From: Taylor, Mary Ellen
Sent: Thursday, August 09, 2012 5:46 PM
To: DeMarco, Edward
Subject: FW: Fannie & Freddie Profitable in 1H 2012; High-Five for FHFA
Attachments: 20120809 Fannie and Freddie Profitable - High-Five for FHFA.pdf

You won't be thrilled with Mary Beth's conservatorship timeline estimate, but do note the straightforward language of her last point (3.) below. MET

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Sent: Thursday, August 09, 2012 5:18 PM
To: mary-beth.fisher@us.bnpparibas.com
Subject: Fannie & Freddie Profitable in 1H 2012; High-Five for FHFA

Executive Summary

- **For the first quarter since Fannie and Freddie entered conservatorship in September 2008, both GSEs has a positive net worth at the end of 2Q12.**

- **Fannie and Freddie had net income of $5.1 bn and $3.0 bn, respectively (shown in Chart 3 of attached document). This was sufficient to cover their respective 10% dividend payments of $2.9 bn and $1.8 bn, on their Treasury preferred stock, and still leave each GSE with a positive net worth for the quarter. Therefore, neither Fannie or Freddie required any further preferred stock from the Treasury – the taxpayers - in 2Q12, leaving their cumulative draws unchanged at $116 bn for Fannie and $71 bn Freddie (shown in Charts 1 and 2 of attached document).**

- **They barely missed simultaneously having a positive net worth last quarter, when both had net income firmly in the black, but Freddie's dividend payment of $1.8 bn just eclipsed its earnings, requiring a draw of $119 million, while Fannie ended 1Q12 with positive net worth of $268 million.**

- **This convincing return to profitability in the first half of 2012 is the result of several factors, including:**

1. Stable to rising home prices nationally have curtailed current and projected future losses at the GSEs;

2. Delinquency rates continue to slowly decline, and both GSEs expect that loan loss reserves peaked in 4Q11.

3. Fierce protection of the conservatorship mandate to minimize taxpayer losses by the FHFA has, well, minimized taxpayer losses. High-five.

Complete article attached above. Please feel free to contact me with any questions or feedback.

Mary Beth

Fannie & Freddie Profitable; High-Five for FHFA

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■ They barely missed being simultaneously profitable last quarter, when both had net income firmly in the black, but Freddie's dividend payment of $1.8 bn just eclipsed its earnings, requiring a draw of $119 million, while Fannie ended 1Q'12 with positive net worth of $268 million.

■ This convincing return to profitability in the first half of 2012 is the result of several factors, including:

■ Stable-to-rising home prices nationally have curtailed current and projected future losses at the GSEs.

■ Delinquency rates continue to slowly decline, and both GSEs expect that loan loss reserves peaked in 4Q11.

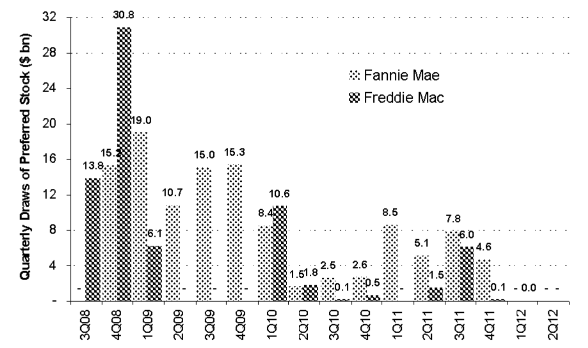
■ Fierce protection of the conservatorship mandate to minimize taxpayer losses by the FHFA has, well, minimized taxpayer losses. High-five.

Past the Trough of the Housing Crisis?

The housing crisis, as reflected by the net income of the GSEs – shown in Chart 3 – when both Fannie and Freddie reported negative net income. A few quarters of low and erratic earnings persisted, then came 3Q 2007, when the housing crisis fully took shape, and both GSEs – along with the broader housing market, then the economy at large –plunged into negative territory.

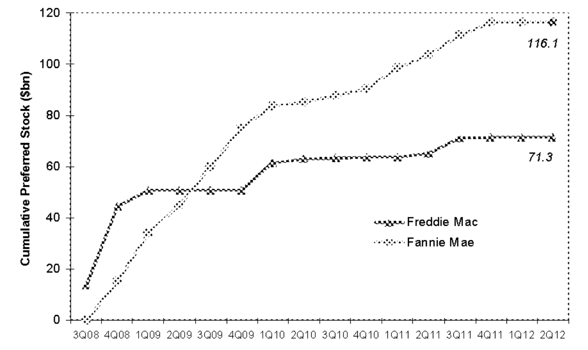
The modest uptick in housing prices in 2012, as indicated by both the FHFA's and Case-Shiller home price indices, also provides some evidence that the trough of the housing crisis might be behind us. We are far from projecting a rebound in home prices or a

Chart 1: Quarterly Draws of Preferred Stock



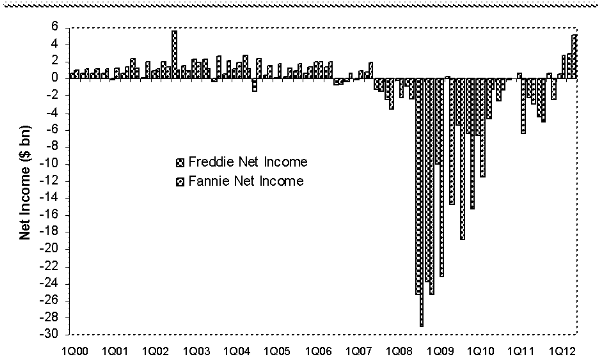
Source: BNP Paribas

Chart 2: Cumulative Treasury Preferred Stock



Source: BNP Paribas

Chart 3: Net Income (Quarterly, since 2000)



Source: BNP Paribas

return to health for the mortgage market. What we do concern ourselves with here is how and whether this changes the end game for Fannie and Freddie.

The End Game a Long Way Off

As the housing crisis escalated, Fannie and Freddie together accumulated enormous losses, which eventually required their placement into conservatorship on 6 September, 2008.

As part of conservatorship, the GSEs were also provided a capital backstop in the form of Treasury preferred stock – similar to, but with more onerous terms than, the injections of capital into the US banks under TARP. What factors caused it to be more onerous?

1. The preferred stock injected into the GSEs has a 10% annual dividend compared to a 5% dividend on the TARP funds.
2. Furthermore, under the purchase agreement Fannie and Freddie are not permitted to redeem the preferred stock prior to termination of the Treasury's funding commitment.

The circumstances under which the Treasury's funding commitment will terminate are exceptionally limited and, practically speaking, would require them exiting conservatorship either via receivership, by returning to their prior incarnation as public-private hybrid companies or by the passage of GSE reform legislation.

We strongly suspect that GSE reform is on the back burner, possibly for several more years. Whatever the result of the November elections, in the aftermath Congress will have more pressing matters on its plate dealing with the fiscal cliff. Now that the GSEs are stable and – at least in a fashion – healthy, there is no immediate crisis.

The FHFA is taking the required steps to streamline the business models of the two GSEs, hoping to eventually diminish their role in the mortgage market and re-attract private capital. This is a slow process, and the return of private capital is complicated by the shifting and tightening regulatory regime on the banks and other financial service providers. We expect conservatorship to remain open-ended at least through 2015, as the FHFA continues executing its plan.

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