

U.S. Housing and Mortgage Market Outlook¹

February 2009

This edition of FundingNotes is written by Fannie Mae's Economic and Mortgage Market Analysis (EMMA) group.

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Fannie Mae was chartered by Congress to support liquidity and stability in the mortgage market, where existing mortgage loans are purchased and sold. Because the company operates within the U.S. residential mortgage market, Fannie Mae monitors the housing market to help determine how changes in this market can potentially affect our business lines.

Mortgage and Housing Market in 2008

Mortgage and housing market conditions worsened progressively and dramatically in 2008 and those looking for a turnaround in the housing market were sorely disappointed last year as the housing market decline that began in a few areas of the country intensified and broadened. We entered 2008 with mild economic growth (though we later ascertained that the current recession began at the end of 2007) and low unemployment at a rate of 4.9 percent, but with a storm brewing in the housing and finance markets. High housing inventory levels, slowing demand, increasing delinquencies and foreclosures were too much for the housing market and the overall economy to bear. Of course home prices plummeted, falling by over 18 percent for the year² and the scope of the problem spread to more areas of the country. Entering 2008, only 34 percent of Metropolitan Statistical Areas (MSAs) had declining home prices on a year-over-year basis, but by the end of the year, 70 percent of the MSAs had declining home prices³.

Mortgage and Housing Markets in 2009⁴

Many of the adverse factors that affected the housing market in 2008 are still with us in 2009. We expect high inventory levels, low demand, and increasing default and foreclosure rates to continue to weigh on the housing market. New home construction is expected to decline again in 2009, with single-family housing starts falling by approximately 40 percent from the already low levels recorded in 2008. Home sales will also remain weak in 2009, with expected decline in total sales at roughly six percent for the year. Most of the decline is in the new home market, which we expect to show a decline of about 34 percent.

Actual results for the first month of the year confirm the gloomy outlook for the housing market. Housing starts for January came in at the lowest level ever recorded⁵ (see **Figure 1**) and given the already mentioned adverse factors, it is difficult to envision a turn around in new home construction market any time soon. However, this is a positive for the health of the

¹ Opinions, analyses, estimates, forecasts and other views of Fannie Mae's Economics & Mortgage Market Analysis (EMMA) group included in these materials should not be construed as indicating Fannie Mae's business prospects or expected results, are based on a number of assumptions, and are subject to change without notice. Although the EMMA group bases its opinions, analyses, estimates, forecasts, and other views on information it considers reliable, it does not guarantee that the information provided in these materials is accurate, current, or suitable for any particular purpose. Changes in the assumptions or the information underlying these views could produce materially different results. The analyses, opinions, estimates, forecasts, and other views published by the EMMA group represent the views of that group as of the date indicated and do not necessarily represent the views of Fannie Mae or its management.

² According to the S&P/Case-Shiller National Home Price Index.

³ This is according to the FHFA total transaction home price index calculated for 2007 Q4 and 2008 Q4.

⁴ Opinions, analyses, estimates, forecasts and other views, including those of Fannie Mae's Economics and Mortgage Market Analysis (EMMA) group, relating to the mortgage and housing markets and the economy included in these Funding Notes should not be construed as indicating Fannie Mae's business prospects or expected results, are based on a number of assumptions, and are subject to change without notice. Actual events may be different, perhaps materially, from these expectations as a result of a number of factors, including the factors that Fannie Mae discusses as "Risk Factors" in its most recent Form 10-K filed with the SEC on February 26, 2009.

⁵ Records have been kept by the Census Bureau since 1959.

