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Freddie Mac- Cost of Affordable Housing Mission

Federal Home Loan Mortgage Association : Board of Directors: Business and Risk Committee

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Cost of Freddie Mac's Affordable Housing Mission

Business and Risk Committee
Board of Directors
June 4, 2009

Confidential

Summary

- Our affordable housing requirements have increased substantially throughout the years.
  - Our housing goals compliance required little direct subsidy prior to 2003, but since then subsidies have averaged $200 million a year.
- Goal-qualifying loans comprise a large share of the conventional, conforming single-family market.
  - Only a small share of our purchases are undertaken specifically because they contribute to the goals (termed ‘targeted affordable’).
- Higher credit risk mortgages disproportionately tend to be goal-qualifying.
  - Targeted affordable lending generally requires ‘accepting’ substantially higher credit risk.
  - Our models are equally good at rank ordering the credit risk of non-goal-qualifying, baseline affordable and targeted affordable loans.
  - We charge more for targeted (and baseline) affordable single-family loans, but not enough to fully offset their higher incremental risk.
- The actual performance of goal-qualifying single-family loans has met or exceeded our expectations (relative to non-goal-qualifying loans).
  - Goal-qualifying single-family loans accounted for the disproportionate share of our 2008 realized losses that was predicted by our models.
  - The Multifamily and Investments business lines contribute little to the costs of Mission.

Our affordable housing requirements have increased substantially throughout the years

1996 - 2000	2001 - 2004	2005 - 2008	2009	2010 -

- Numerical affordable housing goals first came into force in 1996. Since that time the GSEs have operated under increasing goal responsibilities, and Freddie Mac has meet these in all but 2 years.
  - In 2007 Freddie Mac failed two subgoals, but compliance was subsequently deemed infeasible by the regulator due to market conditions.
  - In 2008 Freddie Mac failed six goals and subgoals, five of which were deemed infeasible. No enforcement action was taken regarding the sixth missed goal because of our financial condition.
- More generally, the Charter requires us to serve low and moderate income families through activities "involving a reasonable economic return that may be less than the return earned on other activities."

1996 - 2000

HOUSING GOALS
Low/Moderate 40 - 42%
Underserved 21 - 24%
Special Affordable 12 - 14%
MF Special Affordable $988M

2001 - 2004

HOUSING GOALS
Low/Moderate 50%
Underserved 31%
Special Affordable 20%
MF Special Affordable $2.11B

2005 - 2008

HOUSING SUBGOALS
Low/Moderate 45 - 47%
Underserved 32 - 34%
Special Affordable 17 - 18%

HOUSING GOALS
Low/Moderate 52 - 56%
Underserved 37 - 39%
Special Affordable 22 - 27%
MF Special Affordable $3.92B

2009

HOUSING FUND
4.2 bps of New Purchases
(waived because of financial condition of the enterprises)

HOUSING SUBGOALS
Low/Moderate 40%
Underserved 30%
Special Affordable 14%

HOUSING GOALS
Low/Moderate 51%
Underserved 37%
Special Affordable 23%
MF Special Affordable $3.92B

2010 -

HOUSING FUND
4.2 bps of New Purchases

ENFORCEABLE DUTY TO SERVE UNDERSERVED
Manufactured Housing
Affordable Housing Preservation
Rural
Others can be added

HOUSING GOALS
SF Low Income tbd%
SF Low Income Area tbd%
SF Very Low Income tbd%
MF Very Low Income tbd%
MF LIHTC tbd
MF Small Properties tbd

"1335" DUTIES
- Assist Gov't Programs - For & Non-Profit Relationships - Support Low Income/Minority Lending
- Support CRA - Support First Time Homebuyers - Preservation of Assisted Affordable MF Properties (added 1998)

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Our housing goals compliance required little direct subsidy prior to 2003, but since then subsidies have averaged $200 million a year

