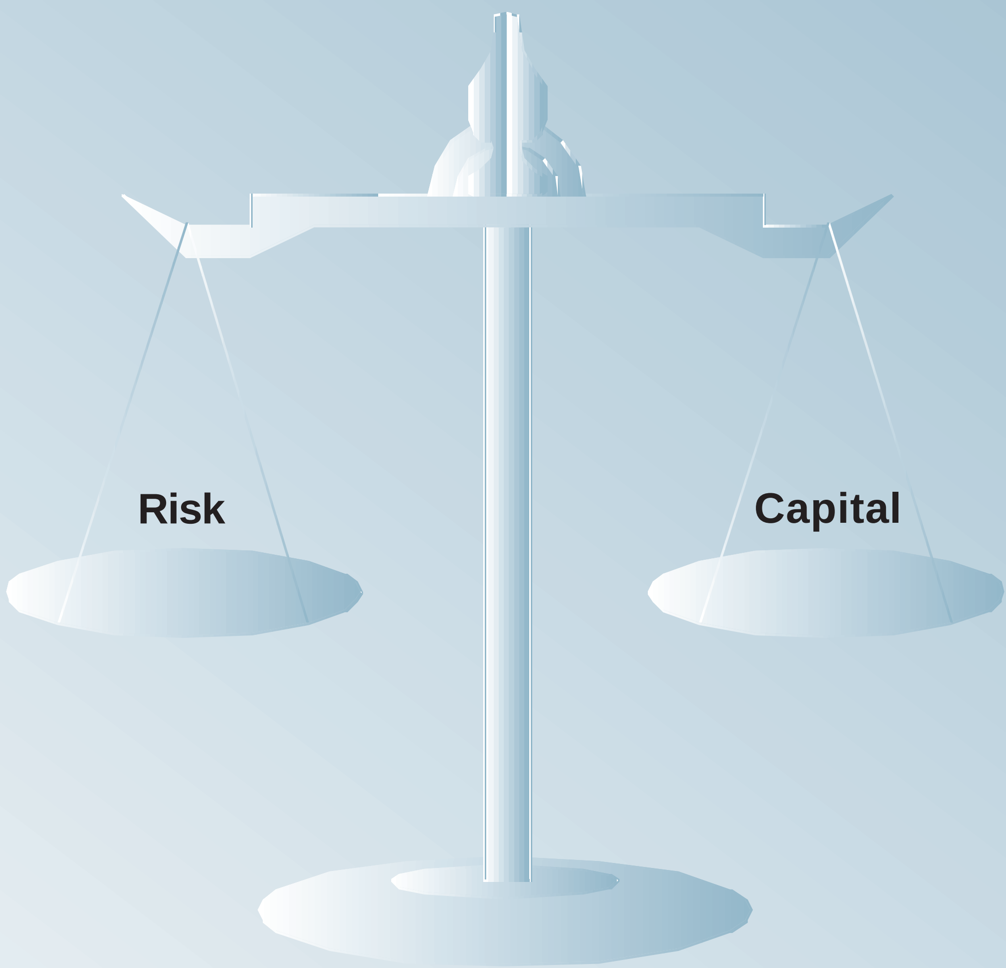
1999 Report to Congress



OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
OFHEO
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Office Of Federal Housing Enterprise Oversight
1700 G Street NW • Washington DC 20552 • (202) 414-3800

June 15, 1999

Honorable Phil Gramm
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Honorable Jim Leach
Chairman
Committee on Banking and Financial Services
House of Representatives
Washington, D.C. 20515-6050

Dear Chairmen:

I am pleased to transmit the 1999 Report to Congress of the Office of Federal Housing Enterprise Oversight (OFHEO). This report has been prepared to meet the statutory requirements in section 1319B of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of Pub. L. No. 102-550).

The views in this report are those of the Acting Director and do not necessarily represent those of the President or the Secretary of Housing and Urban Development.

Sincerely,

Mark Kinsey

Mark Kinsey,
Acting Director

ACTING DIRECTOR'S MESSAGE

1998 was a remarkable year for OFHEO. Major steps were taken to put in place a comprehensive supervisory oversight program to help ensure that Fannie Mae and Freddie Mac are adequately capitalized and operate in a safe and sound manner. We completed our first comprehensive annual risk-based examinations of the Enterprises. And on the capital regulation front, OFHEO completed its proposal for a risk-based capital standard for the Enterprises.

The importance of OFHEO's proposed risk-based capital standard may go beyond that of regulating capital for the Enterprises. It represents a new and innovative models-based approach for determining capital adequacy. It will help to shed light on the many issues surrounding the use of models for determining capital requirements for banks and thrifts.

OFHEO's proposed risk-based capital standard utilizes a stress test that incorporates statistical models to project the performance of all of the mortgages held or guaranteed by the Enterprises, along multiple risk dimensions, resulting from statutorily determined credit and interest rate stresses. The stress test also takes into account how all of the remaining assets and liabilities perform under these same stressful economic conditions.

The stress test measures the need for capital based upon a holistic approach to measuring risk at the Enterprises. Risk reduction activities such as issuing callable debt to protect against falling interest rates, the use of credit enhancements to protect against losses from higher risk mortgages, and the effective use of derivatives to better match the cash flows associated with funding mortgages with Enterprise debt all serve to lower the net or "bottom line" risk exposure. By measuring the true economic risk from an activity, OFHEO's proposed risk-based capital standard closely matches risk and the need for capital. Chapter 1 describes this innovative capital proposal.

Just as important as a strong capital standard is a strong examination program. No amount of capital is adequate if business operations are not conducted in a safe and sound manner. In 1998, OFHEO completed its first comprehensive annual risk-based examination of the Enterprises based on our new examination program. Chapter 2 describes the results and conclusions of these examinations. In keeping with OFHEO's goal for transparent oversight of the Enterprises, we recently published our Examination Handbook, which outlines in detail the comprehensive framework for OFHEO's examination program.

The Examination Handbook and all of OFHEO's regulations, including the proposed risk-based capital standard, are available on OFHEO's website at www.ofheo.gov. OFHEO's quarterly house price index (HPI) is also available here. The popularity of the HPI has resulted in a distribution list of over 1500 requesters.

In connection with the government's goal of improved accountability, OFHEO voluntarily prepared financial statements for FY 1998 and subjected these statements and underlying processes to independent audit. The certified public accounting firm of Dembo, Jones, Healy, Pennington and Ahalt audited our statements and issued an unqualified audit opinion. Chapter 4 contains a copy of the audit opinion and the associated principal financial statements and notes.

As always, none of our accomplishments could have been achieved without the hard work of OFHEO's very talented staff. As we move rapidly to the new millennium, OFHEO will be prepared to fulfill its responsibility of ensuring that the Enterprises remain financially safe and sound. This will enable Fannie Mae and Freddie Mac to continue to fulfill their important public purposes of providing a secondary mortgage market for conforming mortgages and to provide assistance to low- and moderate-income families so that they can achieve homeownership status.

Mark Kinsey
June 15, 1999

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Chapter 1

The Proposed Risk-Based Capital Standard

The 1992 Federal Housing Enterprises Financial Safety and Soundness Act (the Act) requires that the Office of Federal Housing Enterprise Oversight (OFHEO) establish a risk-based capital requirement for Fannie Mae and Freddie Mac (the Enterprises). This risk-based capital requirement sets a regulatory standard for the amount of capital that each Enterprise must hold, commensurate with the risk it assumes. The Act dictates that the requirement must be based on a stress test that simulates the amount of capital each Enterprise would need in order to maintain solvency during ten years of severe economic stress. Key conditions of the stress test's economic scenarios are also specified in the Act. These conditions include high levels of mortgage defaults, with associated losses, and large sustained movements in interest rates.

OFHEO's test uses a computer model to simulate Enterprise cash flows associated with mortgages and other financial assets and obligations under these severe economic conditions. The modeling of incoming and outgoing cash flows captures the risks embedded in those financial assets and obligations and the benefits of the hedges each Enterprise has set in place. To meet the proposed risk-based capital standard Freddie Mac and Fannie Mae must have sufficient capital to survive the losses under these conditions plus an additional 30 percent for unspecified management and operations risks.

The regulation itself is the blueprint needed to construct the stress test and calculate the risk-based capital requirement for Freddie Mac and Fannie Mae. By law, the risk-based capital requirement must be both transparent and replicable. The Enterprises, the mortgage industry, and the public must be able to understand how the capital requirements for Fannie Mae and Freddie Mac are calculated. They must be able to replicate the stress test results so that the impact on capital from changes in the Enterprises' business and changes in economic conditions can be understood.

The law requires that OFHEO develop a single model that is applied equally to both Enterprises. Although the combination of credit and interest rate risks each company takes on differs, the risk components are the same. That is, a newly originated mortgage loan with an 80 percent loan-to-value ratio poses the same credit risk, regardless of the Enterprise that purchases it. Funding a 30-year mortgage with 5-year debt poses the same interest rate risk, regardless of the Enterprise that funds it. A single stress test applied to both Enterprises ensures that equal risks require equal capital. The Enterprises' internal business models were developed to deal with shareholder risks, not public risks. Use of such internal models would not ensure equal treatment, and would not meet the requirements for regulatory fairness and complete transparency.

OFHEO issued an Advance Notice of Proposed Rulemaking in 1995 that requested comments on 65 questions related to the design of the stress test. The first and second Notices of Proposed Rulemaking, published in 1996 and 1999, together describe the stress test and the calculation of the risk-based capital amount. At the close of the comment period for the second Notice of Proposed Rulemaking, OFHEO will evaluate the comments received and determine whether to proceed to final rulemaking or propose a modified version of the regulation. A modified version would be issued as a proposed rule if it were sufficiently different that further public comment would be necessary.

ENSURING CAPITAL ADEQUACY

The risk-based capital requirement is the final and most important piece of the capital regulation of the Enterprises. The 1992 Act requires that the Enterprises meet two capital standards, risk-based and minimum, to be classified as adequately capitalized. The Act authorizes mandatory and discretionary actions that must or can be taken if an Enterprise is less than adequately capitalized. Therefore, the enforcement power to ensure capital adequacy is tied to the risk-based capital requirement and the definition of adequately capitalized. Furthermore, OFHEO's cease-and-desist authority varies, depending on whether an Enterprise is adequately capitalized or not.

Beyond the legal importance of the risk-based capital requirement, there is a compelling economic rationale. The minimum capital requirement is driven by the size of an Enterprise. An Enterprise with conservative investments and an Enterprise with riskier investments would have the same capital requirement if they were the same size. The risk-based capital requirement differentiates among the assets and accounts for both assets and obligations to provide a substantially better measure of risk and the need for capital.

STRESS TEST: THE BEST WAY TO ENSURE THE ENTERPRISES' CAPITAL ADEQUACY

Capital provides a buffer for a company in case of financial difficulties. It allows the company to continue to meet its obligations in the event of a decline in asset values. If capital is inadequate, the company can fail. Generally, investors in a company's debt require higher interest rates the weaker the company's capital adequacy, encouraging firms to hold sufficient capital. In the case of government-sponsored enterprises, such market discipline is debilitated because investors assume that the government would protect them against loss.

The same economic conditions that would cause severe distress for the Enterprises would also threaten homeowners. Bad economic times are those in which the Enterprises would be needed most, and for which they must be sufficiently capitalized. Regulatory capital, particularly for government-sponsored enterprises, is appropriately designed to provide protection in circumstances more adverse than those against which an Enterprise may choose to hold capital. Regulatory capital, therefore, is what protects housing markets and taxpayers.

The tool that Congress charged OFHEO to use in determining the capital adequacy of the Enterprises is a stress test. A stress test uses predictive models of mortgage performance so that it can examine undesired, unexpected, and hopefully preventable, outcomes. It simulates economic conditions and the financial performance of the Enterprises under what-if conditions. It is well suited to the task of determining capital adequacy.

A stress test also works well for determining the capital adequacy of the Enterprises because they engage in similar and narrow lines of business, guaranteeing and investing in mortgage assets. Their businesses can be replicated in a model far more simply than could, for example, the more diverse businesses of commercial banks. By mirroring the performance of the Enterprises' assets, liabilities, and off-balance-sheet obligations, the stress test closely ties capital levels to the risks embedded in the Enterprises' financial positions.

A stress test, in contrast to risk measurement tools such as most value-at-risk models, looks at outcomes over the long term. This is appropriate for companies that hold long-term mortgage assets, and explains why stress tests are used internally by the Enterprises themselves, by rating agencies, and by mortgage insurance companies.

There is a large body of data on the performance of mortgages held by the Enterprises. OFHEO's stress test is based on the performance of Enterprise mortgages over many years and under diverse economic conditions. Such a database substantially improves the reliability of a statistical model. It is far more feasible to acquire the necessary data and understanding of the two Enterprises' operations than it would be if there were thousands of such companies.

STRESS TEST: PROVIDING FLEXIBILITY TO MEET THE RISK-BASED CAPITAL REQUIREMENT

The stress test indicates the amount of capital an Enterprise must hold given its current risk positions. The Enterprise can hold that amount of capital or adjust its risk positions to reduce its capital requirement. The stress test differentiates assets and liabilities along multiple dimensions. For example, the stress test takes into account the maturities of financial instruments, whether coupons are fixed or variable, and how principal balances amortize. Therefore, if an Enterprise changes its mix of asset and liability maturities, or its mix of fixed and variable coupons, it changes its risk position and, as a result, its capital requirement. This aspect of the risk-based capital requirement allows the Enterprises to use all of the dimensions of credit risk and interest rate risk and their interactions to adjust the amount of risk they have and, therefore, the amount of capital they need.

This aspect of the risk-based capital requirement also gives the Enterprises freedom to continue innovating in product design. Because of their statutory charter restrictions, new products are generally customized configurations of familiar features. The credit and interest rate risks deriving from these features are generally known. For example a new product such as a step-down mortgage, which reduces the interest rate on the mortgage that the borrower pays as the mortgage seasons over time, can easily be handled by our proposed rule. The mortgage interest rate is a risk factor that is explicitly modeled in our mortgage default equations. Therefore, as a mortgage's interest rate decreases its capital requirement will go down. New types of Enterprise debt, such as Benchmark and Reference notes and Callable Benchmark and Reference notes, are another example. The first two always mature on a specific date and the second two have a call option. These payment characteristics are already used in the stress test. Furthermore, there is no prior approval notice for new products. The proposed regulation states simply that the Enterprises will be required to provide relevant data with an explanation of new instruments and that they will be reflected in the stress test. OFHEO will appropriately apply a capital treatment to new products based on their characteristics and risks.

New mortgage products contribute modestly to the volume of Enterprise purchases. Product innovation is important for many reasons, but an immediate contribution to volume is not usually one of them. Product innovation can serve unique needs, e.g., needs of small numbers of borrowers. Some new products take time to catch on, and most new products initially produce small purchase volumes. For the stress test, this means that the impact on the capital requirement is small. The flexibility of the stress test allows an Enterprise to meet its requirements **and** continue with its product innovation.

OFHEO's risk-based capital requirement is the first regulatory capital standard that gives credit for the economic benefit of a financial institution's hedging activities. This is because the capital requirement is based on the complete mix of assets and obligations, not simply on the individual instruments. Therefore, the degree to which the Enterprises choose to hedge their risk exposures will also have an important impact on their capital requirements.

RESULTS OF THE STRESS TEST

The results of the stress test at any point in time will reflect an Enterprise's mix of assets and obligations as well as current economic conditions. The proposed rule contains the results using Enterprise and economic data for two dates, September 30, 1996 and June 30, 1997.

Table 1. Risk-Based Capital Requirements ($ in Billions)

Date	Fannie Mae		Freddie Mac	
	Actual Total Capital	Required Total Capital (Proposed)	Actual Total Capital	Required Total Capital (Proposed)
9/30/96	$13.05	$16.55	$7.23	$5.66
6/30/97	$14.05	$17.73	$8.11	$6.83

Using data for the second quarter 1997, Fannie Mae's proposed risk-based capital requirement would have been $3.68 billion above its actual total capital. Freddie Mac's proposed requirement would have been $1.28 billion less than its actual total capital. Fannie Mae would have had to reduce its risk level or raise capital. Freddie Mac would have been required to hold capital equal to its minimum capital requirement.

The primary reason for the different results for Fannie Mae and Freddie Mac is that Freddie Mac's asset/liability structure was more fully hedged against the large interest rate movements of the stress test than was Fannie Mae's. The sensitivity analysis shows that the capital requirement can be quite sensitive to the way an Enterprise chooses to fund its mortgage assets. OFHEO used the stress test to calculate the incremental capital requirement associated with different aspects of an Enterprise's business and to calculate the change in required capital that would result from changes in the credit guarantee business or changes in the portfolio business. This analysis showed that Fannie Mae's overall level of risk was higher than Freddie Mac's, that they had similar levels of risk associated with their credit guarantee businesses, and that Fannie Mae had significantly more risk associated with its portfolio business. The portfolio risk is predominantly interest rate risk.

When interest rates rise, mortgages prepay more slowly. When the debt funding these mortgages matures, it must be replaced with new, higher rate debt. When interest rates fall, mortgages prepay more quickly. The prepaid principal must be reinvested at lower rates. In both scenarios, the asset/liability structure is sensitive to the risk that the profitable spread between rates on mortgages and rates on debt will disappear. The Enterprises manage this risk, but the risk is not eliminated. And the risk management actions they undertake have associated costs. Each Enterprise determines the risk exposure it is comfortable with taking and the cost it will pay.

A projected capital shortfall does not mean that an Enterprise has to raise that amount of capital. An Enterprise could meet a capital shortfall by reducing its risk with less expensive hedging strategies. For example, Fannie Mae has estimated that it could have met the June 1997 requirement at an annual cost of less than $70 million, with no perceptible impact on its future financial performance, using out-of-the-money interest rate hedging tools.

OFHEO's analysis of the Enterprises' mortgage portfolios provides good news for affordable housing. The primary risk associated with affordable housing loans is credit risk. OFHEO's analysis suggests that the credit risk profile of Enterprise loans that meet the affordable housing goals are, on average, close to the risk profile of loans not meeting the goals. Some affordable housing loans do have higher risk characteristics, but the higher risk of this group of loans is muted when risk is averaged across the portfolio. Affordable housing loans have been quite profitable for the Enterprises. Credit enhancements required by the Enterprises on affordable loans they purchase often result in relatively low net credit risks for the Enterprises.

STRESS TEST: REPLICATING THE KEY DRIVERS OF CREDIT AND INTEREST RATE RISK

The key feature of OFHEO's proposed stress test is that it is a tool for measuring credit and interest rate risk at the Enterprises. The Enterprises must then hold capital commensurate with their overall exposure to these risks. Therefore, a stress test approach to determining capital adequacy requires a reasonably precise way to measure risk. OFHEO has developed sophisticated models, tailored to the unique business of the Enterprises, to quantify these two types of risk that are associated with guaranteeing and investing in mortgages.

The stress test models the performance of single-family and multifamily loans and the cash flows of assets and liabilities. It adjusts for other credit factors such as credit enhancements and counterparty risk. It projects income and expenses and translates them to balance sheet positions and, in particular, monthly capital levels. The stress test is run for an increase in interest rates, the up-rate scenario, and for a decrease in interest rates, the down-rate scenario. Through these calculations, the stress test determines whether capital at the start of the test is sufficient to remain positive throughout the 10-year stress period, withstanding a substantial change in interest rates and significant credit losses. The stress test results are used to calculate the risk-based capital requirement.

DATA

The stress test uses historical and current data from the Enterprises, historical and current interest rate data, and historical and current house price, rental price, and vacancy rate data. The historical data are used to construct models that predict loan defaults, prepayments, and loss severity. Historical interest rate data are used to reasonably relate other interest rates that are needed for the stress test to the 10-year constant maturity Treasury yield which is the particular yield specified in the 1992 Act to rise or fall in the first year of the stress period. Historical house price, rental price, and vacancy rate data are used to update the change in property value that occurs between the time the Enterprise purchases a mortgage and the current time period for the stress test simulation. These historical data on changes in property values are also used to project property values over the 10-year stress period.

The current data are the end-of-quarter balance sheet and off-balance-sheet positions of the Enterprises and current market conditions that are the starting positions for each model run of the stress test.

INTEREST RATES

The 1992 Act specifies the change in the 10-year constant maturity Treasury yield and directs that other interest rates be reasonably related. In general, rates either go up by 75 percent or down by 50 percent, with a 600 basis point cap. For the June 1997 period, this requirement translated into a rise in rates of 490 basis points and a fall in rates of 327 basis points. In the stress test, other Treasury yields are related to the 10-year Treasury yield by specifying yield curves. For the scenario involving a large increase in interest rates, the proposed rule uses a flat yield curve. That is, all Treasury yields equal the 10-year constant maturity Treasury yield during the last nine years of the stress period. For the scenario involving a large decrease in interest rates, the proposed rule uses an upward sloping yield curve. In that scenario Treasury yields are lower for shorter maturities and higher for longer maturities. Both of these yield curves are based on historical relationships among Treasury yields of varying maturities. The historical data show a pattern of relatively flat yield curves after interest rate increases and positively sloping yield curves after interest rate decreases.

All adjustable rate mortgages and mortgage-backed securities, floating rate liabilities, and most derivative contracts are linked to interest rate indices such as the 11^{th} Federal Home Loan Bank District cost of funds and LIBOR. In order to model the cash flows of these financial instruments, the stress test incorporates projected interest rate values for key rates. These are based on the historical relationships between non-Treasury and Treasury yields of comparable maturities.

The cost of borrowing for the Enterprises is projected in the same manner as other non-Treasury yields are projected, except that a 50 basis points premium is added after the first year of the stress period. This is to reflect what would likely be the market response to the Enterprises if they were experiencing the economic conditions of the stress test.

PROPERTY VALUES

Property values, in relationship to their associated loan amounts, are an important determinant of mortgage default. The higher the property value is relative to the loan amount, the lower is the probability that the mortgage will default, and vice versa. The stress test uses the OFHEO HPI, a repeat-sales house price index, to determine house price growth rates on mortgaged properties purchased by the Enterprises prior to running the stress test. By doing this, the loan-to-value (LTV) ratios of mortgages held or guaranteed by the Enterprises are effectively marked to market.

The pattern of house price growth rates that occurred in the benchmark experience is replicated in the stress test for single-family property values. In the up-rate scenario, house prices decline for the first five years of the stress period and then increase, regaining the beginning house price level in the eighth year. In the down-rate scenario, house prices likewise decline for five years, but do not regain their previous level until the tenth year of the stress period. If the 10-year constant maturity Treasury yield increases by more than 50 percent in the first year of the stress test, the 1992 Act requires that the estimates of credit losses be adjusted to reflect a high rate of price inflation. This adjustment is implemented in the stress test by increasing house price growth rates beginning in the fifth year of the stress period. The size of the adjustment is based on the amount by which the increase in the 10-year constant maturity Treasury yield exceeds 50 percent. The adjustment is phased in during the fifth through tenth years in equal increments. This pattern reflects historical experience: generally, overall price inflation and house price inflation are not related in the short run, but are related in the long run. The effect of the adjustment is to increase the rate of growth for property values in the second half of the stress period.

MORTGAGE LOAN PERFORMANCE

The Enterprises are exposed to credit risk on the loans that they hold in their retained portfolios and the loans that collateralize their mortgage-backed securities. Within the stress test, there are models to predict default rates, prepayment rates, and loss rates for single-family loans and multifamily loans. The 1992 Act requires that credit losses for all loans owned or guaranteed by an Enterprise occur at a rate that is reasonably related to the worst regional experience, known as the benchmark loss experience.[1] The benchmark loss experience, as proposed in the first notice of proposed rulemaking, entailed a 10-year default rate of 14.9 percent, a loss severity rate of 63.3 percent, and a loss rate of 9.4 percent for 30-year fixed-rate single-family loans. The single-family loan performance

1 As identified in OFHEO's July 1995 Notice of Proposed Rulemaking, the benchmark loss experience occurred for mortgages originated in the States of Oklahoma, Arkansas, Louisiana, and Mississippi during 1983 and 1984.

models in the stress test have been calibrated to produce the same loss rate for 30-year fixed rate single-family loans assuming the same path of interest rates and house price growth that occurred during the 10 years following origination of the benchmark loans. By using these models to forecast loss rates for all single-family mortgages, subject to current interest rates and current house prices, the projected loss rates will be reasonably related to that of the benchmark experience.

Loss rates during the stress period for current mortgage portfolios of the Enterprises will be much lower than the 9.4 percent benchmark case. There are multiple reasons for this. First, actual Enterprise mortgage portfolios are more seasoned (resulting in lower current LTVs) than was the case for benchmark loans which were all newly-originated and tended to have high LTVs. Second, the Enterprises have significant amounts of less risky products today, such as 15-year loans, which did not exist in the early 1980s. Finally, the average loss rate on benchmark loans was a gross rate that did not take into account the effect of credit enhancements. The Enterprises have, as required by law, credit enhancements on mortgages that they purchase with LTVs greater than 80 percent. Taking all of these factors into account, the mortgage credit losses that the Enterprises experienced during the stress test on September 1996 and June 1997 averaged less than 2 percent.

Predicting multifamily loan performance and relating it to the benchmark loss experience is accomplished in a similar way. The stress test includes loan performance models developed specifically for multifamily loans. Multifamily rental prices and vacancy rates from the benchmark time and place are used to reasonably relate the predicted multifamily loan performance to the benchmark. Annual rental rates are increased in the last five years of the stress test for the up-rate scenario, consistent with the increase in property values for single-family loans.

Other Credit Factors

Mortgage credit enhancements include mortgage insurance, recourse, and collateral. Including them in the stress test is one way the stress test captures not only risk but also risk management tools.

In an adverse economic environment, the counterparties in Enterprise transactions would also experience some level of financial stress. Counterparty risk arises in connection with some forms of credit enhancement, securities issued by others that are held as investments, and derivative counterparties. To reflect this risk, the stress test reduces, or haircuts, the receipts that would be expected from these counterparties. The size of the reduction is smaller where the risk is lower, such as when there is collateral set aside to cover payments. For most instruments and counterparties, the stress test uses ratings from public rating agencies as an indicator of risk and ties the size of the haircut to the rating. The size of these haircuts is based on historical default rates of corporate bonds in each AAA through BBB rating category, and they are phased in monthly over the ten-year stress period. For example, as shown in Table 2, the haircut on a AA counterparty is 2 percent in the twelfth month, 10 percent in the sixtieth month, and 20 percent in the final month. Much smaller haircuts apply to collateralized counterparty risks.

Table 2. Rating and Size of Haircut

Month	AAA	AA	A	BBB or lower
12	1%	2%	4%	8%
24	2%	4%	8%	16%
36	3%	6%	12%	24%
48	4%	8%	16%	32%
60	5%	10%	20%	40%
72	6%	12%	24%	48%
84	7%	14%	28%	56%
96	8%	16%	32%	64%
108	9%	18%	36%	72%
120	10%	20%	40%	80%

Operations, Taxes, & Financial Statements

The stress test computes Federal income taxes and operating expenses as they might reasonably occur. Operating expenses decline in proportion to declines in an Enterprise's mortgage portfolio. After incorporating fulfillment of commitments to purchase loans that exist at the start of the stress test period, the stress test allows for no further new business during the stress period.

The stress test simulates new debt issues in months when there is a shortfall of cash, and, in months when there is an excess of cash, simulates short-term investments of that cash. In any month of the stress period in which an Enterprise's capital exceeds the minimum capital requirement, the stress test reflects payment of dividends on preferred stock. Common stock dividends are paid only as long as an Enterprise meets its risk-based capital requirement. For purposes of simplicity, that is assumed to be only during the first four quarters of the stress period.

The cash flows from the financial instruments and non-cash items flow into financial statements for the Enterprises during the stress test period. The balance sheets show the monthly capital amount for each Enterprise.

Calculation of the Risk-Based Capital Requirement

The capital balances for each month of the stress test period, in both the up-rate and the down-rate scenarios, are discounted to its present value at the start of the stress test. The largest negative capital balance or the smallest positive balance of capital is subtracted from the amount of capital the Enterprise had at the start of the stress test. The difference is the amount of capital that was "used" during the stress period. This is the minimum amount of capital that the Enterprise would need to hold at the start of the stress period in order to withstand credit and interest rate risk and maintain positive capital throughout the stress period. Thirty percent of this amount is then added on to cover management and operations risk, as required by statute. The 30 percent add-on is prescribed by the 1992 Act to cover all other risks associated with the conduct of an Enterprise's business that affect its financial performance.

RISK-BASED CAPITAL PLUS COMPREHENSIVE EXAMINATIONS

The proposed risk-based capital standard together with our comprehensive examination program provides OFHEO with the necessary tools for effective regulatory oversight. The examination program ensures the integrity of Enterprise policies and processes in all risk management areas, and informs the qualitative evaluation presented in Chapter 2 of this report. The risk-based capital standard, when in place, will ensure that the quantity of risk undertaken by an Enterprise never exceeds what can be supported by its capital base.

Chapter 2

Risk-Based Examination Program

OFHEO's annual risk-based examination program is an integral part of a system designed to ensure the ongoing safety and soundness of Fannie Mae and Freddie Mac. The examination program assesses the appropriateness and effectiveness of the Enterprises' policies and processes for risk management, and assesses the companies' financial performance. Using a risk-based approach allows OFHEO to recognize the unique operations of each Enterprise while applying uniform safety and soundness standards throughout the year. This aspect of the examination program's design ensures that OFHEO is responsive to changes at the Enterprises while not imposing unnecessary burdens. The analysis and testing conducted during the examinations add further depth and perspective to OFHEO's oversight of Fannie Mae and Freddie Mac. The examination program, together with OFHEO's capital adequacy framework, informs the Director's judgment about the appropriateness of the balance of risk and capital at each Enterprise.

The 1998 examinations found both Enterprises to be financially sound and well-managed.

The process OFHEO employed in its comprehensive annual risk-based examinations to reach these conclusions is briefly described below, and depicted on the chart set forth in Figure 1. This information is provided to give context for the summary of the examination results and conclusions for each Enterprise. The description of the examination process corresponds to the chart in Figure 1, beginning with the base of the chart and concluding at the top. Numeric references to the chart are included in the text that describes the examination process.

