related to the findings of OFHEO’s special examination.	
MEASURE 1.3(2)	Percentage of actions required by formal regulatory agreements with the Enterprises that are resolved as planned.	85%
	2007 PERFORMANCE Monitored each Enterprises’ 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 90% of the items outlined in these formal agreements due as of June 30, 2007.	
MEASURE 1.3(3)	Percentage of Matters Requiring Attention (MRAs) and items related to OFHEO guidances and directives in noncompliance that are resolved to OFHEO’s satisfaction.	95%
	2007 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 have completed 94% of the MRAs due as of June 30, 2007.	

Prior Year Performance

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.

2007 Performance Discussion for Goal 1.3

OFHEO monitors compliance with laws, regulations, guidance and directives through continuous supervision activities including examinations and compliance reviews and enforcement actions. The Enterprises' compliance with portfolio growth limitations established in 2006 and amended in 2007 are described in the feature on page 18.

In FY 2003 Freddie Mac and in FY 2006 Fannie Mae entered into consent orders with OFHEO based on the results of OFHEO's special examinations. OFHEO closely monitors the Enterprises' progress toward meeting the requirements of the consent orders. The Enterprises have made progress toward implementing these corrections and improvements. As of September 30, 2007, Freddie Mac was in compliance with the 2003 consent order, with the exception of the provision requiring the Enterprise to separate the CEO and Chairman of the Board positions. Fannie Mae was in compliance with 88 percent of the 81 items in the 2006 consent order as of September 30, 2007. The 10 remaining items are in process by the Enterprise or pending review with OFHEO. Both Enterprises were in compliance with the 2005 agreement to provide public disclosures on their risks and risk management practices.




OFHEO also monitors each Enterprise on its progress toward correcting Matters Requiring Attention (MRAs) identified through the course of the OFHEO's examinations and other supervision reviews. At the end of the fiscal year, Fannie Mae and Freddie Mac had completed 94 percent of the MRAs due as of June 30, 2007.

In December 2006, OFHEO filed a Notice of Charges against three former Fannie Mae executives—former Chairman and CEO Franklin D. Raines, former Vice Chairman and CFO J. Timothy Howard and former Senior Vice President and Controller Leanne G. Spencer—based on the findings of the special examination of Fannie Mae OFHEO conducted. The Notice contained 101 charges related to how the individuals improperly manipulated earnings to maximize their bonuses, while knowingly neglecting accounting systems and internal controls, misapplying over 20 accounting principles and misleading the regulator and the public. In September 2007, OFHEO entered into a consent order with former Freddie Mac Executive Vice President and CFO Vaughn A. Clarke. In October 2007, hearings began against former Freddie Mac CEO Leland Brendsel and in November, OFHEO entered into a consent order with Mr. Brendsel that totaled \$16.4 million, including payments to the U.S. government, income disgorgement and the

dropping of claims against Freddie Mac for additional compensation. OFHEO worked closely with the Department of Justice to respond to motions and discovery related to the cases.

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 Matters Requiring Attention are collected in OFHEO’s automated systems and reviewed by agency management and staff as part of the quality assurance program. OFHEO only considers items validated when its review finds them acceptable and sustainable. Because compliance is determined after OFHEO completes a validation process, there is a quarterly lag in reporting. Data on the Enterprises compliance with regulatory agreements and MRAs as of September 30, 2007 will be available in December 2007. OFHEO will include this data in its annual Report to Congress in April 2008 and in subsequent agency performance budgets and reports.

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.	Meet quarterly milestones
	<p>2007 PERFORMANCE Issued revised conforming loan limit guidance and new guidances for examinations on corporate governance, executive compensation and accounting practices. Sent for OMB review a draft notice of proposed rulemaking related to a change in the loss severity calculation for the risk-based capital stress test.</p>	
MEASURE 1.4(2)	Develop a quality assurance function and implement other planned initiatives to strengthen supervision of the Enterprises.	Meet quarterly milestones
	<p>2007 PERFORMANCE Issued a revised Supervisory Handbook outlining the principles and standards for OFHEO’s examinations of the Enterprises. Implemented a quality assurance function to ensure the integrity of the supervision program.</p>	
MEASURE 1.4(3)	Develop an Enterprise Call Report.	Meet quarterly milestones
	<p>2007 PERFORMANCE Began to develop an Enterprise call report and made progress in designing an appropriate financial report that promotes consistent data between the Enterprises and over successive time periods. OFHEO did not achieve two of the four milestones for this project in FY 2007.</p>	

Prior Year Performance

This is a new goal for 2007.

2007 Performance Discussion for Goal 1.4

During FY 2007, OFHEO took several steps to enhance the supervision of Fannie Mae and Freddie Mac by improving the guidance provided on key topics, initiating changes in the capital standards that the Enterprises must meet, undertaking the development of an Enterprise call report and implementing a quality assurance program within the agency to assure the integrity of the supervision process.

In November 2006, OFHEO issued new guidances for examinations on corporate governance, executive compensation and accounting practices. These guidances outline the standards against which the Enterprises are evaluated during OFHEO's examinations. OFHEO also issued for public comment draft guidance on calculating the conforming loan limit. The agency published a new Supervision Handbook in January 2007. The handbook improves the transparency of the supervision processes, applies uniform standards to both Enterprises, and clarifies OFHEO's expectations. It is available on OFHEO's web site www.ofheo.gov.

During the fiscal year, OFHEO drafted a proposed amendment to the risk-based capital regulation that would improve the accuracy of the loss severity calculation embedded in the rule. The amendment was issued for public comment in October 2008.

OFHEO made a significant improvement to its supervision program by implementing a quality assurance function. The quality assurance function is critical to ensure the integrity of the supervisory process, including the complete documentation of the results and conclusions of supervisory activities. 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. Over time, OFHEO expects to see improvements and enhancements made to the supervision program as a result of the new quality assurance function.



OFHEO Deputy Director Ed DeMarco speaks to OFHEO staff about the Enterprises and OFHEO's efforts in July 2007.