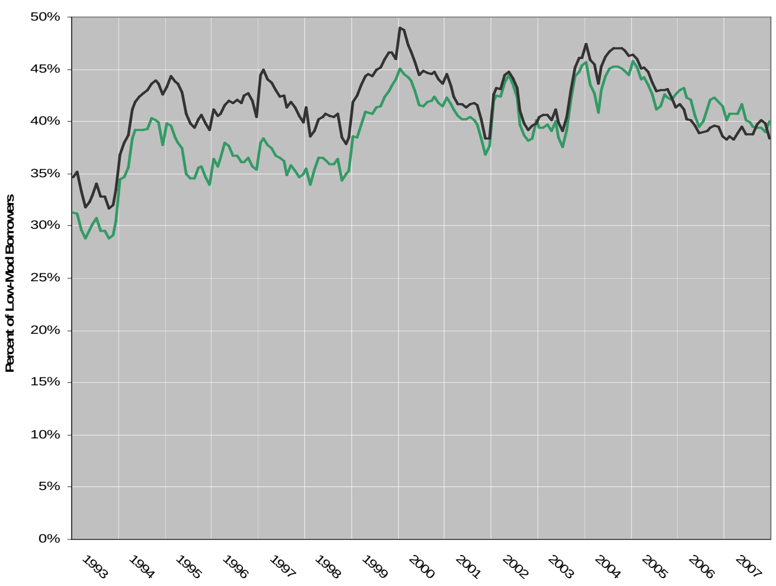
Cost of housing goals compliance	
Year	**Subsidy ($M)**
2003	222
2004	96
2005	85
2006	151
2007	499
2008	172

Note: These subsidy costs capture transactions performed for goals compliance that have ex ante present values below our cost of capital. Ex ante present values are nominal dollars, based on costing models at the time of the transactions, rather than constant dollars, based on a single costing model. Subsidies also include some opportunity costs for foregone dilutive investments.

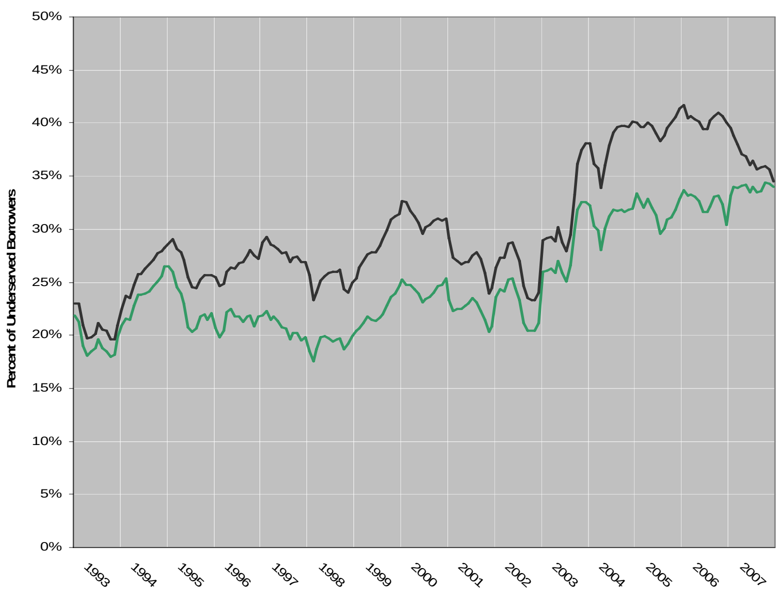
- Until 2003, compliance with rising housing goals was achieved primarily through profitable expansion of the goals-rich, multifamily business.
- In 2003 and 2004, because of the single-family refinance boom, subsidized multifamily transactions were undertaken.
- Since then, rising goal targets and the newly introduced subgoals have continued the need for both single-family and multifamily subsidies.