The summaries of examination results and conclusions contained in this Report vary between Fannie Mae and Freddie Mac. These differences are to be expected given the different approaches the Enterprises choose to conduct business, and the tailored examination strategies and work plans OFHEO developed to complete its examination program at each Enterprise.

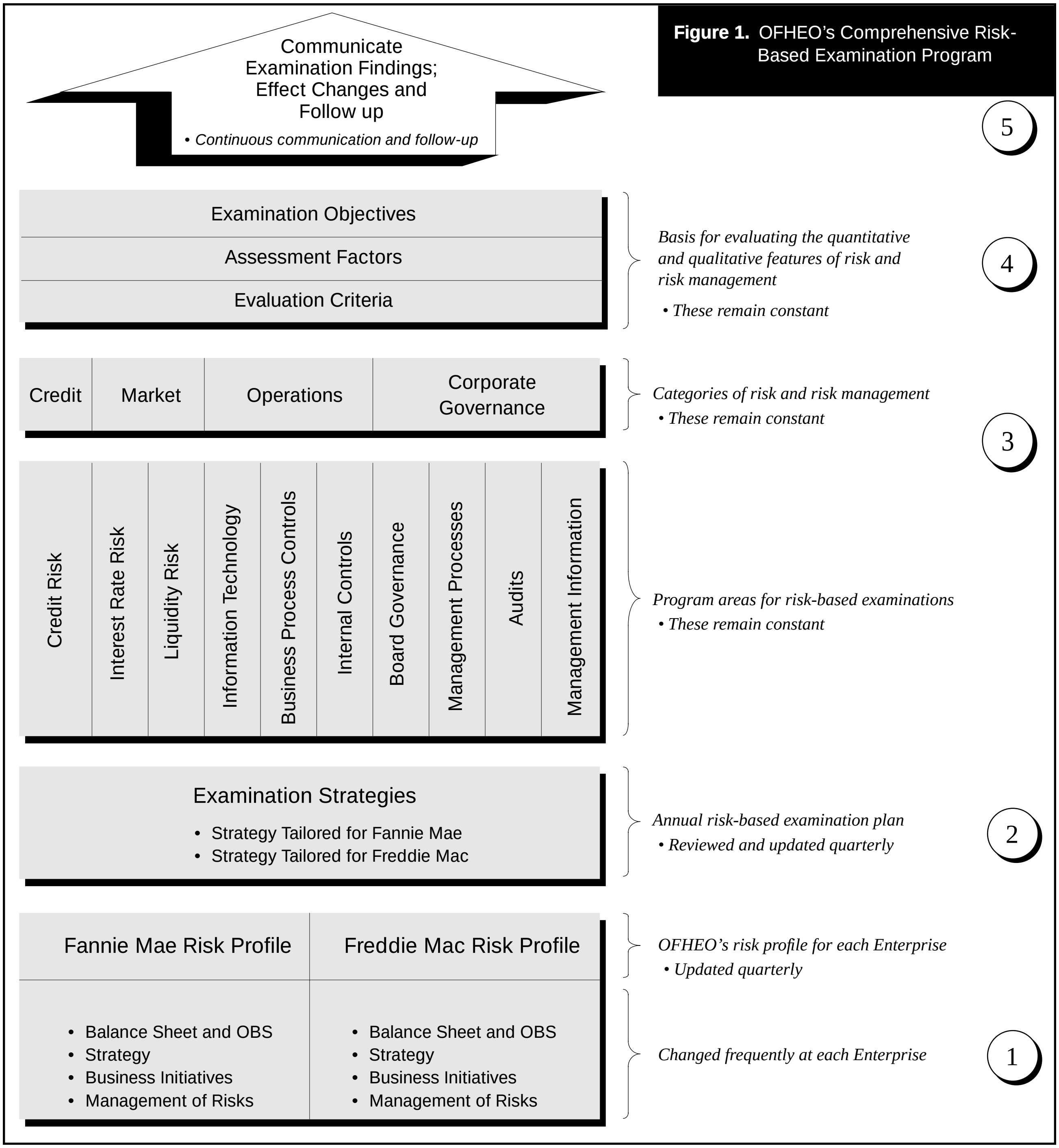


Figure 1. OFHEO's Comprehensive Risk-Based Examination Program

OFHEO'S EXAMINATION PROGRAM

RISK PROFILES

1

Through a wealth of resources (including OFHEO knowledge, external sources and proprietary Enterprise information and data), the examination process begins by assessing the quantity of risk and quality of risk management at each Enterprise. OFHEO reviews each Enterprise's risk profile at least quarterly, and revises its views if, for example, the Enterprise has planned or undertaken substantive new business initiatives, or if the Enterprise has substantially changed its level of risk or the manner in which it manages risks.

EXAMINATION STRATEGIES

2

Based upon OFHEO's unique understanding of the Enterprises' risk profiles, in the next step of the examination process OFHEO develops detailed examination strategies to provide effective, efficient oversight of each Enterprise. The annual written examination strategies are dynamic and represent a blueprint of the examination work to be conducted in the coming year. The examination strategies are reviewed and updated quarterly based on Enterprise, industry and economic developments. Each strategy is tailored to the Enterprise and is based on OFHEO's knowledge of a variety of factors: the Enterprise's management, strengths, weaknesses, past performance and markets; the Enterprise's level of risk and risk management techniques and tools; the applicable economic conditions and their potential or actual impact on the Enterprise; OFHEO's guidelines, standards and priorities; and statutory examination requirements. Each strategy is designed for OFHEO to assess the continued effectiveness of the Enterprise's risk management processes, any changes in risk appetites, enhancements management has made and, if applicable, actions management has taken in response to previously identified issues. Examination activities identified in the strategy correlate to the quantity of risk and quality of risk management in the Enterprise or in a particular current or proposed activity. In conjunction with the strategies, OFHEO creates subsidiary work plans that describe how the strategies will be achieved. The work plans outline the scope, timing, and resources needed to meet the objectives and examination activities set forth in the strategies.

PROGRAM AREAS FOR RISK-BASED EXAMINATIONS AND CATEGORIES OF RISK AND RISK MANAGEMENT

3

Once OFHEO has strategies and work plans in place, examiners implement the strategies by completing exam work in each of the program areas for risk-based examinations. These are the program areas that capture the areas of risk and risk management being assessed at the Enterprises, with each program area focusing on specific sources of risk or risk management practices and tools. (Later in this Chapter, OFHEO presents results and conclusions by program area for both Fannie Mae and Freddie Mac.)

In order to enhance examinations and maximize expertise, OFHEO has grouped the program areas into four categories of risk and risk management, and aligned its examiner force expertise into five teams that correspond to the categories of risk and risk management, and provide analytical expertise and financial monitoring.

The ten program areas, grouped by category, are:

Credit

Credit Risk Program. The risk that borrowers and counterparties will fail to meet their contractual or other obligations to the Enterprise

Market

Interest Rate Risk Program. The risk from movements in interest rates, including changes in: the level of interest rates, the shape of the yield curve, the level of volatility, and the relationships or spreads among various yield curves or indices.

Liquidity Management Program. The risk that could arise from the Enterprise's inability to efficiently meet its obligations as they come due and to transact the next incremental dollar of business cost effectively.

Operations

Information Technology Program. The infrastructure, or the general controls, needed to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations in case of unexpected interruptions.

Business Process Controls Program. Assesses the process employed to ensure business initiatives and endeavors are considered and evaluated within a complete business context with particular attention directed to risk assessment and risk management framework.

Internal Controls Program. The plan of organization, methods and procedures adopted by management to ensure that: goals and objectives are met; resource use is consistent with laws, regulations and policies; resources are safeguarded against waste, loss and misuse; and reliable data are obtained, maintained and fairly disclosed in reports.

Corporate Governance

Audit Program. The risk that the Board of Directors' or management's reliance on internal or external audits is misplaced.

Management Information Program. The risk that management will make decisions based on ineffective, inaccurate or incomplete information or reports.

Management Processes Program. The processes used to drive behaviors to support the Enterprise's defined corporate goals, standards and risk tolerances.

Board Governance Program. The manner in which the Board discharges its duties and responsibilities.

Evaluation Criteria, Assessment Factors and Examination Objectives

4

OFHEO conducts examination work in each of the program areas by using evaluation criteria, assessment factors and examination objectives. The examination objectives are broad in scope, the assessment factors are more narrowly focused and the evaluative criteria are narrower still.

The approximately 700 evaluation criteria in the examination program detail both qualitative and quantitative items that examiners consider when making decisions about the assessment factors. The evaluation criteria are designed to assist the examiners and to ensure that the examination work is consistent at both Enterprises by creating transparency and understanding of the framework within which examiners make judgments.

Examiners use the information and data from the evaluation criteria to form their expert opinions about the almost 100 assessment factors which in turn link directly to one or more of the examination objectives for each of the program areas. (The assessment factors for the reported program areas are detailed at the end of this Chapter.) Sources for the assessment factors included industry standards and benchmarks, best practices and examiner expertise.

For each program area there are examination objectives. These are the broad statements of what OFHEO's examiners will achieve through their work in each of the program areas. In order to make a determination on an examination objective, OFHEO's examiners are required to opine on each of the supporting assessment factors. By using the evaluation criteria to reach judgments about the approximately 100 assessment factors, OFHEO achieves its examination objectives, and reaches the examination results and conclusions that are reported in this Chapter. The examination objectives unique to each program area are listed in Table 3.

Table 3. Examination Objectives Unique to Each Program Area

Credit Risk Program
Evaluate the risk management framework surrounding credit risk.
Identify and evaluate any changes occurring in the level and quality of credit risk as well as the potential impact on the Enterprise.
Assess the overall adequacy and effectiveness of credit risk management. Determine how well the Enterprise manages and/or hedges credit risk.
Interest Rate Risk Program
Evaluate the risk management framework surrounding interest rate risk.
Identify and evaluate any changes occurring in the level and quality of interest rate risk as well as the potential impact on the Enterprise.
Identify and evaluate the use of derivative instruments.
Assess the overall adequacy and effectiveness of interest rate risk management. Determine how well the Enterprise manages and/or hedges interest rate risk.
Liquidity Management Program
Evaluate the liquidity positions and the surrounding management framework.
Identify and evaluate any changes occurring in the quality of liquidity and the Enterprise's position in the credit markets.
Information Technology Program
Evaluate the information technology infrastructure and the surrounding risk management framework.
Identify and evaluate changes that may influence the risks associated with information technology as well as the potential impact on the Enterprise.
Assess the overall adequacy and effectiveness of risk management and controls for information technology.

Table 3. Examination Objectives Unique to Each Program Area (Continued)

Business Process Controls Program
Evaluate the framework for building the control environment surrounding revisions to the business proposition or new initiatives.
Identify changes to the business proposition that may influence the quality of business process controls and the potential impact on the Enterprise.
Determine the adequacy and effectiveness of the due diligence process for new or revised business initiatives.
Internal Controls Program
Evaluate the framework for internal controls and the management of this framework.
Identify and evaluate any changes that may influence the quality of internal controls and the potential impact on the Enterprise.
Determine the adequacy and effectiveness of the Enterprise's system of internal controls.
Audit Program
Assess the overall adequacy and effectiveness of both internal and external audit functions and the management of the audit program.
Identify and evaluate any changes occurring in internal and external audit functions or roles, as well as the potential impact on the Enterprise.
Management Information Program
Evaluate the framework employed to produce reliable management information.
Identify and evaluate any changes occurring that may substantially alter the production of management information.
Determine whether the Enterprise's management information produces timely, accurate and meaningful information and reports that are appropriately tailored for their audiences and purpose.
Management Process Program
Evaluate the framework for key management processes influencing organizational talent and behavior and the management of this framework.
Identify and evaluate any changes occurring that may influence the quality of the key management processes, as well as the potential impact on the Enterprise.
Determine the adequacy and effectiveness of the key management processes influencing organizational talent and behavior on a company-wide basis.
Board Governance Program
Evaluate the framework the Board of Directors uses to govern the Enterprise.
Identify and evaluate the changes occurring in the structure and composition of the Board of Directors as well as the potential impact on the Enterprise.
Determine whether the Board effectively discharges its duties and responsibilities for governing the Enterprise.

Communicate Examination Findings

5

Throughout the course of conducting examinations, OFHEO communicates with Enterprise personnel not only to gather information, but also to share findings and discuss observations. The type of communication runs the gamut from an informal discussion with a technical expert to clarify a point, to a letter addressed to executive management or the Board. Regardless of the format, OFHEO has the same goal for all communications: that the free flow of information furthers the objective of ensuring the safe and sound operations of the Enterprises. OFHEO is committed to continuous, effective communication with the Enterprises.

Communications are tailored to the individual structure and dynamics of the Enterprise, and the timing of the communication depends on the situation being addressed. OFHEO keeps executive management and the Board appropriately informed and communicates with them as often as required by the Enterprise's condition and the findings from examination activities. OFHEO brings to the immediate attention of the Board and executive management those issues that introduce an exposure to the stable operation of the Enterprise, otherwise fall under the normal duties and responsibilities of the Board or warrant the Board's attention. Technical issues and matters relating to a single line of business or activity will generally be brought to the attention of operating managers with the Board and executive management kept appropriately informed.

One formal communication delivered at least annually to each Enterprise is the written Report of Examination (ROE). The ROEs have an opening date and closing date. The opening date is January 1 and the closing date is December 31. An ROE is delivered to each Enterprise's Board of Directors no later than 60 days after the closing date. The ROE reflects the cumulative conclusions made throughout the year-long examination process and addresses the Enterprise's safety and soundness on an ongoing basis. The ROE reflects the focus of the examination activities at each Enterprise.

Another form of communicating examination results and conclusions is OFHEO's annual Report to Congress. In its Report to Congress, OFHEO presents results and conclusions from the annual examinations of the Enterprises by program area.

Effect Changes and Follow Up

5

A primary goal of the examination process is to influence positive changes at the Enterprises to enhance their financial safety and soundness. The intensity of the influence exerted by OFHEO relates directly to the risk presented by an issue. If, for example, in the course of an examination, OFHEO identifies a significant issue in risk management systems or an undesirable risk level, OFHEO will require management to develop and execute a corrective action plan, and will ensure that the Board holds management accountable for executing the action plan. OFHEO will review the action plan to ensure that it identifies the steps or methods required to cure the root causes of significant deficiencies, and to determine whether the plan is likely to resolve the significant issues within an appropriate time frame. As part of follow-up, OFHEO will verify that the action plan has been executed and evaluate its success.

OFHEO will consider the responsiveness of the Enterprise in recognizing the issue and formulating an effective solution when determining if OFHEO needs to take incremental action. If an Enterprise is unresponsive or unable to effect the resolution of meaningful issues, OFHEO will take more formal steps to ensure deficiencies are corrected.

While “effect changes and follow up” is at the top of the chart for the comprehensive annual risk-based examination process, in practice, the final step starts the examination cycle anew.

1998 EXAMINATION RESULTS AND CONCLUSIONS FOR FANNIE MAE

In accordance with OFHEO’s examination program, the results and conclusions for each category of risk and risk management are reported in relation to safety and soundness standards. The results of the 1998 examination show that in all categories, Fannie Mae exceeds safety and soundness standards. These results reflect the examination work conducted from January through December 1998, and do not necessarily reflect the current condition or operations of the Enterprise.

CREDIT RISK

Fannie Mae’s credit risk management and credit risk management framework exceed safety and soundness standards. Management is experienced and competent, and has developed appropriate and effective credit risk management tools to evaluate and manage the credit risk of the assets Fannie Mae purchases and securitizes. Fannie Mae has comprehensive credit policies that effectively address all aspects of credit risk. There is a well-conceived and thorough internal control framework that supports the credit risk management function. Fannie Mae is adequately compensated for the credit risk it assumes, and effectively reduces its credit risk exposure through the use of credit enhancements. Fannie Mae effectively identifies, quantifies and monitors its credit risk exposure. Management effectively manages its relationships with counterparties. Fannie Mae has a sound reserve determination process. The credit risk management framework and reporting structure provide an effective means for following up on credit-related issues.

INTEREST RATE RISK

Fannie Mae’s interest rate risk management exceeds safety and soundness standards. There are appropriate policies and procedures governing interest rate risk management. There is effective and appropriate separation of duties between those who analyze interest rate risk and those who execute transactions. Fannie Mae has effective tools and models that measure interest rate risk and the company’s sensitivity to changing interest rate environments. The processes Fannie Mae uses to monitor its interest rate profile, and manage interest rate risk data are effective. Fannie Mae effectively uses derivatives and its Liquid Investment Portfolio to manage its interest rate risk.

LIQUIDITY MANAGEMENT

Fannie Mae’s liquidity and the surrounding management framework exceed safety and soundness standards. Fannie Mae has appropriate policies and procedures for managing its liquidity position. There is a strong internal control framework surrounding liquidity management. Fannie Mae effectively measures the adequacy of its liquidity position through the use of proprietary models and monitoring systems. Tools that estimate how changing interest rates will affect Fannie Mae’s liquidity position are effective. There is strong technical support for Fannie Mae’s liquidity management function.

INFORMATION TECHNOLOGY

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Fannie Mae has effective operating processes that ensure secure, effective and efficient data center processing and problem management. There are policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users. Fannie Mae has effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Fannie Mae has an appropriate process to ensure information technology plans effectively address business unit and corporate objectives. The processes in place ensure appropriate controls are implemented and documentation for systems development and maintenance is complete. Fannie Mae has an effective plan for identifying, renovating, testing and implementing solutions for the Year 2000 issue. Fannie Mae has appropriately coordinated Year 2000 processing capabilities with customers, vendors and business partners. Fannie Mae has appropriately managed the effect of Year 2000 efforts on the company's strategic and operating plans.

INTERNAL CONTROLS

Fannie Mae's internal control framework and the management of that framework exceed safety and soundness standards. Fannie Mae has effective policies and procedures that delineate internal control processes and standards for the control environment. Fannie Mae has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. Fannie Mae has a reliable process for ensuring timely resolution of control-related issues. Control-related issues are appropriately communicated with management and the Board.

AUDIT PROGRAM

Fannie Mae's audit functions exceed safety and soundness standards. Both the internal and external audit functions are independent with appropriate access to the Board. The internal audit staff is highly qualified, and the external auditors possess appropriate experience and expertise. The management of internal audit and the risk assessment process are both strong. The 1998 audit work was both appropriate and complete. Executive management's involvement and follow-up of identified audit issues is strong, as is the Board's follow-up of identified audit issues. The Office of Internal Audit is appropriately involved with new products and initiatives.

MANAGEMENT INFORMATION

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. The framework is based on information systems that are linked to Fannie Mae's overall strategy and are developed and refined pursuant to a strategic plan for information systems. Processes and controls effectively ensure that reports used by management for decision making are accurate. Information and reports are appropriately tailored for their audiences. Fannie Mae's management and Board of Directors receive meaningful and appropriately tailored reports on performance relative to established goals and objectives. Reports permit the Board and management to gauge the quality and impact of decisions. Strategy, roles and responsibilities are effectively communicated across the company, and employees have appropriate two-way channels of communication.

MANAGEMENT PROCESS

The key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. Fannie Mae's management processes are grounded on strong, comprehensive planning processes, including strategic planning. Fannie Mae effectively uses appropriate measures that align with its strategy. Behavior management programs are effectively designed to achieve corporate goals and objectives. Fannie Mae has effective programs for career and management development, and for recruiting a talented and diverse staff. Fannie Mae's proprietary risk management systems and programs effectively identify and analyze risks, thereby enhancing management's ability to control risks. Management effectively conveys an appropriate message of integrity and ethical values.

Board Governance

Fannie Mae's Board of Directors discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. The committee structure and frequency of Board and committee meetings are effective in ensuring the Board remains appropriately informed of Fannie Mae's condition, operations, performance, and compliance. The Board has sufficient, well-organized time to carry out its responsibilities. In addition, the Board is appropriately engaged in the development of a strategic direction for Fannie Mae. The Board's processes for holding the executive management team accountable for achieving defined goals and objectives is effective. The process the Board uses for hiring and maintaining a quality executive management team is effective.

1998 EXAMINATION RESULTS AND CONCLUSIONS FOR FREDDIE MAC

In accordance with OFHEO's examination program, the results and conclusions for each category of risk and risk management are reported in relation to safety and soundness standards. The results of the 1998 examination show that in all categories, Freddie Mac exceeds safety and soundness standards. These results reflect the examination work conducted from January through December 1998, and do not necessarily reflect the current condition or operations of the Enterprise.

Credit Risk

Freddie Mac's credit risk management and credit risk management framework exceed safety and soundness standards. Management is experienced and competent, and has developed an appropriate set of credit risk management tools to evaluate and manage the credit risk of the assets Freddie Mac purchases and securitizes. Freddie Mac's credit risk management framework provides management with the information to understand the performance characteristics of the risk exposures the Enterprise selects, and the technology to assess actual performance. The expanded use of scoring and default probability technology has enhanced management's ability to more precisely gauge performance within the retained and guaranteed portfolios. The framework effectively positions management to identify credit mortgages that are likely to default, to attempt foreclosure alternatives when appropriate, and to foreclose and take possession of properties expeditiously. Once Freddie Mac owns a property, the framework enables management to effectively repair, market and sell at an acceptable price. The management committee structures, information systems, and reporting practices allow management to effectively monitor developments in credit risk management. Management effectively manages its relationships with the counterparties that service assets, provide mortgage insurance and other forms of credit enhancement, and maintain and enhance credit risk management technology. In addition, Freddie Mac's credit risk profile exceeds safety and soundness standards. Net recoveries (versus charge-offs), reduced credit losses and reduced foreclosed property expenses have resulted in significant reductions in the average loss per foreclosed property.

Interest Rate Risk

Freddie Mac's interest rate risk management exceeds safety and soundness standards. Policies and procedures appropriately describe the functions of all departments that manage interest rate risk. Risk limits and appetites are effectively communicated in management reports and Board materials. The interest rate risk analysis functions are appropriately separate from the transaction functions. New products and initiatives relating to interest rate risk are well researched prior to implementation. There are appropriate and effective tools that evaluate the effect of changing interest rates on all areas of the balance sheet. Actions to alter the risk/reward relationship are thoroughly analyzed and discussed. Interest rate risk models are sound and continuously refined. Derivatives are used in a manner consistent with risk management policies and in accordance with standards of other large financial intermediaries. Management continuously monitors its interest rate risk profile and effectively follows up on issues related to interest rate risk.

Liquidity Management

Freddie Mac's liquidity and surrounding management framework exceed safety and soundness standards. There are effective and appropriate policies and procedures that precisely detail the nature of the desired levels of liquidity and how it is managed. Risk limits for liquidity are clearly identified and effectively communicated. Liquid investments are consistent with the strategies of the company. Tools effectively estimate how changing interest rates affect liquidity positions. There are effective technology and controls for liquidity management. The quality of the planning process for liquidity, including tactical, strategic and contingency planning, is sound. New products, programs or initiatives that relate to liquidity are well researched prior to implementation. Management effectively follows up on issues or initiatives that influence liquidity.

Information Technology

The information technology infrastructure and surrounding risk management framework exceed safety and soundness standards. Operating processes are in place to ensure secure, effective and efficient data center processing and problem management. Effective policies and procedures are in place to ensure data, information and computing resources are secure and accessed only by authorized users. There are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster. Adequate processes are in place to ensure appropriate controls are implemented and documentation is complete for system development and maintenance. The plan for identifying, renovating, testing and implementing solutions for the Year 2000 issue is effective. Processes ensure information technology plans effectively address business unit and corporate objectives. Effective processes have been implemented for the processing of data and information to ensure accuracy and timeliness.

Internal Controls

The internal control framework and the management of that framework exceed safety and soundness standards. Freddie Mac has an accurate and reliable process for identifying risks to business processes and implementing appropriate controls. There is a reliable process for ensuring timely resolution of control-related issues. Policies and procedures delineate internal control processes and standards for the control environment. Management effectively ensures compliance with established internal controls.

AUDIT

The audit functions exceed safety and soundness standards. The organizational structure and reporting lines effectively support and promote the independence of the audit functions. The auditors demonstrate professional proficiency. The scope of the audit work performed is appropriate. The audit work is complete and generates necessary and appropriate information. The management of the Internal Audit department is strong. The Board and executive management are appropriately involved with, and effectively follow up on, identified audit issues. The auditors' comprehensive risk assessment process is strong and effective. Internal audit is appropriately involved with new products and initiatives.

MANAGEMENT INFORMATION

The framework used to produce timely, accurate and reliable reports exceeds safety and soundness standards. Information systems are linked to support Freddie Mac's overall strategy, and are developed and refined pursuant to a strategic plan for information systems. Management information reports are designed to answer appropriate key questions. Freddie Mac's strategy, roles and responsibilities are effectively communicated. Reports for executive management and the Board provide appropriate information about performance relative to established goals and objectives. Management reporting provides all levels of management with necessary information to carry out their responsibilities efficiently and effectively, and to gauge the quality of decisions. The reports used by management for decision making are accurate.

MANAGEMENT PROCESS

Key management processes that influence company-wide talent and behaviors exceed safety and soundness standards. Freddie Mac's planning process is comprehensive. Management has demonstrated an ability to manage and monitor change. The key performance measures are appropriate, effective and align with the company's strategy. Behavior management programs are designed to achieve corporate goals and objectives. There are effective programs for career and management development and for recruiting competent personnel. Proprietary risk management systems and programs are strong and effective. The decision making roles and assignment of responsibilities effectively provide for accountability and promote internal controls.

BOARD GOVERNANCE

The Board discharges its duties and responsibilities in a manner that exceeds safety and soundness standards. The orientation and briefings provided to new Board members are both thorough and effective. The Board's committee structure aligns with the company's lines of business and governance responsibilities. Materials are provided to Board members sufficiently in advance of meetings, and the Board has sufficiently well organized time to carry out its responsibilities. The Board is appropriately engaged in the development of a strategic direction for the company. The Board ensures that executive management appropriately defines the operating parameters and risk tolerances of the Enterprise, and the Board's process for hiring and maintaining a quality executive management team is effective. The Board appropriately holds the executive management team accountable for achieving defined goals and objectives. The Board is appropriately informed of Freddie Mac's condition, operations, compliance and performance.

THE YEAR 2000 CHALLENGE AND EXAMINATION ACTIVITIES

WHAT IS THE YEAR 2000 CHALLENGE?

The Year 2000 "challenge" arises because computer systems have typically used two digits, rather than four, to represent the year – for example, "99" represents the year 1999. The problem with a two-digit date field is that computer systems may identify "00" as the year 1900, rather than 2000. This error would lead to errors in performing date-sensitive tasks, including calculations to determine payment amounts, payment dates, payoff balances, interest payments, investor payouts, and other mortgage-related payment information. Failure to address this problem also may lead to errors in annual financial reporting to investors, shareholders, and Federal regulatory agencies; reporting related to mortgage-backed and debt securities and derivative financial instruments; portfolio rebalancing; mortgage commitments and purchases; and the issuance of securities.

OFHEO's role as the Enterprises' financial safety and soundness regulator requires it to evaluate management's efforts to resolve the problem as it may impact the Enterprises' internal systems. OFHEO also is evaluating management's efforts to safeguard against circumstances where an Enterprise's key business partners (such as sellers, servicers, vendors, and service providers) have not corrected the problem in their own systems.

How OFHEO Evaluates the Enterprises' Efforts to Achieve Year 2000 Compliance

Year 2000 compliance efforts were an important focus of OFHEO's examination effort during 1998 and will remain an examination priority into the new millennium. OFHEO follows the principles and framework laid out in the General Accounting Office's guide entitled *Year 2000 Computing Crisis: An Assessment Guide* to evaluate the Enterprises' efforts to address the problem. Additionally, OFHEO has been participating in the Federal Financial Institutions Examination Council's Year 2000 efforts and Working Group on Year 2000, and The President's Council on Year 2000 Conversion, Financial Sector Group to ensure consistent standards and treatment with the other financial regulators.

The complexity of the effort to achieve Year 2000 compliance is not in the solution to the actual problem, but in the size and scope of the project itself. Given that this is essentially a project management issue, OFHEO has examined, and will continue to examine, the Enterprises' timely and successful management of this critical project.

The Year 2000 Evaluative Framework

The framework used to achieve Year 2000 compliance follows a five-phase approach. This five-phase approach progresses in the following sequence:

Awareness Phase. Define the Year 2000 problem, make personnel aware of the issue, establish a Year 2000 program team, and develop an overall compliance strategy.

Assessment Phase. Assess the Year 2000 impact on the organization, identify core business areas and processes, analyze the systems supporting the core business areas, and prioritize conversion and/or replacement of those critical systems.

Renovation Phase. Perform the conversions, replacement, or elimination of critical platforms, applications, databases, and utilities, and modify interfaces.

Validation Phase. Test, verify, and validate the converted or replacement platforms, applications, databases, and utilities to ensure that they meet the organization's needs.

Implementation Phase. Implement the converted and replacement platforms, applications, databases, utilities, and interfaces while maintaining appropriate back-up.

The Enterprises' Year 2000 Efforts Are Appropriate

In addition to examining the Enterprises' efforts to achieve Year 2000 compliance with their systems, OFHEO also assesses the Enterprises' efforts to ensure that their critical business partners achieve timely Year 2000 compliance. Because technology is a cornerstone of the Enterprises' business, Year 2000 compliance is critical for business continuity.

OFHEO's Year 2000 priority with respect to the Enterprises is to safeguard the orderly operation of the secondary mortgage market by ensuring that the Enterprises are able to process transactions and information at the new millennium. OFHEO will continue to treat the Year 2000 challenge as a priority during 1999 (and thereafter as appropriate) and will monitor the Enterprises' efforts to lead, and ultimately require, their business partners to be Year 2000 compliant.

OFHEO is able to report that each Enterprise is proceeding with an acceptable plan, and the implementation of these plans is on schedule. Year 2000 ranks among the top priorities at each Enterprise and receives the attention of executive management and the Board of Directors and is receiving substantial resource investments (both human and financial). The Enterprises recognize the significance of the Year 2000 challenge, and each organization has designated working groups to address the numerous business and technology issues. The implementation plans for correcting the problem are comprehensive, and these plans are also being enhanced as the body of knowledge for Year 2000 issues evolves. Each Enterprise has been actively involved in comprehensive testing (including testing with business partners and important industry-sponsored tests). Testing, including external testing, has been a priority during 1999 and is scheduled to be at a very advanced stage at each Enterprise by the end of second quarter 1999. Also, comprehensive business continuity plans have been documented by each Enterprise and these plans are being continuously refined and updated.