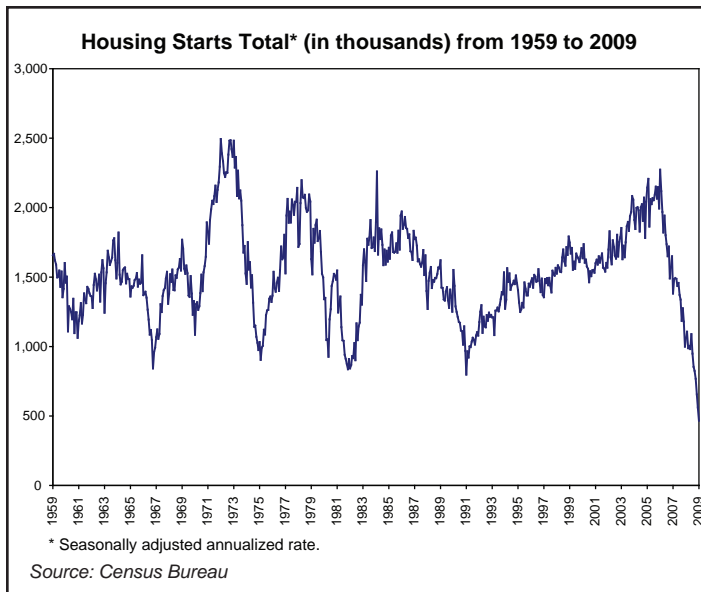


Figure 1

housing market. The decline and continued low level of housing starts will help restore the supply/demand imbalance, which is critical for the turnaround to occur.

Home Sales in 2009

New single-family home sales have followed the same path as single-family construction, and we expect that they will continue to fall at roughly the same rate as single-family housing starts this year. This continued slowdown in sales of new homes has caused the months supply of new homes on the market to remain high. In January, the number of new homes on the market fell to the lowest level since the middle of 2003. However, the months supply available at the current sales rate climbed to 13.3 months, which is the highest level recorded⁶ (see Figure 2).

While they have also slowed, sales of existing homes are holding up better since sales of distressed properties are captured as existing home sales. In January, the National Association of Realtors estimated that distressed sales accounted for 45 percent of all existing home sales in that month. Foreclosures are also putting pressure on the supply of homes on the market, and adding to the supply at roughly the same pace as sales reduce it. At the end of January, there was a 9.6 month supply of existing homes on the market, down from the peak of 11.3 months in early 2008, but still a far cry from the four to seven months supply that most analysts believe is the equilibrium level of supply.

Credit conditions have not helped the housing market. According to the Federal Reserve Senior Loan Officer

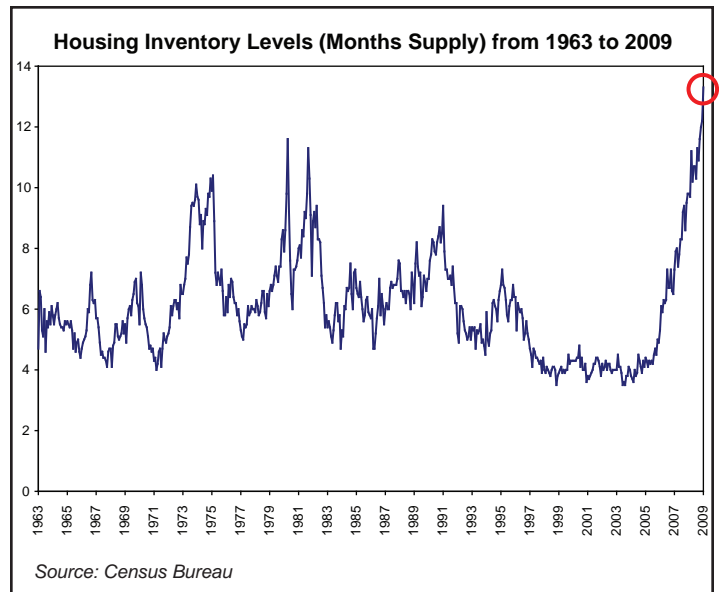


Figure 2

Survey, banks began tightening standards on residential mortgage as of the end of 2006, and increased tightening into this year. Tighter credit conditions can also be seen in the spreads between mortgage interest rates and Treasury rates. Interest rates on 30-year fixed-rate mortgages have historically ranged 1.5 to 1.75 percentage points above the 10-year treasury rate and recently stood at roughly 2.10 percentage points.