Goal-qualifying loans comprise a large share of the conventional, conforming single-family market

Percent of low-mod borrowers



Percent of underserved borrowers



Market **Sold to GSEs**

Notes: Based on HMDA Data that are restricted to owner-occupied, single family and manufactured housing, conventional, super conforming, purchase-money and refinance, first lien and second lien originations. Prime and Subprime are defined at the lender-level using the HUD definition. Subprime monthly hit rates are weighted by 50%. For income based goals, the super conforming qualifying rate is assumed to be zero. Market = Prime + ½ Subprime. The super conforming population consists of area specific conforming limits based on the National Association of Realtors Area Median House Price (Economy.com). The minimum (floor) area specific conforming limit is the national conforming limit. The adjusted limit is 1.15*NAR Area Median House Price (Economy.com), where the maximum (ceiling) must not exceed 1.5x the original conforming limit for the given year. Area specific conforming limits are not adjusted for Alaska and Hawaii.

- GSE purchases of goal-qualifying loans closely follow the market, particularly for low-mod borrowers since 2002.
- Most goal-qualifying mortgages are purchased under standard terms of business (termed 'baseline affordable').

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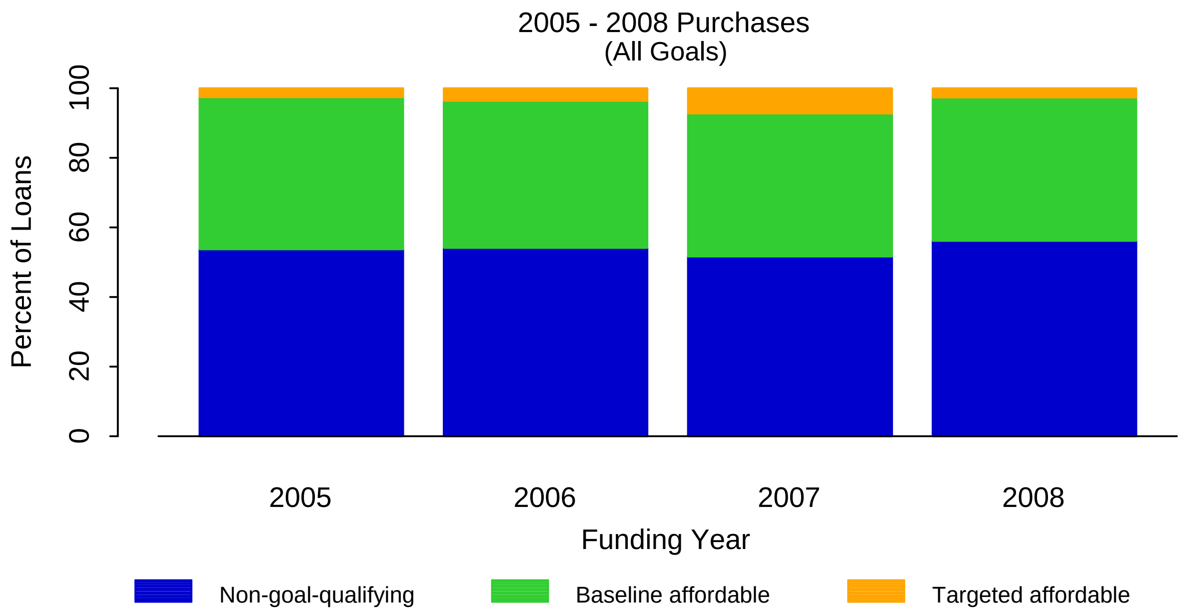
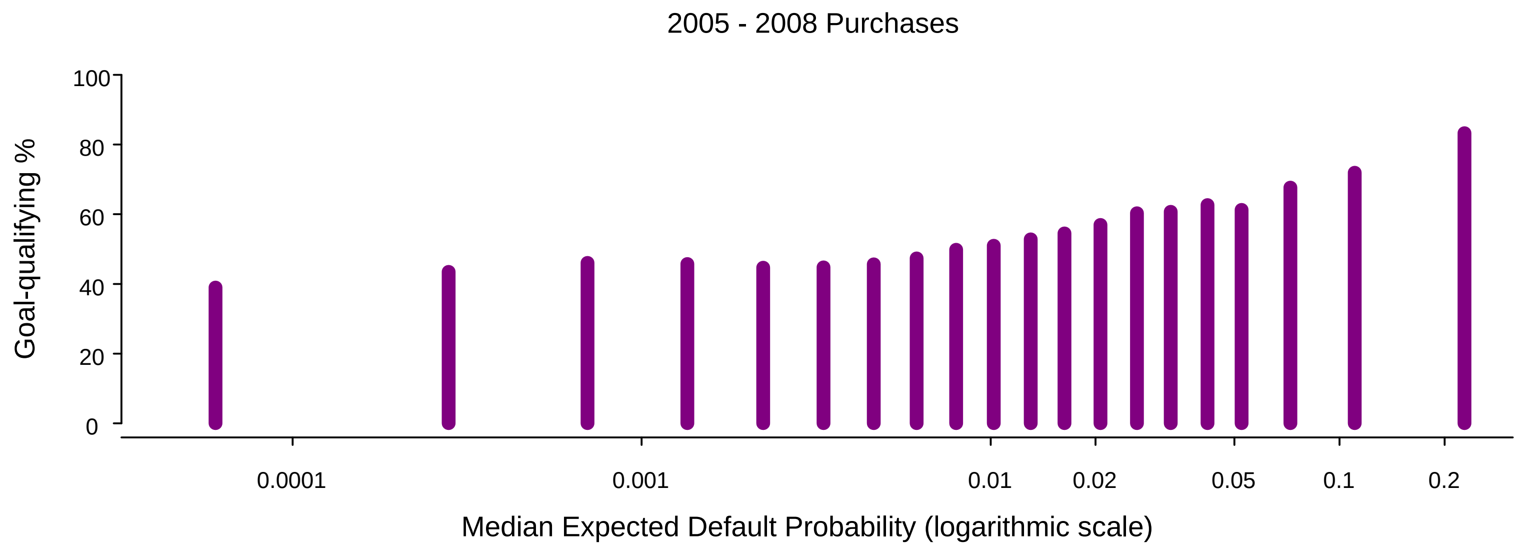
Only a small share of our purchases are undertaken specifically because they contribute to the goals (termed 'targeted affordable')