Because OFHEO believes the Year 2000 challenge is a crucial operating issue for the Enterprises, it believes that the Board of Directors and executive management of each company should be actively involved. OFHEO has determined that the Boards of Directors are being appropriately and routinely briefed on the progress toward Year 2000 compliance, including the meeting of pertinent timetables. Senior executives at both Enterprises are actively engaged and routinely receive status updates. In addition to frequent dialogue with appropriate Enterprise representatives, OFHEO has been testing, and will continue to test and verify, each Enterprise's performance against its respective plan and evaluate each Enterprise's respective business continuity plan. In the event there are adverse deviations from the plans or timetables, OFHEO will immediately determine the appropriate regulatory response.

Examination Assessment Factors

CREDIT RISK

1. Determine the degree and trend of diversification of credit risk. Determine whether there are any noteworthy concentrations. For the concentrations identified, determine the nature of any identifiable trends. Determine whether the actual profile of credit risk is in compliance with prescribed limits or guidelines.

2. Determine the quality of policies, procedures, internal controls, and management reporting for the credit function. Share determinations with the examination teams responsible for internal controls, management process, management information and board governance.

3. Determine whether the Enterprise is adequately compensated for the credit risk it assumes. Determine whether credit models produce accurate and reliable results.

4. Determine whether management prudently manages counterparty exposure.

5. Determine the manner and extent to which new products, programs or initiatives impact the credit risk profile.

6. Determine the adequacy of the reserve determination process.

7. Determine whether credit risk management tools are effective. Share determinations about proprietary risk management programs and systems with the examination team responsible for management processes.

8. Determine the effectiveness of credit risk sharing strategies.

9. Determine the quality of the Enterprise's methodology for identifying and quantifying credit risk exposure.

10. Determine the quality of the Enterprise's tracking and analyzing of risk exposures.

11. Determine the effectiveness of technology and controls supporting the credit management function. Share determinations with the examination teams responsible for information technology and internal controls.
12. Determine whether management appropriately/effectively reconciles differences between actual and expected credit portfolio performance.
13. Determine whether management has an effective means of following up on credit related issues. Share determinations with the examination teams responsible for audit, management information, management process and internal controls.

INTEREST RATE RISK

1. Determine the quality of policies, procedures, internal controls, and management reporting relating to interest rate risk. Share determinations with the examination teams responsible for internal controls, board governance, management process and management information.
2. Determine whether management has established a meaningful methodology for quantifying and monitoring the level and nature of interest rate risk and determine whether management routinely evaluates the impact of events or alternative environments.
3. Determine management's effectiveness in following up on issues related to interest rate risk. Share determinations with the examination teams responsible for audit, management information, management process and internal controls.
4. Determine the manner and extent to which new products, programs or initiatives impact the interest rate risk profile. Share determinations with the examination team responsible for business process controls.
5. Determine the effectiveness of technology and controls supporting the interest rate risk management function. Share determinations with the examination teams responsible for information technology and internal controls.
6. Evaluate the quality of the tools used to model interest rate risk and the strategies to alter the exposures to interest rates. Share determinations about proprietary risk management programs and systems with the examination team responsible for management processes.
7. Determine management's effectiveness at incorporating tactical and strategic issues into the management of interest rate risk. Share determinations with the examination team responsible for management processes.
8. Determine whether the appropriate separation of responsibilities exists between the strategy and analytics function and the execution function.
9. Identify the various derivative instruments being used and determine whether these derivative instruments are used prudently.
10. Determine whether management governs the use of derivatives in accordance with the standards used by other large financial intermediaries.

LIQUIDITY MANAGEMENT

1. Determine the quality of policies, procedures, internal controls, and management reporting for liquidity management. Share determinations with the examination teams responsible for internal controls board governance, management process and management information.
2. Determine whether management has established an effective methodology for quantifying and monitoring liquidity and determine whether management routinely evaluates the impact of events or alternative environments and develops appropriate contingency plans.
3. Evaluate the quality of the planning process for liquidity management including tactical, strategic, and contingency planning.
4. Determine the manner and extent to which new products, programs or initiatives impact the liquidity management profile. Share determinations with the examination team responsible for business process controls.
5. Determine management's effectiveness in following up on issues or initiatives that influence liquidity.
6. Determine the effectiveness of technology and controls for the liquidity management program. Share determinations with the examination teams responsible for information technology and internal controls.
7. Evaluate the quality of the tools used to manage and monitor liquidity, and the quality of tools used to perform scenario analyses. Share determinations about proprietary risk management programs and systems with the examination team responsible for management processes.
8. Determine whether the appropriate separation of duties exists between the strategy and analytics function and the execution function.
9. Determine trends and/or anomalies in funding spreads.
10. Determine the quality of integration of liquidity management with other management and financial performance issues.

INFORMATION TECHNOLOGY

1. Determine whether operating processes are in place to ensure secure, effective and efficient data center processing and problem management.
2. Determine whether there are effective policies and processes in place to ensure that data, information and computing resources are secure and accessed only by authorized users.
3. Determine whether there are effective policies and processes in place to ensure the timely and appropriate resumption of business in the event of a disaster.
4. Determine whether management has an adequate process to ensure information technology plans effectively addresses business unit and corporate objectives.
5. Determine whether effective processes are in place to ensure appropriate controls are implemented and documentation is complete for system development and maintenance.

6. Determine whether effective processes have been implemented for the processing of data and information to ensure accuracy and timeliness.

The following three assessment factors will be dropped from the examination program once the Enterprises demonstrate satisfactory information and data processing after the millennium date change.

1. Determine whether there is an effective plan for identifying, renovating, testing and implementing solutions for the Year 2000 issue.
2. Determine whether the Year 2000 processing capabilities are effectively coordinated with customers, vendors and business partners.
3. Determine the effect of Year 2000 efforts on strategic and operating plans.

BUSINESS PROCESS CONTROLS

1. Determine if there is an effective "process" or "control environment" used when considering or developing new or substantially revised business initiatives
2. Determine the appropriateness of criteria used to subject a business initiative to review as new or substantially revised.
3. Evaluate the quality of the analysis and review conducted for new or substantially revised business initiatives.
4. Evaluate after consulting with the other examination teams, the quality of the communication flows associated with new or substantially revised business initiatives.
5. Evaluate the appropriateness of the balance between risk management, internal controls and the pressure to deliver new or substantially revised business initiatives.
6. Determine the effectiveness of pilot programs used with new or substantially revised business initiatives.
7. Determine if corporate culture and desired employee behavior are appropriately considered when plans for managing and marketing new or substantially revised business initiatives are developed.
8. Evaluate the quality of analysis conducted after new or substantially revised business initiatives are launched that determine whether the initiative is a success and/or has aspects that warrant reconsideration or modification.
9. Evaluate after consulting with the other examination teams, the corporate environment to determine if the introduction of new ideas and intellectual capital are promoted and supported.
10. Determine after consulting with the other examination teams whether the Board and executive management are appropriately informed about the adequacy of due diligence for new or substantially revised business initiatives. Share determinations with the examination teams responsible for management information and board governance.

INTERNAL CONTROLS

1. Determine after consulting with the other examination teams whether management has an accurate and reliable process for identifying risks to business processes and implementing the appropriate controls.
2. Determine after consulting with the other examination teams whether implemented controls properly address the risks assessed by management.
3. Determine after consulting with the other examination teams whether management has a reliable process for ensuring timely resolution of control-related issues.
4. Determine after consulting with the other examination teams whether internal audit appropriately identifies and communicates internal control deficiencies to management and the Board of Directors. Share determinations with the examination team responsible for audit and board governance.
5. Determine after consulting with the other examination teams whether there are established policies and procedures that delineate internal control process and standards for the control environment.
6. Determine after consulting with the other examination teams whether management ensures compliance with established internal controls.

AUDIT

1. Determine if the Audit Functions have the appropriate independence.
2. Determine if the auditors performing the work posses the appropriate professional proficiency.
3. Determine after consulting with the other examination teams if the scope of the audit work performed is appropriate.
4. Determine after consulting with the other examination teams if the performance of the audit work has been complete.
5. Evaluate the quality of the management of the Internal Audit Department.
6. Determine after consulting with the other examination teams the appropriateness of executive management's involvement and follow-up of identified audit issues. Determine the quality of the Board of Directors' involvement and follow-up of identified audit issues.
7. Determine after consulting with the other examination teams the quality of the auditor's risk assessment process.
8. Determine after consulting with the other examination teams the appropriateness of internal audit's involvement with new products and new initiatives. Share determinations with the examination team responsible for business process controls.

MANAGEMENT INFORMATION

1. Determine if executive management and the Board of Directors receive necessary reports on the Enterprise's performance relative to established goals and objectives.
2. Determine if management reporting provides the levels of management with the necessary information to carry out their responsibilities efficiently and effectively, and to gauge the quality of their decisions.
3. Determine if information systems are linked to the Enterprise's overall strategy, and if the information systems are developed and refined pursuant to a strategic plan for information systems.
4. Evaluate after consulting with the other examination teams the accuracy of reports used by management for decision making.
5. Determine after consulting with the other examination teams the effectiveness with which Enterprise strategy, roles and responsibilities are communicated.
6. Evaluate the effectiveness of channels of communication available to employees to provide feedback, report irregularities, and suggest enhancements.
7. Determine after consulting with the other examination teams the effectiveness of communication across the Enterprise.

MANAGEMENT PROCESS

1. Evaluate the comprehensive nature of the planning process.
2. Determine after consulting with the other examination teams the effectiveness of business unit goals, implementing plans and programs to achieve the corporate plans.
3. Determine after consulting with the other examination teams management's ability to monitor and manage change.
4. Determine after consulting with the other examination teams if key performance measures are appropriate, effective and align with strategy.
5. Determine after consulting with the other examination teams if the behavior management programs are designed to achieve corporate goals and objectives.
6. Determine if the Enterprise has an effective program for career and management development.
7. Determine if the Enterprise has effective programs for recruiting competent people.
8. Determine after consulting with the other examination teams the effectiveness of proprietary risk management systems or programs.
9. Determine after consulting with the other examination teams whether management effectively conveys an appropriate message of integrity and ethical values.
10. Determine after consulting with the other examination teams the pervasive effect of management's philosophy and operating style on the Enterprise.
11. Determine after consulting with the other examination teams if the decision making roles and the assignment of responsibilities provide for accountability and controls. Share determinations with the examination team responsible for internal controls.

BOARD GOVERNANCE

1. Determine whether the Board has been engaged in the development of a strategic direction for the Enterprise.
2. Determine whether the Board ensures that executive management appropriately defines: operating parameters and risk tolerances for the Enterprise consistent with the strategic direction, legal standards, and ethical standards.
3. Determine whether the Board has a process for hiring and maintaining a quality executive management team.
4. Determine whether the Board holds the executive management team accountable for achieving the defined goals and objectives.
5. Determine after consulting with the other examination teams, whether the Board remains appropriately informed of the condition, activities and operations of the Enterprise.
6. Determine whether the Board has sufficient well-organized time to carry out its responsibilities.

Chapter 3

Mortgage Markets and the Enterprises in 1998

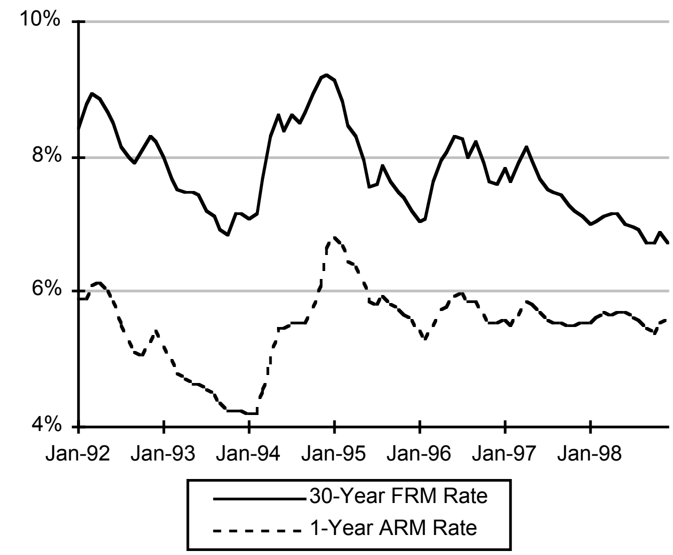
The strong U.S. economy, relatively low interest rates, and a booming housing market boosted Fannie Mae's and Freddie Mac's profits to record levels in 1998. Combined net income for the Enterprises was $5.1 billion in 1998, an increase of $660 million from 1997. A record $1.4 trillion single-family mortgages were originated in 1998, which contributed to record mortgage purchases for the Enterprises. Mortgage portfolio investments increased 31 percent at Fannie Mae and 55 percent at Freddie Mac, causing net interest income to increase for both Enterprises. Favorable housing conditions coupled with enhancements to credit loss management continued to reduce the Enterprises' credit losses. Credit related losses declined by 39 percent. Fannie Mae's and Freddie Mac's combined capital increased approximately $5 billion in 1998 to protect against the increased credit and interest rate risks associated with rapidly growing business volumes. Both Enterprises met their statutory minimum capital requirements throughout the year.

HOUSING AND PRIMARY MORTGAGE MARKET DEVELOPMENTS

RECORD ACTIVITY

The housing market enjoyed a record year due to favorable economic conditions, continued low mortgage interest rates (See Figure 2) and strong consumer confidence. Job growth was a healthy 2 percent in 1998, while unemployment remained low at 4.3 percent (the lowest rate in 28 years) and inflation remained dormant. In addition, the economy grew at a strong rate of 3.9 percent, matching the economic growth rate achieved in 1997. During 1998, the average mortgage rate was 6.9 percent, compared with 7.6 percent in 1997. Strong consumer confidence was evident in the fact that consumer spending increased 5 percent in 1998, the highest increase in consumer spending in more than a decade.

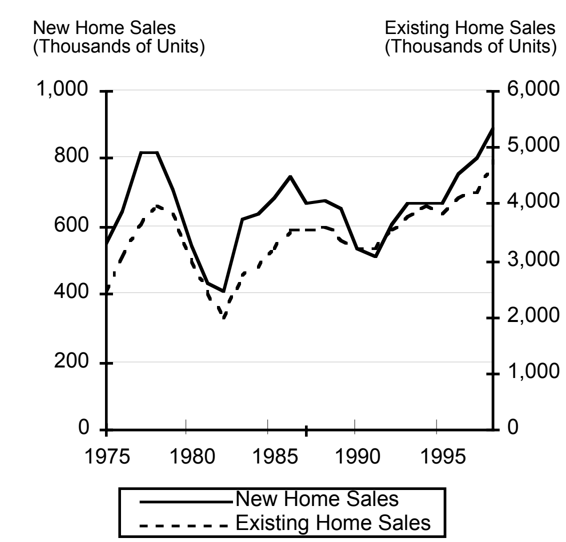
Figure 2. Mortgage Interest Rates



Source: Freddie Mac Primary Mortgage Market Survey

Consumers bought 888,000 new homes in 1998, up 10.6 percent from 1997 and outstripping the previous record set in 1977 by 8.4 percent (See Figure 3). Existing home sales also achieved record levels. They soared 13.5 percent in 1998 to 4.8 million, breaking last year's record. Multifamily markets were strong as well. New multifamily construction rose to $19.9 billion, the largest amount in 9 years, while vacancy rates remained stable at just under 8 percent.

Figure 3. New and Existing Single-Family Home Sales

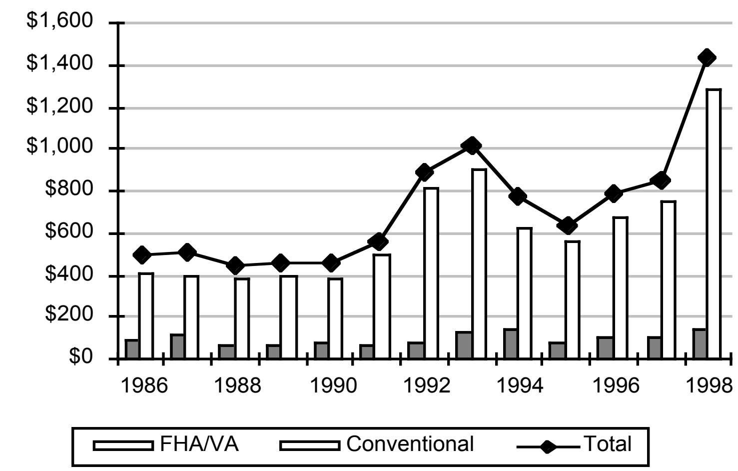


Source: Bureau of the Census

The high level of activity in home sales and low level of mortgage rates generated a huge increase in the volume of mortgages originated. A record $1.4 trillion of mortgages were originated in 1998, 40 percent above the previous record established in 1993 (See Figure 4). The top 25 mortgage originators accounted for over half of all originations (See Box 1). Refinancings accounted for a monthly average of 52 percent of mortgage originations in 1998, up from 31 percent in 1997 (See Figure 5). The vast majority of borrowers refinanced their loans into long-term fixed-rate mortgages, taking advantage of the lowest mortgage rates in three decades. The proportion of refinancings in which borrowers withdrew cash fell only slightly last year to 51 percent.

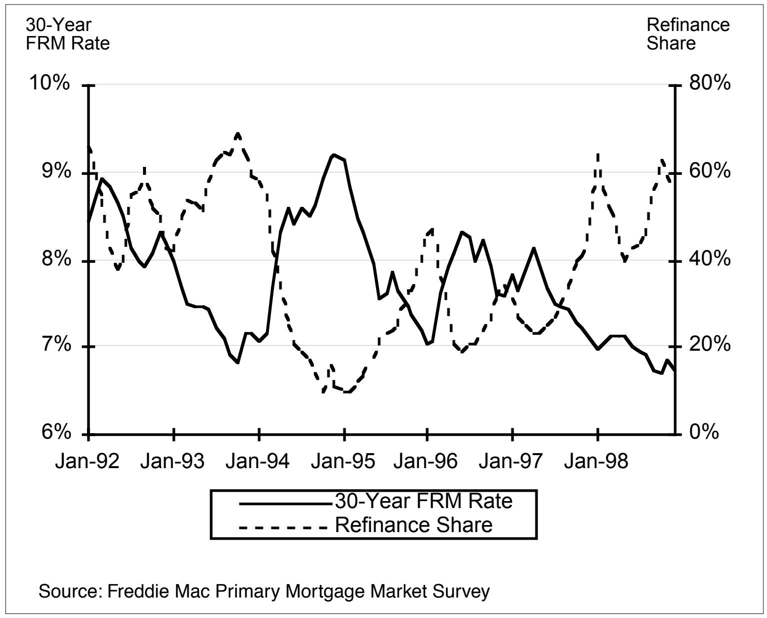
In contrast, during the last refinancing boom of 1992-93, borrowers chose much higher proportions of adjustable rate and intermediate-term fixed-rate loans, and the proportion of cash-out loans was much lower (34 percent). The differences were caused by a flatter yield curve in 1998, smaller decreases in interest rates and greater property value appreciation.

Figure 4. Originations of Single-Family Mortgages ($ in Billions)



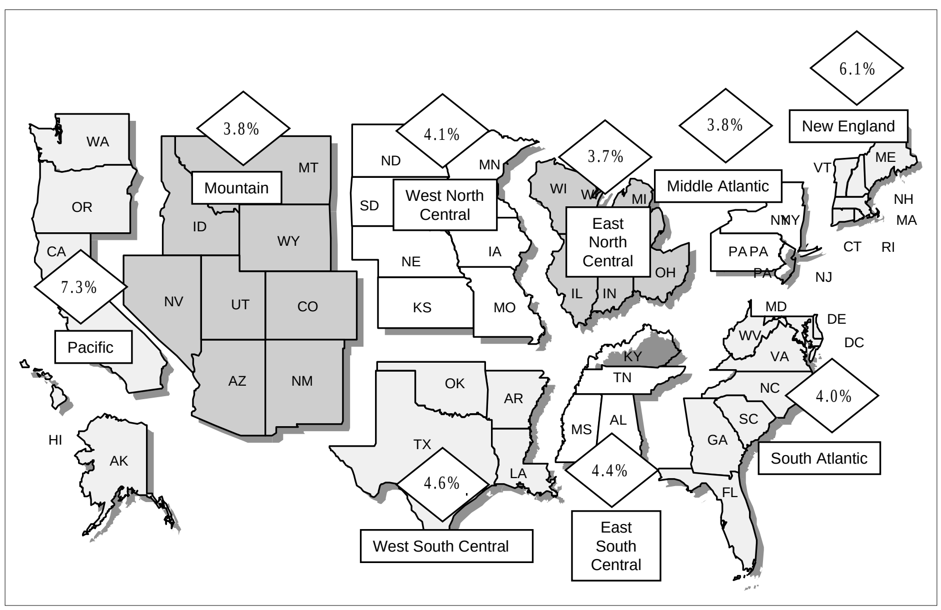
Source: Inside Mortgage Finance

Figure 5. Refinance Share of Total Mortgage Originations vs. Commitment Rate on 30-Year FRMs



The high level of home sales propelled a healthy increase in the value of many homes. Single-family house prices, as measured by OFHEO's House Price Index, increased 4.7 percent in 1998. Areas with the highest house appreciation were the Pacific (California, Washington, Hawaii, Oregon, and Arkansas) at 7.3 percent and New England (Connecticut, Massachusetts, Maine, New Hampshire, Rhode Island, and Vermont) at 6.1 percent (See Figure 6). Over the past 5 years, U.S. house prices increased an average 19.9 percent.

Figure 6. Change in House Prices, by Census Division, Fourth Quarter 1997 to Fourth Quarter 1998

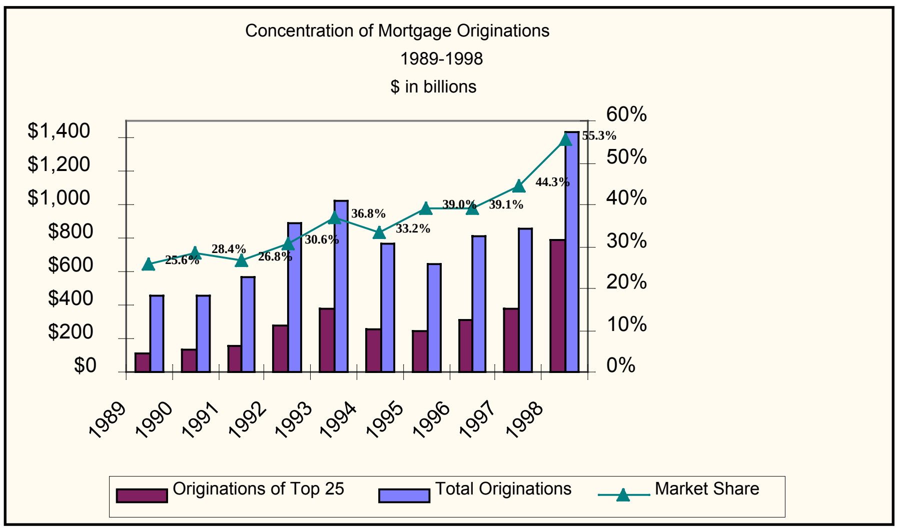


The homeownership rate also benefitted from the record housing activity. The homeownership rate increased to a record 66.3 percent in 1998, compared with the previous record of 65.7 percent in 1997.

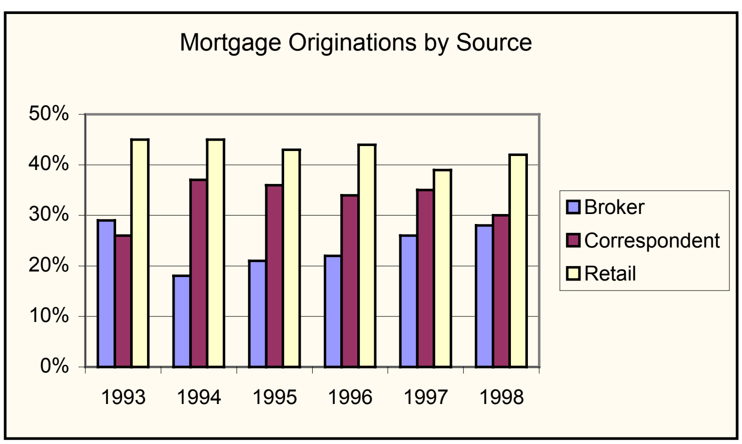
Box 1: Concentration of Mortgage Originations

Concentration of mortgage originations has been increasing throughout the 1990s. In 1998, the top 25 mortgage originators accounted for an all-time high of 55 percent of single-family mortgage originations. This was the first year in which over half of all mortgage originations were made by the very largest lenders.

Of all mortgage originations, 28 percent were originated by brokers, 30 percent came from correspondents, and 42 percent were originated through retail channels. While the proportions originated by brokers, correspondents, and retail channels have shifted from year to year, no fundamental trend is evident. What is evident, however, is that the top mortgage originators have developed strong wholesale, retail, and correspondent networks. The top originators tend to be also the top wholesalers, the top in retail originations, and the top in correspondent originations. They have developed the capability to originate loans through whichever channel is best suited to the economic environment and housing market conditions. The continued availability of large numbers of correspondent and broker sources has been facilitated by technology, in particular, by automated underwriting systems and communication networks.



Source: Inside Mortgage Finance



Source: Inside Mortgage Finance

FHA/VA Originations Experience Gains

Federal Housing Administration mortgage originations rose 38.8 percent in 1998 to a new annual record of $103.2 billion. This was $10 billion more than in the previous record year of 1994 when FHA originations totaled $91.6 billion. Veterans Administration mortgage production rose 58.4 percent to $42.6 billion, from $26.9 billion in 1997. The record for VA mortgage originations of $49.5 billion was set in 1994.

Subprime Market Share Decline

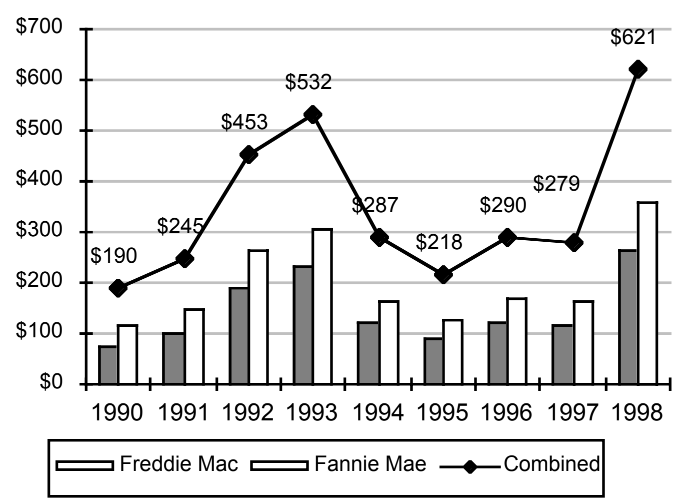
Subprime lending (excluding home-equity loans) totaled an estimated $150 billion, or about 10 percent of all mortgage originations in 1998, compared with $135 billion, or 16 percent of originations in 1997. The loss of market share for subprime lenders was due primarily to the effects of higher-than-expected prepayment rates and illiquid markets associated with the global financial crisis. Low interest rates and improving borrower credit ratings in the strong economy caused higher-than-expected prepayment speeds on subprime securities. High prepayment speeds had a negative effect on earnings, causing some subprime lenders to exit the business. The reduction in subprime lenders contributed to reduced subprime lending. In addition, securitization became difficult for subprime lenders in late 1998, as fixed-income investors tended to favor the higher quality Treasuries during the financial crisis. The resulting liquidity crunch forced lenders to curtail their subprime lending activities.

SECONDARY MARKET ACTIVITIES OF THE ENTERPRISES

Purchases and Issuances Achieve Record Levels

The Enterprises purchased a record $621 billion in single-family mortgages in 1998, over $89 billion more than the previous record set in 1993 (See Figure 7). Fannie Mae purchased $358 billion last year, an increase of 118 percent over 1997. Freddie Mac recorded total purchases of $263 billion in 1998, a gain of 129 percent. The Enterprises' share of total mortgage originations jumped to 45 percent in 1998, from 34 percent in 1997.