Also OFHEO continued to develop an Enterprise call report. The call report will serve to facilitate and support the regulatory and supervisory analysis, monitoring and research functions of OFHEO. The call report will also promote consistency in the reported data between the Enterprises and over successive time periods to enhance comparability. OFHEO expects to complete the development of the call report and issue a proposed regulation related to its use in FY 2008.

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.

STRATEGIC GOAL 2

Provide support for statutory reforms to strengthen our regulatory powers.

OFHEO's ability to ensure the financial safety and soundness of the Enterprises faces major limitations within current law. As OFHEO identified problems through its special examinations of both Enterprises, the agency had to rely on consent agreements with each Enterprise to effect change. Going forward, OFHEO needs the full set of regulatory powers similar to the tools available to bank regulators so it may act quickly to address problems.

OFHEO will continue to work with both the Administration and the Congress to identify and support appropriate changes to its statutory authorities to strengthen OFHEO's ability to carry out its mission. The turmoil in the mortgage market in 2007 and its effects on the Enterprises reemphasized the need for regulatory reform.

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.	As needed
	2007 PERFORMANCE Prepared analysis, presentations and research papers for internal use on topical issues, for example subprime and nontraditional mortgages. Issued a Mortgage Market Note which clarifies issues related to the conforming loan limit and portfolio limits currently before Congress.	
MEASURE 2.1(2)	Make recommendations to Congress about legislative changes OFHEO needs to accomplish its mission.	At least annually
	2007 PERFORMANCE Presented OFHEO's legislative priorities in the 2007 annual Report to Congress. Provided technical assistance to Congress during consideration of GSE reform legislation.	
MEASURE 2.1(3)	Respond to all Congressional Inquiries.	Within 10 business days
	2007 PERFORMANCE Responded to all inquiries within the timeframe.	

Performance Results Key: Goal Fulfillment

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

Prior Year Performance

This is a new goal for 2007.

2007 Performance Discussion for Goal 2.1

OFHEO continued to support statutory reforms to strengthen the agency's regulatory powers during FY 2007. OFHEO produced for internal use analysis, presentations and research papers on topical issues including the developments in the market 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 initiated a new series, Mortgage Market Notes, in order to inform policymakers and the public on current issues and trends in mortgage markets. The first Mortgage Market Note covered the conforming loan limit and portfolio limits.

In March 2007, OFHEO's Director testified in support of GSE reform legislation before the House Committee on Financial Services and outlined specific legislative priorities in his testimony and, later, in the agency's 2007 Report to Congress, issued in April 2007. The House of Representatives passed GSE regulatory reform legislation (H.R. 1427) on May 22, 2007. OFHEO continued to support reform legislation by responding to questions and working 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 its possible effects and to gather their input. The agency also responded to numerous media inquiries about the legislation.

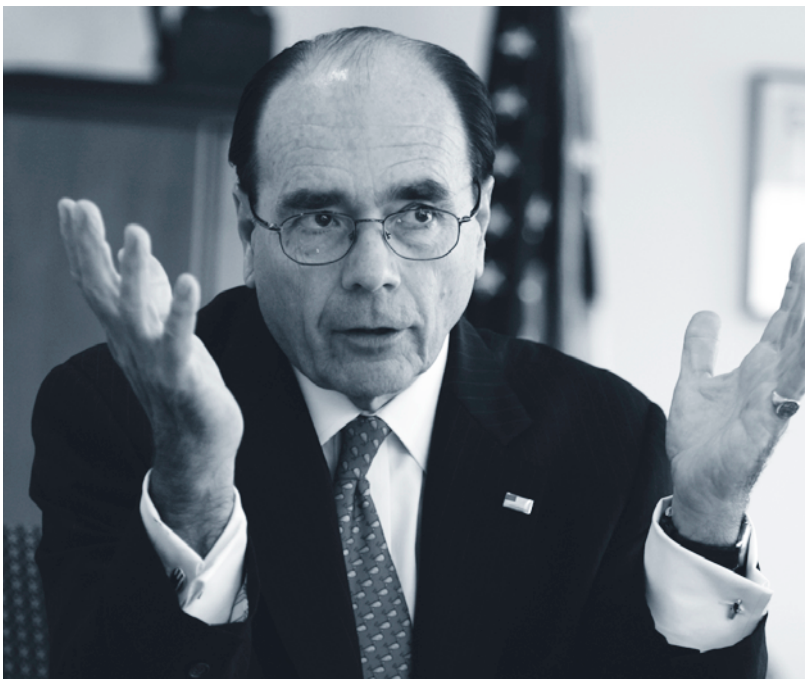
OFHEO maintained communication with Congress during the fiscal year and provided technical assistance as the House of Representatives and the Senate worked on GSE regulatory reform legislation. OFHEO continued briefings with congressional committee members and staff on

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 by senior management quarterly.




OFHEO Director James B. Lockhart III describes the benefits of GSE reform legislation in a media interview on September 25, 2007.



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, especially in late FY 2007 as the private-label MBS market froze, and are increasingly important participants in the financial system as a whole. 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 works 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)	Report about house price trends through the House Price Index (HPI) report.	Each quarter
	2007 PERFORMANCE Issued HPI report quarterly. Provided additional information in the regular quarterly reports, including an expanded "purchase-only" index.	
MEASURE 3.1(2)	Report on OFHEO activities, examination results and conclusions, and the secondary mortgage market in the OFHEO annual Report to Congress.	March 31, 2007
	2007 PERFORMANCE Annual Report to Congress sent to Congress on April 10, 2007.	
MEASURE 3.1(3)	Publish reports to enhance understanding of mortgages, mortgage markets and the nation's housing finance system.	At least 5 per year
	2007 PERFORMANCE Published five working papers and three research papers on OFHEO's website during the year. Initiated the publication of a new series called the "Mortgage Market Note" to inform the public.	