- Targeted affordable loans are those that we likely would not purchase in the absence of housing goals.
  - Targeted affordable loans typically use goal-qualification status as an explicit eligibility criterion.
  - The vast majority of our targeted affordable loans are single-family purchases.
  - Home Possible mortgages and Loan Prospector Dials (lower 'accept' threshold for goal-qualifying loans) are primary examples of targeted affordable purchases.

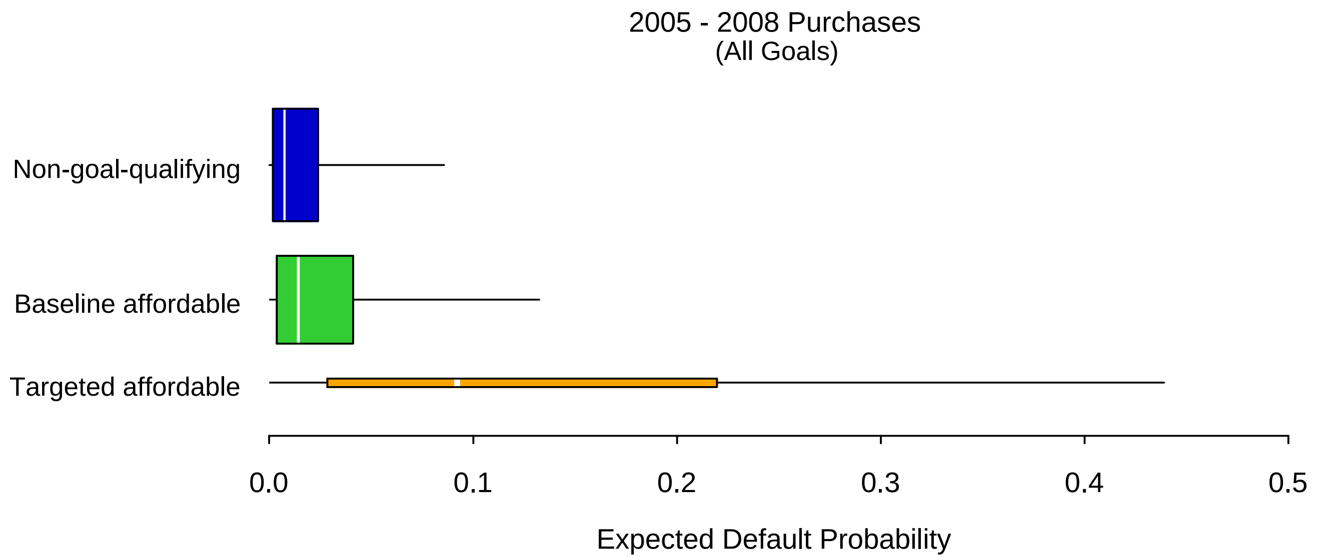
Higher credit risk mortgages disproportionately tend to be goal-qualifying



