

Updates

- **Fannie Mae MBS backed by loans with LTV ratios greater than 105 Percent and up to 125 Percent**
- **Fannie Mae MBS backed by Rural Development 502 Guaranteed Loans**

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Fannie Mae's new CQ prefix MBS is backed entirely by 30-year fixed-rate fully amortizing Fannie Mae-to-Fannie Mae refinance loans with LTV ratios greater than 105 percent and up to 125 percent.

In this edition of *MBSenger*, we provide two updates related to Fannie Mae MBS programs. We discuss:

- I. How loans with greater than 105 percent and up to 125 percent loan-to-value (LTV) ratios will be used as collateral for our new CQ prefix MBS; and
- II. Fannie Mae's Rural Development MBS program and how we provide liquidity to the market for Rural Development 502 Guaranteed loans as they are securitized into our GL prefix MBS.

On July 1, 2009, Fannie Mae announced a new LTV¹ ceiling of 125 percent for our Home Affordable Refinance Program (HARP), which is a part of the Obama Administration's Making Home Affordable initiative. As part of this announcement, we introduced our new CQ prefix MBS. Fannie Mae's new CQ prefix MBS is backed entirely by 30-year fixed-rate fully amortizing Fannie Mae-to-Fannie Mae refinance loans with LTV ratios greater than 105 percent and up to 125 percent. CQ prefix MBS are not eligible to be traded in the "to-be-announced" (TBA) market. Loans with LTV ratios greater than 105 percent and up to 125 percent are eligible for delivery into Fannie Mae CQ prefix MBS issued on or after October 1, 2009.

Fannie Mae's GL prefix MBS are backed by loans originated through U.S. Government guaranteed programs, including Rural Development 502 Guaranteed loans, as well as Federal Housing Authority (FHA) and U.S. Department of Veteran Affairs (VA) loans. Rural Development 502 Guaranteed loans are offered and guaranteed through the U.S. Department of Agriculture and these loans have seen a significant increase in originations over the past few years.

The following discussion aims to inform investors who are looking to enhance their understanding of the potential performance characteristics of these two distinct MBS programs.

I. Fannie Mae Implements New LTV Ceiling for the Home Affordable Refinance Program

On July 1, 2009, Fannie Mae announced revisions to HARP that increases the maximum allowable LTV ratios from 105 percent and up to 125 percent for qualified refinance mortgage loans. This step was aimed to allow

¹ The LTV is calculated as the original unpaid principal balance of the refinanced loan to the valuation of the property at the time of the refinancing in accordance with Fannie Mae's applicable underwriting guidelines.

HARP to reach even more borrowers who would benefit from refinancing under the program. Before this announcement, loans with LTVs greater than 105 percent were not eligible to be securitized into Fannie Mae MBS. All loans refinanced as part of this program must be owned or securitized by Fannie Mae.

To qualify for a HARP refinance, the refinance loan must demonstrate a benefit to the borrower, in one of the following ways:

- 1.) The borrower's payment must be decreased upon refinancing. This can be accomplished by extending the amortization term beyond the borrower's previous mortgage term; or
- 2.) If the borrower's payment is not decreased upon refinancing, the borrower must be moving to a more stable mortgage product (e.g. move to a fixed-rate mortgage from an adjustable-rate mortgage).

Special Reduction in Loan-Level Price Adjustment for High LTV Loans

With the increase in the maximum allowable LTV, Fannie Mae will offer a special 0.50 percent reduction in the loan-level price adjustment (LLPA) charged for loans with LTVs above 105 percent and loan terms of 15 to 25 years. The reduction is intended to give borrowers an incentive to select shorter-term mortgages and build positive equity in their homes sooner than would occur with a typical 30 year mortgage. Additionally, for loans with terms of 15 to 25 years, there will be a reduction in the cap on total LLPA and the Adverse Market Delivery Charges (AMDC) to 1.50 percent. For all other high LTV loans with terms greater than 25 years and up to 30 years, the LLPA and AMDC that apply to loans at 105 percent LTV will be charged, subject to the 2.00 percent cap on total LLPA and AMDC.

New CQ Prefix for High LTV Loans

These high LTV loans can be securitized into Fannie Mae's new CQ prefix MBS. A CQ prefix pool is defined as follows:

Definition of CQ Prefix MBS

Conventional Long-Term, Level-Payment Mortgages; Single-Family; maturing or due in 30 years or less. The pool is comprised entirely of mortgages with loan-to-value ratios greater than 105 percent and less than or equal to 125 percent.