Performance Results Key: Goal Fulfillment




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

GOAL 3.1 (continued)	Promote an efficient secondary mortgage market by increasing the transparency of mortgage market developments and Enterprise risks and activities.	
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MEASURE 3.1(4)	Create a housing statistics section on the OFHEO website.	By the end of the fiscal year
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	<p>2007 PERFORMANCE Launched a revamped and updated website in September 2007 which included a much-improved housing statistics section.</p>
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Prior Year Performance

<p>2006 </p>	<p>HPI Report issued quarterly. Annual Report to Congress sent on June 15, 2006. Report of the Special Examination of Fannie Mae issued in May 2006. One research paper and one working paper published.</p>
<p>2005 </p>	<p>HPI Report issued quarterly. Three research papers published as planned. Annual Report to Congress sent June 15, 2005.</p>
<p>2004 </p>	<p>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. Other papers and reports on special topics were completed. Annual Report to Congress sent on June 15, 2004.</p>

2007 Performance Discussion for Goal 3.1

During FY 2007, OFHEO provided valuable information to the public about the financial performance and condition of the Enterprises and their secondary mortgage market activities, as well as developments in the housing sector and the primary and secondary mortgage markets, through the publication of reports, research papers and housing statistics. As part of the upgrade and redesign of the OFHEO website in FY 2007, the agency developed a housing statistics section that includes housing market indicators and mortgage rates from the Federal Housing Finance Board, Freddie Mac and OFHEO. The section also includes an improved House Price Calculator, which the general public can use to estimate the value of their homes based on OFHEO’s House Price Index (HPI).

For each quarter OFHEO issued the HPI two months after the quarter-end. The HPI documents changes in home prices for the nation, each state, many Metropolitan Statistical Areas (MSAs) and the nine census divisions. OFHEO has used the HPI to provide pertinent and timely information to the public on the cyclical status of housing prices. In FY 2007, OFHEO began publishing a

census division and state level data in addition to the national purchase-only index. OFHEO continued to publish the original house price index and provided additional analyses of specific geographic areas and house price trends in its quarterly reports. The purchase-only index reports changes based only on transactions of home purchases, while the original HPI reports changes based on refinancing transactions as well as home purchases. The advantages of the two separate indexes are discussed in the HPI report issued June 1, 2007. The HPI report for each quarter is on the OFHEO website.



OFHEO published its annual Report to Congress, describing the results and conclusions of the OFHEO calendar year 2006 examinations of the Enterprises and some of the regulatory activities of the agency. The report explained the results of the examinations through the CAMELSO framework. OFHEO is unique among financial regulators as it is required by law to make public its examination results and conclusions. OFHEO issued the report in April 2007, two months earlier than the June 15 statutory due date. The timing of the report follows OFHEO's capital classification of the Enterprises for the quarter ending December 31. OFHEO intends to issue the report in this time frame in future years. This report is available on the OFHEO website.




OFHEO's employees attend an all-hands meeting in July 2007 about key supervisory activities the agency accomplished during the year.

While much of OFHEO's research and analysis includes 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 two research papers in June 2007, "Mortgage Markets and the Enterprises in 2006" and "A Note on the Differences between the OFHEO and S&P/Case-Shiller House Price Indexes" and in September 2007, a Mortgage Market Note titled "Portfolio Caps and Conforming Loan Limits." The agency also issued five working papers during FY 2007:

- ▲ "Signals from the Markets for Fannie Mae and Freddie Mac Subordinated Debt" (June 2007)
- ▲ "Subordinated Debt Issuance by Fannie Mae and Freddie Mac" (June 2007)
- ▲ "Home Improvements and Appreciation Rates Reflected in the OFHEO House Price Index" (June 2007)
- ▲ "Securitized Jumbo Mortgages: 1986 - 2005" (June 2007)
- ▲ "Zero Down Payment Mortgage Default" (August 2007)

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.

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.	Greater than prior year
	2007 PERFORMANCE Over 93% of respondents indicated they found OFHEO's website a valuable resource.	
MEASURE 3.2(2)	Respond to all public inquiries.	Within 15 business days
	2007 PERFORMANCE Responded to all inquiries within the time frame.	
MEASURE 3.2(3)	Meet with industry stakeholders to address current topics and receive input from the industry.	Quarterly
	2007 PERFORMANCE Director Lockhart and senior OFHEO staff met regularly with trade associations, industry representatives and housing advocacy groups.	

Prior Year Performance

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.

2007 Performance Discussion for Goal 3.2

OFHEO supports 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 produces in its oversight of the Enterprises. In 2006, OFHEO initiated a survey to ensure that the agency's website served the needs of stakeholders and the general public by providing them valuable information. In FY 2007, for the second year in a row, more than 93 percent of survey respondents found the OFHEO website valuable and many



provided suggestions for further improvements. This year, OFHEO used that feedback to completely revamp its website, making it easier to navigate, more user-friendly and more accessible.

OFHEO also continued to respond promptly to inquiries from the public during FY 2007. The agency resolved all public inquiries within the target time frames despite the continued high 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 makes every effort to help the inquirer find the appropriate source instead of turning the request away.

OFHEO also maintains 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.

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 data is collected by a contractor external to OFHEO and summarized for use by OFHEO management.

GOAL 3.3	Cooperate with other Federal financial 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.	At least quarterly
	2007 PERFORMANCE 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, reports and other information relating to Fannie Mae and Freddie Mac.	
MEASURE 3.3(2)	Respond to requests from other Federal agencies for information about housing finance markets and the Enterprises.	Within 30 days
	2007 PERFORMANCE Responded to all requests within the time frame.	

GOAL 3.3
(continued)

Cooperate with other Federal financial agencies on mortgage markets, the nation's housing finance system and regulatory issues.

Prior Year Performance2006 

Responded to all requests within the time frame. Worked on various issues, such as accounting policy and mortgage fraud, and participated in inter-agency 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 time frame.

2004 

Cooperated with other federal financial agencies on regulatory issues.