Note: Each bar represents one-twentieth of the total 2005-2008 purchases (a twentile), ordered by increasing expected default risk (the horizontal axis). The height of each bar represents the percent of loans that qualify for one or more goals or subgoals (the vertical axis).

- Goal-qualifying loans tend to be higher risk.
  - Housing goals and subgoals target lower-income borrowers and areas.
  - Lower household income correlates with various risk factors such as less wealth, less employment stability, higher loan-to-value ratios, or lower credit scores.
  - Lower income areas may exhibit greater house price volatility.

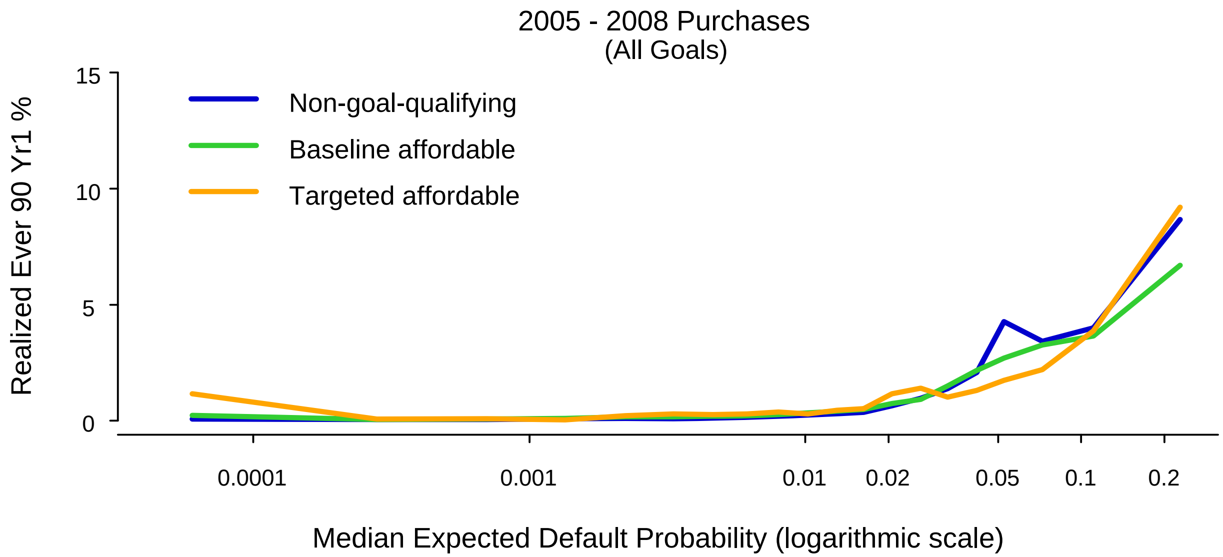
Targeted affordable lending generally requires ‘accepting’ substantially higher credit risk



Note: The box represents the middle 50% of the observations, the median is marked by the white line in the box, and the lines extend to the 5th (on the left) and 95th (on the right) percentiles. The height of the box is proportionate to the overall share for that group.