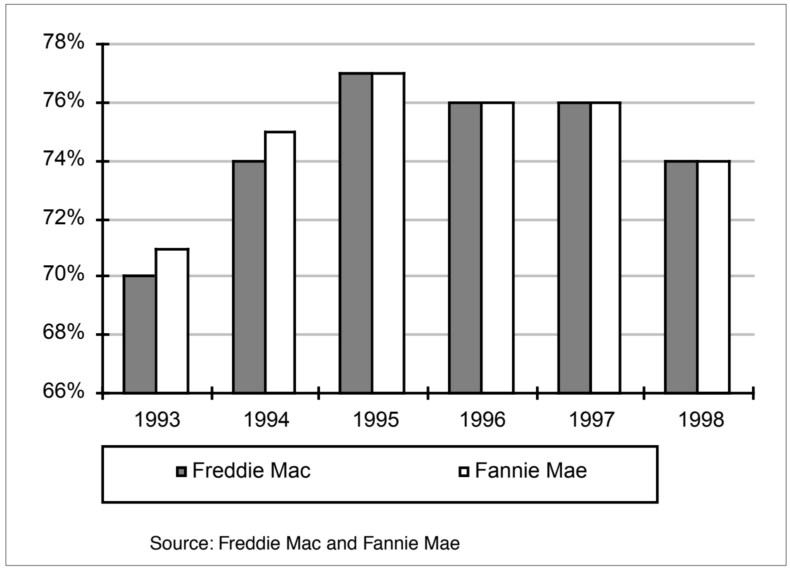
Figure 7. Enterprise Single-Family Mortgage Purchases ($ in Billions)



Source: Freddie Mac, Fannie Mae, and Inside Mortgage Finance

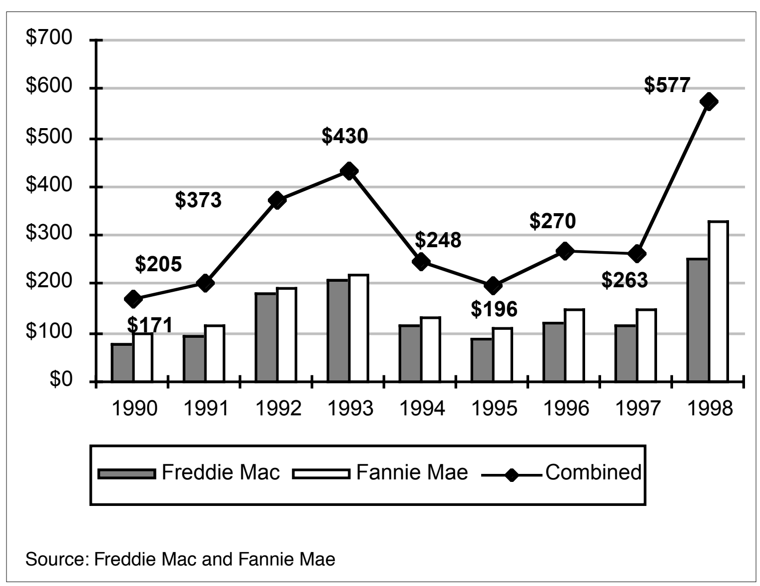
The Enterprises purchased primarily fixed-rate mortgages (See Box 2), reflecting the small supply of adjustable rate mortgages due to the attractive mortgage rates on fixed-rate products. Also reflecting primary market trends, the majority of Enterprise purchases were refinance loans. A high proportion of refinance loans usually improves the overall credit quality of Enterprise purchases because refinancing borrowers generally have increased equity in their properties through house price appreciation and principal repayments. Higher borrower equity (lower loan-to-value, or LTV ratios) makes loans less likely to default. Last year, however, a large proportion of refinancing borrowers increased the size of their mortgages by taking cash out, so average LTV ratios on new purchases for both Enterprise fell only slightly to 74 percent in 1998 from 76 percent in 1997 (See Figure 8).

Figure 8. Average LTV of Enterprise Purchases



Single-class mortgage-backed securities (MBS) issuance more than doubled at both Enterprises in 1998 (See Figure 9). Fannie Mae issued $326 billion in MBS, while Freddie Mac issued $251 billion. The increase in issuances was offset at both Enterprises by high mortgage liquidation activity brought on by the high refinance environment in 1998. Liquidations of mortgages backing Freddie Mac's MBS doubled in 1998 to $184 billion from $89 billion, while comparable Fannie Mae liquidations also doubled to $201 billion from $91 billion.

Figure 9. Enterprise Single-Class MBS Issuance ($ in Billions)



Box 2: Conforming Loan Limits

Background

Mortgage loans purchased or guaranteed by the Enterprises must meet loan amount restrictions commonly called *conforming loan limits*. Conforming loan limits were established by Congress to increase the availability of mortgage funds for low- to moderate-income homebuyers and to reduce the Enterprises' exposure to risk. Table 27 at the end of this Report provides a history of the single-family conforming loan limits from 1971 to 1999.

The Enterprises' conforming limits were the same as the Federal Housing Administration's (FHA) maximum insurable limits until 1980. The Housing and Community Development Act of 1980 amended the Enterprises' charters by establishing loan limits and the guidelines to increase the limits for conventional, single-family (one to four units) mortgage loan amounts. The Federal Home Loan Bank Board initially provided an index, via its house price survey, to set the single-family conforming loan limits from 1980 to 1989. Multifamily (properties of five or more units) conforming loan limits were set at 125 percent of the FHA insurance limits for multifamily housing established in the National Housing Act of 1938. The Secondary Mortgage Market Enhancement Act of 1984 permitted multifamily loan limits to increase in high cost areas as determined by the Department of Housing and Urban Development to 240 percent of the FHA insurable limits.

Recent Developments

Since 1990, single-family conforming loan limits have been based on the Federal Housing Finance Board's Monthly Interest Rate Survey (MIRS). The MIRS monitors changes in average house prices nationwide. The methodology and criteria for the survey remained relatively unchanged from 1990 until last year. Three changes implemented in January 1998 were designed to produce a more accurate average house price calculation. These changes were:

- replacing the underlying weighting data with the Federal Reserve's Home Mortgage Disclosure Act information,
- eliminating loans with terms of seven years or less, and
- increasing both the loan size and house price upper limits.

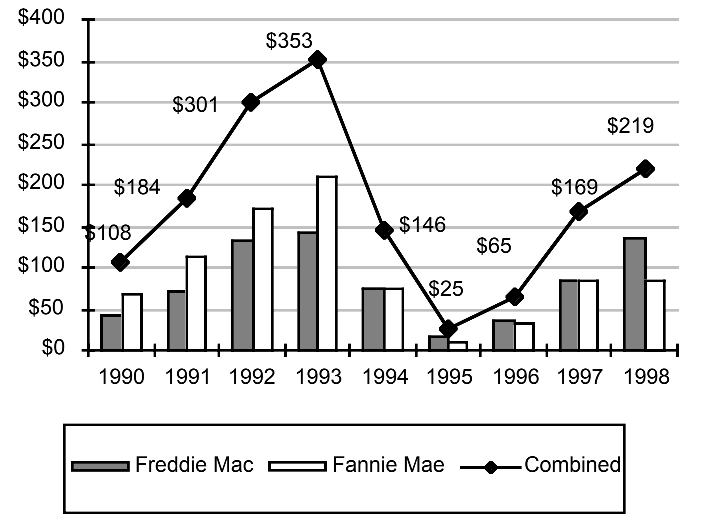
The net effect of these changes reduced the October 1998 house price calculation by $200 (to $175,200), compared to previous survey calculations. Similar changes were applied to October 1997 survey data to create comparability between 1998 and 1997 house price averages.

Recent legislative changes related to loan limits were part of a 1999 VA-HUD Appropriations Bill (1999 Bill). The 1999 Bill modified the Enterprise multifamily limits as well as the FHA insurable guarantee limits. Enterprise multifamily loan limits were eliminated in the 1999 Bill. This change was an attempt to address the escalating multifamily property valuations in large metropolitan areas (e.g. New York City). The Enterprises were unable to finance many properties because an improved economy created project values exceeding the multifamily per unit limits.

The 1999 Bill additionally modified the single-family FHA limits. These limits vary by county and Metropolitan Statistical Area, subject to an overall maximum. The maximum was increased to 48 percent to 87 percent of the Enterprises' conforming loan limits. This 1999 adjustment created the largest increase ever to the FHA ceiling. The single-family one-unit insurable maximum limit increased by $38,438 from the 1997 level of $170,362 to the 1999 level of $208,800.

Issuance of multi-class MBS, mostly Real Estate Mortgage Investment Conduit (REMIC) securities, increased a strong 61 percent at Freddie Mac to $135 billion in 1998 (See Figure 10). However, the volume of new Fannie Mae issues declined slightly to $84 billion.

Figure 10. Enterprise REMIC Issuances ($ in Billions)



Source: Freddie Mac and Fannie Mae

Both Fannie Mae and Freddie Mac continued to become increasingly important investors in their own securities. Fannie Mae's holdings of its own MBS grew to $197 billion, up 51 percent from 1997. Freddie Mac held $168 billion of its own securities at year-end 1998, an increase of 63 percent from 1997. Fannie Mae now holds 24 percent of its total MBS outstanding, while Freddie Mac holds 26 percent of its total MBS outstanding. Commercial banks were also active purchasers of agency mortgage securities in 1998. The industry's holdings of single-class MBS rose 14 percent to $277 billion, and its investment in multi-class MBS grew 34 percent. By contrast, total commercial bank assets grew only 8 percent in 1998.

FINANCIAL CONDITION OF THE ENTERPRISES

DOUBLE-DIGIT INCREASES IN MORTGAGE INVESTMENTS PUSH EARNINGS ABOVE $5 BILLION

Combined earnings for the Enterprises grew to $5.1 billion in 1998, as Freddie Mac's income rose 22 percent and Fannie Mae's rose 12 percent (See Tables 4 & 5). Net interest income drove revenues for both Enterprises as combined net interest income rose to $6.3 billion in 1998, from $5.8 billion in 1997 (See Figure 11). The growth in net interest income was largely attributable to a 31 percent rise in mortgage investments at Fannie Mae and a 55 percent increase at Freddie Mac. Growth of mortgage asset portfolios, lower credit losses, and higher miscellaneous fee income more than offset declining revenue yields on the Enterprises' two principal lines of business – portfolio investments and mortgage guarantees. Net interest margins and guarantee fee rates declined at both Enterprises. About one-fourth of the increase in Fannie Mae's net income came as a result of accelerated recognition of tax credits.

Table 4. Fannie Mae Financial Highlights

SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)					
	1998	**1997**	**1996**	**1995**	**1994**
Earnings Performance:					
Net Income ($)	3.42	3.06	2.72	2.14	2.13
Net Interest Income ($)	4.11	3.95	3.59	3.05	2.82
Guarantee Fees ($)	1.23	1.27	1.20	1.09	1.08
Net Interest Margin (%) [1]	1.03	1.17	1.18	1.16	1.24
Average Guarantee Fee (basis points) [2]	20.2	22.7	22.4	22.0	22.5
Return on Common Equity (%)	25.2	24.6	24.1	20.9	24.3
Dividend Payout Ratio (%) [3]	30.9	30.9	31.5	34.6	30.8
Balance Sheet Position:					
Total Assets ($)	485.0	391.7	351.0	316.5	272.5
Outstanding Debt ($)[4]	460.3	369.8	331.3	299.2	257.2
Mortgages:					
Retained Mortgage Portfolio ($)	415.4	316.6	286.5	252.9	220.8
MBS ($) (excludes MBS in Portfolio)	637.1	579.1	548.2	513.2	486.3
Retained as % of Total Mortgages in Portfolio and MBS	39.5	35.3	34.3	33.0	31.2
Capital:					
Equity/Assets & MBS (%)	1.38	1.42	1.42	1.32	1.26
Equity & Reserves/Assets & MBS (%) [5]	1.45	1.50	1.50	1.41	1.37

Source: Fannie Mae

1 Taxable equivalent net interest income divided by average earning assets.

2 Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.

3 Common and preferred dividends divided by net income.

4 Includes subordinated borrowings.

5 Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

Table 5. Freddie Mac Financial Highlights

SELECTED FINANCIAL HIGHLIGHTS (Dollars in Billions)	1998	1997	1996	1995	1994
Earnings Performance:					
Net Income ($)	1.70	1.40	1.24	1.09	0.98
Net Interest Income ($)[1]	2.22	1.85	1.71	1.40	1.11
Guarantee Fees ($)[1]	1.02	1.08	1.08	1.09	1.11
Net Interest Margin (%) [1, 2]	0.97	1.06	1.15	1.23	1.25
Average Guarantee Fee (basis points) [3]	21.4	22.9	23.4	23.8	24.4
Return on Common Equity (%)	22.6	23.1	22.6	22.1	23.3
Dividend Payout Ratio (%) [4]	26.2	26.4	26.0	25.8	25.7
Balance Sheet Position:					
Total Assets ($)	321.4	194.6	173.9	137.2	106.2
Outstanding Debt[5] ($)	287.2	172.3	156.5	119.3	92.1
Mortgages:					
Retained Mortgage Portfolio ($)	255.7	164.5	137.8	107.7	73.2
MBS ($) (excludes MBS in Portfolio)	478.4	476.0	473.1	459.0	460.7
Retained as % of Total Mortgages in Portfolio and MBS	34.8	25.7	22.6	19.0	13.7
Capital:					
Equity/Assets & MBS (%)	1.36	1.12	1.04	0.98	0.91
Equity + Reserves/Assets + MBS (%) [6]	1.45	1.22	1.14	1.09	1.04

Source: Freddie Mac

1 Effective 1/1/96, Freddie Mac reports guarantee fees on retained Freddie Mac Participation Certificates or “MBS” as guarantee fee income. Previously these fees were included in net interest income. However, for comparability with Fannie Mae, guarantee fee income on retained MBS for subsequent periods has been estimated and included in net interest income rather than fee income.

2 Taxable equivalent net interest income divided by average earning assets.

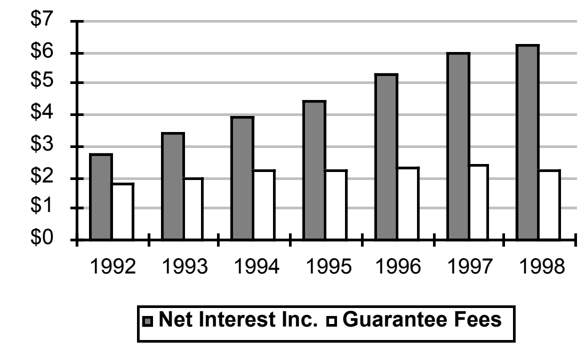
3 Guarantee fees divided by average MBS outstanding net of MBS held in portfolio.

4 Common and preferred dividends divided by net income.

5 Excludes subordinated borrowings.

6 Effective 1/1/95, reserves exclude valuation allowance related to impaired loans pursuant to SFAS 114.

Figure 11. Enterprises' Primary Sources of Revenue ($ in Billions)

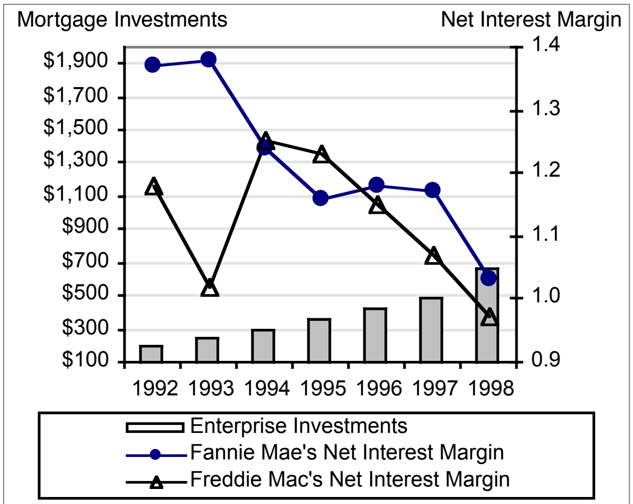


Source: Freddie Mac, Fannie Mae, and OFHEO

Revenues Increase Despite Lower Interest Margins and Guarantee Fees

A $308 million increase in total revenues at Freddie Mac outpaced Fannie Mae's $266 million increase. Net interest income accounted for most of the gains, but grew much less rapidly than investment balances. Fannie Mae's net interest margin declined to 1.03 percent in 1998 from 1.17 percent in 1997, while Freddie Mac's fell to 0.97 percent from 1.06 percent (See Figure 12). The declines in margin reflect the effects of interest rate declines on imperfectly matched investment and liability positions held in the previous year, as well as smaller average equity-to-assets ratios. (Lower equity ratios reduce interest margins because equity creates no interest expense.)

Figure 12. Enterprises' Mortgage Investments ($ in Billions) and Net Interest Margin (%)



Source: Freddie Mac, Fannie Mae, and OFHEO

The combined guarantee fee income for the Enterprises fell 4 percent during 1998. Fannie Mae's average guarantee fee rate fell to 20.2 basis points in 1998, compared with 22.7 basis points in 1997. Freddie Mac's guarantee fee income also dropped in 1998, falling by 1.5 basis points to 21.4 basis points. The drop in average guarantee fee rates was caused by more competitive pricing and an increase in credit-enhanced mortgages.

Another factor that affected Freddie Mac's guarantee fee income in 1998 was a transaction it undertook in May 1998. Freddie Mac entered into a reinsurance agreement (a form of credit enhancement) under which the Enterprise transferred a portion of the credit risk associated with $20 billion of mortgages originated in 1996 to a third-party reinsuror. The third-party reinsuror, in turn, issued a series of bonds bearing this credit risk. Freddie Mac pays monthly insurance premiums to the reinsuror to compensate for this risk transfer. The payments reduce Freddie Mac's guarantee fee income, but they will also reduce its future credit losses.

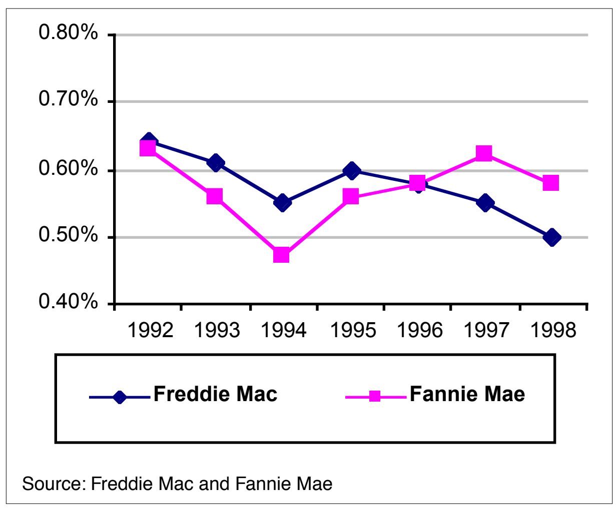
Fannie Mae's other fee revenues increased almost as much as its net interest income. Other fee income includes multifamily fees, structured transaction fees, technology fees, other miscellaneous items, and income or operating losses from certain tax advantaged investments. All of these fee income components increased at Fannie Mae in 1998, led by a $46.2 million increase in technology fees. Technology fees are related to fees charged for the use of automated underwriting software such as Desktop Originator and Desktop Underwriter.

Credit Losses Decline While Delinquencies Remain Low

The healthy national housing market coupled with the Enterprises' ongoing loss mitigation programs translated into very low credit losses (charge-offs plus foreclosure expenses) for Fannie Mae and Freddie Mac. Credit losses for Fannie Mae fell 26 percent to $262 million, 0.027 percent of its average total mortgage portfolio. Freddie Mac's credit losses declined 48 percent to $268 million, 0.040 percent of its average total mortgage portfolio.

The single-family delinquency rate for both Enterprises fell in 1998 (See Figure 13). Fannie Mae's single-family delinquency rate dropped to 0.58 percent in 1998, from 0.62 percent in 1997, after climbing for 4 years. Freddie Mac's single-family delinquency rate declined 5 basis points to 0.50 percent in 1998 from 0.55 basis points in 1997.

Figure 13. Single-Family Deliquency Rates (Loans Deliquent 90 Days or More or in Foreclosure)



Fannie Mae's multifamily delinquency rate fell to a very low 0.29 percent in 1998, while Freddie Mac's multifamily delinquency rate dropped to 0.37 percent from 0.96 percent in 1997. The improvement in Freddie Mac's delinquency rate continues to reflect the diminishing impact of pre-1991 multifamily mortgage originations. Mortgages purchased since the Enterprise's full re-entry into the multifamily mortgage market in 1994 continue to outperform earlier purchases. Multifamily business at both Enterprises continued to benefit from lower vacancy rates and increasing market rents in various parts of the country (i.e., Southwest and Northeast).

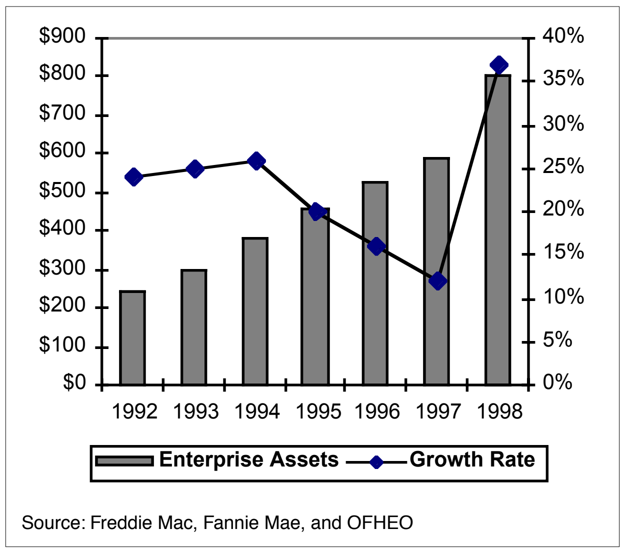
Administrative Expenses Grow

Administrative expenses continued to grow faster than revenues in 1998. The combined revenue growth rate for the Enterprises was 7 percent in 1998. Administrative expenses increased 11 percent at Fannie Mae and 17 percent at Freddie Mac. Higher administrative expenses were again impacted by costs associated with the Year 2000 date change issue. Chapter 2 provides an assessment of the Enterprises' readiness with respect to the Year 2000 date change.

Asset Growth Rate Reverses Trend

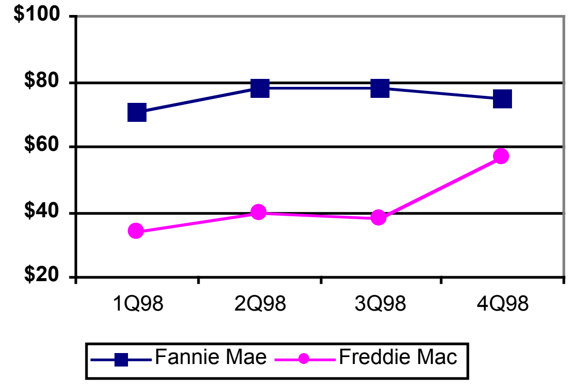
Total assets for the Enterprises increased 37 percent to $806 billion during 1998, reversing a three-year slow down in the rate of asset growth (See Figure 14). Fannie Mae's mortgage investments increased $99 billion or 31 percent, while Freddie Mac's mortgage investments rose $91 billion or 55 percent from year-end 1997. The Enterprises took advantage of mortgage investment opportunities related to the refinance market of 1998 and widened interest rate spreads during the financial crisis.

Figure 14. Combined Enterprise Assets And Growth Rate ($ in Billions)



Quarterly-average non-mortgage investments increased at both Enterprises during 1998 (See Figure 15). Fannie Mae's non-mortgage investments rose by $4 billion to $75 billion, while Freddie Mac's non-mortgage investments increased by $23 billion to $57 billion. The bulk of Freddie Mac's increase in non-mortgage investments occurred during fourth quarter 1998 following two large equity issues. Examples of non-mortgage investments for the Enterprises include U.S. Treasury and agency securities, federal funds, repurchase agreements, commercial paper, municipal bonds, and asset-backed securities. While average non-mortgage investments increased at both Enterprises, the ratio of average non-mortgage investments to average earning assets remained roughly unchanged in 1998 for the year as a whole. Fannie Mae's ratio of annual-average non-mortgage investments to annual-average earning assets was 18 percent in 1998, while Freddie Mac's was 17 percent.

Figure 15. Enterprise Average Non-Mortgage Investments ($ in Billions)



Source: Freddie Mac, Fannie Mae, and OFHEO

Liquidations Affect Debt Activity

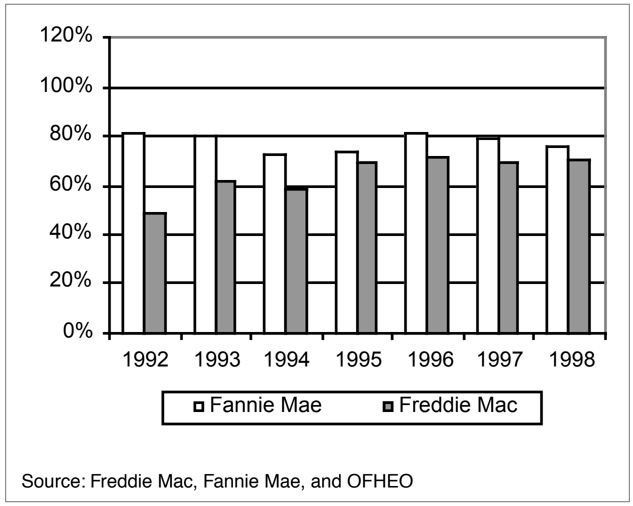
The Enterprises' abilities to manage interest rate risk was challenged in 1998, as large volumes of mortgage assets rolled off of the balance sheet. Mortgage liquidations rose due to lower interest rates in 1998. Mortgage asset liquidations for the Enterprises amounted to nearly $150 billion, 31 percent of their mortgage assets at the beginning of the year.

The Enterprises exercised call options on their callable debt in 1998. Fannie Mae called $76 billion in 1998, compared with $30 billion in 1997. Freddie Mac similarly called $49 billion in debt, compared with $16 billion in 1997. The Enterprises subsequently replaced the called issues with cheaper debt that more closely matched the shorter expected asset durations of the remaining mortgages.

Option embedded (mostly callable) debt continued to comprise the majority of Freddie Mac's long-term debt portfolio and half of Fannie Mae's long-term debt portfolio. At year-end 1998, 76 percent of Freddie Mac's debt was option embedded debt, while 50 percent of Fannie Mae's long-term debt was comprised of option embedded debt. Option embedded debt remains attractive to the Enterprises because it reduces the risk associated with the prepayment uncertainty of their mortgage-related assets.

The total combined debt outstanding for the Enterprises reached $747 billion in 1998, an increase of 38 percent from 1997. Roughly three-fourths of the Enterprises' outstanding debt is effectively long-term (See Figure 16).

Figure 16. Effective Long-Term Debt As a Percent of Total Debt

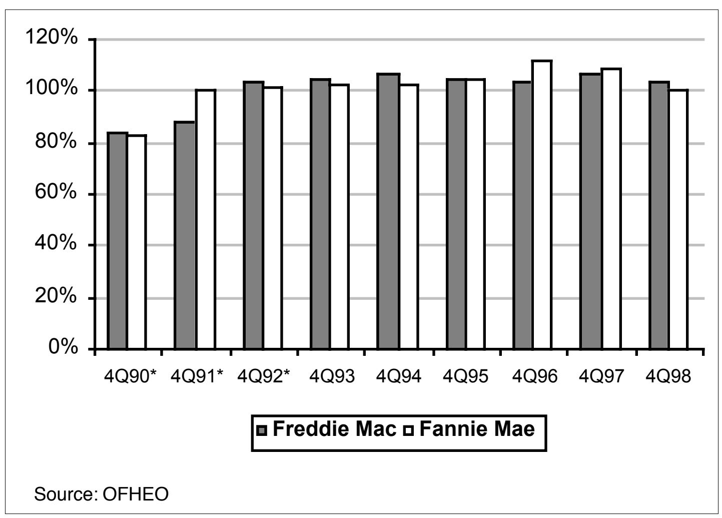


The Enterprises introduced new debt programs during first quarter 1998. The new programs, Fannie Mae's B*enchmark Notes* and Freddie Mac's *Reference Notes* focus on the issuance of large long-term non-callable bonds. (See Box 3).

ENTERPRISES MEET REGULATORY MINIMUM CAPITAL REQUIREMENTS

The Enterprises met their regulatory minimum capital requirements[1] in 1998. Fannie Mae's minimum capital requirement was $15.3 billion at year-end 1998. Freddie Mac's minimum capital requirement was $10.3 billion. The Enterprises were required to hold $5.9 billion more in regulatory capital at year-end 1998 compared with 1997, due to higher levels of assets.

Figure 17. Enterprises' Core Capital as a Percent of Minimum Capital Requirements



Surplus capital, the margin by which Enterprise core capital [2] exceeds minimum capital, shrank at Fannie Mae (See Figure 17). Fannie Mae's surplus capital fell to $0.1 million in 1998 from $1.1 billion in 1997. While Fannie Mae's assets grew 24 percent in 1998, its equity grew only 12 percent. Freddie Mac's surplus capital was $0.4 million in 1998, compared to $0.3 million in 1997.

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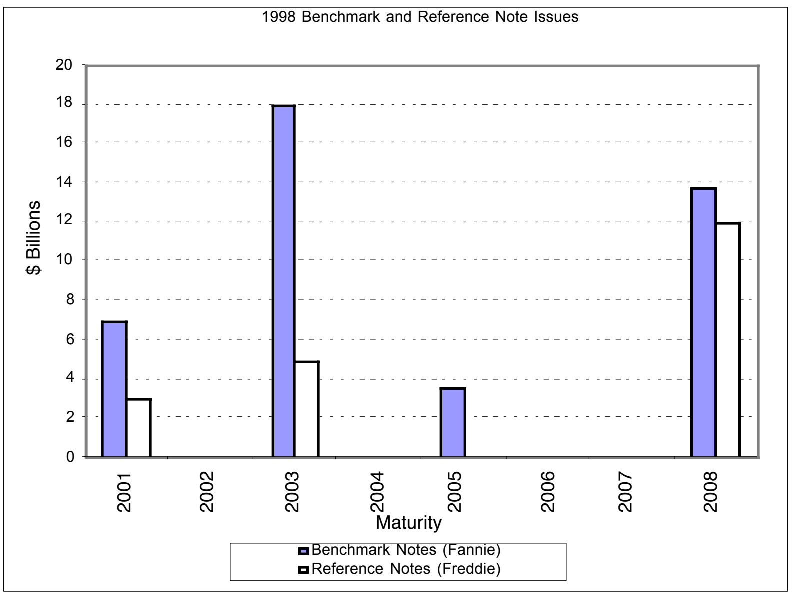
[1] The minimum capital requirement is the sum of: 2.50 percent of on-balance sheet assets, 0.45 percent of outstanding MBS and 0.45 percent of other off-balance sheet obligations.

[2] Core capital is the sum of: the par value of outstanding common stock, the par value of outstanding noncumulative perpetual preferred stock and paid-in capital and retained earnings.

Box 3: Benchmark and Reference Notes

As noted in last year's Annual Report, both Fannie Mae and Freddie Mac embarked upon programs to issue large non-callable bonds as a means of attracting new investors to their debt and lowering their funding costs. Funding costs are minimized because these bonds, with initial issue sizes of $2-$5 billion, are more liquid than smaller issues, and thus trade with thinner bid/ask spreads, which in turn lowers their required yields. Also, underwriting costs for these bonds, as a percent of face value, are lower than for smaller debt issues, which further reduces funding costs.

Fannie Mae was the first with its Benchmark Notes, issuing a $4 billion 5-year note on January 15, 1998. Freddie Mac soon responded with a $5 billion 10-year Reference Note on April 9, 1998. For the entire year, Fannie Mae issued $42.25 billion of Benchmark Notes, and Freddie Mac issued $20 billion of Reference Notes. Fannie Mae came out with eight issues with maturities ranging from three to ten years, while Freddie Mac issued four separate notes with maturities of three to ten years (See figure below). Fannie Mae reopened four of its issues, while Freddie Mac reopened two.