2007 Performance Discussion for Goal 3.3

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 FY 2007, OFHEO worked with the following federal agencies and departments:

- ▲ Department of Housing and Urban Development (HUD)
- ▲ Federal Reserve System
- ▲ Office of Thrift Supervision (OTS)
- ▲ Federal Housing Finance Board (FHFB)
- ▲ Office of the Comptroller of the Currency (OCC)
- ▲ Federal Deposit Insurance Corporation (FDIC)
- ▲ Farm Credit System Insurance Corporation (FCSIC)
- ▲ Farm Credit Administration (FCA)
- ▲ Office of Management and Budget (OMB)
- ▲ Department of the Treasury
- ▲ Internal Revenue Service (IRS)
- ▲ National Credit Union Administration (NCUA)
- ▲ Securities and Exchange Commission (SEC)
- ▲ Department of Justice (DOJ)
- ▲ Public Company Accounting Oversight Board (PCAOB)
- ▲ Conference of State Bank Supervisors (CSBS)
- ▲ President's Council of Economic Advisors (CEA)
- ▲ Congressional Research Service (CRS)
- ▲ Congressional Budget Office (CBO)

OHEO worked with these agencies on a variety of issues: developments in the subprime and nontraditional mortgage market; GSE reform legislation; legal and regulatory issues related to the special examinations of Fannie Mae and Freddie Mac; accounting policy and practices; examination planning; foreclosure prevention; House Price Index data; pandemic influenza, emergency preparedness and disaster planning; and planning, performance management and performance measurement.

OFHEO worked directly with HUD on a number of issues to ensure coordinated responses and appropriate sharing of information. Throughout the year the Director met regularly with the Secretary and Assistant Secretary for Housing and OFHEO senior management met regularly with representatives from the HUD Office of GSE Oversight, which has mission oversight responsibilities for the Enterprises.

In July 2007, OFHEO cohosted a conference with the FDIC entitled “Private-Label MBS Outlook: Investors and the Subprime and Nontraditional Mortgage Guidance.” This was the third in a series of interagency conferences to address significant issues on these topics and include representatives from the mortgage market community.

OFHEO established Memorandums of Understanding (MOU) with OTS, FHFB and HUD during the year to share information on issues of mutual supervisory interest and resources between the agencies. OFHEO continues to forward any information indicating mortgage fraud to the Treasury Department’s FinCEN, following the MOU established in 2006.

OFHEO continues to participate in the Financial and Banking Information Infrastructure Committee, a standing committee of the President’s Working Group on Financial Markets. OFHEO also maintained active involvement with the Joint Agency Task Force on Discrimination in Lending, the Bank Fraud Working Group, the Mortgage Fraud Working Group and the Interagency Task Force on National Flood Insurance. During FY 2007, OFHEO also briefed the Mortgage Finance Authority of Egypt, at their request, on OFHEO’s supervisory and regulatory functions.




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 ensures that resources are 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 workforce that is skilled, flexible and performance-oriented to fulfill the goals of the agency.
MEASURE 4.1(1)	Develop a work force plan that is focused on aligning human capital with OFHEO's strategic goals.	By the end of the 3rd quarter
	2007 PERFORMANCE Published a work force plan as part of OFHEO's five-year Human Capital Strategic Plan in July 2007.	
MEASURE 4.1(2)	Conduct an OFHEO-wide competency analysis review.	By the end of the fiscal year
	2007 PERFORMANCE Conducted a competency analysis for leadership skills and mission-critical technical skills.	
MEASURE 4.1(3)	Develop a succession plan to address OFHEO's future workforce needs.	By the end of the fiscal year
	Published a general agency-wide succession plan as part of OFHEO's five-year Human Capital Strategic Plan in July 2007. Developed succession plans for individual offices as well.	

Performance Results Key: Goal Fulfillment

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

GOAL 4.1 (continued)		Maintain a diverse workforce that is skilled, flexible and performance-oriented to fulfill the goals of the agency.
MEASURE 4.1(4)	Conduct first annual employee survey to establish a baseline.	Acquire baseline survey results in 2007
	2007 PERFORMANCE Conducted an agency-wide employee survey in July 2007 and received summary data for analysis from OPM in September 2007.	
MEASURE 4.1(5)	Develop draft changes to the performance management system to incorporate office and individual work plans and identify a specific connection between the employee's work plan and OFHEO's performance goals.	By the end of the fiscal year
	2007 PERFORMANCE 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.	

Prior Year Performance

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.

2007 Performance Discussion for Goal 4.1

OFHEO published its first Human Capital Strategic Plan in FY 2007. The plan provides a vision and structure for future workforce and succession planning; outlines the agency's objectives and principles regarding human capital management; and addresses strategic alignment, workforce planning, leadership knowledge, results-oriented performance culture, talent management and accountability in the context of OFHEO's workforce and operating environment. The Human Capital Strategic Plan is especially important because of OFHEO's recent growth. In the past few years, OFHEO staff has increased by over 80 percent, from 126 Full-Time Equivalent (FTE) work years in FY 2003 to 230 in FY 2007, as shown in Figure 17. Over the course of the fiscal year, OFHEO hired more than 30 new employees and, net of departures, grew from 225 staff on board as of September 2006, to 236 as of September 2007, an increase of five percent.

OFHEO maintains a strong commitment to recruiting and retaining a high-caliber workforce and ensuring that the employees have the skills and expertise necessary to meet the important goals