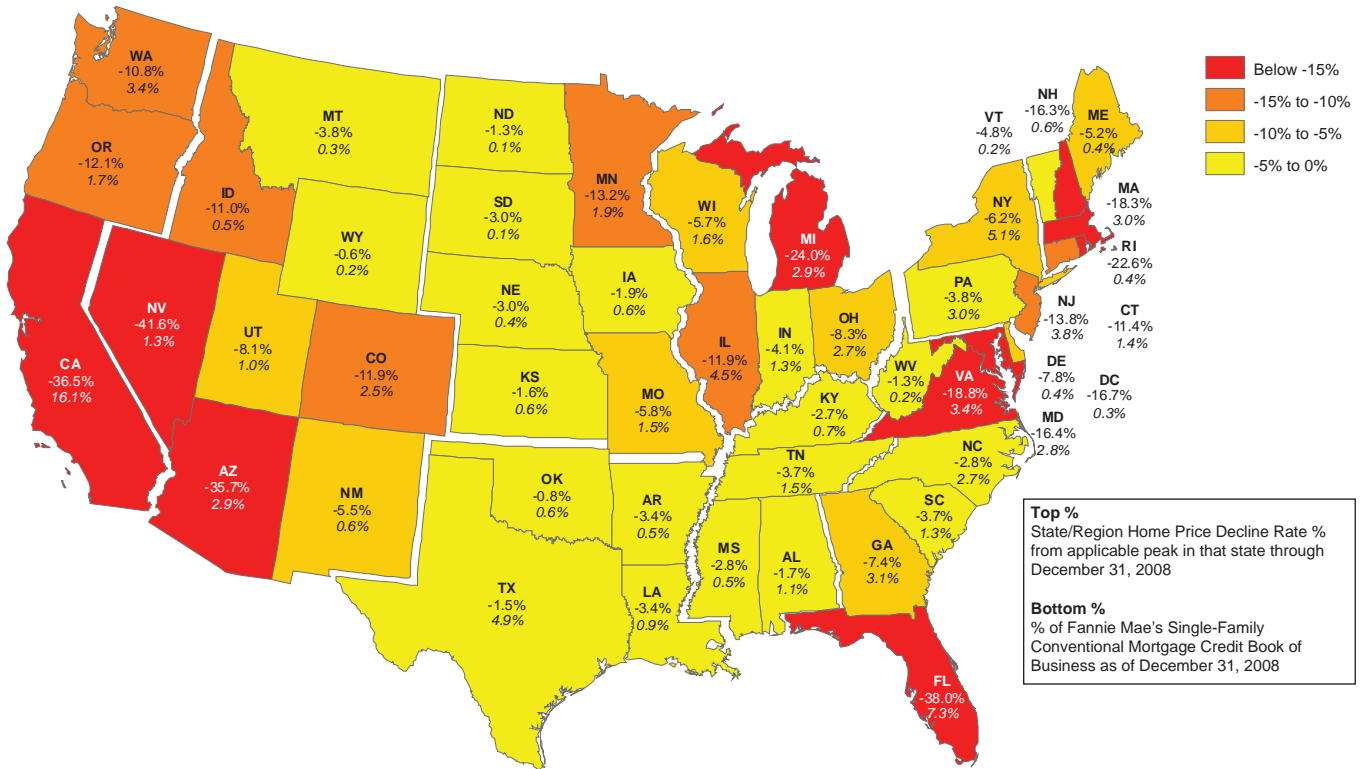
Home prices continue to fall due to the demand/supply imbalance, tight credit conditions and recession-related job loss. We expect that prices will continue to fall this year, with a Fannie Mae Home Price Index (HPI) decline in the range of 7 to 12 percent and 20 to 30 percent peak-to-trough. The projected decline in the Fannie Mae HPI is comparable to a 12 to 18 percent decline in the S&P/Case-Shiller HPI in 2009 and a 33 to 46 percent peak-to-trough decline. Figure 3 displays the home price declines peak-to-current by state as of the 4th quarter of 2008.

The methodology of the Fannie Mae home price index differs from the S&P/Case-Shiller HPI, in two principal ways: 1) the Fannie Mae HPI estimate weights expectations for each property by number of properties, whereas the Case-Shiller index weights expectations for home prices base on property value, and 2) the Fannie Mae estimates do not include sales of foreclosed homes. These indices are shown in Figure 4.

Home price declines and low mortgage rates have had a positive effect on affordability. By the National Association of Realtors housing affordability index, affordability is now at the highest level since the index has been tracked since 1971, as shown in Figure 5.