Loans backing these pools must be existing Fannie Mae loans refinanced into a standard fully amortizing, fixed-rate mortgage loan maturing or due in 30-years or less (specifically, terms greater than 15 years and up to 30 years). Furthermore, a minimum servicing fee of 25 basis points is applied, all applicable conforming loan limits must be satisfied, and investor properties are eligible. Adjustable-rate mortgages are not eligible for Fannie Mae's high LTV refinancing option. In terms of disclosure, all at-issuance disclosure documents for CQ pools are identical to other Fannie Mae MBS.

CQ prefix MBS are not TBA-eligible. The introduction of LTVs in excess of 105 percent could potentially create greater uncertainty around prepayment speeds for TBA pools since no historical prepayment data exists for loans with LTVs above 105 percent.

REMICs, Megas, and Fannie Majors Incorporating High LTV Loans

CQ prefix MBS may be used as collateral for Fannie Mae REMICs. CQ prefix Fannie Majors can potentially be issued, and Fannie Mega pools backed by CQ prefix MBS can be created as well.

Using Desktop Underwriter® Refi Plus™ for High LTV Loans

Upon the implementation of our Desktop Underwriter (DU) update on September 19, 2009, our DU Refi Plus² option under HARP was expanded to offer LTV ratios up to 125 percent. This expansion is intended to help facilitate an easier and more efficient refinancing process, compared to the initially available manual underwriting process for these loans, and allow Fannie Mae to help even more borrowers in a timely manner. DU will perform its standard credit risk assessment, which has been updated to reflect the credit risk of loans with LTV ratios greater than 105 percent and up to 125 percent. DU Refi Plus is available to any lender using DU for underwriting. When using DU Refi Plus to underwrite these refinanced loans, the lender does not have to be the current servicer of the mortgage loan. To be eligible for DU Refi Plus, an existing loan must have been delivered to Fannie Mae before March 1, 2009. Once the loan has been refinanced, the new loan is not eligible for further DU Refi Plus consideration.

² <http://www.fanniemae.com/newsreleases/2009/4605.jhtml?p=Media&s=News+Releases>

Exhibit 1: CQ-Prefix MBS Summary

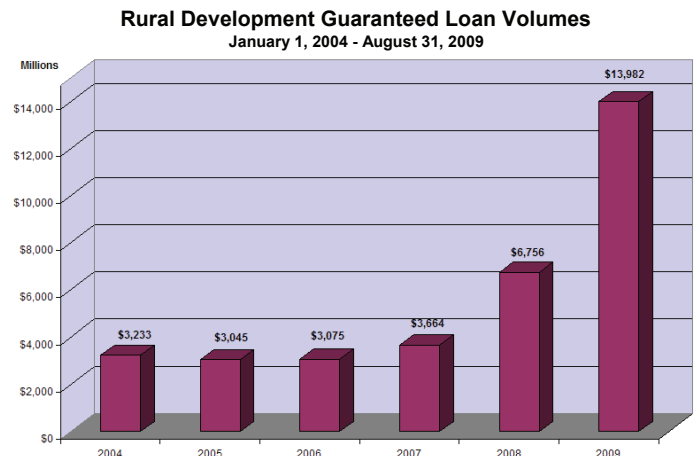
Prefix CQ Program Scope/Details	
Loan Description	Existing Fannie Mae loan refinanced into a standard fully amortizing fixed-rate 30-year mortgage (specifically terms greater than 15 years up to 30 years)
Original Loan LTV	105.01 – 125%
Timing	Available to all Fannie Mae-approved lenders for delivery into MBS issued starting October 1, 2009. (Fannie Mae has no plans to sunset the program. However, the current flexibility regarding mortgage insurance coverage on loans with LTVs over 80 percent, as directed by the Federal Housing Finance Agency under the Home Affordable Refinance Program, is scheduled to end on June 10, 2010.)
Pooling	<ul style="list-style-type: none"> • <i>REMICs</i>: Eligible • <i>Fannie Majors</i>[®] and <i>Fannie Megas</i>[®]: Standard pooling parameters • <i>Pool from Portfolio</i>: CQ MBS pools may be formed from existing whole loans in our portfolio