- Targeted affordable loans have much higher expected default probabilities.
  - The median targeted affordable expected default probability is significantly higher and the high-risk ‘tail’ is considerably longer, implying higher risk and uncertainty for this type of lending.
  - 75% of targeted affordable loans have equal or higher expected default probabilities than the highest 25% of non-goal-qualifying loans.
  - Over one-half of targeted affordable loans have higher expected default probabilities than the highest 5% of non-goal-qualifying loans.
- Baseline affordable loans have only somewhat higher expected default probability.

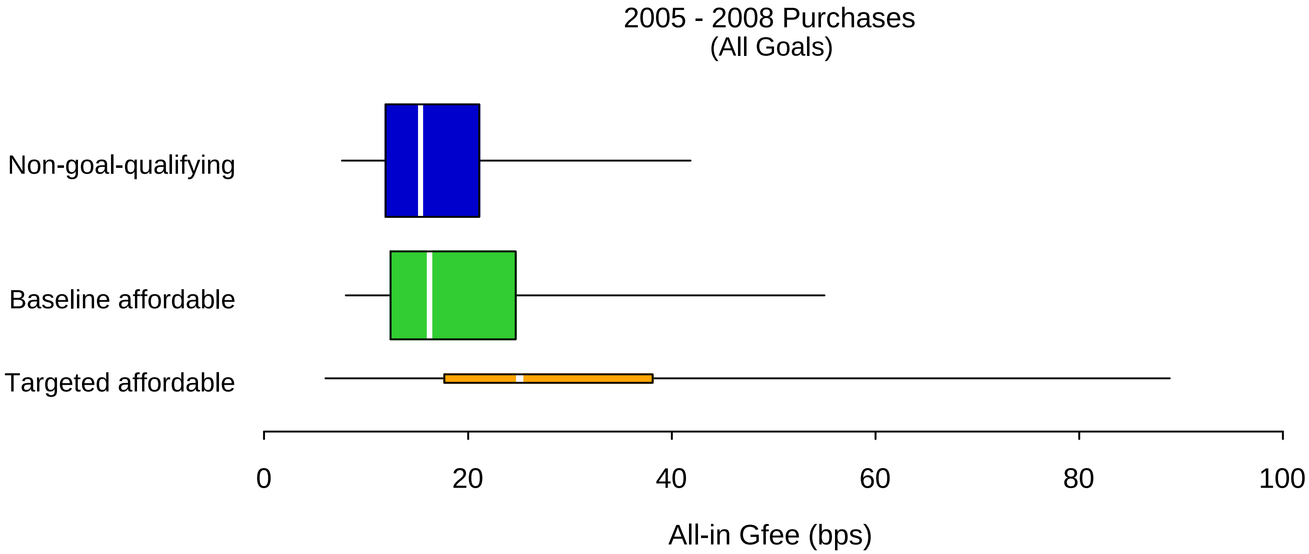
Our models are equally good at rank ordering the credit risk of non-goal-qualifying, baseline affordable and targeted affordable loans



Note: Before separating into groups, data are bucketed into twentiles by expected default probability. ‘Ever 90 Yr 1’ is the incidence of 90-day delinquency during the first 12 months following funding. Performance is measured by loan count not UPB exposure.

- At any level of expected default probability, realized performance is similar for non-goal-qualifying, baseline affordable and targeted affordable single-family loans.
- Other measures of realized performance yield equivalent results.