Source: Bloomberg

By the end of 1998, Fannie Mae's Benchmark Notes accounted for 12 percent of its effective long-term debt outstanding, while Freddie Mac's Reference Notes comprised 13 percent of its effective long-term debt. (Effective long-term debt includes short-term debt converted to long-term debt via interest rate swaps.)

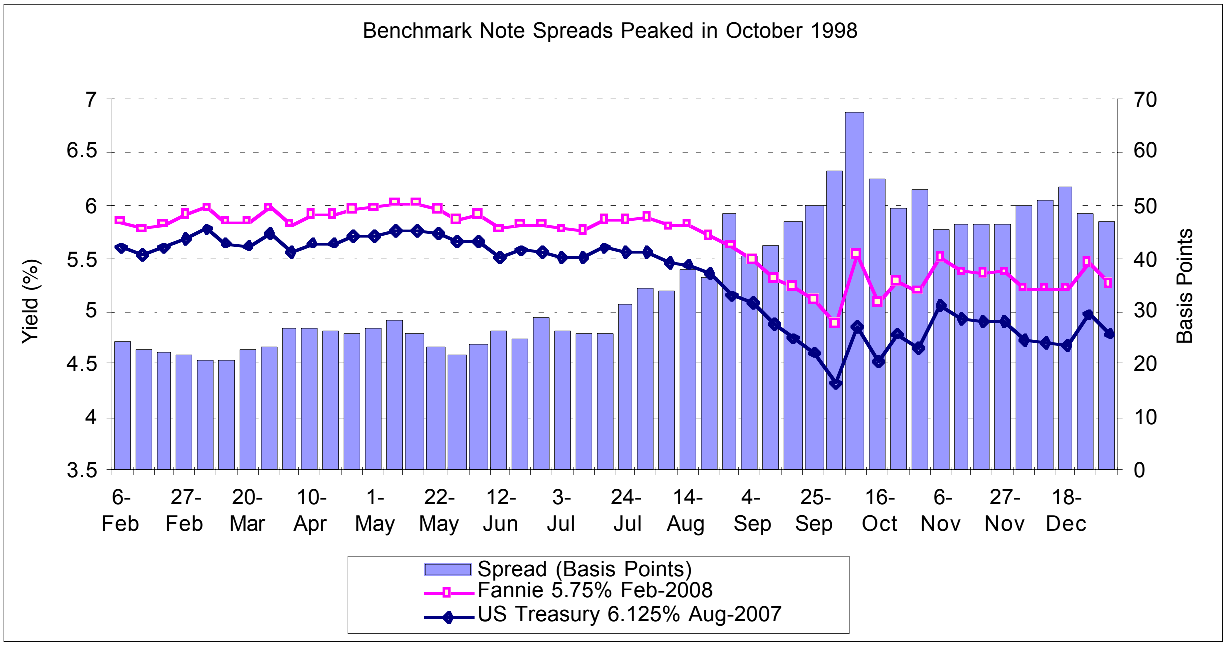
These programs took advantage of the reduction in debt issued by the U.S. Treasury, which has resulted in strong demand for large liquid securities that can be used as hedging tools. There are active secondary markets for these instruments, and current prices and yields are visible via services like Bloomberg and Telerate.

Both Enterprises succeeded in their efforts to attract new investors, with dealers placing many securities in Europe and Asia, and issues were sometimes oversubscribed. Another priority for both Enterprises is to make the timing of their bond issues predictable. Fannie Mae came to market in every month in 1998 despite markets that were sometimes turbulent. In November, Freddie Mac announced that it would issue Reference Notes on a monthly basis.

Box 3: Benchmark and Reference Notes (Continued)

Relative to U.S. Treasury securities, spreads on Benchmark and Reference Notes widened during 1998, peaking during the liquidity crunch in October. (See figure below) This spread widening occurred throughout the credit markets as investors flocked to the safety of U.S. Treasuries in the wake of the Russian ruble default, hedge fund meltdowns, and other credit events. However, Benchmark and Reference spreads were relatively stable when compared to interest rate swaps. The widening of mortgage spreads was even more dramatic and created profitable purchase opportunities for both Enterprises.

In April 1999, the Enterprises announced new programs to issue callable Benchmark and Reference Notes.



Source: Bloomberg

Chapter 4

Financing OFHEO's Operations

OFHEO'S BUDGET

OFHEO's operations are not financed by taxpayer funds. OFHEO's annual operating budget is, however, subject to the Federal appropriations process and is based on the amount appropriated by Congress and signed into law by the President. The amounts provided for by the appropriations process are collected from Fannie Mae and Freddie Mac in the form of an annual assessment paid semi-annually.

For fiscal year 1998, OFHEO's budgetary resources totaled $16,582,000. This operating budget supported drafting of the Notice of Proposed Rulemaking for the risk-based capital regulation for Fannie Mae and Freddie Mac, implementing comprehensive annual risk-based examinations of Fannie Mae and Freddie Mac, and performing other safety and soundness related regulatory activities. For fiscal year 1999, OFHEO's budgetary resources total $16,100,000. The fiscal year 1999 budget supports the further refinement of the proposed risk-based capital regulation through the public comment process, continuation of comprehensive annual risk-based examinations for Fannie Mae and Freddie Mac, and completion of the other goals and objectives identified in OFHEO's fiscal year 1999 Performance Plan (available on OFHEO's website at www.ofheo.gov).

As part of the President's fiscal year 2000 budget request, OFHEO requested a budget of $19,500,000. OFHEO's fiscal year 2000 budget request will support the work required on an ongoing basis to respond to the increased size and complexity of the Enterprises activities and to ensure the capital adequacy and safety and soundness of the Enterprises. To accomplish these objectives, OFHEO's fiscal year 2000 budget request strengthens OFHEO's regulatory infrastructure, provides the necessary depth and expertise to accomplish the Office's regulatory mission, and supports 90 full-time permanent positions. OFHEO's reliance on information technology to perform its mission requires that the Office take steps to ensure institutional capacity and stability in this critical area. Specifically, OFHEO's fiscal year 2000 budget will allow the Office to:

- ➢ increase efficiency and effectiveness of examinations and risk-based capital regulatory-related activities, through the increased automation of data management that will take place upon the completion of OFHEO's Data Warehouse project;
- ➢ enhance examination efficiency through the completion of OFHEO's Surveillance and Monitoring System; and
- ➢ enhance the management, and maximize the value, of OFHEO's information technology investments.

These investments will allow OFHEO to continue its effective regulatory oversight of the activities and operations of Fannie Mae and Freddie Mac.

UNQUALIFIED AUDIT OPINION OF FY 1998 FINANCIAL STATEMENTS

In conjunction with the government's goal of improved accountability, OFHEO voluntarily prepared financial statements for fiscal year1998 and subjected these statements and underlying processes to an independent audit. The certified public accounting firm of Dembo, Jones, Healy, Pennington and Ahalt audited the statements. The firm issued an unqualified audit opinion on OFHEO's fiscal year1998 Financial Statements. The following document is a copy of the audit opinion and the associated principal financial statements and notes.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT (OFHEO)

FISCAL YEAR 1998 FINANCIAL STATEMENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

OFHEO MISSION STATEMENT

OFHEO effectively protects the interests of the American taxpayer and contributes to the strength and vitality of the nation's housing finance system through independent and fair safety and soundness regulation of Fannie Mae and Freddie Mac.

OVERVIEW OF THE REPORTING ENTITY

OFHEO was created by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the Act), Title XIII of the Housing and Community Development Act of 1992. OFHEO is an independent office in the Department of Housing and Urban Development (HUD). Its principal responsibility is to ensure that the two largest government sponsored enterprises, Fannie Mae and Freddie Mac, are adequately capitalized and operating safely. OFHEO is headed by a Director who is appointed by the President for a five-year term and is responsible for the overall operation of OFHEO. The OFHEO Director position has been vacant since early 1997 when the incumbent was appointed as the Administrator for the Small Business Administration. Since that time, OFHEO's Deputy Director has served as Acting Director.

The Act requires OFHEO to develop a stress test to determine risk-based capital requirements and to conduct other research and financial analysis necessary for effective regulatory oversight of Fannie Mae and Freddie Mac. OFHEO is also required by statute to conduct on-site, annual examinations at Fannie Mae and Freddie Mac to determine the condition of each Enterprise for the purpose of ensuring their financial safety and soundness. The examinations are designed to identify the overall risks in the business activities of the Enterprises, and to determine if those risks are being prudently managed, controlled, and monitored. Additional special examinations may be conducted as determined by the OFHEO Director.

OVERVIEW OF THE ENTERPRISES

It is critical that OFHEO fully develop and maintain its capacity to assess risks and market conditions that could affect the financial safety and soundness of Fannie Mae and Freddie Mac. The assets of the Enterprises have roughly doubled in the past four years and continue to grow rapidly. At the end of September 1998, Fannie Mae and Freddie Mac together managed the credit risk of $1.8 trillion in mortgages, an increase of 5% from June 30, 1998. By the end of September 1998, the Enterprises had more than $1.4 trillion in mortgage-backed securities outstanding. The Enterprises also hold over 40% of all U.S. single family mortgages and purchased about 50% of the single-family mortgages originated in the first three quarters of 1998. To finance their growing portfolios, the Enterprises have expanded their global debt facilities to issue debt securities to

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international investors in both dollars and foreign-denominated currencies. At the same time, the mortgage finance markets are undergoing major changes, including increased automation and consolidation. The Enterprises are also expanding the scope of their housing finance activities, including entry into the alternative "A" and subprime loan markets. All of this new activity and growth is occurring in a domestic economic environment that is coming under increasing pressure from weaknesses in foreign economies.

FUNDING OF OFHEO OPERATIONS

OFHEO submits its annual operating budget request directly to the Office of Management and Budget (OMB). OMB reviews the budget request as part of its government-wide review of the President's Budget. Once the President's Budget is final, OFHEO may submit its annual budget request to the Congress for review. The Act provides at section 1316 (g) (3) that OFHEO's Congressional Budget Justification be included with HUD's Congressional Budget Justification. Formulation of budget requirements is independent of HUD.

While OFHEO is subject to the appropriations process, it is not funded by taxpayer dollars. Fannie Mae and Freddie Mac bear the full cost of OFHEO's operations through an annual assessment based on OFHEO's appropriation. After the appropriation has been enacted, OFHEO receives a General Fund Appropriation from the U.S. Treasury that is fully offset by collections from the Enterprises. The cost to the U.S. Treasury for OFHEO's operations is zero due to the offsetting collections.

Each Enterprise pays a pro rata share of the annual assessment (appropriation). The pro rata shares are determined by the combined assets and off-balance sheet obligations of each Enterprise. OFHEO receives the annual assessment in semi-annual payments each fiscal year. These payments are due to OFHEO October 1 and April 1 of each fiscal year.

OFHEO's appropriation is available until expended and is classified as a no-year fund. Due to the unique crediting provision in OFHEO's authorizing statue, the amount of unobligated assessment funds at year-end must be credited to the next year's annual assessment. Consequently, the treatment of these funds is different from a normal no-year fund. In a normal no-year fund, the unobligated amount is automatically carried forward as budgetary resources. In OFHEO's fund, the unobligated amount is carried forward in OFHEO's cash account, but it does not add to enacted budget authority for the new budget year.

FUNDING FROM REIMBURSABLE AGREEMENT

In FY 1996 and 1997, OFHEO had a reimbursable agreement with the Agency for International Development (AID) and OFHEO received funding from AID in both years. Through the agreement, AID relied on OFHEO's technical expertise to assist the Government of Mexico in developing a secondary mortgage market. OFHEO did not receive additional funds from AID in FY 1998. During FY 1998, OFHEO administered work already in progress but made no new obligations pursuant to the agreement with AID.

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FINANCIAL MANAGEMENT AND INTERNAL CONTROLS

Federal Managers Financial Integrity Act (FMFIA). As of the end of FY 1998, OFHEO had no material weaknesses or other reportable conditions pertaining to internal management controls. OFHEO managers maintain effective internal controls pursuant to FMFIA and implementing guidance from OMB. OFHEO is cognizant of its responsibility to address audit recommendations as well as internal management control weaknesses.

OFHEO's senior managers and supervisors evaluate internal management controls at least annually with oversight provided by the Director of Finance and Administration. Management officials were required to address "Year 2000" issues and control weaknesses in their annual assurance statements to the Acting Director. OFHEO effectively evaluated "Year 2000" issues and monitored administrative cross servicers for "Year 2000" compliance. OFHEO's senior executives identified some program vulnerabilities which were not material. Proper actions were taken to minimize potential risks related to the vulnerabilities.

For FY 1998, OFHEO contracted for a review of internal controls related to its financial management systems (OMB Circulars A-123 and A-127). This review did not identify any material non-conformance with Section 4 of FMFIA nor did it identify any reportable weakness in OFHEO's financial management internal controls. The report emphasized the strength and effectiveness of OFHEO's financial management control structure that provides early identification of potential problem areas to facilitate immediate problem evaluation and corrective action to eliminate or manage risk.

General Accounting Office (GAO) Audit. In October 1997, GAO released a report of its audit at OFHEO pursuant to Section 430 of the Department of Veterans Affairs/Department of Housing and Urban Development Appropriations Act of 1997 (P.L. 104-204). The focus of the audit was to review OFHEO's progress in the development of final risk-based capital standards for the Enterprises and to assess OFHEO's implementation of its safety and soundness examination. GAO recommended that OFHEO's Acting Director:

- Periodically report to Congress on OFHEO's progress toward complying with the current estimate of completing a stress test and risk-based capital standards by 1999,
- Assess the examination staff resources necessary to adequately cover all risk areas on 1- and 2-year examination cycles,
- Identify the most appropriate examination cycle after considering the trade-offs between examination coverage and resource requirements that would be involved, and
- Develop a strategy for obtaining the necessary examination office resources, which may involve reallocating existing resources over time.

OFHEO acted quickly to address the GAO recommendations. During FY 1998, OFHEO's Acting Director briefed congressional staff on thirteen occasions on the status of the risk-based capital standard and examinations. Two of these were formal appearances on October 30, 1997 and on July 30, 1998 before the Subcommittee on Capital Markets, Securities, and Government Sponsored

Enterprises of the House Banking and Financial Services Committee. The Acting Director spoke about the audit findings and OFHEO's plan to address the audit recommendations.

OFHEO significantly revised the examination program in a manner consistent with the recommendations contained in the GAO report. OFHEO completed the initial three-year cycle of discovery examinations of the Enterprises, which facilitated the implementation of a comprehensive annual risk-based examination process. This comprehensive examination process includes regular risk assessments of the core risks of the Enterprises to ensure an ongoing assessment of the safety and soundness of the Enterprises. During the first quarter of FY 1998, OFHEO initiated the first examination under this framework for calendar year 1998.

OFHEO has also been responsive to the staffing concerns raised in the GAO report. As of September 1997, the Acting Director had already reallocated within OFHEO two positions to the examination program. In FY 1998, the Acting Director secured the approval of OMB to add four additional full-time positions to OFHEO's staffing plan in order to bolster the number of examiners when it became clear that other Federal financial regulators were unable to provide OFHEO detailees, as had been previously planned. OFHEO reallocated existing resources to finance these new positions and received no new funding for the positions. The effect of these staffing actions was to increase the percentage of staff allocation to the examination program by 35%.

In conjunction with revising the examination program, OFHEO reorganized its examination staff. This reorganization of staff has achieved several important objectives. First, the realignment organizes the staff around the four major categories of risk management, allowing for a greater concentration of skill and ongoing expertise in particular areas among the examiners to facilitate the early identification of potential risks. Second, the reorganization facilitates direct accountability for examination activities. Finally, OFHEO created an explicit role for surveillance and monitoring within the examination function to target the identification of trends and/or anomalies for immediate investigation. OFHEO has also initiated an effort to expand the capability of the surveillance and monitoring function through increased leveraging of technology and data.

Compliance with Prompt Payment Act. The Prompt Payment Act and OMB circular A-125 focus on improving the cash management practices of the government. OMB defines "on time as those payments made 23 to 30 days after receipt of the invoice, earlier payments where discounts were taken, and earlier payments made in accordance with management guidance." During FY 1998, OFHEO continued to demonstrate excellent compliance with the prompt payment rules and reduced the amount of interest paid due to prompt payment rules.

While OFHEO's prompt payment performance in FY 1997 was very good, performance during FY 1998 improved. During FY 1998, OFHEO paid only $244.95 in interest as a result of late payment penalties for vendor invoices totaling almost $5.8 million, which are covered by OMB's Circular A-125. This equates to .00422% of the covered disbursements.

During FY 1998, OFHEO's disbursements covered by prompt payment rules grew by over 16%, from just under $5 million to $5.8 million. While the workload grew, the amount of interest paid in FY 1998 declined by over 46.6%, $189.07 less than the $434.02 paid during FY 1997.

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EVOLUTION OF OFHEO'S FINANCIAL MANAGEMENT PROGRAM

From OFHEO's inception until October 1, 1996, OFHEO relied on HUD for financial accounting service and systems. On October 1, 1996, OFHEO converted its financial accounting activities from HUD to a new servicing agent, the Department of Veterans Affairs (VA). OFHEO's goals were to improve its accountability over its financial resources as well as help HUD and OFHEO to better leverage resources in making improvements in financial accounting in both organizations.

FY 1998 is the first year that OFHEO has prepared its own principal financial statements for independent audit. During FY 1998, OFHEO coordinated with HUD, Office of Inspector General (OIG), in OFHEO's effort to contract for an independent audit of its FY 1998 Financial Statements and internal controls systems. In the last quarter of FY 1998, OFHEO issued a task order to a Certified Public Accounting and Consulting firm (Dembo, Jones, Healy, Pennington & Ahalt, P.C.) through the Department of Labor (DOL) OIG contract for financial audits pursuant to the Chief Financial Officers Act.

PERFORMANCE FOR FY 1998

OFHEO had two primary goals for FY 1998. These goals were to strengthen the examination program and to submit for interagency review the second notice of proposed rulemaking on the stress test for the risk-based capital standard. During FY 1998, OFHEO achieved its goal with respect to the examination program, and sent the proposed rule for the risk-based capital standard to OMB for interagency review in October 1998. Following is a summary of the significant accomplishments of OFHEO during FY 1998.

Rulemaking

During FY 1998, OFHEO continued a series of informal meetings on the risk based capital stress test with representatives from OMB, Treasury, HUD and the Office of Thrift Supervision (OTS). These informal meetings familiarized these agencies with the Financial Simulation Model and stress test policy issues in order to facilitate formal interagency review of OFHEO's second notice of proposed rulemaking for the risk-based capital standard. OFHEO also briefed Treasury and HUD on the parameters selected and policy decisions made for the stress test that are included in the second notice of proposed rulemaking. OFHEO drafted the second notice of proposed rulemaking for the risk-based capital standard during FY 1998 and sent it to OMB for interagency review on October 30, 1998.

During FY 1998, OFHEO completed the final rule to implement the Privacy Act. OFHEO also completed a final rule to adjust civil money penalties for inflation. OFHEO issued a proposed regulation establishing the Rules of Practice and Procedure related to the conduct of enforcement actions. The office also sent to OMB for interagency review a final regulation on the release of information, which implements the Freedom of Information Act.

Research and Policy Analysis

During FY 1998, OFHEO continued to classify each of the Enterprises as "adequately capitalized" each quarter by applying regulatory minimum capital standards. OFHEO also continued to publish each quarter its House Price Index documenting changes in home prices for the nation, each state, and the nine Census regions.

OFHEO made policy decisions for the Financial Simulation Model, the platform for completing the development and running of the risk-based capital stress test. OFHEO continued to make substantial progress in readying the stress test by completing documentation of the initial version of the Financial Simulation Model.

OFHEO continued work on the Data Warehouse, which will house the large volume of data that OFHEO receives from the Enterprises, and enhanced the efficiency of the Financial Simulation Model and the stress test. OFHEO developed the data transfer system and initiated data normalization of the Enterprise data. OFHEO also completed the conceptual design of the Data Warehouse to include capability to support OFHEO's surveillance and monitoring system that will provide analytical support to OFHEO's examination staff.

OFHEO continued original research in the areas of single- and multi-family mortgage performance to enhance OFHEO's understanding of the risks taken by the Enterprises with these types of activities. OFHEO also determined that a new program proposed by Freddie Mac, the Financial Assets Securitization Investment Trust program, would not risk significant deterioration of Freddie Mac's financial condition and forwarded that determination to the Secretary of HUD for his consideration in acting on the new program request.

OFHEO implemented a comprehensive framework for determining the comparability of executive compensation and the reasonableness of termination packages at the Enterprises.

OFHEO continued to make full reports to the Congress regarding its activities. The Annual Report to the Congress was published on June 15, 1998.

Examination and Oversight

OFHEO enhanced its examination strategy by initiating an annual continuous risk-based examination process with regular risk assessments of the core risks of the Enterprises to ensure a comprehensive ongoing assessment of the safety and soundness of the Enterprises. OFHEO drafted an Examination Handbook to codify the continuous risk-based examination approach, including supervisory philosophy, examination policies and procedures, and standards for risk management practices and initiated the calendar year 1998 examination of the Enterprises.

During FY 1998, OFHEO completed examinations of the information systems and technology risk of the Enterprises. The Office also completed examinations of operations risk management and internal audit at the Enterprises. OFHEO presented examination reports and met with the Board of Directors on each examination. OFHEO also monitored the progress of the Enterprises' "Year 2000" compliance, including regular briefings by the Enterprises.

OFHEO conducted flood insurance compliance reviews of the Enterprises to assess the adequacy of procedures at the Enterprises to comply with the requirements of applicable laws pertaining to flood insurance. OFHEO reported on the adequacy of compliance in the Annual Report.

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OFHEO maintained and enhanced surveillance and monitoring programs to ensure that they provide a comprehensive and timely assessment of the safety and soundness of the Enterprises. Staff analyzed the financial condition and performance of the Enterprises and completed evaluations of risks of the Enterprises. OFHEO also hosted a joint meeting of the examination staffs from Federal agencies that supervise Government Sponsored Enterprises.

Infrastructure

OFHEO continued to focus on improved accountability over financial resources by issuing a task order through the Department of Labor, Office of Inspector General, for an independent audit of OFHEO's FY 1998 financial statements and internal control processes. OFHEO also continued reconciliation of financial data carried forward in FY 1997 from the HUD accounting system. OFHEO identified surplus cash in its Treasury Fund and completed action necessary to dispose of the cash by providing additional credit to the Enterprises against the FY 1999 annual assessment. Through the reconciliation, OFHEO also recovered over $582,000 from prior year obligations for use in FY 1998 enabling OFHEO to fund mission related contract services.

OFHEO revised its Performance Evaluation Management System based on feedback and recommendations. The Office implemented a voluntary multi-source feedback (360 degree) review program for supervisors.

OFHEO continued to maintain automation support for the Office and upgraded the operating system for OFHEO's Office Automation Local Area Network.

The Office began identifying potential "Year 2000" issues in April 1997. In FY 1998, OFHEO continued to track progress to assure "Year 2000" compliance and monitored "Year 2000" compliance of administrative cross-servicing providers. Contingency plans will be implemented in the case of any "Year 2000" systems disruption and OFHEO will be able to continue all necessary functions. As of the end of FY 1998, OFHEO had achieved a state of readiness regarding "Year 2000".

OFHEO has three broad system types potentially impacted by "Year 2000" issues.

1) Mission systems under development that will be "Year 2000" compliant when put in service.

2) Administrative support systems developed and operated by OFHEO that are already "Year 2000" compliant.

3) Administrative and financial support systems owned by other federal agencies and used by OFHEO. These support systems have either been certified as "Year 2000" compliant by the servicing agency or corrective actions will be completed by owner agencies before OFHEO would realize an adverse impact.

At the end of FY 1998, OFHEO had one software program used through its cross-servicing agreement with the Department of Veterans Affairs (VA) that is not "Year 2000" compliant. The software, a travel management program, is scheduled for replacement by VA during the second quarter of FY 1999.

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OFHEO also receives data from the Enterprises and is coordinating with both Enterprises to ensure that OFHEO's systems currently under development are designed in a way to ensure that Enterprise data may be efficiently received by OFHEO.

LIMITATIONS OF THE FINANCIAL STATEMENTS

While OFHEO is not specifically covered by the requirements in the Chief Financial Officers Act, the Office has prepared financial statements to report the financial position and results of operations of OFHEO, pursuant to the requirements of 31 U.S.C. 3515(b). The statements have been prepared from the books and records of OFHEO with the format prescribed by OMB. 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 realization that they are for a component of the U.S. Government.

The following principal statements present the financial position of OFHEO, an independent office within HUD, as of September 30, 1998. The statements are in conformity with the instructions provided for federal entities by the OMB and comply with Statements of Federal Financial Accounting Standards effective as of September 30, 1998.

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

Report of Independent Auditors
on the Financial Statements

Mr. Mark A. Kinsey
Acting Director
Office of Federal Housing Enterprise Oversight

We have audited the accompanying balance sheet of Office of Federal Housing Enterprise Oversight as of September 30, 1998, and the related statements of net cost, changes in net position, budgetary resources and financing for the year then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin 98-08, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 1998, and the results of its net costs, changes in net position, its budgeting resources and its financing for the year then ended in conformity with Federal accounting standards.

Dembo, Jones, Healy, Pennington + Ahalt, P.C.

January 21, 1999

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

Report of Independent Auditors
on Internal Control

Mr. Mark A. Kinsey
Acting Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Office of Federal Housing Enterprise Oversight as of and for the year ended September 30, 1998, and have issued our report thereon dated January 21, 1999. We conducted our audit in accordance with generally accepted auditing standards; 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. 98-08, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered Office of Federal Housing Enterprise Oversight's internal control over financial reporting by obtaining an understanding of the agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal controls.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of Office of Federal Housing Enterprise Oversight in a separate letter dated January 21, 1999.

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In addition, with respect to internal controls related to performance measures reported in the accountability report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08. 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.

This report is intended for the information of the management of Office of Federal Housing Enterprise Oversight, OMB, and Congress. However, this report is a matter of public record and its distribution is not limited.

Demko, Jones, Healy, Remington & Ahalt, P.C.

January 21, 1999

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

Report of Independent Auditors
on Compliance with Laws and Regulations

Mr. Mark A. Kinsey
Acting Director
Office of Federal Housing Enterprise Oversight

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Office of Federal Housing Enterprise Oversight as of and for the year ended September 30, 1998, and have issued our report thereon dated January 21, 1999. We conducted our audit in accordance with: generally accepted auditing standards; 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. 98-08, "Audit Requirements for Federal Financial Statements."

The management of Office of Federal Housing Enterprise Oversight is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency'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 98-08.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph that are required to be reported under *Government Auditing Standards* or OMB Bulletin 98-08.

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

This report is intended for the information of the management of Office of Federal Housing Enterprise Oversight, OMB, and Congress. However, this report is a matter of public record, and its distribution is not limited.

Dembo, Jones, Healy, Pennington + Ahalt, P.C.