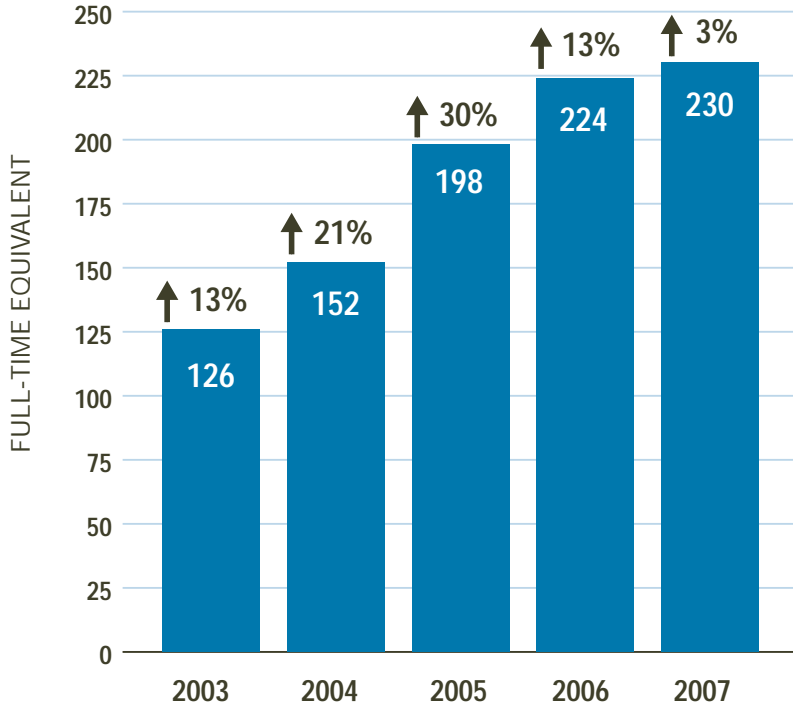


Figure 17 – OFHEO’s Growth in Full-Time Equivalents, FY 2003 - 2007

OFHEO Director Lockhart presents Special Act Awards to the Financial Performance, Comparative Analysis and Reporting Task Force whose outstanding work led to the creation of the agency’s new Office of Risk Analysis and Financial Performance.

leadership quality, performance culture and talent capacity. OFHEO will analyze the results and share them with the staff. By using the feedback to address any issues that surface, OFHEO can become an even more effective agency and an even better place to work.

During the year, OFHEO shifted resources to achieve its goals, including reorganizing or detailing staff when necessary and hiring additional staff in critical areas. OFHEO established two new offices within the Office of Supervision to focus on supervision policy, quality assurance and financial analysis. OFHEO also revised the employee performance review system to more clearly link individual results to the agency’s goals.





and mission of the agency. At the end of FY 2007, OFHEO hired a recruiter to help ensure that job postings are widely distributed and available to potential minority applicants. OFHEO also completed an agency-wide competency analysis review for technical competencies for mission-critical occupations and leadership competencies during the year. The competency analysis will help OFHEO create appropriate development opportunities and outreach efforts in future years.

Also during FY 2007, OFHEO conducted an agency-wide employee survey, using the survey questions established by OPM. The employee survey measures employees’ perceptions of conditions that characterize successful organizations at OFHEO, such as



Completeness and Reliability of Performance Data

The data for this performance goal are complete and reliable. With the exception of employee survey data, the data are created internally, reported in the agency’s performance tracking system and reviewed by senior management quarterly. Employee survey data were collected by OPM and summarized for OFHEO’s use.

GOAL 4.2		Provide effective information resources management services to OFHEO managers and staff to support the goals of the agency.
MEASURE 4.2(1)	Publish the Five-Year IT Strategic Plan	By the end of the 3rd quarter
	2007 PERFORMANCE Published the Five-Year Information Technology Strategic Plan on OFHEO's website in June 2007.	
MEASURE 4.2(2)	Implement the fiscal year 2007 component of the OFHEO Five-Year IT Strategic Plan.	By the end of the fiscal year
	2007 PERFORMANCE Completed all milestones for four major projects in the 2007 plan, including a project on security, systems development lifecycle, FISMA and xWorks, OFHEO's automated supervisory tool.	
MEASURE 4.2(3)	Percent of time OFHEO's IT systems are available for use by the OFHEO staff.	97%
	2007 PERFORMANCE System availability exceeded 97% during the year.	
MEASURE 4.2(4)	Certification and Accreditation of all major OFHEO systems completed.	100%
	2007 PERFORMANCE Completed Certification and Accreditation for all six major systems.	

Prior Year Performance

2006



Successfully implemented four of six projects outlined in the FY 2006 component of the Five-Year IT Strategic Plan. Substantially completed the remaining two projects in FY 2006 and completed them in the first and second quarter of FY 2007.

2005



Implemented all three projects outlined in the FY 2005 Component of Five-Year IT Strategic Plan.

2004



Implemented all three projects outlined in the FY 2004 Component of Five-Year IT Strategic Plan.

2007 Performance Discussion for Goal 4.2


OFHEO depends upon the strategic use of information technology in order to effectively supervise and oversee the Enterprises. The agency made significant progress during 2007. In FY 2007, OFHEO issued a significantly revised Information Technology Management Strategic Plan that outlines the goals and objectives needed to support the mission and functions of OFHEO and carries out the E-Gov goals of the PMA. This plan allows the agency to stage and upgrade the information technology that is appropriate for the work planned each year and improves the management of information technology resources.

OFHEO also revamped its Investment Review Board (IRB) to focus not only on acquisition but also on management of systems over their life cycle. The IRB reviews purchases, enhancements and performance of the major systems OFHEO uses to accomplish its daily work.

During FY 2007, OFHEO completed all the projects planned as part of the annual component of the five-year strategic plan, including making significant improvements to the security program and certifying and accrediting all the major systems in the agency. OFHEO also maintained availability of its network for staff use over 97 percent of business hours during the year. This low level of system outages helps maintain employee productivity.

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 are collected through an automated help-desk system.

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 a clean opinion and no material weaknesses.	100%
	2007 PERFORMANCE Received unqualified audit opinion on 2007 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.	

GOAL 4.3
(continued)**Maintain a strong internal control and risk management program.****Prior Year Performance**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 were 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.

2007 Performance Discussion for Goal 4.3

During the year, external auditors conducted a complete financial audit and issued a clean audit opinion finding no material weaknesses for OFHEO for FY 2007. Throughout the year, OFHEO continued its quarterly time studies, begun in 2005, to more accurately estimate expenses by strategic 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. OFHEO also received an opinion from an independent review of the information security program, as required by the Federal Information Security Management Act, indicating no material or significant weaknesses.

As precursor to a full internal controls audit, OFHEO initiated two "Agreed-Upon Procedures" reviews with an independent auditor to review both internal controls and change management controls related to the agency's new automated time and attendance system, Kronos, and the Financial Information Management System's new automated internal controls program, Applimation. No material control weaknesses were identified in either of these two reviews.