We charge more for targeted (and baseline) affordable SF loans, but not enough to fully offset their higher incremental risk



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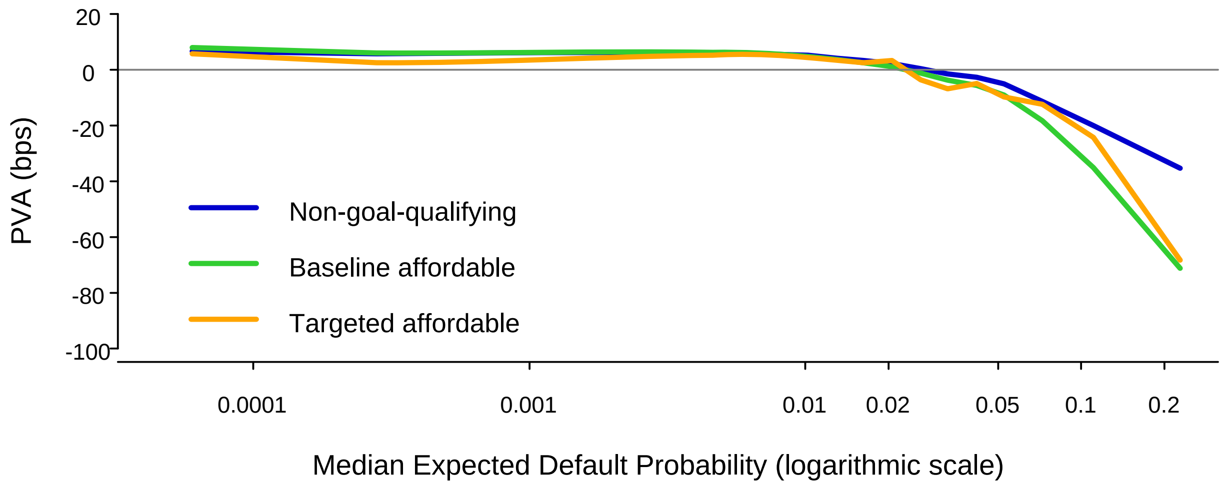

Note: Before separating into groups, the data are bucketed into twentiles by expected default probability. Ex ante present values are nominal dollars, based on costing models at the time of the transactions, rather than constant dollars, based on a single costing model.

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The actual performance of goal-qualifying SF loans has met or exceeded our expectations (relative to non-goal-qualifying loans)