January 21, 1999

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
BALANCE SHEET
as of September 30, 1998

Assets	
Fund Balance with Treasury – Note 2	$ 5,176,075
Accounts Receivable - Note 3	17,511
Property, Plant and Equipment – Note 4	5,425,211
Total Assets	**$ 10,618,797**
Liabilities	
Liabilities Covered by Budgetary Resources:	
Intragovernmental Liabilities:	
Accounts Payable	$ 601
Accrued Payables	151,428
Total Intragovernmental Liabilities - Note 5	152,029
Other Liabilities	
Accounts Payable	1,298,409
Other Liabilities	417,431
Total Other Liabilities - Note 5	1,715,840
Total Liabilities Covered by Budgetary Resources	1,867,869
Liabilities Not Covered by Budgetary Resources:	
Intragovernmental Liabilities:	
Other Intragovernmental Liabilities	406,250
Total Intragovernmental Liabilities	406,250
Other Liabilities:	
Accrued Annual Leave	389,707
Total Other Liabilities	389,707
Total Liabilities Not Covered by Budgetary Resources	795,957
Total Liabilities	**$ 2,663,826**
Net Position	
Unexpended Appropriations - Note 6	$ 3,325,717
Cumulative Results of Operations	4,629,254
Total Net Position - Note 7	**$ 7,954,971**
Total Liabilities and Net Position	**$ 10,618,797**

The accompanying notes are an integral part of these Statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENT OF NET COST
for the Year Ended September 30, 1998

Program Costs	
Intragovernmental Production	
Public Production	$ 11,075,929
Federal Production	2,008,838
Total Production Costs - Note 8	13,084,767
Non-production Costs	
Imputed Financing Sources - PEB - Note 9	331,497
Financing Sources Yet to be Provided (A/L) - Note 10	28,407
Financing Sources Yet to be Provided (FWC) - Note 11	(18,916)
Total Non-Production Costs	340,988
Total Program Costs	**$ 13,425,755**
Less Earned Revenues - Note 12	(36,479)
Net Program Costs	**$ 13,389,276**
Net Cost of Operations	**$ 13,389,276**

The accompanying notes are an integral part of these Statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENT OF CHANGES IN NET POSITION
for the Year Ended September 30, 1998

Net Cost of Operations	**$ (13,389,276)**
Financing Sources	
Appropriations Used - Note 13	16,063,521
Imputed Financing Sources - PEB - Note 9	331,497
Subtotal - Financing Sources	16,395,018
Net Changes in Cumulative Results of Operations	**$ 3,005,742**
(Decrease) in Unexpended Appropriations - Note 14	(119,346)
Changes in Net Position	**$ 2,886,396**
Net Position - Beginning of Period - Note 15	5,068,575
Net Position - End of Period - Note 15	**$ 7,954,971**

The accompanying notes are an integral part of
these Statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENT OF BUDGETARY RESOURCES
for the Year Ended September 30, 1998

Budgetary Sources	
Appropriations - Note 16	$ 16,000,000
Unobligated Balance Brought Forward October 1	55,593
Spending Authority from Offsetting Collections	
Collected	68,955
Receivable from Federal Source – Note 12	(32,476)
Change in Unfilled Customer Orders Without Advance from Federal Sources - Note 12	(36,479)
Adjustments	
Recoveries of Prior Year Obligations - Note 17	582,250
Permanently not available Pursuant to Public Law 102-550	(55,593)
Total Budgetary Resources	**$ 16,582,250**
Status of Budgetary Resources	
Obligations Incurred	16,556,930
Unobligated Balance Not Available	25,320
Total Status of Budgetary Resources	**$ 16,582,250**
OUTLAYS	
Obligations Incurred	$ 16,556,930
Less: Spending Authority from Offsetting Collections/Adjustments	
Collected	68,955
Receivable from Federal Sources - Note 12	(32,476)
Change in Unfilled Customer Orders Without Advance from Federal Sources - Note 12	(36,479)
Actual Recoveries of Prior Year Obligations - Note 17	(582,250)
Total Obligations Incurred	15,974,680
Obligated Balance, Net - Beginning of Period	4,947,080
Obligated Balance, Net - End of Period	
Accounts Receivable - Note 3	17,511
Unfilled Customer Orders Federal Sources Without Advances	3,060
Undelivered Orders	(3,303,456)
Accounts Payable	(1,867,869)
Total Obligated Balance, Net – End of Period	(5,150,754)
Outlays	
Disbursements	15,827,201
Collections	(68,970)
End of Fiscal Year Adjustments - Note 19	12,775
Total Outlays	**$ 15,771,006**

The accompanying notes are an integral part of
these Statements

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OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT
STATEMENT OF FINANCING
for the Year Ended September 30, 1998

Obligations and Nonbudgetary Resources	
Obligations Incurred	**$ 16,556,930**
Less: Spending Authority from Offsetting Collections/Adjustments	
Earned Reimbursements	
Collections	68,955
Receivables from Federal Sources – Note 12	(32,476)
Change in Unfilled Customer Orders – Note 12	(36,479)
Recoveries of Prior Year Obligations – Note 17	(582,250)
Other - Imputed Financing Sources –PEB – Note 9	331,497
Total Obligations as Adjusted and Nonbudgetary Resources	**$ 16,306,177**
Resources That Do Not Fund Net Cost of Operations	
Change in Goods/Services/Benefits Ordered but not Provided (Increase)	127,951
Change in Unfilled Customer Orders (Decrease)	(39,109)
Costs Capitalized on the Balance Sheet (Increase)	
General Property, Plant and Equipment	(3,015,234)
Total Resources That Do Not Fund Net Costs of Prior Periods	(2,926,392)
Financing Sources Yet to be Provided (Annual Leave) - Note 10	28,407
Financing Sources Yet to be Provided (Future Workers Compensation) - Note 11	(18,916)
Total Financing Sources Yet to be Provided	9,491
Net Cost of Operations	**$ 13,389,276**

The accompanying notes are an integral part of these Statements

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NOTES TO FINANCIAL STATEMENTS

NOTE 1 - OFHEO ACCOUNTING PRINCIPLES AND STANDARDS

A. FY 1998 reflects a significant change in the manner in which OFHEO aggregates information for financial reporting purposes.

Beginning with FY 1997, OFHEO assumed responsibility over the financial accounting activities associated with its appropriation. This required the separation of accounting data from HUD. OFHEO used FY 1997 as a transition year to convert accounting operations to a system managed by OFHEO and to reconcile records transferred from the HUD system. FY 1998 is the first year that OFHEO has developed its own financial statements to stand on an independent basis for reporting and audit. Consequently, for FY 1998 financial reporting, OFHEO captured costs related to pension, post employment benefits and annual leave and is disclosing these costs for both FY 1997 and FY 1998 in Notes associated with these liabilities. OFHEO is reporting a portion of the actuarially determined costs for HUD for Future Workers Compensation (FWC) pursuant to the Federal Employees Compensation Act (FECA) benefits. Because the cost is determined by the Department of Labor (DOL) for HUD and includes OFHEO, OFHEO prorated the cost based on a per employee basis. OFHEO has asked DOL, in future years, to separate OFHEO from HUD on both a claim basis and actuarial liability basis. OFHEO believes this separation will provide a more meaningful disclosure for future liabilities.

B. The following presentation outlines the accounting principles and standards under which OFHEO operates and under which the FY 1998 financial statements were produced.

- ***Basis of Presentation***

These principal statements were prepared to report the financial position and results of operations of OFHEO. While OFHEO is not an entity covered by the Chief Financial Officers (CFO) Act, the principal statements were prepared from the accounting system and records of OFHEO in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 97-01 and OFHEO accounting policies summarized in this note.

- ***Reporting Entity/ Program Name***

OFHEO was established as an independent office within HUD by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (title XIII of P.L. 102-550).

- ***Budgets and Budgetary Accounting***

Since 1993, Congress has enacted no-year appropriations, which are available for obligation by OFHEO until expended. The appropriation is funded by an annual assessment of Fannie Mae and Freddie Mac and not with taxpayer funds. Beginning with the FY 1998 appropriation, OFHEO receives an appropriation from the U.S. Treasury General Fund each year. OFHEO fully offsets the General Fund appropriation with collections from the annual assessment of the Enterprises and ensures that no taxpayer funds are used for OFHEO's operations.

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OFHEO's enabling statute requires that OFHEO return to the Enterprises in the form of a credit against the next year's annual assessment any unobligated assessment funds at the end of the fiscal year. This effectively makes OFHEO operate like a hybrid annual appropriation with no-year authority -- OFHEO's annual resources are available for obligation and expenditure without regard to any fiscal year limitation. OFHEO reduces the current year's assessment by the amount of the unobligated balance from the previous year. Consequently, there is no carry over of budget authority from one year to the next and cash is adjusted by the credit given to the Enterprises each year.

- ***Basis of Accounting***

Transactions are recorded on both an accrual accounting basis and on a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or 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 the hierarchy of accounting principles for the Federal Government:

- ❑ Standards approved by the Director of OMB, the Controller General, and the Secretary of the Treasury;
- ❑ Interpretations related to Standards issued by OMB in accordance with the procedures outlined in OMB Circular A-134, Financial Accounting Principles and Standards;
- ❑ Requirements contained in OMB's Form and Content Bulletin in effect for the period covered by the financial statement;
- ❑ Accounting principles published by other authoritative standard-setting bodies and other authoritative sources in the absence of guidance provided above; and
- ❑ Accounting principles established by HUD, VA or OFHEO that OFHEO implements to enhance consistency or to provide guidance in the absence of government-wide standards.

- ***Revenues and Other Financing Sources***

For reporting purposes, appropriations are recognized as revenues. At the time expenses are accrued, revenue is adjusted as Appropriations Used.

Assessment collections based on appropriations are deposited in OFHEO's fund account at the U.S. Treasury (Treasury) and are used to offset the appropriation warrant from the General Fund. Receipts which result from moneys due to OFHEO as a result of work performed for other agencies (e.g. AID) are deposited in OFHEO's fund and must be warranted from Treasury before the funds are available for expenditure by OFHEO. Miscellaneous receipts collected by OFHEO are not available to OFHEO for obligation or expenditure. These receipts must be transferred to the Treasury when collected.

- ***Funds with the Treasury and Cash***

OFHEO cash receipts and disbursements are processed by Treasury. The funds with Treasury are primarily assessment funds that are available to pay current liabilities and to finance authorized purchase commitments. The Office does not have monetary assets held outside OFHEO's fund balance at Treasury. OFHEO does not have an advance from Treasury to maintain an Imprest Fund and does not hold any marketable or non-marketable securities. The Office does not operate a direct loan or loan guarantee program.

- ***Accounts Receivable***

OFHEO's receivables result from the interagency agreement with AID and are related to HUD payroll transactions processed in error by the National Finance Center against OFHEO's appropriation. There is no need to estimate an uncollectable account percentage at this time.

- ***Advances***

Advance payments are rarely made. Advances, when given, are normally for employee travel. These advance payments are recorded as assets, which are reduced when reports of expenditures are received by OFHEO or when accruals of cost estimates are made by OFHEO.

- ***Property and Equipment***

Property is capitalized and depreciated consistent with the criteria established by HUD. OFHEO believes it is mutually beneficial to adopt the same threshold as HUD to facilitate the preparation of consolidated financial statements that HUD would prepare under the CFO Act. Thus, property with a cost of $100,000 or more per unit and a useful life of two years or more will be capitalized at cost and depreciated. Other property items are expensed when purchased. Normal repairs and maintenance are charged to expense as incurred.

At present, OFHEO has one qualifying item under the current capitalization threshold. This asset is software under development to support the oversight of the Enterprises. The software supports the development of risk-based capital standards and will be used to implement the final risk-based capital standards. It also supports surveillance and monitoring of the Enterprises. The software is being constructed "in-house", utilizing significant contractor support. The asset had not been placed in service as of September 30, 1998 and no depreciation has been taken. Straight-line depreciation will be used once the software has been placed into service. OFHEO owns no real property and has no capitalized leases.

- ***Operating Lease***

OFHEO has an operating lease with OTS at 1700 G Street, NW, Washington, D.C. The lease covers office space and building services to include 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. OFHEO may renew the lease for three 5-year options.

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OFHEO may terminate the lease agreement in whole or in part. In the event of a termination in OFHEO's discretion, OFHEO is required to pay OTS two months rent. The OTS is required to use its best effort to rent the space. OFHEO's obligation to make payments ceases on the date that OTS rents the space. If either OTS or OFHEO cease to exist or merge with another entity by operation of law, either party may terminate the rental agreement. In the event of termination under this provision, neither OTS nor OFHEO is liable for further costs, fees, damages, or other monies due to the termination except for payments through the date of termination.

- ***Prepaid and Deferred Charges***

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and are recognized as expenditures/expenses when the related goods and services are received. OFHEO rarely prepays for services or goods.

- ***Liabilities***

Liabilities represent the amount of moneys or other resources that are likely to be paid by OFHEO as the result of a transaction or event that has already occurred. However, no liability can be paid by OFHEO absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is no certainty that an appropriation will be enacted are classified, as Liabilities not covered by Budgetary Resources. During FY 1998, OFHEO had five types of liabilities: (1) accounts payable, (2) accrued accounts payable, (3) payroll accruals, (4) unencumbered cash, and (5) unfunded liabilities.

Accounts payable reflect invoices processed for payment during FY 1998 which are yet unpaid as of the end of the fiscal year due to scheduling of payments to reflect prompt payment guidelines. Accrued accounts payable are estimates of the value of services received during FY 1998 for which OFHEO had not been billed during the fiscal year. Payroll accruals reflect payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year.

Unencumbered cash represents surplus cash in OFHEO's fund documented through a reconciliation of OFHEO's obligations, accounts payable, and cash. In FY 1998, OFHEO recorded a liability for "unencumbered cash". This liability resulted from OFHEO's reconciliation of budgetary and proprietary accounts related to conversion from the HUD accounting system in FY 1997. The liability will be liquidated in the first month of FY 1999 when the unencumbered cash will be credited against the FY 1999 assessment of the Enterprises. Unfunded liabilities represent annual leave balances at the end of the fiscal year and Future Workers Compensation (FWC) benefits under the Federal Employees Compensation Act (FECA). OFHEO's current year budgetary resources do not fund these liabilities.

- ***Annual, Sick, and Other Leave***

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. For FY 1997, OFHEO identified $361,300 for annual leave balances as of the end of the fiscal year; this compares to $389,707 calculated for FY 1998 leave balances. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future appropriations and assessments.

Sick leave and other types of nonvested leave are expensed as taken.

- ***Retirement Plans***

OFHEO participates in the retirement plans offered by the Office of Personnel Management (OPM) and does not maintain any private retirement plans or benefits. The majority of OFHEO's 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.

A primary feature of FERS is a savings plan whereby OFHEO automatically contributes one percent of pay and matches any employee contribution up to an additional four- percent of pay. Under CSRS, employees can contribute up to five percent of their pay to the savings plan, but there is no matching contribution by OFHEO. OFHEO expenses its matching contribution on behalf of employees as expenses are incurred.

OFHEO is reporting imputed financing 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 programs.

Fiscal Year	Retirement	Health	Life
1997	$180,635	$133,376	$797
1998	$177,014	$153,637	$846

- ***Contingencies***

OFHEO has no material pending or threatened litigation, claim or assessment outstanding or to our knowledge any unasserted possible claim or assessment that would require disclosure in accordance with Statement of Federal Financial Accounting Standard 5.

Certain legal matters to which OFHEO may be named a party are administered, and in some cases, litigated by other Federal agencies. Amounts paid pursuant to a decision, settlement, or awards pertaining thereto are generally funded through the Treasury. OFHEO is not aware of any legal matters pending which may result in this type of settlement.

In most cases, claims (including personal injury claims) are administered and resolved by the Department of Justice and any amounts necessary for resolution are obtained from a special fund maintained by Treasury. Any legal actions for Workers' Compensation claims brought by OFHEO employees fall under FECA, which is administered by the Employment Standards Administration of the Department of Labor. The cost of administering, litigating, and settling these legal matters has not been delegated to individual Federal agencies.

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- ***Net Position***

OFHEO's net position is comprised of the following components:

1. Unexpended appropriations include the undelivered orders and unobligated balances of OFHEO's funds.

2. Invested capital represents U.S. Government resources invested in OFHEO's property and equipment and inventory not held for sale. Increases to invested capital are recorded when assets are acquired with direct appropriations, and decreases are recorded as a result of the depreciation, disposition of capital assets, or consumption of inventory.

3. Future funding requirements represent (a) accumulated annual leave earned but not taken as of the financial statement date and (b) Future Workers Compensation. The expense for these accruals is not funded from current appropriations, but will be funded from future appropriations and assessments.

NOTE 2 - FUND BALANCE WITH TREASURY

Fund Balance With Treasury consists of the following as of September 30, 1998:

Obligated	$4,746,098
Unobligated from FY 1998 assessment	25,321
Unencumbered prior year assessments	417,431
Collections not warranted	(13,376)
HUD SF-224 reporting error	601
Total Fund Balance With Treasury	$5,176,075

The unobligated FY 1998 funds will be credited to the FY 1999 annual assessment of the Enterprises. The unencumbered balance from prior years, is the result of OFHEO's continuing reconciliation of its fund account during FY 1998. These funds represent a surplus of cash in the OFHEO fund, a result of a number of factors including inadequate cash reconciliation and accounting recordation errors in prior years. These funds will be returned to the Enterprises as credits against the FY 1999 assessment on the Enterprises. The funds collected, but not warranted, pertain to work performed under OFHEO's Reimbursable Agreement with AID. Reimbursement was earned and collected during FY 1998 for FY 1997 obligations. OFHEO is required to secure a warrant from Treasury for funds collected by OFHEO for OFHEO's use. Treasury warranted these funds for OFHEO's use shortly after the close of FY 1998. The HUD SF-224 reporting error was a vendor refund check that HUD received and determined that the refund belonged to OFHEO. The refund belonged to HUD not OFHEO, and OFHEO has coordinated with HUD to return these funds to HUD in FY 1999.

NOTE 3 - ACCOUNTS RECEIVABLE

OFHEO's Accounts Receivable consists of receivables and reimbursements due from other Federal agencies. The accounts receivable for FY 1998 are due from AID and HUD. OFHEO is including the amount that should have been warranted to OFHEO by the Department of Treasury as an accounts receivable. No account is estimated as uncollectible.

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Accounts Receivable is composed of the following amounts as of September 30, 1998:

Intragovernmental:	
Amount due from AID	$ 1,649
Amount due from HUD	2,486
Collections not Warranted	13,376
Total Accounts Receivable	$ 17,511

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

OFHEO is developing software for regulatory use, which meets the capitalization requirement. Depreciation will begin when the asset is placed into service. The software supports two functions: 1) the development and implementation of risk-based capital standards for the Enterprises and 2) surveillance and monitoring for OFHEO's examination program. Property, Plant and Equipment consists of the following as of September 30, 1998:

Fixed Assets Class	Book Value
Prior FY Contract Costs	$1,741,303
Prior FY Staff Costs	668,674
Prior FY Total	$2,409,977
FY 1998 Contract Costs	$2,795,125
FY 1998 OFHEO Staff Costs	220,109
FY1998 Total	$3,015,234
Total Property, Plant and Equipment	$5,425,211

NOTE 5 - LIABILITIES

Liabilities Covered by Budgetary Resources:	
Intragovernmental Liabilities:	
1) Accounts Payable	$ 601
2) Accrued Accounts Payables	151,428
Total Intragovernmental Liabilities	$ 152,029
Other Liabilities:	
3) Accounts Payable	$ 3,529
4) Accrued Payroll and Benefits	390,139
5) Accrued Accounts Payables	904,741
6) Other Liabilities	417,431
Total Other Liabilities	$1,715,840
Total Liabilities Covered by Budgetary Resources	$1,867,869

Other Information:

- Accounts payable represents payments in transit at the end of the fiscal year and the reflection of the incorrect reporting of a refund check processed against OFHEO's appropriation by HUD.

- Accrued Payroll and Benefits represent wages and benefits, which have been earned but not paid as of September 30, 1998.

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- Other Governmental Liabilities reflect unencumbered assessment funds for years prior to FY 1997. As of the end of FY 1998, these prior year funds were verified as surplus and not encumbered by valid obligations. These funds will be distributed to the Enterprises in the form of a credit against the FY 1999 annual assessment.

- Accrued Payables reflect goods and/or services provided by September 30, 1998, from outside sources, for which OFHEO had not received a bill.

- Intragovernmental Payables reflects goods and/or services received, by September 30, 1998, from other Federal agencies.

Liabilities not Covered by Budgetary Resources:

Intragovernmental	
Annual Leave	$ 389,707
Future Workers Compensation	406,250
Total Intragovernmental Liabilities	$ 795,957

Annual Leave represents the amount of annual leave earned by OFHEO employees but not taken as of September 30, 1998. Future Workers Compensation represents an actuarial liability established by DOL for HUD. OFHEO is reporting a pro rata share of HUD's liability on a per employee basis.

NOTE 6 - UNEXPENDED APPROPRIATIONS

Unobligated Unavailable	$ 25,321
Undelivered orders	3,300,396
Total	$3,325,717

In accordance with law, the amount of unobligated appropriations at fiscal year end are unavailable to OFHEO as budget authority in the next year. The value of the unobligated balance at fiscal year end is returned to the enterprises as a credit to the following year's annual assessment. Undelivered orders reflect unliquidated (open) obligations as of September 30, 1998, as adjusted by end of fiscal year estimated accounts payable for goods or services received by OFHEO but not billed.

NOTE 7 - NET POSITION

The OFHEO's financial activities interact with and are dependent upon those of the Federal Government as a whole. Other Federal agencies make financial decisions and report certain financial matters on behalf of all Federal agencies. The practice of having Federal agencies record or report only those government-wide financial matters for which they are directly responsible is consistent with generally accepted accounting principles for Federal agencies which seek to identify financial matters to the department or agency that has been granted budget authority and resources to manage them. Activities which are performed or reported by other Federal agencies in which OFHEO is indirectly involved are as follows:

- *Thrift Savings Plan (TSP)*: OFHEO makes contributions to the TSP on behalf of its employees. OFHEO does not have control over the plan's assets. The TSP is administered by the National Finance Center, U.S. Department of Agriculture.

- *Interest*: Interest on borrowings of the U.S. Treasury is not included as a cost to OFHEO's programs and is not included in the accompanying financial statements. OFHEO's appropriation is fully offset by collections from the Enterprises.

- *Pension and Other Post Retirement Benefits*: As required by the Statement of Federal Financial Standards Number 5, the Office of Personnel Management provides "costs factors" to each Federal agency to compute the agencies "service cost". This service cost represents an estimate of the amount of funds, which, if accumulated annually and invested over the careers of covered employees, will be enough to pay the employees future benefits. Each agency must recognize the difference between the service cost and the regular contributions made by the agency and the employee.

- *Federal Employees Compensation Act (FECA)*: Accrued Worker's Compensation benefits are paid by DOL on OFHEO's behalf through HUD. During FY 1998, OFHEO had no claims for benefits under FECA. OFHEO is reporting, for disclosure purposes, on a per employee, pro rata basis, a portion of the actuarial liability calculated for HUD (an employee count was included for OFHEO in the actuarial calculation).

The Net Position consists of the following as of September 30, 1998:

Unexpended Appropriations	$ 4,381,886
Less: Accrued Payables 09/30/98	(1,056,169)
Total Unexpended Appropriation	$ 3,325,717
Invested Capital	$ 5,425,211
Cumulative Results of Operations	(795,957)
Total Cumulative Results of Operations	$ 4,629,254
Total Net Position	$ 7,954,971

Invested Capital represents the net investment of the U.S. Government appropriations expended for OFHEO's capitalized property, plant, and equipment. Cumulative Results of Operation reflects the amount of unfunded liabilities (Future Workers Compensation and Annual Leave) for FY 1998.

NOTE 8 - PROGRAM COSTS

OFHEO is a single program for budget purposes. OFHEO does not have heritage assets or stewardship responsibilities for federal lands. Program Costs represent appropriated funds that have been expensed for salaries and expenses to support OFHEO's operations during the fiscal year ended September 30, 1998.

Operating Expenses	
Public Program Costs	$10,171,188
Accrued Accounts Payables Public 09/30/98	904,741
Subtotal Public Program Costs	$11,075,929
Federal Program Costs	1,857,410
Accrued Accounts Payable Federal 09/30/98	151,428
Subtotal Federal Program Costs	$ 2,008,838
Total Program Costs – Production	$13,084,767

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NOTE 9 - IMPUTED FINANCING - POST EMPLOYMENT BENEFITS (PEB)

Imputed Financing represents the post retirement benefits calculated pursuant to instructions from OPM. OPM furnishes funding for these costs.

CSRS Imputed	$ 161,615
CSRS Offset Imputed	15,399
Life Insurance Imputed	846
Health Insurance Imputed	153,637
Total Imputed Financing – Post Employment	$ 331,497

NOTE 10 - FINANCING SOURCES YET TO BE PROVIDED (ANNUAL LEAVE)

Financing Sources Yet to be Provided consists of the net change in the amount of annual leave earned by OFHEO employees during FY 1998.

Annual Leave FY 1998	$ 389,707
Annual Leave FY 1997	(361,300)
Net Change FY1998	$ 28,407

NOTE 11 - FINANCING SOURCES YET TO BE PROVIDED (FWC)

Financing Sources Yet to be Provided represents the actuarial liability for Future Workers Compensation determined by DOL for HUD. OFHEO is reporting a share of HUD's liability on a per employee basis.

Prorated share FY 1998	$ 406,250
Prorated share FY 1997	(425,166)
Net Change for FY 1998	$ (18,916)

NOTE 12 - EARNED REVENUES

Earned revenues reflect the work performed by OFHEO under its reimbursable agreement with AID during FY 1998. These revenues reflect the liquidation of obligations made in prior fiscal years by OFHEO that were earned and collected from AID during FY 1998.

Earned Revenues	$ 36,479

At the end of FY 1997, AID owed OFHEO $34,125 from work performed. During FY 1998, OFHEO collected a total of $68,955 from AID and earned an additional amount of $1,649.

The net change in Receivables consists of:

FY 1998 account receivable	$ 1,649
Less FY 1997 account receivable	(34,125)
Net change during FY 1998	$ (32,476)

The net change in Unfilled Customer Orders consists of:

FY 1998 Unfilled Customer Orders	$ 3,060
Deobligations during FY 1998	2,630
Less: FY 1997 Unfilled Customer Orders	(42,169)
Net Change in Unfilled Customer Orders	$ (36,479)

NOTE 13 - APPROPRIATIONS USED

Appropriations used reflect expenses funded by appropriations.

Appropriation Used	$15,007,352
Accrued Payables	1,056,169
Total Appropriations Used	$16,063,521

NOTE 14 - INCREASE/DECREASE IN UNEXPENDED APPROPRIATIONS

Net difference in unexpended appropriations between FY September 30, 1998 and FY September 30, 1997:

Unexpended Appropriations – FY 1998	$ 3,325,717
Less: Unexpended Appropriations – FY 1997	3,445,063
Decrease in Unexpended Appropriations	$ (119,346)

NOTE 15 - NET POSITION

Beginning Balance	
Unexpended Appropriations	$ 3,445,063
Cumulative Results of Operations	1,623,512
Net Position, Beginning Balance	$ 5,068,575
Ending Balance	
Unexpended Appropriations	$ 3,325,717
Cumulative Results of Operations	4,629,254
Net Position, Ending Balance	$ 7,954,971

NOTE 16 - APPROPRIATIONS

For OFHEO, appropriations reflect the FY1998 General Fund warrant from the Department of the Treasury.

Appropriation -- FY 1998	$16,000,000

NOTE 17 - RECOVERIES OF PRIOR YEAR OBLIGATIONS

Recoveries of prior year obligations consist of the reapportionment of funds by the OMB. OFHEO requested and received the authority to re-obligate these prior year funds in FY 1998, for valid current year requirements.

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NOTE 18 - OBLIGATIONS INCURRED

Obligations incurred reflect orders placed during FY1998.

NOTE 19 - ADJUSTMENTS

Collections not Warranted	$ 13,376
Accounts Payable	(601)
Total Adjustments	$ 12,775

Collections not warranted pertain to work performed under OFHEO's Reimbursable Agreement with AID. Reimbursement was earned and collected during FY 1998 for FY 1997 obligations. Accounts Payable reflect the incorrect reporting of a refund check processed against OFHEO's appropriation by HUD. This was a vendor refund check that HUD received and determined that the refund belonged to OFHEO. The refund belonged to HUD not OFHEO, and OFHEO has coordinated with HUD to return these funds to HUD in FY 1999.

Historical Data Tables

Table 1. Fannie Mae Business Activities

Business Activity ($ Millions)				
	Purchases			
Period	Single-Family Purchases ($)	Multifamily Purchases ($)	Total Purchases[1] ($)	Mortgage Securities Purchases[2] ($)
4q98	107,509	3,901	111,410	55,351
3q98	91,291	4,697	95,988	37,329
2q98	92,935	2,021	94,956	32,931
1q98	66,070	1,711	67,781	18,850
Annual Data				
1998	357,805	12,330	370,135	144,461
1997	164,434	6,612	171,046	48,848
1996	166,965	6,506	173,471	45,016
1995	127,988	5,030	133,018	34,036
1994	164,619	3,840	168,459	24,552
1993	303,071	4,135	307,206	6,275
1992	262,055	2,956	265,011	4,930
1991	144,517	3,204	147,721	2,384
1990	116,496	3,181	119,677	977
1989	87,446	4,836	92,282	Not Applicable Before 1990
1988	73,808	4,180	77,988	
1987	82,277	1,483	83,760	
1986	89,515	1,877	91,392	
1985	43,959	1,200	45,159	
1984	29,161	1,106	30,267	
1983	30,757	140	30,897	
1982	29,077	9	29,086	
1981	6,828	2	6,830	
1980	8,074	27	8,101	
1979	10,798	9	10,807	
1978	12,302	3	12,305	
1977	4,650	134	4,784	
1976	3,337	295	3,632	
1975	3,646	674	4,320	
1974	4,746	2,273	7,019	
1973	4,170	2,082	6,252	
1972	2,596	1,268	3,864	
1971	2,742	1,298	4,040	

Source: Fannie Mae

1 Cash purchases plus securitizations; excludes non-Fannie Mae securities and repurchased Fannie Mae MBS.
2 Not included in total purchases.

Table 2. Fannie Mae MBS Issuances

Business Activity ($ Millions)				
	MBS Issuances			
Period	Single-Family MBS Issued ($)	Multifamily MBS Issued ($)	Total MBS Issued ($)	Multiclass MBS Issued[1] ($)
4q98	94,473	3,542	98,015	9,266
3q98	81,618	4,376	85,994	25,443
2q98	82,245	1,635	83,880	27,056
1q98	56,784	1,475	58,259	22,382
Annual Data				
1998	315,120	11,028	326,148	84,147
1997	143,615	5,814	149,429	85,415
1996	144,201	5,668	149,869	30,780
1995	106,269	4,187	110,456	9,681
1994	128,385	2,237	130,622	73,365
1993	220,485	959	221,444	210,630
1992	193,187	850	194,037	170,205
1991	111,488	1,415	112,903	112,808
1990	96,006	689	96,695	68,291
1989	66,489	3,275	69,764	41,715
1988	51,120	3,758	54,878	17,005
1987	62,067	1,162	63,229	9,917
1986	60,017	549	60,566	2,400
1985	23,142	507	23,649	Not Issued Before 1986
1984	13,087	459	13,546	
1983	13,214	126	13,340	
1982	13,970	Not issued Before 1983	13,970	
1981	717		717	
1980	Not issued Before 1981		Not issued Before 1981	
1979				
1978				
1977				
1976				
1975				
1974				
1973				
1972				
1971				

Source: Fannie Mae

1 The majority qualify as Real Estate Mortgage Investment Conduits (REMICs) and are also known as structured securitizations.

Table 3. Fannie Mae Earnings

Period	Earnings ($ Millions)						
	Net Interest Income[1] ($)	Guarantee Fee Income ($)	Average Guarantee Fee Rate (basis points)	Admin Expenses ($)	Credit-related Expenses[2] ($)	Net Income ($)	Return on Common Equity[3] (%)
4q98	976	261	16.5	185	50	889	25.0
3q98	1,067	324	21.0	179	65	857	25.2
2q98	1,031	323	21.5	174	69	848	25.6
1q98	1,036	321	21.9	170	77	824	25.0
Annual Data							
1998	4,110	1,229	20.2	708	261	3,418	25.2
1997	3,949	1,274	22.7	636	375	3,056	24.6
1996	3,592	1,196	22.4	560	409	2,725	24.1
1995	3,047	1,086	22.0	546	335	2,144	20.9
1994	2,823	1,083	22.5	525	378	2,132	24.3
1993	2,533	961	21.3	443	305	1,873	25.3
1992	2,058	834	21.2	381	320	1,623	26.5
1991	1,778	675	21.0	319	370	1,363	27.7
1990	1,593	536	21.1	286	310	1,173	33.7
1989	1,191	408	21.3	254	310	807	31.1
1988	837	328	21.6	218	Not Applicable Before 1989	507	25.2
1987	890	263	22.1	197		376	23.5
1986	384	175	23.8	175		105	9.5
1985	139	112	25.6	142		(7)	(0.7)
1984	(90)	78	26.2	112		(71)	(7.4)
1983	(9)	54	26.3	81		49	5.1
1982	(464)	16	27.2	60		(192)	(18.9)
1981	(429)	0.3	25.0	49		(206)	(17.2)
1980	21	Not Available Before 1981	Not Available Before 1981	44		14	0.9
1979	322			46		162	11.3
1978	294			39		209	16.5
1977	251			32		165	15.3
1976	203			30		127	13.8
1975	174			27		115	14.1
1974	142			23		107	14.7
1973	180			18		126	20.3
1972	138			13		96	18.8
1971	49			15		61	14.4

Source: Fannie Mae

1 Interest income net of interest expense, nominal basis.
2 Credit-related expenses are mortgage loan loss provision plus real estate owned expense.
3 Average common equity used to calculate return.