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)**

Complete continuity of operations plan as outlined by Federal Preparedness Circular 65.

By year end

**2007 PERFORMANCE**

Issued revised and updated Continuity of Operations (COOP) plan for OFHEO that meets the requirements found in Federal Preparedness Circular 65 and follows current best practices in business continuity planning.

Prior Year Performance

This is a new goal for 2007.

2007 Performance Discussion for Goal 4.4

OFHEO is 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. In FY 2007, OFHEO completed a major revision and updated its continuity of operations (COOP) plan, which identifies essential functions and alternate plans in case of an emergency, including alternative work sites. The plan also includes a regular schedule of testing to assess and validate the plan and proactively identify any gaps or operational problem areas. This testing will include alert and notification procedures, recovery plans for vital systems and data, infrastructure systems such as computer systems and after-action reviews to ensure that lessons learned from testing are incorporated into the plan.

The revised COOP plan follows Federal Preparedness Circular 65, which provides guidance to federal agencies about business continuity planning and outlines requirements for agency plans. OFHEO also completed a pandemic influenza supplement to the COOP plan and began testing the plan through an interagency pandemic influenza exercise in September 2007.

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.

Financial Section



Message From The Chief Financial Officer

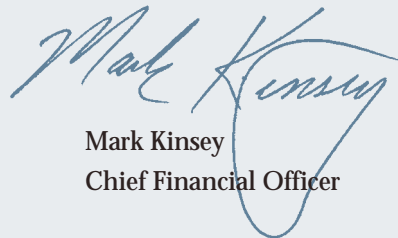
I am pleased to report that for fiscal year 2007 OFHEO has once again received an unqualified audit opinion on its financial statements. This marks the tenth straight year OFHEO has received a clean audit opinion, dating back to 1998, when OFHEO first chose to have its financial statements audited by external auditors. With no identified material weaknesses in internal controls or instances of non-compliance with laws and regulations, the most recent audit results place OFHEO at the head of the class using the Financial Performance Standards contained in the President's Management Agenda.

This outstanding record of accomplishment reflects a strong internal control environment that has been established within the organization. OFHEO's managers reported no material internal control weaknesses in any of the agency's programs. The Executive Committee on Internal Controls (ECIC) met at least quarterly this past fiscal year to oversee internal controls throughout the agency. The ECIC concurred with management assurances on the effectiveness of OFHEO's internal controls. This involvement by senior management helped to maintain and reinforce a strong internal control environment during FY 2007.

OFHEO's record of accomplishment extended to other areas of external review as well. An independent annual FISMA review of the agency's information systems security program revealed no significant or material weaknesses in the program. Two "Agreed-Upon Procedures" reviews focusing on internal controls were also conducted during the fiscal year. No material control weaknesses were identified in either of these two reviews.

As always, these impressive results could not have been achieved without the dedication and hard work of OFHEO's staff in establishing and adhering to OFHEO policies and controls.

Sincerely,



Mark Kinsey
Chief Financial Officer



Mark Kinsey,
OFHEO Chief Financial Officer

**OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT**

1700 G STREET NW WASHINGTON DC 20552 (202) 414-3801

OFFICE OF THE DIRECTOR

Fiscal Year 2007

Annual Assurance Statement on Internal Control over Financial Reporting

The Office of Federal Housing Enterprise Oversight management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding assets and compliance with applicable laws and regulations. OFHEO conducted assessment of the effectiveness of its internal control over financial reporting 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 internal control over financial reporting as of June 30, 2007 was operating effectively and no material weaknesses were found in design or operation of the internal controls over financial reporting.


James B Lockhart III


Date



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, 2007 and 2006, 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, 2007 and 2006, 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, 2007, on our consideration of the Office of Federal Housing Enterprise Oversight's internal control over financial reporting and a report dated October 31, 2007 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, 2007

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MEMBER: AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AND PKF INTERNATIONAL



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

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, 2007 and 2006, 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, 2007. 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 by October 31, 2007.

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Finally, with respect to internal control related to performance measures reported in the annual performance plan, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 07-04. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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, 2007



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, 2007 and 2006, 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, 2007. 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, 2007

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

Balance Sheets

as of September 30, 2007 and 2006

(Amounts Shown in Thousands)

	2007	2006
Assets		
Intragovernmental		
Fund Balance with Treasury - Note 3	\$ 25,387	\$ 72,256
Total Intragovernmental	25,387	72,256
Property, Plant & Equipment, Net - Note 4	8,718	11,234
Total Assets	34,105	83,490
Liabilities		
Intragovernmental		
Other Liabilities		
Due To Treasury	5	50,016
Total Other Liabilities	5	50,016
Total Intragovernmental	5	50,016
With the Public		
Accounts Payable	1,453	1,386
Other Liabilities		
Accrued Payroll	1,566	1,378
Annual Leave	3,061	2,304
Deferred Rent	196	171
Total Other Liabilities	4,823	3,853
Total With the Public - Note 5	6,276	5,239
Total Liabilities	6,281	55,255
Net Position		
Unexpended Appropriations - Note 1.K	22,363	19,475
Cumulative Results of Operations - Note 1.K	5,461	8,760
Total Net Position	27,824	28,235
Total Liabilities and Net Position	\$ 34,105	\$ 83,490

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, 2007 and 2006

(Amounts Shown in Thousands)

	<u>2007</u>	<u>2006</u>
Program Costs		
Program Costs - Note 7	\$ 68,082	\$ 61,243
Net Cost of operations	\$ 68,082	\$ 61,243

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, 2007 and 2006

(Amounts Shown in Thousands)