⁶ Records have been kept by the Census Bureau since 1963.

Home Price Declines of the Continental U.S. as of 2008 Q4



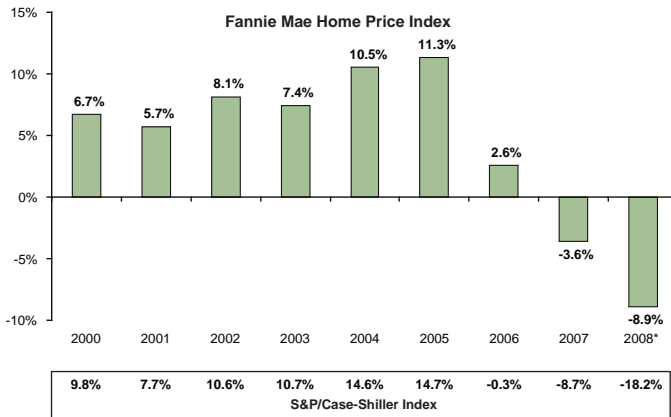
Top %
State/Region Home Price Decline Rate % from applicable peak in that state through December 31, 2008

Bottom %
% of Fannie Mae's Single-Family Conventional Mortgage Credit Book of Business as of December 31, 2008

Figure 3

Source: Fannie Mae. Initial estimate based on purchase transactions in Fannie-Freddie acquisition and public deed data available through the end of December 2008, supplemented by preliminary data available for January and February 2009. Including subsequent data may lead to materially different results

Fannie Mae/Case-Shiller Home Price Projections



*Growth rates are from period-end to period-end.

*Initial estimate based on purchase transactions in Fannie-Freddie acquisition and public deed data available through the end of December 2008, supplemented by preliminary data available for January and February 2009. Including subsequent data may lead to materially different results.

*The S&P/Case-Shiller comparison numbers shown above are calculated using our models and assumptions, but modified to use two factors (weighting of expectations based on property value and the inclusion of foreclosed property sales). In addition to these differences, our estimates are based on our own internally available data combined with publicly available data, and are therefore based on data collected nationwide, whereas the S&P/Case-Shiller index is based only on publicly available data, which may be limited in certain geographies. Our comparative calculations to the S&P/Case-Shiller index provided above are not modified to account for this data pool difference.

Figure 4

Affordability Index from 1971 to 2009

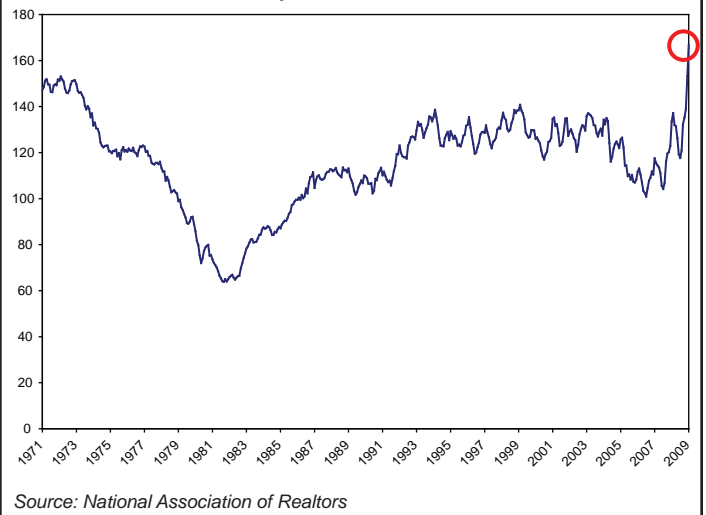


Figure 5

The index measures the ability of a family earning the median income to afford the median-priced home with 20 percent down payment and qualifying housing-to-income ratio of 25 percent. The index does not take into account credit conditions and economic conditions, such as job loss, which will have an adverse effect on demand.

Mortgage Originations in 2009

We expect total mortgage originations to increase in 2009, but there are two parts to this story. With the continued decline in the housing market, and our expectation that housing starts, sales, and prices will decrease in 2009, we expect purchase originations to decline by approximately 16 percent for all of 2009 to roughly \$800 billion.