Table 4. Fannie Mae Balance Sheet

Period	Balance Sheet ($ Millions)					Mortgage Backed Securities Outstanding ($ Millions)	
	Total Assets ($)	Retained Mortgage Portfolio ($) [1]	Non-Mortgage Investments ($) [2]	Debt Outstanding ($) [3]	Stock-holder's Equity ($)	Total MBS Outstanding ($) [4]	Multiclass MBS Outstanding ($) [4]
4q98	485,014	415,434	58,515	460,291	15,453	637,143	361,613
3q98	455,099	376,332	68,653	430,582	14,852	625,563	383,173
2q98	429,448	349,538	69,643	406,162	14,185	605,104	382,702
1q98	403,993	327,171	67,209	381,093	14,071	593,303	397,116
Annual Data							
1998	485,014	415,434	58,515	460,291	15,453	637,143	361,613
1997	391,673	316,592	64,596	369,774	13,793	579,138	388,360
1996	351,041	286,527	56,606	331,270	12,773	548,173	339,798
1995	316,550	252,868	57,273	299,174	10,959	513,230	353,528
1994	272,508	220,815	46,335	257,230	9,541	486,345	378,733
1993	216,979	190,169	21,396	201,112	8,052	471,306	381,865
1992	180,978	156,260	19,574	166,300	6,774	424,444	312,369
1991	147,072	126,679	9,836	133,937	5,547	355,284	224,806
1990	133,113	114,066	9,868	123,403	3,941	288,075	127,278
1989	124,315	107,981	8,338	116,064	2,991	216,512	64,826
1988	112,258	100,099	5,289	105,459	2,260	170,097	26,660
1987	103,459	93,665	3,468	97,057	1,811	135,734	11,359
1986	99,621	94,123	1,775	93,563	1,182	95,568	Not Issued Before 1987
1985	99,076	94,609	1,466	93,985	1,009	54,552	
1984	87,798	84,135	1,840	83,719	918	35,738	
1983	78,383	75,247	1,689	74,594	1,000	25,121	
1982	72,981	69,356	2,430	69,614	953	14,450	
1981	61,578	59,629	1,047	58,551	1,080	717	
1980	57,879	55,589	1,556	54,880	1,457	Not Issued Before 1981	
1979	51,300	49,777	843	48,424	1,501		
1978	43,506	42,103	834	40,985	1,362		
1977	33,980	33,252	318	31,890	1,173		
1976	32,393	31,775	245	30,565	983		
1975	31,596	30,820	239	29,963	861		
1974	29,671	28,666	466	28,168	772		
1973	24,318	23,589	227	23,003	680		
1972	20,346	19,652	268	19,239	559		
1971	18,591	17,886	349	17,672	460		

Source: Fannie Mae

1 Gross retained portfolio net of unamortized purchase premium, discounts and fees.
2 Prior to 1982 balances primarily composed of U.S. government and agency securities.
3 Includes subordinated borrowings.
4 The majority qualify as REMICs and are also known as structured securitizations.

Table 5. Fannie Mae Financial Derivatives

Period	Financial Derivatives[1] ($ Millions)						
	Interest Rate Swaps ($)	Interest Rate Caps Floors Corridors ($)	Spread Lock Agreements ($)	Foreign Currency ($)	Futures & Options($)	Other ($)	Total ($)
4q98	142,846	14,500	100	12,995	816	16,300	187,557
3q98	135,825	6,600	0	11,961	102	5,045	159,533
2q98	139,073	3,600	0	11,376	670	4,025	158,744
1q98	143,916	100	115	10,465	492	4,170	159,259
Annual Data							
1998	142,846	14,500	100	12,995	816	16,300	187,557
1997	149,673	100	35	9,968	0	1,625	161,401
1996	158,140	300	0	2,429	0	353	161,222
1995	125,679	300	0	1,224	29	990	128,221
1994	87,470	360	0	1,023	0	1,511	90,363
1993	49,458	360	0	1,023	0	1,425	52,265
1992	24,130	0	0	1,177	0	1,350	26,658
1991	9,100	0	0	Not Available Before 1992	50	1,050	10,200
1990	4,800	0	0		25	1,700	6,525
1989	Not Available Before 1990	Not Available Before 1990	Not Available Before 1990		Not Available Before 1990	Not Available Before 1990	Not Available Before 1990
1988							
1987							
1986							
1985							
1984							
1983							
1982							
1981							
1980							
1979							
1978							
1977							
1976							
1975							
1974							
1973							
1972							
1971							

Source: Fannie Mae

[1] Synthetically created debt instruments or interest-bearing assets used to reduce the corporation's exposure to interest-rate and/or foreign currency risk; notional balances or contract amounts.

Table 6. Fannie Mae Non-Mortgage Investments

Period	Non-Mortgage Investments ($ Millions)					
	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total[1] ($)
4q98	7,926	20,993	7,556	5,155	16,885	58,515
3q98	14,673	20,131	4,416	9,736	19,697	68,653
2q98	15,330	18,605	6,358	12,190	17,160	69,643
1q98	16,939	16,832	6,503	11,888	15,045	67,207
Annual Data						
1998	7,926	20,993	7,556	5,155	16,885	58,515
1997	19,212	16,639	6,715	11,745	10,285	64,596
1996	21,734	14,635	4,667	6,191	9,379	56,606
1995	19,775	9,905	10,175	8,629	8,789	57,273
1994	17,593	3,796	9,006	7,719	8,221	46,335
1993	4,496	3,557	4,684	0	8,659	21,396
1992	6,587	4,124	3,189	0	5,674	19,574
1991	2,954	2,416	2,195	0	2,271	9,836
1990	5,329	1,780	951	0	1,808	9,868
1989	5,158	1,107	0	0	2,073	8,338
1988	4,125	481	0	0	683	5,289
1987	2,559	25	0	0	884	3,468
1986	1,530	0	0	0	245	1,775
1985	1,391	0	0	0	75	1,466
1984	1,575	0	0	0	265	1,840
1983	1,462	0	0	0	227	1,689
1982	1,799	0	0	0	631	2,430
1981	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	Not Available Before 1982	1,047
1980						1,556
1979						843
1978						834
1977						318
1976						245
1975						239
1974						466
1973						227
1972						268
1971						349

Source: Fannie Mae

1 Prior to 1982, the majority of non-mortgage investments were comprised of U.S. government securities and agency securities.

Table 7. Fannie Mae Asset Liability Mix

	Asset Liability Ratios ($ Millions)			
	Asset Mix		Liability Mix	
Period	Retained Portfolio / Total Assets (%)	Non-mortgage Investments/ Total Assets (%)	Callable Debt / Total Effective Long-Term Debt[1] (%)	Total Effective Long-Term Debt / Total Debt[2] (%)
4q98	85.7	12.1	42.9	76.4
3q98	82.7	15.1	43.9	76.9
2q98	81.4	16.2	46.5	78.6
1q98	81.0	16.6	46.0	79.8
Annual Data				
1998	85.7	12.1	42.9	76.4
1997	80.8	16.5	46.4	79.4
1996	81.6	16.1	47.5	80.5
1995	79.9	18.1	48.0	73.9
1994	81.0	17.0	54.6	72.6
1993	87.6	9.9	58.1	80.0
1992	86.3	10.8	48.8	77.9
1991	86.1	6.7	36.0	85.5
1990	85.7	7.4	21.9	82.6
1989	86.9	6.9	10.1	80.1
1988	89.2	4.7	3.6	78.7
1987	90.5	3.4	Not Available Before 1988	Not Available Before 1988
1986	94.5	1.8		
1985	95.5	1.5		
1984	95.8	2.1		
1983	96.0	2.2		
1982	95.0	3.3		
1981	96.8	1.7		
1980	96.0	2.7		
1979	97.0	1.6		
1978	96.8	1.9		
1977	97.9	0.9		
1976	98.1	0.8		
1975	97.5	0.8		
1974	96.6	1.6		
1973	97.0	1.0		
1972	96.6	1.3		
1971	96.2	1.8		

Source: Fannie Mae

1 Callable debt includes derivative financial instruments that provide interest-rate protection similar to callable debt.
2 Total effective long-term debt represents debt with an effective repricing date greater than one year.

Table 8. Fannie Mae Mortgage Asset Quality

Period	Mortgage Asset Quality ($ Millions)				
	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2] (%)	Credit Losses / Total MBS Outstanding plus Retained Portfolio[3] (%)	REO /Total MBS Outstanding plus Retained Portfolio[4] (%)	Credit-Enhanced Outstanding /Total MBS Outstanding plus Retained Portfolio[5] (%)
4q98	0.58	0.29	0.02	0.08	17.5
3q98	0.57	0.36	0.03	0.09	16.4
2q98	0.57	0.36	0.03	0.10	14.8
1q98	0.61	0.36	0.03	0.10	13.5
Annual Data					
1998	0.58	0.29	0.03	0.08	17.5
1997	0.62	0.37	0.04	0.10	12.8
1996	0.58	0.68	0.05	0.11	10.5
1995	0.56	0.81	0.05	0.08	10.6
1994	0.47	1.21	0.06	0.10	10.2
1993	0.48	2.34	0.04	0.10	10.6
1992	0.53	2.65	0.04	0.09	15.6
1991	0.64	3.62	0.04	0.07	22.1
1990	0.58	1.70	0.06	0.09	26.1
1989	0.69	3.20	0.07	0.14	Not Available Before 1990
1988	0.88	6.60	0.11	0.15	
1987	1.12	Not Applicable Before 1988	0.11	0.18	
1986	1.38		0.12	0.22	
1985	1.48		0.13	0.32	
1984	1.65		0.09	0.33	
1983	1.49		0.05	0.35	
1982	1.41		0.01	0.20	
1981	0.96		0.01	0.13	
1980	0.90		0.01	0.09	
1979	0.56		0.02	0.11	
1978	0.55		0.02	0.18	
1977	0.46		0.02	0.26	
1976	1.58		0.03	0.27	
1975	0.56		0.03	0.51	
1974	0.51		0.02	0.52	
1973	Not Available Before 1974		0.00	0.61	
1972			0.02	0.98	
1971			0.01	0.59	

Source: Fannie Mae
Note: Asset quality figures are not restated for the December 1987 FAS 91 change for years 1971 through 1979.

1 The single-family delinquency rate has been restated for periods prior to 12/31/95 to include loans three or more months delinquent, or in foreclosure.
2 Includes loans that are two or more months delinquent based on the dollar amount of such loans in the portfolio and underlying MBS.
3 Credit losses are charge-offs plus real estate owned expense; average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.
4 Real Estate Owned balances reflect end-of-period amounts. Beginning with 1995, data reflect adoption of SFAS 114.
5 The proportion of the retained portfolio that has additional recourse from a third party to accept some or all of the expected losses on defaulted mortgages.

Table 9. Fannie Mae Capital

Capital ($ Millions)							
Period	Stockholders' Equity /Total MBS Outstanding plus Total Assets (%)	Stockholders' Equity plus Reserves / Total MBS Outstanding plus Total Assets[1] (%)	Core Capital[2] ($)	Minimum Regulatory Capital Requirements[3] ($)	Regulatory Capital Surplus (Deficit)[4] ($)	Market Capitalization[5] ($)	Common Share Dividend Payout Rate[6, 7] (%)
4q98	1.38	1.45	15,465	15,334	131	75,881	28.6
3q98	1.37	1.45	14,852	14,520	332	65,831	29.6
2q98	1.37	1.45	14,185	13,772	413	62,321	30.0
1q98	1.41	1.49	14,071	13,079	992	65,398	30.2
Annual Data							
1998	1.38	1.45	15,465	15,334	131	75,881	29.7
1997	1.42	1.50	13,793	12,703	1,090	59,167	29.7
1996	1.42	1.50	12,773	11,466	1,307	39,932	30.6
1995	1.32	1.41	10,959	10,451	508	33,812	34.9
1994	1.26	1.37	9,541	9,415	126	19,882	30.9
1993	1.17	1.29	8,052	7,064	988	21,387	27.0
1992	1.12	1.25	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993	20,871	23.4
1991	1.10	1.24				18,836	20.9
1990	0.94	1.06				8,490	16.0
1989	0.88	1.01				8,092	13.9
1988	0.80	0.94				3,992	11.4
1987	0.76	0.90				2,401	7.8
1986	0.61	0.74				3,006	8.1
1985	0.66	0.76				19,040	30.8
1984	0.74	0.85				1,012	N/A
1983	0.97	1.10				15,140	14.2
1982	1.09	1.25				1,603	N/A
1981	1.73	1.90				502	N/A
1980	2.49	2.73				702	487.0
1979	2.93	3.17				Not Available Before 1980	47.8
1978	3.13	3.36					33.1
1977	3.45	3.66					36.9
1976	3.03	3.19					40.4
1975	2.73	2.84					38.5
1974	2.60	2.69					35.8
1973	2.80	2.87					22.2
1972	2.75	2.78					18.4
1971	2.47	2.49					19.9

Source: Fannie Mae

1 Effective 1995, reserves exclude specific allowances for impaired loans pursuant to SFAS 114.
2 The sum of: (Outstanding Common Stock, Noncumulative preferred stock, paid-in capital and retained earnings).
3 Minimum capital requirement in accordance with the Federal Housing Enterprise Financial Safety and Soundness Act of 1992.
4 The difference between Core Capital and Minimum Regulatory Capital Requirement.
5 Stock price multiplied by number of outstanding common shares.
6 Paid Dividends per share as a percentage of earnings per common share.
7 Dividends per common share as a percentage of (diluted) earnings per common share.

Table 10. Freddie Mac Business Activities

Period	Business Activity ($ Millions)			
	Mortgage Purchases			
	Single-Family Purchases ($)	Multifamily Purchases ($)	Total Purchases[1] ($)	Mortgage Securities Purchases[2] ($)
4q98	77,189	1,725	78,914	47,780
3q98	68,139	1,337	69,476	29,470
2q98	70,717	552	71,269	20,967
1q98	47,445	296	47,741	30,229
Annual Data				
1998	263,490	3,910	267,400	128,446
1997	115,160	2,241	117,401	35,385
1996	122,850	2,229	125,079	36,824
1995	89,971	1,565	91,536	39,292
1994	122,563	847	123,410	19,817
1993	229,051	191	229,242	Not Available Before 1994
1992	191,099	27	191,126	
1991	99,729	236	99,965	
1990	74,180	1,338	75,518	
1989	76,765	1,824	78,589	
1988	42,884	1,191	44,075	
1987	74,824	2,016	76,840	
1986	99,936	3,538	103,474	
1985	42,110	1,902	44,012	
1984	Not Available Before 1985	Not Available Before 1985	21,885	
1983			22,952	
1982			23,671	
1981			3,744	
1980			3,690	
1979			5,716	
1978			6,524	
1977			4,124	
1976			1,129	
1975			1,716	
1974			2,185	
1973			1,334	
1972			1,265	
1971			778	

Source: Freddie Mac

1 Loans purchased from Lenders; excludes non-Freddie Mac securities and repurchased Freddie Mac MBS.

Table 11. Freddie Mac MBS Issuances

Business Activity ($ Millions)				
	MBS Issuances			
Period	Single Family MBS Issued ($)	Multifamily MBS ($)	Total MBS Issued ($)	Multiclass MBS Issued[1]
4q98	69,634	522	70,156	27,118
3q98	66,775	415	67,190	37,296
2q98	68,950	0	68,950	44,189
1q98	44,268	0	44,268	26,559
Annual Data				
1998	249,627	937	250,564	135,162
1997	113,758	500	114,258	84,366
1996	118,932	770	119,702	34,145
1995	85,522	355	85,877	15,372
1994	116,901	209	117,110	73,131
1993	208,724	0	208,724	143,336
1992	179,202	5	179,207	131,284
1991	92,479	0	92,479	72,032
1990	71,998	1,817	73,815	40,479
1989	72,931	587	73,518	39,754
1988	39,490	287	39,777	12,985
1987	72,866	2,152	75,018	Not Issued Before 1988
1986	96,798	3,400	100,198	
1985	37,584	1,245	38,829	
1984	Not Available Before 1985	Not Available Before 1985	18,684	
1983			19,691	
1982			24,169	
1981			3,526	
1980			2,526	
1979			4,546	
1978			6,412	
1977			4,657	
1976			1,360	
1975			950	
1974			46	
1973			323	
1972			494	
1971			65	

Source: Freddie Mac

1 The majority qualify as Real Estate Mortgage Investment Conduits (REMICs), and are also known as structured securitizations.

Table 12. Freddie Mac Earnings

Earnings ($ Millions)							
Period	Net Interest Income [1, 2, 3] ($)	Guarantee Fee Income [2, 3] ($)	Average Guarantee Fee[3, 4] (basis points)	Admin Expenses ($)	Credit-related Expenses[4] ($)	Net Income ($)	Return on Common Equity[5](%)
4q98	621	245	20.6	169	69	468	23.4
3q98	553	255	21.1	142	79	425	24.2
2q98	534	256	21.7	135	90	414	24.4
1q98	507	263	22.4	132	104	393	24.2
Annual Data							
1998	2,215	1,019	21.4	578	342	1,700	22.6
1997	1,847	1,082	22.9	495	529	1,395	23.1
1996	1,705	1,086	23.4	440	608	1,243	22.6
1995	1,396	1,087	23.8	395	541	1,091	22.1
1994	1,112	1,108	24.4	379	425	983	23.3
1993	772	1,009	23.8	361	524	786	22.3
1992	695	936	24.7	329	Not Applicable Before 1993	622	21.2
1991	683	792	23.7	287		555	23.6
1990	619	654	22.4	243		414	20.4
1989	517	572	23.4	217		437	25
1988	492	465	21.5	194		381	27.5
1987	319	472	24.2	150		301	28.2
1986	299	301	22.4	110		247	28.5
1985	312	188	22.1	81		208	30
1984	213	158	24.7	71		144	52
1983	125	132	26.2	53		86	44.5
1982	30	77	24.5	37		60	21.9
1981	34	36	19.5	30		31	13.1
1980	54	23	14.3	26		34	14.7
1979	55	18	13.2	19		36	16.2
1978	37	14	14.9	14		25	13.4
1977	31	9	18.9	12		21	12.4
1976	18	3	13.6	10		14	9.5
1975	31	3	24.8	10		16	11.6
1974	42	2	25.5	8		5	4
1973	31	2	32.4	7		12	9.9
1972	10	1	39.4	5		4	3.5
1971	10	1	Not Available Before 1972	Not Available Before 1972		6	5.5

Source: Freddie Mac

1 Interest income net of interest expense, nominal basis.

2 Effective 1/1/96, Freddie Mac reports guarantee fees on retained MBS as guarantee fee income. However, in these data, fees on retained MBS have been estimated and reclassified as interest income for comparability with Fannie Mae.

3 In 1993, Freddie Mac adopted a change in reporting of uncollectable interest on single-family mortgages. Pre-1993 amounts do not reflect this change.

4 Credit-related expenses are mortgage loan loss provision plus real estate owned expense.

5 Average common equity used to calculate return for annual data. Quarterly data are based on averages of quarter-end equity.

Table 13. Freddie Mac Balance Sheet

Balance Sheet ($ Millions)						Mortgage-Backed Securities Outstanding ($ Millions)	
Period	Total Assets ($)	Retained Mortgage Portfolio[1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstanding[3] ($)	Stock-holder's Equity	Total MBS Outstanding[4] ($)	Multiclass MBS Outstanding[5] ($)
4q98	321,421	255,670	42,160	287,234	10,835	478,351	260,336
3q98	263,256	216,946	26,417	236,387	9,288	490,687	236,202
2q98	229,991	197,126	16,523	203,494	8,413	480,687	230,373
1q98	226,571	186,357	25,830	196,551	8,204	462,765	214,330
Annual Data							
1998	321,421	255,670	42,160	287,234	10,835	478,351	260,336
1997	194,597	164,543	16,430	172,321	7,521	475,985	233,591
1996	173,866	137,826	22,248	156,491	6,731	473,065	237,630
1995	137,181	107,706	12,711	119,328	5,863	459,045	246,969
1994	106,199	73,171	17,808	92,053	5,162	460,656	263,662
1993	83,880	55,938	18,225	48,510	4,437	439,029	264,122
1992	59,502	33,629	12,542	28,173	3,570	407,514	217,030
1991	46,860	26,667	9,956	28,300	2,566	359,163	142,960
1990	40,579	21,520	12,124	28,375	2,136	316,359	83,437
1989	35,462	21,448	11,050	24,102	1,916	272,870	47,573
1988	34,352	16,918	14,607	24,846	1,584	226,406	10,877
1987	25,674	12,354	10,467	17,461	1,182	212,635	Not Issued Before 1988
1986	23,229	13,093	Not Available Before 1987	13,378	953	169,186	
1985	16,587	13,547		11,754	779	99,909	
1984	13,778	10,018		10,186	606	70,026	
1983	8,995	7,485		6,782	421	57,720	
1982	5,999	4,679		4,521	296	42,952	
1981	6,326	5,178		5,480	250	19,897	
1980	5,478	5,006		4,686	221	16,962	
1979	4,648	4,003		3,981	238	15,316	
1978	3,697	3,038		3,066	202	12,017	
1977	3,501	3,204		3,110	177	6,765	
1976	4,832	4,175		4,523	156	2,765	
1975	5,899	4,878		5,609	142	1,643	
1974	4,901	4,469		4,684	126	780	
1973	2,873	2,521		2,696	121	791	
1972	1,772	1,726		1,639	110	444	
1971	1,038	935		915	107	64	

Source: Freddie Mac

1 Gross retained portfolio net of unamortized purchases premiums, discounts and fees.
2 Excludes mortgage-related securities held for trading purposes.
3 Excludes subordinated borrowings
4 Total MBS outstanding net of repurchased MBS held in the retained portfolio.
5 The majority qualify as REMICs and are also known as structured securitizations.

Table 14. Freddie Mac Financial Derivatives

Financial Derivatives[1] ($ Millions)							
	Interest Rate Swaps ($)	Interest Rate Caps Floors Corridors ($)	Spread Lock Agreements ($)	Foreign Currency ($)	Futures & Options ($)	Other ($)	Total ($)
4q98	42,480	21,845	26,617	1,464	220,832	0	313,238
3q98	45,885	22,190	6,577	1,579	158,349	0	234,580
2q98	46,620	23,246	14,363	1,153	66,200	0	151,582
1q98	50,826	24,510	4,071	1,153	77,400	0	157,960
Annual Data							
1998	42,480	21,845	26,617	1,464	220,832	0	313,238
1997	54,172	21,995	12,228	1,152	6,000	0	95,547
1996	46,646	14,095	651	544	0	0	61,936
1995	45,384	13,055	24	0	0	0	58,463
1994	21,834	9,003	0	0	0	0	30,837
1993	17,888	1,500	0	0	0	0	19,388
1992	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available	Not Available
1991	Before 1993	Before 1993	Before 1993	Before 1993	Before 1993	Before 1993	Before 1993
1990							
1989							
1988							
1987							
1986							
1985							
1984							
1983							
1982							
1981							
1980							
1979							
1978							
1977							
1976							
1975							
1974							
1973							
1972							
1971							

Source: Freddie Mac

1 Synthetically created debt instruments or interest-bearing assets used to reduce the corporation's exposure to interest-rate and/or foreign currency risk; notional balances or contract amounts reported.

Table 15. Freddie Mac Non-Mortgage Investments

Non-Mortgage Investments[1] ($ Millions)						
Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other[1] ($)	Total ($)
4q98	20,524	7,124	1,756	7,795	4,961	42,160
3q98	6,409	5,146	3,532	6,560	4,770	26,417
2q98	1,890	3,230	2,269	6,458	2,676	16,523
1q98	8,239	2,425	4,997	8,925	1,244	25,830
Annual Data						
1998	20,524	7,124	1,756	7,795	4,961	42,160
1997	2,750	2,200	6,982	3,203	1,295	16,430
1996	9,968	2,086	6,440	1,058	2,696	22,248
1995	110	499	9,217	1,201	1,684	12,711
1994	7,260	Not Available Before 1995	5,913	1,234	3,401	17,808
1993	9,267		4,198	1,438	3,322	18,225
1992	5,632		4,060	53	2,797	12,542
1991	2,949		4,437	0	2,570	9,956
1990	1,112		9,063	0	1,949	12,124
1989	3,527		5,765	0	1,758	11,050
1988	4,469		9,107	0	1,031	14,607
1987	3,177		5,859	0	1,431	10,467
1986	Not Available Before 1987		Not Available Before 1987	Not Available Before 1987	Not Available Before 1987	Not Available Before 1987
1985						
1984						
1983						
1982						
1981						
1980						
1979						
1978						
1977						
1976						
1975						
1974						
1973						
1972						
1971						

Source: Freddie Mac

[1] Excludes mortgage-related securities held for trading purposes.

Table 16. Freddie Mac Asset Liability Mix

Asset Liability Ratios ($ Millions)				
	Asset Mix		Liability Mix	
Period	Retained Portfolio / Total Assets (%)	Non-mortgage Investments/ Total Assets (%)	Callable Debt / Total Effective Long-Term Debt[1] (%)	Total Effective Long-Term Debt / Total Debt[2] (%)
4q98	79.5	13.1	75.6	70.6
3q98	82.4	10.0	86.8	65.2
2q98	85.7	7.2	88.6	68.4
1q98	82.3	11.4	85.7	71.3
Annual Data				
1998	79.5	13.1	75.6	70.6
1997	84.6	8.4	83.9	70.8
1996	79.3	12.8	73.8	72.4
1995	78.5	9.3	72.5	70.2
1994	68.9	16.8	81.0	59.8
1993	66.7	21.7	86.1	63.9
1992	56.5	21.1	Not Available Before 1993	Not Available Before 1993
1991	56.9	21.2		
1990	53.0	29.9		
1989	60.5	31.2		
1988	49.2	42.5		
1987	48.1	40.8		
1986	56.4	Not Available Before 1987		
1985	81.7			
1984	72.7			
1983	83.2			
1982	78.0			
1981	81.9			
1980	91.4			
1979	86.1			
1978	82.2			
1977	91.5			
1976	86.4			
1975	82.7			
1974	91.2			
1973	87.7			
1972	97.4			
1971	90.1			

Source: Freddie Mac

1 Callable debt includes derivative financial instruments that provide interest-rate protection similar to callable debt.
2 Total effective long-term debt represents debt with an effective repricing date greater than one year.

Table 17. Freddie Mac Mortgage Asset Quality

Mortgage Asset Quality ($ Million)					
Period	Single-Family Delinquency Rate[1] (%)	Multifamily Delinquency Rate[2, 3] (%)	REO/Total MBS Outstanding plus Retained Portfolio[4] (%)	Credit Losses / Total MBS Outstanding plus Retained Portfolio[5] (%)	Credit-Enhanced / Total MBS Outstanding plus Retained Portfolio[6] (%)
4q98	0.50	0.37	0.08	0.03	27.3
3q98	0.49	0.53	0.08	0.03	25.2
2q98	0.53	0.81	0.09	0.05	23.3
1q98	0.55	0.96	0.11	0.06	17.9
Annual Data					
1998	0.50	0.37	0.08	0.04	27.3
1997	0.55	0.96	0.11	0.08	15.9
1996	0.58	1.96	0.13	0.10	10.0
1995	0.60	2.88	0.14	0.11	9.7
1994	0.55	3.79	0.18	0.08	7.2
1993	0.61	5.92	0.16	0.11	5.3
1992	0.64	6.81	0.12	0.09	Not Available Before 1993
1991	0.61	5.42	0.14	0.08	
1990	0.45	2.63	0.12	0.08	
1989	0.38	2.53	0.09	0.08	
1988	0.36	2.24	0.09	0.07	
1987	0.36	1.49	0.08	0.07	
1986	0.42	1.07	0.07	Not Available Before 1987	
1985	0.42	0.63	0.10		
1984	0.46	0.42	0.15		
1983	0.47	0.58	0.15		
1982	0.54	1.04	0.12		
1981	0.61	Not Available Before 1982	0.07		
1980	0.44		0.04		
1979	0.31		0.02		
1978	0.21		0.02		
1977	Not Available Before 1987		0.03		
1976			0.04		
1975			0.03		
1974			0.02		
1973			Not Available Before 1974		
1972					
1971					

Source: Freddie Mac

1 1994-1998 data include only loans for which Freddie Mac has assumed primary default risk (“at-risk”); includes foreclosures and in process. Pre-1994 calculations include both at-risk and non-at-risk loans.

2 1982-1987 data based on the number of loans delinquent 60 days or more; calculations subsequent to 1987 based on unpaid principal balance of loans 60 days or more.

3 Pre-1991 amounts do not reflect change in reporting of multifamily in-substance foreclosures pursuant to adoption of SFAS 114.

4 Real Estate Owned balances reflect end-of-period balances; beginning in 1992, data reflects adoption of SFAS 114.

5 Credit losses are defined as charge-offs plus real estate owned expense, average balances used to calculate ratios subsequent to 1994; quarterly data are annualized.

6 Includes loans for which the lender or third-party has agreed to retain primary default risk. Also includes securities guaranteed by agencies such as GNMA, as well as asset-backed securities and commercial mortgage-backed securities.