	<u>2007</u>	<u>2006</u>
Cumulative Results of Operations		
Beginning Balance	\$ 8,760	\$ 7,768
Budgetary Financing Sources		
Appropriations Used	63,209	60,752
Other Financing Sources		
Imputed Financing	1,574	1,483
Total Financing Sources	<u>64,783</u>	<u>62,235</u>
Net Cost of Operations	<u>(68,082)</u>	<u>(61,243)</u>
Net Change	(3,299)	992
Cumulative Results of Operations	5,461	8,760
Unexpended Appropriations		
Beginning Balance	19,475	20,247
Budgetary Financing Sources		
Appropriations Received	66,150	60,000
Other Adjustments	(53)	(20)
Appropriations Used	<u>(63,209)</u>	<u>(60,752)</u>
Total Budgetary Financing sources	2,888	(772)
Unexpended Appropriations	22,363	19,475
Net Position	\$ 27,824	\$ 28,235

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, 2007 and 2006

	<i>(Amounts Shown in Thousands)</i>	
	<u>2007</u>	<u>2006</u>
Budgetary Resources		
Unobligated Balance, Beginning	\$ 53	\$ 20
Recoveries of Prior Year Obligations - Note 9	1,409	612
Budget Authority:		
Appropriation	66,150	60,000
Permanently Not Available Pursuant to P.L. 102-550 - Note 10	(53)	(20)
Total Budgetary Resources	<u>67,559</u>	<u>60,612</u>
Status of Budgetary Resources		
Obligations Incurred - Note 8	67,437	60,559
Unobligated Balance Not Available	122	53
Total Status of Budgetary Resources	<u>67,559</u>	<u>60,612</u>
Change in Obligated Balance		
Obligated Balance, Beginning	22,187	24,315
Obligations Incurred	67,437	60,559
Gross Outlays	(62,955)	(62,075)
Recoveries	(1,409)	(612)
Obligated Balance, Ending	<u>25,260</u>	<u>22,187</u>
Net Outlays		
Disbursements	62,955	62,075
Net Outlays	\$ 62,955	\$ 62,075

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, 2007 and 2006

(Amounts Shown in Thousands)

	<u>2007</u>	<u>2006</u>
Revenue Activity		
Sources of Cash - Note 14		
Fines Assessed	\$ -	\$ 50,000
FOIA Fees Collected	5	16
	<u>5</u>	<u>50,016</u>
Total Cash Collections	5	50,016
	<u>5</u>	<u>50,016</u>
Total Custodial Revenue	5	50,016
Disposition of Collections		
Due to Treasury - Note 14	5	50,016
	<u>5</u>	<u>50,016</u>
Total Disposition of Collections	5	50,016
	<u>5</u>	<u>50,016</u>
Net Custodial Activity	\$ 0	\$ 0

The accompanying notes are an integral part of these statements.

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 are 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.

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 year-end 2006 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. 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 non-entity 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. 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.

H. Accounts Receivable

OFHEO records an accounts receivable when amounts are due from employees or from individuals requesting FOIA services. There were no account receivables at September 30, 2007 or 2006.

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.

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 both 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. Accounts payable represent amounts owed to another entity for goods ordered and received and for services rendered by other than employees. Accrued payroll represents 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 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 no unpaid FECA claims and therefore no liability is accrued. Additionally, no liability is recorded for future worker's compensation as of September 30, fiscal years 2007 and 2006, since 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 6 – 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 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 2 – Non-entity Assets

Assets that are classified as non-entity are the portion of fund balance with Treasury represented by collections of a civil penalty and FOIA request fees. Those non-entity asset balances consist of the following as of September 30, 2007 and 2006:

	2007	2006
Intragovernmental Fund Balance	\$ 5	\$ 50,016

Note 3 – Fund Balance with Treasury

Fund Balance with Treasury consists of the following as of September 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Fund Balances:		
Appropriated Funds	\$ 25,382	\$ 22,240
Other	5	50,016
Total	\$ 25,387	\$ 72,256
Status of Fund Balances:		
Unobligated Balance		
Unavailable	\$ 122	\$ 53
Obligated Balance	25,260	22,187
Non-Budgetary	5	50,016
Total	\$ 25,387	\$ 72,256

Note 4 – Property, Plant and Equipment

Property, Plant and Equipment balances as of September 30, 2007, are as follows:

	<u>Acquisition Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
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

Property, Plant and Equipment balances as of September 30, 2006, are as follows:

	<u>Acquisition Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Equipment	\$ 10,695	\$ 6,855	\$ 3,840
Leasehold Improvements	6,296	3,022	3,274
Internal Use Software	21,652	17,532	4,120
Total	\$ 38,643	\$ 27,409	\$ 11,234

Internal use software applications included in the current net book value include OFHEO's Financial Information Management System (FIMS) and the automated supervisory tool (xWorks). The Risk-Based Capital (RBC) software was fully depreciated in FY 2005.

Note 5 - Liabilities Covered and Not Covered by Budgetary Resources

	2007			2006		
	Covered	Not Covered	Total	Covered	Not Covered	Total
Intragovernmental						
Other Liabilities:						
Due to Treasury	\$ -	\$ 5	\$ 5	\$ -	\$ 50,016	\$ 50,016
Total Other Liabilities	-	5	5	-	50,016	50,016
Total Intragovernmental	\$ -	\$ 5	\$ 5	\$ -	\$ 50,016	\$ 50,016
With the Public						
Accounts Payable	\$ 1,453	\$ -	\$ 1,453	\$ 1,386	\$ -	\$ 1,386
Other Liabilities:						
Accrued Payroll	1,566	-	1,566	1,378	-	1,378
Annual Leave	-	3,061	3,061	-	2,304	2,304
Deferred Rent	-	196	196	-	171	171
Total Other Liabilities	1,566	3,257	4,823	1,378	2,475	3,853
Total With the Public	\$ 3,019	\$ 3,257	\$ 6,276	\$ 2,764	\$ 2,475	\$ 5,239
Total Liabilities	\$ 3,019	\$ 3,262	\$ 6,281	\$ 2,764	\$ 52,491	\$ 55,255

All "Other Liabilities" are considered current, except for the deferred rent.

Note 6 – 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 five-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, 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 FY 2008 are estimated to be \$4.4 million.

1750 Pennsylvania Avenue NW

In FY 2005, 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 terminates earlier than the expiration date, the sublease then also terminates. A deferred rent liability is established for this lease.