	CQ
TBA Eligible	No
Original Loan LTV	105.01 – 125%
De Minimis Limits (high-balance loans, co-ops, relocation, certain buydowns)	No
Loan Type/Term	Standard fully amortizing fixed-rate 30-year mortgage (specifically terms greater than 15 years up to 30 years)
Prepayment Penalties	None
Assumable	No
Minimum Servicing Fee	25 bps
Investor Properties	Eligible
Modified Loan Limits	Hawaii, Alaska, Guam, U.S. Virgin Islands
Disclosures	Identical (except prefix definition), at issuance/ongoing

II. Fannie Mae's Purchase and Securitization of Rural Development 502 Guaranteed Loans

The Rural Development (RD) Section 502 Guaranteed loan program is an affordable housing initiative administered by the U.S. Department of Agriculture (USDA). Initiated in 1989, the program has grown to over \$29 billion in principal balance outstanding and has originated over 275,000 loans since inception. Over the past two years the maximum LTV ratios of conventional and FHA products have been reduced. Rural Development, year-to-date as of August 31, 2009, has guaranteed approximately \$14 billion in RD 502 loans (see **Exhibit 2**).

Exhibit 2: RD 502 Loan Origination Volumes



The program seeks to help low- to moderate-income individuals or households purchase homes “of a modest nature” in rural areas. RD generally considers any town with less than 20,000 inhabitants to be rural in nature. These financed properties must be residential, not commercial agricultural businesses. Funds can be used to build, repair, renovate or relocate a home, or to purchase and prepare home sites, including provision of water and sewage facilities. The loan program has a maximum LTV ratio of 100 percent (102 percent when the two percent guaranty fee charged by RD is financed into the loan). Additionally, RD 502 loans may be designated as “due-on-sale,” or non-assumable, at origination.

Lenders who wish to originate RD 502 loans must submit a request to Rural Development to become an approved lender. Currently, there are approximately 3,400 RD 502-approved lenders, of which about 650 lenders are nationally approved with the balance being approved as state-specific lenders. For 2008, the highest volumes of RD 502 loans were originated in Illinois (\$194.3 million), Texas (\$181.9 million), Michigan (\$181.2 million), and Puerto Rico (\$154.6 million). Other states with high RD loan volumes (over \$100 million) in 2008 included California, Arkansas, Minnesota, Kentucky, North Carolina, Pennsylvania, Tennessee, Virginia, and Missouri.

How the Guaranty Works with RD 502

Fannie Mae’s guaranty of timely payment of principal and interest to investors is described in the related single-family MBS Prospectus. Fannie Mae’s guaranty applies to investors who own any outstanding Fannie Mae MBS.

Fannie Mae guarantees to the MBS trust that we will supplement amounts received by the MBS trust as required to permit timely payments of principal and interest on the certificates. Originators of RD 502 loans are provided a government guaranty as well. RD 502 loans carry a 90 percent guaranty against credit loss to the RD mortgage holder, which, upon delivery, is Fannie Mae. Overall, RD 502 loan foreclosure ratios are under 1.5 percent over the past 12-months, lower than those of FHA and VA.

Borrower Eligibility

Borrowers are underwritten to RD guidelines. While a significant number of loans are still manually underwritten, RD does support an automated underwriting system (Guaranteed Underwriting System – GUS). The use of GUS is gaining traction and it is expected that the majority of loans guaranteed in 2009 will be approved through this system. Two significant eligibility requirements are the income limit (based on family size) of 115 percent of the national area median income (AMI); and, the home has to be in a designated “rural” geographic area as defined by RD. Given this criteria, RD loans tend to have a lower than average original loan amount. During fiscal year 2008, the average RD 502 loan amount was approximately \$111,000.

Fannie Mae and RD 502 Loans

Fannie Mae participates in the secondary market for RD 502 Guaranteed loans through portfolio purchases for cash and securitization through GL Prefix MBS. A GL pool is defined as follows:

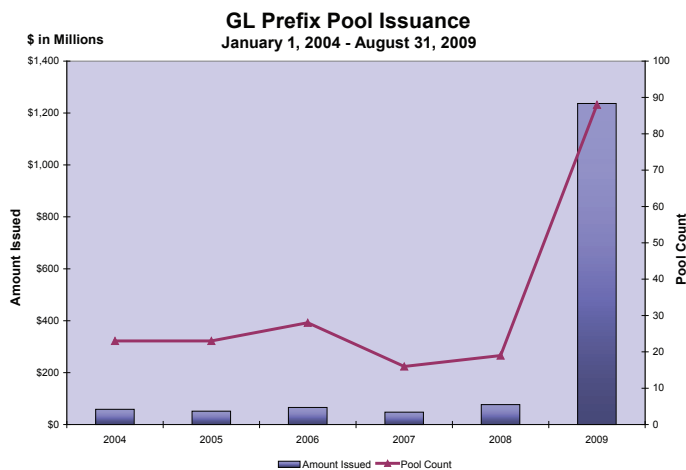
Definition of GL Prefix MBS

Government, Level-Payment Mortgages; Single-Family; maturing or due in 30 years or less. Pool may contain certain higher balance FHA loans originated on or after March 6, 2008.

Currently, Fannie Mae does not disclose how much of a GL prefix pool is composed of RD, FHA, or VA loans. The RD 502 non-assumable product is classified as a “standard” program; meaning that any Fannie Mae approved seller/servicer can deliver RD 502 Guaranteed loans without a specific negotiated transaction. Fannie Mae may purchase RD 502 assumable loans for its mortgage portfolio. However, a lender would have to sell these loans to Fannie Mae under a negotiated commitment. With the exception of a minimum 580 FICO score, there is no overlay of any underwriting guideline or limitation above the requirements set forth by Rural Development in issuing its guaranty.

Our issuance of GL prefix pools has grown significantly year-to-date through August 31, 2009, representing approximately a 94% increase from all of 2008 (see **Exhibit 3**). GL prefix issuance remained fairly steady from 2004 through 2008, with total issuance ranging from approximately \$58 million in 2004 to \$76 million in 2008. The average amount of GL pools issued from 2004 through 2008 was approximately 22 pools per year. However, as of August 31, 2009, Fannie Mae had issued 88 pools totaling approximately \$1.2 billion year-to-date. This dramatic increase mirrors increased originations in FHA and VA loans over the past year and Fannie Mae's issuance of pooled-from-portfolio (PFP) pools. As of September 23, 2009, GL prefix MBS traded approximately one-point behind TBA MBS across the coupon stack.

Exhibit 3: GL Prefix Pool Issuance



Disclosure Information Available for CQ and GL Prefix MBS

Fannie Mae provides clear, timely and easily accessible information to market participants about all of our mortgage-related securities; including CQ prefix and GL prefix MBS. All single-family MBS are issued with a Base Prospectus, which contains general information such as the nature of Fannie Mae's guaranty, yield considerations, class definitions, and abbreviations.

Along with the Base Prospectus, each MBS or Mega is issued with a Prospectus Supplement, which contains information that is specific to a particular security or trust. The supplements are to be read in conjunction with the applicable disclosure documents referred to therein. The applicable Prospectus and Prospectus Supplement can be obtained by entering the applicable CUSIP or pool number on our website at the following link:

<http://www.fanniemae.com/mbs/index.jhtml>

Additionally, Fannie Mae discloses information regarding the collateral that back REMIC and Mega transactions, including a Final Data Statement, which provides pool level information about the MBS used as collateral for each REMIC Trust or Mega. The Final Data Statements can be obtained on our website at the following links:

REMICs

<http://www.fanniemae.com/mbs/documents/remic/finaldata/index.jhtml>

MEGAs

<http://www.fanniemae.com/mbs/documents/mega/finaldata/index.jhtml>

Fannie Mae Guaranty

For both CQ Prefix MBS and GL Prefix MBS, Fannie Mae's guaranty of the timely payment of principal and interest to investors is described in the related single-family MBS Prospectus, which can be found on our website at the link above. The guaranty of Fannie Mae is not backed by the full faith and credit of the U.S. government. The value of the guaranty is important to investors because it reduces credit risk and increases the marketability of the securities. It does not, however, eliminate interest rate risk, prepayment risk or market risk.

Summary

In this edition of MBSenger, we discussed how loans with greater than 105 percent and up to 125 percent LTVs will be pooled into our new CQ prefix MBS and how Fannie Mae helps to provide liquidity to the market for RD 502 Guaranteed loans through securitizing them in our GL prefix MBS. It is important for investors to understand the performance characteristics of the loans that back each of these types of MBS in order to better determine their suitability in meeting their investment goals.

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