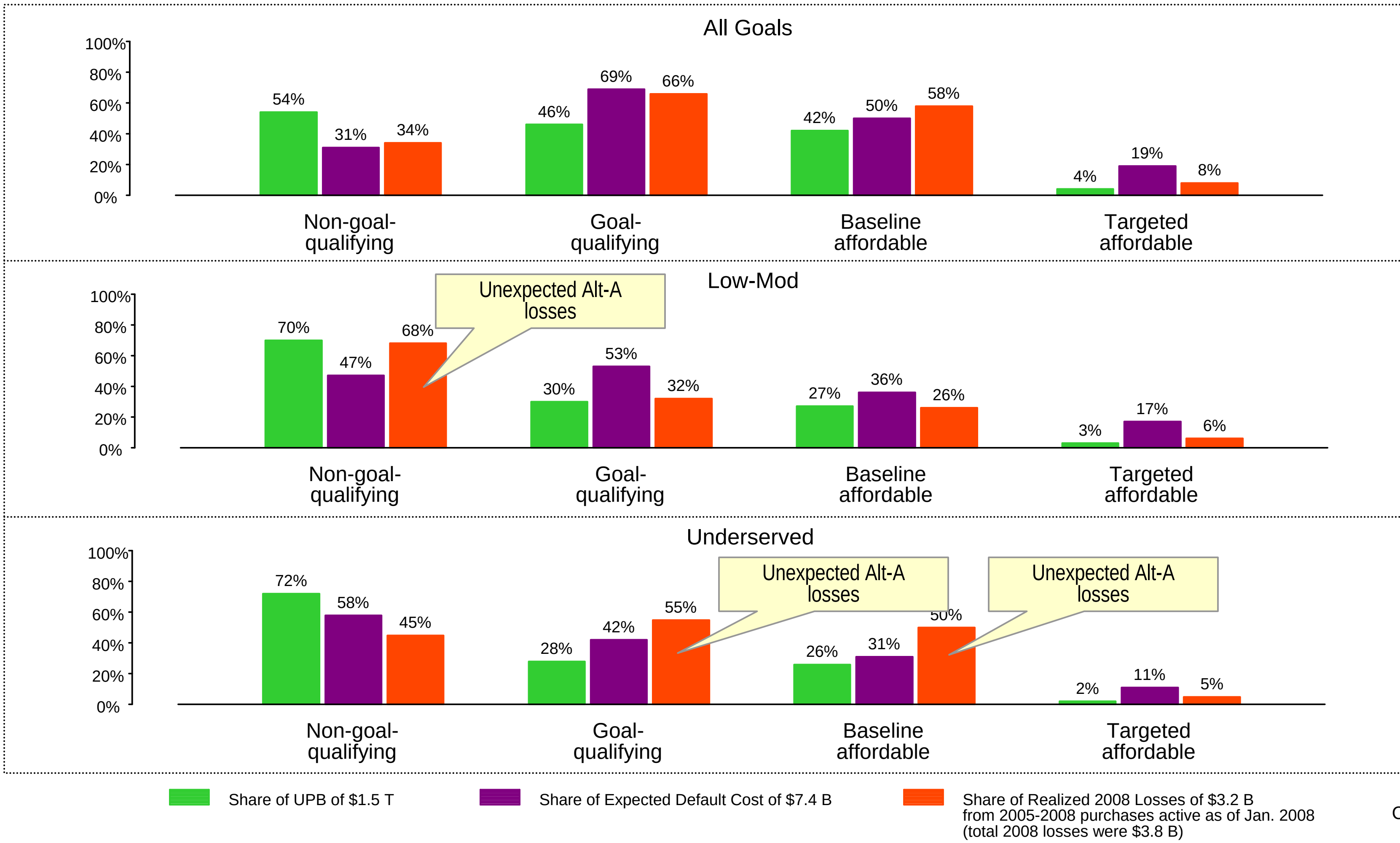
2005 - 2008 Purchases (All Goals)			
	Share of Purchase UPB	Expected Default Probability (bps)	Realized Ever90 Yr1 (bps)
Performance:			
Non-goal-qualifying	54%	213	90
Goal-qualifying:	46%	451	162
Baseline affordable	42%	336	126
Targeted affordable	4%	1,408	453
Multipliers:			
Goal-qualifying v. non-goal-qualifying		2.1	1.8
Baseline v. non-goal-qualifying		1.6	1.4
Targeted v. non-goal-qualifying		6.6	5.0

We expected defaults for targeted affordable loans to be 6.6 times greater than for non-goal-qualifying loans, but realized ever-90-day delinquency in the first year was ‘only’ 5.0 times greater.

Goal-qualifying SF loans accounted for the disproportionate share of our 2008 realized losses that was predicted by our models

- Goal-qualifying single-family loans (all goals) contributed a disproportionate share to our realized losses in 2008 (compare green to red bars), but that was as expected (compare purple to red bars).
- Actual performance was better than expected for targeted affordable loans, primarily because the unexpectedly poor performance of our Alt-A purchases mostly affected non-goal-qualifying and baseline affordable loans.

2005 – 2008 Purchases



The Multifamily and Investments business lines contribute little to the costs of Mission

- **Multifamily:** The housing goals cause the multifamily business to seek greater purchase volume at lower prices than would maximize profit. However, the pricing discount is less than the funding and scale advantages created by the Charter and housing goals. Consequently, management believes there is no net economic cost due to the affordable housing mission.
- **Investments:** Housing goals affect the type and volume of non-agency MBS purchased by Investments. Because Freddie Mac sought specially-designed ABS with exceptional goal-qualifying collateral, managing to housing goals caused us to forgo certain subprime ABS purchases. This ex ante opportunity cost was included in the historical subsidies. The purchase of agency MBS is neutral from a goals perspective because goals eligibility is determined at MBS origination, not MBS purchase.