Under existing commitments, the future minimum lease payments through FY 2011 are as follows:

<u>Fiscal year Ending September 30,</u>	<u>1750 Penn Ave NW</u>
2008	\$ 907
2009	944
2010	981
2011	505
Total Future Minimum Lease Payments	\$ 3,337

Total rent expenses on the two leases for the years ended September 30, 2007 and 2006 were approximately \$5.1 million and \$4.9 million, respectively.

Note 7 – 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 OPM. 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, 2007 and 2006 were:

	<u>2007</u>	<u>2006</u>
Intragovernmental	\$ 13,036	\$ 12,016
With the Public	55,046	49,227
Total Program Costs	\$ 68,082	\$ 61,243

Note 8 – Apportionment Categories of Obligations Incurred

All obligations incurred, 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, 2007 and 2006 were:

	<u>2007</u>	<u>2006</u>
Direct Obligations – Category B	\$ 67,437	\$ 60,559

Note 9 – 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 2007 and 2006.

Note 10 – Legal Arrangements Affecting Use of Unobligated Balances

P.L. 102-550 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 11 – Explanation of Differences Between the Statement of Budgetary Resources (SBR) and the Budget of the U.S Government (Budget)

The financial statements for FY 2007 are published before the 2007 U.S. Budget actual figures are available. Therefore, reconciliation between the SBR and the Budget is prepared for FY 2006. OFHEO has no differences between the SBR and the U.S. Budget for FY 2006. OFHEO routinely reconciles financial data reported throughout the entire reporting process to ensure consistency.

	2006 SBR (in Millions)	2006 Budget (in Millions)
New Budget Authority	\$ 60	\$ 60
Resources from Recoveries	1	1
Total Budgetary Resources	<u>\$ 61</u>	<u>\$ 61</u>
Change in Obligated Balance		
Obligated Balance, start of year	\$ 24	\$ 24
New Obligations	61	61
Outlays	(62)	(62)
Recoveries	(1)	(1)
Obligated Balance, end of year	<u>\$ 22</u>	<u>\$ 22</u>
Gross Outlays	<u>\$ 62</u>	<u>\$ 62</u>

Note 12 – 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, 2007 and 2006 were:

	2007	2006
Undelivered Orders	<u>\$ 22,240</u>	<u>\$ 19,422</u>

Note 13 – 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.

	<u>2007</u>	<u>2006</u>
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 67,437	\$ 60,559
Recoveries	(1,409)	(612)
Net Obligations	66,028	59,947
Other Non-Budgetary Resources		
Imputed Financing	1,574	1,483
Net Other Non-Budgetary Resources	1,574	1,483
Total Resources Used to Finance Activities	\$ 67,602	\$ 61,430
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	(2,818)	804
Resources that Finance the Acquisition of Assets	(3,279)	(6,232)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(6,097)	(5,428)
Total Resources Used to Finance the Net Cost of Operations	\$ 61,505	\$ 56,002
Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period		
Annual Leave	757	554
Deferred Rent	25	171
Depreciation and Revaluation of Assets	5,795	4,516
Total Components of Net Cost of Operations Not Requiring or Generating Resources in the Current Period	\$ 6,577	\$ 5,241
Net Cost of Operations	\$ 68,082	\$ 61,243

Note 14 – Custodial Activities

The \$50 million presented on the Statement of Custodial Activity in FY 2006 represented a penalty paid by Fannie Mae as part of a settlement with OFHEO regarding Fannie Mae's accounting improprieties uncovered in a special examination. Fannie Mae paid a total penalty of \$400 million, of which \$50 million was directed to OFHEO and \$350 million directed to the SEC. The \$50 million collected by OFHEO was not for OFHEO's use. A liability Due to Treasury was reported by OFHEO at September 30, 2006, for the amount of the penalty 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, 2007 and 2006 for the amount of fees collected.

GLOSSARY

ARM	adjustable-rate mortgage	GAO	Government Accountability Office
CAMELSO	Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk and Operational risk	GSE	government-sponsored enterprise
CEO	Chief Executive Officer	HPI	House Price Index
CFO	Chief Financial Officer	HUD	Department of Housing and Urban Development
COOP	Continuity of Operations	IG	Inspector General
DOL	Department of Labor	IRB	Investment Review Board
ECIC	Executive Committee on Internal Controls	IT	information technology
FASAB	Federal Accounting Standards Advisory Board	LTV	loan-to-value ratio
FECA	Federal Employees Compensation Act	MBS	mortgage-backed securities
FFIEC	Federal Financial Institutions Examinations Council	MIRS	Mortgage Interest Rate Survey
FFMIA	Federal Financial Managers Improvement Act of 1996	MOU	Memorandum of Understanding
FHFB	Federal Housing Finance Board	MRA	Matter Requiring Attention
FHLB	Federal Home Loan Bank	MSA	Metropolitan Statistical Area
FIMS	Financial Information Management System	NFC	National Finance Center
FinCEN	Financial Crimes Enforcement Network	OFHEO	Office of Federal Housing Enterprise Oversight
FISMA	Federal Information Security Management Act	OMB	Office of Management and Budget
FMFIA	Federal Financial Managers Improvement Act of 1982	OPM	Office of Personnel Management
FOIA	Freedom of Information Act	OTS	Office of Thrift Supervision
FSIO	Financial Systems Integration Office	PAR	Performance and Accountability Report
FTE	full-time equivalent	PART	Performance Assessment Rating Tool
FY	fiscal year	PMA	President's Management Agenda
GAAP	Generally Accepted Accounting Principles	RBC	risk-based capital
		S&P	Standard & Poor's
		SBR	Statement of Budgetary Resources
		SEC	Securities and Exchange Commission
		SFAS	Statement of Federal Financial Accounting Standard

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OFHEO PERFORMANCE AND ACCOUNTABILITY REPORT

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The 2007 OFHEO PAR
can be accessed on the World Wide Web at :
www.ofheo.gov/OFHEOPARNovember2007.pdf.



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