Table 18. Freddie Mac Capital

Capital ($ Millions)							
Period	Stockholders' Equity / Total MBS Outstanding plus Total Assets (%)	Stockholders' Equity plus Reserves / Total MBS Outstanding plus Total Assets (%) [1]	Core Capital [2] ($)	Regulatory Minimum Capital Requirements [3] ($)	Regulatory Capital Surplus (Deficit) [4] ($)	Market Capitalization [5]	Common Share Dividend Payout Rate [6, 7] (%)
4q98	1.35	1.45	10,715	10,333	382	44,797	19.0
3q98	1.23	1.33	9,189	8,899	290	33,624	20.7
2q98	1.18	1.28	8,255	8,008	247	31,857	21.1
1q98	1.19	1.29	8,053	7,848	204	32,199	22.2
Annual Data							
1998	1.35	1.45	10,715	10,333	382	44,797	20.7
1997	1.12	1.22	7,376	7,082	294	28,461	21.1
1996	1.04	1.14	6,743	6,517	226	19,161	21.2
1995	0.98	1.09	5,829	5,584	245	14,932	21.1
1994	0.91	1.04	5,169	4,884	285	9,132	20.5
1993	0.85	0.99	4,437	3,782	655	9,005	21.6
1992	0.76	0.93		Not Applicable Before 1993	Not Applicable Before 1993	8,721	23.2
1991	0.63	0.81				8,247	22.1
1990	0.60	0.77				2,925	22.4
1989	0.62	0.77				4,024	21.3
1988	0.61	0.76				Not Applicable Before 1989	Not Applicable Before 1989
1987	0.50	0.64					
1986	0.50	0.64					
1985	0.67	0.85					
1984	0.73	0.93					
1983	0.63	0.83					
1982	0.60	0.82					
1981	0.95	1.25					
1980	0.98	1.27					
1979	1.19	1.44					
1978	1.29	1.50					
1977	1.72	1.93					
1976	2.05	2.22					
1975	1.88	2.03					
1974	2.22	2.34					
1973	3.30	3.47					
1972	4.95	4.96					
1971	9.71	9.80					

Source: Freddie Mac

1 Effective 1995, reserves exclude specific allowances for impaired loans pursuant to SFAS 114.
2 The sum of: (Outstanding common stock, Noncumulative preferred stock, paid-in capital and retained earnings).
3 Minimum capital requirement in accordance with the Federal Housing Enterprise Financial Safety and Soundness Act of 1992.
4 The difference between Core Capital and Minimum Regulatory Capital Requirement.
5 Stock price multiplied by number of outstanding common shares.
6 Paid Dividends per share as a percentage of earnings per common share.
7 Dividends per common share as a percentage of (basic) earnings per common share.

Table 19. Aggregate Business Activity

Business Activity ($ Millions)				
Period	Single-Family Purchases ($)	Multifamily Purchases ($)	Total Purchases($)	Mortgage Securities Purchases[1]($)
4q98	184,698	5,626	190,324	103,131
3q98	159,430	6,034	165,464	66,799
2q98	163,652	2,573	166,225	53,898
1q98	113,515	2,007	115,522	49,079
Annual Data				
1998	621,295	16,240	637,535	272,907
1997	279,594	8,853	288,447	84,233
1996	289,815	8,735	298,550	81,840
1995	217,959	6,595	224,554	73,328
1994	287,182	4,687	291,869	44,369
1993	532,122	4,326	536,448	Not Applicable Before 1994
1992	453,154	2,983	456,137	
1991	244,246	3,440	247,686	
1990	190,676	4,519	195,195	
1989	164,211	6,660	170,871	
1988	116,692	5,371	122,063	
1987	157,101	3,499	160,600	
1986	189,451	5,415	194,866	
1985	86,069	3,102	89,171	
1984	Not Applicable Before 1985	Not Applicable Before 1985	Not Applicable Before 1985	
1983				
1982				
1981				
1980				
1979				
1978				
1977				
1976				
1975				
1974				
1973				
1972				
1971				

Source: Fannie Mae and Freddie Mac

1 Not included in total purchases.

Table 20. Aggregate MBS Issuances

Period	Business Activity ($ Millions)			
	MBS Issuances			
	Single Family MBS Issued ($)	Multifamily MBS Issued($)	Total MBS Issued ($)	Multiclass Issued ($)
4q98	164,107	4,064	168,171	36,384
3q98	148,393	4,791	153,184	62,739
2q98	151,195	1,635	152,830	71,245
1q98	101,052	1,475	102,527	48,941
Annual Data				
1998	564,747	11,965	576,712	219,309
1997	257,373	6,314	263,687	169,781
1996	263,133	6,438	269,571	64,925
1995	191,791	4,542	196,333	25,053
1994	245,286	2,446	247,732	146,496
1993	429,209	959	430,168	353,966
1992	372,389	855	373,244	301,489
1991	203,967	1,415	205,382	184,840
1990	168,004	2,506	170,510	108,770
1989	139,420	3,862	143,282	81,469
1988	90,610	4,045	94,655	29,990
1987	134,933	3,314	138,247	Not Applicable Before 1988
1986	156,815	3,949	160,764	
1985	60,726	1,752	62,478	
1984	Not Applicable Before 1985	Not Applicable Before 1985	32,230	
1983			33,031	
1982			38,139	
1981			4,243	
1980			Not Applicable Before 1981	
1979				
1978				
1977				
1976				
1975				
1974				
1973				
1972				
1971				

Source: Fannie Mae and Freddie Mac

Table 21. Aggregate Earnings

	Earnings ($ Millions)				
Period	Net Income ($)	Guarantee Fee Income ($)	Administrative Expenses ($)	Credit-Related Expenses ($)	Net Income ($)
4q98	1,597	506	354	119	1,357
3q98	1,620	579	321	144	1,282
2q98	1,565	579	309	159	1,262
1q98	1,543	585	302	181	1,217
Annual Data					
1998	6,325	2,248	1,286	603	5,118
1997	5,796	2,356	1,131	904	4,451
1996	5,297	2,282	1,000	1,017	3,968
1995	4,443	2,173	941	876	3,235
1994	3,935	2,191	904	803	3,115
1993	3,385	1,994	804	829	2,659
1992	2,753	1,770	710	Not Applicable Before 1993	2,245
1991	2,461	1,467	606		1,918
1990	2,212	1,190	529		1,587
1989	1,708	980	471		1,244
1988	1,329	793	412		888
1987	1,209	735	347		677
1986	683	476	285		352
1985	451	300	223		201
1984	123	236	183		73
1983	116	186	134		135
1982	(434)	93	97		(132)
1981	(395)	36	79		(175)
1980	75	Not Applicable Before 1981	70		48
1979	377		65		198
1978	331		53		234
1977	282		44		186
1976	221		40		141
1975	205		37		131
1974	184		31		112
1973	211		25		138
1972	148		18		100
1971	59		Not Available Before 1972		67

Source: Fannie Mae and Freddie Mac

Table 22. Aggregate Balance Sheet

Period	Balance Sheet Outstanding ($ Millions)						
	Total Assets ($)	Retained Mortgage Portfolio [1] ($)	Non-Mortgage Investments[2] ($)	Debt Outstanding ($)	Stockholders' Equity ($)	Total MBS Outstanding ($)	Multiclass MBS Outstanding[2] ($)
4q98	806,435	671,104	100,675	747,525	26,288	1,115,494	621,949
3q98	718,355	593,278	95,070	666,969	24,140	1,116,250	619,375
2q98	659,439	546,664	86,166	609,656	22,598	1,085,791	613,075
1q98	630,564	513,528	93,039	577,644	22,275	1,056,068	611,446
Annual Data							
1998	806,435	671,104	100,675	542,095	26,288	1,115,494	621,949
1997	586,270	481,135	81,026	487,761	21,314	1,055,123	621,951
1996	524,907	424,353	78,854	418,502	19,504	1,021,238	577,428
1995	453,731	360,574	69,984	349,283	16,822	972,275	600,497
1994	378,707	293,986	64,143	249,622	14,703	947,001	642,395
1993	300,859	246,107	39,621	194,473	12,489	910,335	645,987
1992	240,480	189,889	32,116	162,237	10,344	831,958	529,399
1991	193,932	153,346	19,792	151,778	8,113	714,447	367,766
1990	173,692	135,586	21,992	140,166	6,077	604,434	210,715
1989	159,777	129,429	19,388	130,305	4,907	489,382	112,399
1988	146,610	117,017	19,896	114,518	3,844	396,503	37,537
1987	129,133	106,019	13,935	106,941	2,993	348,369	Not Applicable Before 1988
1986	122,850	107,216	Not Applicable Before 1987	105,739	2,135	264,754	
1985	115,663	108,156		93,905	1,788	154,461	
1984	101,576	94,153		81,376	1,524	105,764	
1983	87,378	82,732		74,135	1,421	82,841	
1982	78,980	74,035		64,031	1,249	57,402	
1981	67,904	64,807		59,566	1,330	20,614	
1980	63,357	60,595		52,405	1,678	Not Applicable Before 1981	
1979	55,948	53,780		44,051	1,739		
1978	47,203	45,141		35,000	1,564		
1977	37,481	36,456		35,088	1,350		
1976	37,225	35,950		35,572	1,139		
1975	37,495	35,698		32,852	1,003		
1974	34,572	33,135		25,699	898		
1973	27,191	26,110		20,878	801		
1972	22,118	21,378		18,587	669		
1971	19,629	18,821		0	567		

Source: Fannie Mae and Freddie Mac

1 Total MBS Outstanding net of MBS in (retained) portfolio.
2 The majority qualify as REMICS and may also be known as structured securitizations.

Table 23. Aggregate Financial Derivatives

	Financial Derivatives[1] ($ Millions)							
Period	Interest Rate Swaps ($)	Interest Rate Caps Floors Corridors ($)	Spread Lock Agreements ($)	Options ($)	Foreign Currency ($)	Futures ($)	Other ($)	Total ($)
4q98	185,326	36,345	26,717	220,832	14,459	816	16,300	500,795
3q98	181,710	28,790	6,577	158,349	13,540	102	5,045	394,113
2q98	185,693	26,846	14,363	66,200	12,529	670	4,025	310,326
1q98	194,742	24,610	4,186	77,400	11,618	492	4,170	317,219
Annual Data								
1998	185,326	36,345	26,717	220,832	14,459	816	16,300	500,795
1997	203,845	22,095	12,263	6,000	11,120	0	1,625	256,948
1996	204,786	14,395	651	0	2,973	0	353	223,158
1995	171,063	13,355	24	0	1,224	29	990	186,684
1994	109,304	9,363	0	0	1,023	0	1,511	121,200
1993	67,346	1,860	0	0	1,023	0	1,425	71,653
1992	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993	Not Available Before 1993
1991								
1990								
1989								
1988								
1987								
1986								
1985								
1984								
1983								
1982								
1981								
1980								
1979								
1978								
1977								
1976								
1975								
1974								
1973								
1972								
1971								

Source: Fannie Mae and Freddie Mac

1 Synthetically created debt instruments or interest-bearing assets used to reduce the corporation's exposure to interest-rate and/or foreign currency risk; notional balances or contract amounts.

Table 24. Aggregate Non-Mortgage Investments

Non-Mortgage Investments ($ Millions)						
Period	Federal Funds and Eurodollars ($)	Asset Backed Securities ($)	Repurchase Agreements ($)	Commercial Paper and Corporate Debt ($)	Other ($)	Total ($)
4q98	28,452	28,117	9,312	12,950	21,846	100,675
3q98	21,082	25,277	7,948	16,296	24,467	95,070
2q98	17,220	21,835	8,627	18,648	19,836	86,166
1q98	25,178	19,257	11,500	20,813	16,289	93,037
Annual Data						
1998	28,452	28,117	9,312	12,950	21,846	100,675
1997	21,962	18,839	13,697	14,948	11,580	81,026
1996	31,702	16,721	11,107	7,249	12,075	78,854
1995	19,885	10,404	19,392	9,830	10,473	69,984
1994	24,853	Not Available Before 1995	14,919	8,953	11,622	64,143
1993	13,763		8,882	1,438	11,981	39,621
1992	12,219		7,249	53	8,471	32,116
1991	5,903		6,632	0	4,841	19,792
1990	6,441		10,014	0	3,757	21,992
1989	8,685		5,765	0	3,831	19,388
1988	8,594		9,107	0	1,714	19,896
1987	5,736		5,859	0	2,315	13,935
1986	Not Applicable Before 1987		Not Applicable Before 1987	Not Applicable Before 1987	Not Applicable Before 1987	Not Applicable Before 1987
1985						
1984						
1983						
1982						
1981						
1980						
1979						
1978						
1977						
1976						
1975						
1974						
1973						
1972						
1971						

Source: Fannie Mae and Freddie Mac

Table 25. Aggregate Asset Liability Mix

Aggregate Asset Liability Ratios ($ Millions)				
	Asset Mix		Liability Mix	
Period	Retained Portfolio / Total Assets (%)	Non-mortgage Investments/ Total Assets (%)	Callable Debt / Total Effective Long-Term Debt (%)	Total Effective Long-Term Debt / Total Debt (%)
4q98	83.2	12.5	59.1	74.1
3q98	82.6	13.2	59.5	72.8
2q98	82.9	13.1	60.8	75.2
1q98	81.4	14.8	59.2	76.9
Annual Data				
1998	83.2	12.5	59.1	74.1
1997	82.1	13.8	58.2	76.7
1996	80.8	15.0	56.2	77.9
1995	79.5	15.4	55.7	72.9
1994	77.6	16.9	61.9	69.2
1993	81.8	13.2	62.7	76.9
1992	79.0	13.4	Not Applicable Before 1993	Not Applicable Before 1993
1991	79.1	10.2		
1990	78.1	12.7		
1989	81.0	12.1		
1988	79.8	13.6		
1987	82.1	10.8		
1986	87.3	Not Available Before 1987		
1985	93.5			
1984	92.7			
1983	94.7			
1982	93.7			
1981	95.4			
1980	95.6			
1979	96.1			
1978	95.6			
1977	97.3			
1976	96.6			
1975	95.2			
1974	95.8			
1973	96.0			
1972	96.7			
1971	95.9			

Source: Fannie Mae and Freddie Mac

Table 26. Aggregate Capital

Capital ($ Millions)					
Period	Stockholders' Equity /Total MBS Outstanding plus Total Assets (%)	Stockholders' Equity plus Reserves / Total MBS Outstanding plus Total Assets	Core Capital	Minimum Regulatory Capital Requirements ($)	Capital Surplus (Deficit) ($)
4q98	1.37	1.45	26,180	25,667	513
3q98	1.32	1.40	24,041	23,419	622
2q98	1.29	1.38	22,440	21,779	661
1q98	1.32	1.41	22,124	20,927	1,196
Annual Data					
1998	1.37	1.45	26,181	25,667	513
1997	1.30	1.39	21,169	19,785	1,384
1996	1.26	1.31	19,516	17,983	1,533
1995	1.18	1.28	16,788	16,035	753
1994	1.11	1.23	14,710	14,299	411
1993	1.03	1.16	12,489	10,846	1,643
1992	0.96	1.11	Not Applicable Before 1993	Not Applicable Before 1993	Not Applicable Before 1993
1991	0.89	1.05			
1990	0.78	0.93			
1989	0.76	0.90			
1988	0.71	0.85			
1987	0.63	0.77			
1986	0.55	0.69			
1985	0.66	0.80			
1984	0.74	0.88			
1983	0.83	0.99			
1982	0.92	1.10			
1981	1.50	1.71			
1980	2.09	2.35			
1979	2.44	2.68			
1978	2.64	2.87			
1977	3.05	3.26			
1976	2.85	3.01			
1975	2.56	2.68			
1974	2.54	2.63			
1973	2.86	2.95			
1972	2.97	2.99			
1971	2.88	2.90			

Source: Fannie Mae and Freddie Mac

Table 27. Loan Limits

Single-Family Conforming Loan Limits[1] ($ Millions)				
Year	1-unit	2-units	3-units	4-units
1970 - 1976	33,000	Not Available	Not Available	Not Available
1977 - 1978	60,000	Not Available	Not Available	Not Available
1979	67,500	Not Available	Not Available	Not Available
1980	93,750	120,000	145,000	180,000
1981	98,500	126,000	152,000	189,000
1982	107,000	136,800	165,100	205,300
1983	108,300	138,500	167,200	207,900
1984	114,000	145,800	176,100	218,900
1985	115,300	147,500	178,200	221,500
1986	133,250	170,450	205,950	256,000
1987	153,100	195,850	236,650	294,150
1988	168,700	215,800	260,800	324,150
1989	187,600	239,950	290,000	360,450
1990	187,450	239,750	289,750	360,150
1991	191,250	244,650	295,650	367,500
1992	202,300	258,800	312,800	388,800
1993	203,150	259,850	314,100	390,400
1994	203,150	259,850	314,100	390,400
1995	203,150	259,850	314,100	390,400
1996	207,000	264,750	320,050	397,800
1997	214,600	274,550	331,850	412,450
1998	227,150	290,650	351,300	436,000
1999	240,000	307,100	371,200	461,350

Sources: Department of Housing and Urban Development (HUD), Federal Housing Finance Board, Freddie Mac

[1] Conforming Loan Limits are 50% higher in Alaska, Hawaii, Guam, and the U.S. Virgin Islands

FHA Single Family Insurable Limits

	1-Unit		2-units		3-units		4-units	
Year	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max	Low Cost Area Max	High Cost Area Max
1997	81,546	170,362	104,310	205,875	126,103	248,888	156,731	309,338
1998	109,032	197,621	139,512	252,866	168,624	305,631	209,568	379,842
1999	115,200	208,800	147,408	267,177	178,176	322,944	221,448	401,375

Table 28. Mortgage Interest Rates

Period	Average Commitment Rates on Loans		Effective Rates on Closed Loans	
	Conventional		Conventional	
	30-Year Fixed Rate (%)	One-Year ARMs (%)	Fixed-Rate (%)	Adjustable Rate (%)
4Q98	6.8	5.5	7.0	6.1
3Q98	6.7	7.0	6.8	6.3
2Q98	7.1	5.7	7.2	6.4
1Q98	7.1	5.6	7.2	6.5
Annual Data				
1998	6.9	5.6	7.05	6.3
1997	7.6	5.6	7.9	6.9
1996	7.8	5.7	8.0	7.0
1995	7.9	6.1	8.2	7.1
1994	8.4	5.3	8.2	6.4
1993	7.3	4.6	7.5	5.7
1992	8.4	5.6	8.5	6.6
1991	9.2	7.1	9.7	8.3
1990	10.1	8.4	10.4	9.2
1989	10.3	8.8	10.5	9.4
1988	10.3	7.9	10.4	8.5
1987	10.2	7.8	9.9	8.5
1986	10.2	8.4	10.5	9.4
1985	12.4	10.0	12.4	10.9
1984	13.9	11.5	13.2	12.1
1983	13.2	Not Available Before 1984	13.0	12.3
1982	16.1		15.2	15.4
1981	16.6		Not Available Before 1982	Not Available Before 1982
1980	13.8			
1979	11.2			
1978	9.6			
1977	8.8			
1976	8.9			
1975	9.0			
1974	9.2			
1973	8.0			
1972	7.4			
1971	Not Available Before 1971			

Average Commitment Rate Source: Freddie Mac
Effective Rates Source: Federal Housing Finance Board

Table 29. Housing Market Activity

	Housing Starts units in thousands			Home Sales units in thousands	
Period	Single-Family Housing Starts	Multifamily Housing Starts	Total Housing Starts	New Single-Family Home Sale	Existing Single-Family Homes Sales
4Q98*	1376	316	1692	967	4893
3Q98*	1312	320	1631	852	4777
2Q98*	1290	278	1580	901	4780
1Q98*	1295	287	1582	856	4677
Annual Data					
1998	1313	302	1616	888	4785
1997	1179	296	1474	804	4215
1996	1206	271	1477	757	4087
1995	1110	244	1354	667	3802
1994	1234	224	1457	670	3946
1993	1155	133	1288	666	3802
1992	1061	139	1200	610	3520
1991	876	138	1014	509	3220
1990	932	260	1193	534	3211
1989	1059	318	1376	650	3346
1988	1140	348	1488	676	3594
1987	1212	409	1621	671	3526
1986	1263	542	1805	750	3565
1985	1166	576	1742	688	3214
1984	1206	544	1750	639	2868
1983	1181	522	1703	623	2719
1982	743	320	1062	412	1990
1981	796	288	1084	436	2419
1980	962	331	1292	545	2973
1979	1316	429	1745	709	3827
1978	1558	462	2020	817	3986
1977	1573	414	1987	819	3650
1976	1248	289	1538	646	3064
1975	956	204	1160	549	2476
1974	956	382	1338	519	2272
1973	1250	795	2045	634	2334
1972	1451	906	2357	718	2252
1971	1271	781	2052	656	2019

Components may not add to totals due to rounding. *Adjusted Annual Rates.

Housing Starts Source and New Single-Family Home Sales Source: Bureau of the Census.

Existing Single-Family Home Sales Source: National Association of Realtors

Table 30. Weighted Repeat Sales House Price Index

Weighted Repeat Sales House Price Index (Annual Data)[1]										
% Change	USA	New England	Mid-Atlantic	South Atlantic	East North Central	West North Central	East South Central	West South Central	Mountain	Pacific
1Q99	4.8%	6.7%	3.8%	3.8%	4.8%	4.7%	4.6%	3.7%	4.1%	6.5%
4Q98	5.2%	6.8%	4.5%	4.5%	4.2%	4.8%	4.9%	5.3%	4.4%	8.0%
3Q98	5.7%	7.0%	4.4%	5.3%	4.9%	5.0%	5.3%	5.7%	5.3%	8.1%
2Q98	5.8%	6.3%	4.9%	5.7%	5.2%	5.3%	5.8%	5.0%	5.7%	8.0%
1Q98	5.5%	5.7%	4.4%	5.5%	5.0%	5.1%	5.1%	5.4%	5.4%	7.3%
Annual Data										
1998	5.2%	6.8%	4.5%	4.5%	4.2%	4.8%	4.9%	5.3%	4.4%	8.0%
1997	5.0%	5.1%	3.6%	5.1%	5.4%	5.1%	5.3%	4.0%	5.3%	5.9%
1996	2.7%	1.9%	0.4%	2.3%	5.2%	4.2%	4.2%	2.2%	4.6%	1.3%
1995	4.6%	4.3%	3.3%	4.5%	6.0%	5.2%	5.6%	4.2%	7.5%	3.1%
1994	1.2%	-2.8%	-2.8%	0.5%	5.6%	5.9%	5.1%	1.7%	9.6%	-3.3%
1993	2.2%	0.5%	1.5%	2.1%	3.6%	3.9%	4.1%	4.2%	8.1%	-1.7%
1992	1.9%	-1.1%	1.7%	2.1%	3.9%	3.0%	3.5%	3.4%	5.4%	-1.2%
1991	2.6%	-2.0%	1.5%	3.2%	4.5%	3.8%	4.2%	3.8%	4.9%	1.6%
1990	0.3%	-7.6%	-2.4%	0.3%	3.9%	0.7%	0.7%	0.7%	1.8%	2.9%
1989	6.2%	0.8%	2.5%	5.3%	6.2%	3.3%	3.5%	2.9%	2.7%	19.4%
1988	6.3%	4.0%	6.3%	7.1%	6.6%	2.7%	3.0%	-2.0%	0.5%	17.1%
1987	7.9%	13.3%	17.5%	8.0%	8.8%	4.3%	5.2%	-8.0%	-0.3%	10.0%
1986	10.0%	21.3%	20.2%	9.0%	8.4%	5.9%	9.1%	1.1%	4.5%	7.6%
1985	6.5%	24.6%	12.4%	6.1%	4.5%	3.2%	11.8%	-2.4%	0.4%	4.6%
1984	3.8%	17.9%	12.7%	0.5%	2.5%	4.6%	-3.6%	-1.0%	0.9%	4.4%
1983	3.9%	15.5%	10.3%	3.6%	3.6%	3.6%	5.0%	-0.1%	-2.8%	1.1%
1982	2.7%	5.0%	4.2%	4.8%	-3.3%	-0.2%	5.1%	6.3%	6.9%	0.7%
1981	3.5%	5.1%	-1.0%	3.9%	0.5%	0.0%	-1.7%	11.6%	6.6%	6.5%
1980	6.3%	5.8%	8.6%	8.1%	1.3%	3.6%	3.4%	7.1%	5.7%	11.5%
1979	12.1%	12.2%	14.9%	12.4%	9.1%	8.7%	6.3%	13.0%	15.8%	16.7%
1978	13.3%	15.8%	8.1%	10.4%	14.7%	12.7%	10.3%	17.0%	16.7%	16.6%
1977	13.5%	10.0%	9.5%	9.1%	13.4%	14.4%	12.4%	11.7%	19.4%	25.5%
1976	8.4%	3.1%	7.6%	4.8%	8.3%	7.1%	4.8%	10.0%	10.6%	20.3%

Regional Divisions:
New England: CT, MA, ME, NH, RI, VT
Mid-Atlantic: NJ, NY, PA
South Atlantic: DC, DE, FL, GA, MD, NC, SC, VA, WV
East North Central: IL, IN, MI, OH, WI, ND, SD, NE
East South Central: AL, KY, MS, TN
West South Central: AR, LA, OK, TX
Mountain: AZ, CO, ID, MT, NM, NV, UT, WY
Pacific: AK, CA, HI, OR, WA

1 All data is measured based on percentage change over the previous four quarters. Data from 1976 - 1998 is measured based on fourth quarter to fourth quarter percentage change.

Appendix

FEDERAL HOUSING ENTERPRISES FINANCIAL SAFETY AND SOUNDNESS ACT OF 1992

(TITLE 13 OF PUBLIC LAW 102-550)

Section 1313. DUTY AND AUTHORITY OF DIRECTOR.

(a) DUTY.- The duty of the Director shall be to ensure that the enterprises are adequately capitalized and operating safely, in accordance with this title.

(b) AUTHORITY EXCLUSIVE OF SECRETARY.- The Director is authorized, without the review or approval of the Secretary, to make such determinations, take such actions, and perform such functions as the Director determines necessary regarding -

(1) the issuance of regulations to carry out this part, subtitle B, and subtitle C (including the establishment of capital standards pursuant to subtitle B);

(2) examinations of the enterprises under section 1317;

(3) determining the capital levels of the enterprises and classification of the enterprises within capital classifications established under subtitle B;

(4) decisions to appoint conservators for the enterprises;

(5) administrative and enforcement actions under subtitle B, actions taken under subtitle C with respect to enforcement of subtitle B, and other matters relating to safety and soundness;

(6) approval of payments of capital distributions by the enterprises under section 303(c)(2) of the Federal National Mortgage Association Charter Act and section 303(b)(2) of the Federal Home Loan Mortgage Corporation Act;

(7) requiring the enterprises to submit reports under section 1314 of this title, section 309(k) of the Federal National Mortgage Association Charter Act, and section 307(c) of the Federal Home Loan Mortgage Corporation Act;

(8) prohibiting the payment of excessive compensation by the enterprises to any executive officer of the enterprises under section 1318;

(9) the management of the Office, including the establishment and implementation of annual budgets, the hiring of, and compensation levels for, personnel of the Office, and annual assessments for the costs of the Office;

(10) conducting research and financial analysis;

(11) the submission of reports required by the Director under this title.

(c) AUTHORITY SUBJECT TO APPROVAL OF SECRETARY.- Any determinations, actions, and functions of the Director not referred to in subsection (b) shall be subject to the review and approval of the Secretary.

(d) DELEGATION OF AUTHORITY.- The Director may delegate to officers and employees of the Office any of the functions, powers, and duties of the Director, as the Director considers appropriate.

(e) INDEPENDENCE IN PROVIDING INFORMATION TO CONGRESS.- The Director shall not be required to obtain the prior approval, comment, or review of any officer or agency of the United States before submitting to the Congress, or any committee or subcommittee thereof, any reports, recommendations, testimony, or comments if such submissions include a statement indicating that the views expressed therein are those of the Director and do not necessarily represent the views of the Secretary or the President.

OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

The Office of Federal Housing Enterprise Oversight (OFHEO) was established as an independent entity within the Department of Housing and Urban Development by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Title XIII of P.L. 102-550). The Office is headed by a Director appointed by the President for a five-year term.

OFHEO's primary mission is ensuring the capital adequacy and financial safety and soundness of two government-sponsored enterprises (GSEs) — the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Fannie Mae and Freddie Mac are the nation's largest housing finance institutions. They buy mortgages from commercial banks, thrift institutions, mortgage banks, and other primary lenders, and either hold these mortgages in their own portfolios or package them into mortgage-backed securities for resale to investors. These secondary mortgage market operations play a major role in creating a ready supply of mortgage funds for American homebuyers. Combined assets and off-balance sheet obligations of Fannie Mae and Freddie Mac were nearly 2 trillion at the end of 1998.

Fannie Mae and Freddie Mac are Congressionally-chartered, publicly-owned corporations whose shares are listed on the New York Stock Exchange. Under terms of their GSE charters, they are exempt from state and local taxation and from registration requirements of the Securities and Exchange Commission. Each firm has a back-up credit line with the U.S. Treasury.

OFHEO's oversight responsibility includes:

- Conducting broad-based examinations of Fannie Mae and Freddie Mac;
- Developing risk-based capital standards using a "stress test" that simulates stressful interest rate and credit risk scenarios;
- Making quarterly findings of capital adequacy based on minimum capital standards until a risk-based standard is completed;
- Prohibiting excessive executive compensation;
- Issuing regulations concerning capital and enforcement standards; and
- Taking necessary enforcement actions.

OFHEO is funded through assessments of Fannie Mae and Freddie Mac. OFHEO's operations represent no direct cost to the taxpayer.

In its safety and soundness mission, OFHEO has regulatory authority similar to such other federal financial regulators as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Reserve System.

(*The legislation that established OFHEO also requires Fannie Mae and Freddie Mac to meet certain affordable housing goals set annually by the Secretary of Housing and Urban Development. These goals specify the share of mortgages that the two GSEs are required to purchase annually from low-income, moderate-income and central-city homebuyers.)*

1999 Report to Congress

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Official Business