The large drop in long-term mortgage rates and its potential impact on refinance originations completes the mortgage originations story. Refinance originations, however, are expected to be high this year as mortgage interest rates are at low enough levels that a large share of currently outstanding mortgage debt has a rate incentive to refinance. As mortgage rates move around, this estimate moves around, but we estimate that this year will see a significant amount of refinancing. Of course there are other factors to consider that would bring the level of refinancing down, but these factors would be somewhat offset by recently announced government policies on mortgage refinancing. The increase in refinancing will not be accompanied by much equity withdrawal. We expect a small drop in the level of mortgage debt outstanding this year.

Impact of Housing Decline on Fannie Mae's Business⁷

For the year ended December 31, 2008, our conventional single-family business volume was comprised of 92% fixed-rate mortgage product and 8% adjustable-rate mortgage product, compared to 90% and 10% for the year ended December 31, 2007, respectively. We have also experienced a significant decline of Alt-A loan volumes in the composition of our new business for 2008 relative to 2007. The change in the composition of our new business, including the reduction in the proportion of higher risk, interest-only loans to more traditional, fully amortized fixed-rate mortgage loans, reflects an improvement in overall credit quality of our new business. Furthermore, we made changes in our underwriting and eligibility criteria to improve the credit risk quality of our acquisitions, which resulted in a shift in our risk profile of our new business in 2008. Despite improvements in the credit risk quality of our new business, we expect to continue to experience credit losses that are significantly higher than historical levels prior to 2007 due to the tremendous pressures on the housing market and the deepening economic downturn.

⁷ This section is written by Fannie Mae's Fixed-Income Securities Marketing team.

We expect that the current crisis in the U.S. and global financial markets will continue, which will continue to adversely affect our financial results throughout 2009. We expect the unemployment rate to continue to increase as the economic recession continues. We expect to continue to experience home price declines and rising default and severity rate, all of which may worsen as unemployment rates continue to increase and if the U.S. continues to experience a broad-based recession. We foresee mortgage debt outstanding to shrink by approximately 0.2 percent in 2009. Furthermore, we expect the level of foreclosures and single-family delinquency rates to increase further in 2009.

Conclusion

In this edition of *FundingNotes*, we examine Fannie Mae's Economic and Mortgage Market Analysis Group's projections for the housing and mortgage markets in 2009. Fannie Mae expects that housing prices will continue to decline in 2009, with a Fannie Mae HPI decline of 7 to 12 percent in 2009, and a peak-to-trough decline of 20 to 30 percent. The projected decline in the Fannie Mae HPI is comparable to a 12 to 18 percent decline in the Case Shiller HPI in 2009 and a 33 to 46 percent peak-to-trough decline. Fannie Mae's EMMA group projects that originations for home purchase are expected to remain weak in 2009, falling to the lowest level in about 10 years, as home sales and prices to continue to fall. Refinance originations, however, are expected to be high this year as mortgage interest rates are at low enough levels that a large share of currently outstanding mortgage debt has a rate incentive to refinance.



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For Fannie Mae's Investors and Dealers

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Summary Breakdown of 2009 Debt Issuances

Fannie Mae Fixed-Rate Callable Debt

Maturity/Call (Year)	January 2009 Par Amount (in thousands)	# Issues	YTD 2009 Par Amount (in thousands)	# Issues
1.50NC0.25	\$ 1,435,000,000	8	1,435,000,000	8
2.00NC0.25	200,000,000	3	200,000,000	3
2.00NC0.50	115,000,000	2	115,000,000	2
2.00NC1.00	555,000,000	7	555,000,000	7
2.50NC0.25	95,000,000	2	95,000,000	2
2.50NC0.50	195,000,000	1	195,000,000	1
2.50NC1.00	95,000,000	3	95,000,000	3
3.00NC0.24	25,000,000	1	25,000,000	1
3.00NC0.25	450,000,000	3	450,000,000	3
3.00NC0.50	10,000,000	1	10,000,000	1
3.00NC1.00	50,000,000	2	50,000,000	2
3.00NC1.50	85,000,000	1	85,000,000	1
3.42NC1.41	15,000,000	1	15,000,000	1
3.50NC0.25	25,000,000	1	25,000,000	1
4.00NC1.00	100,000,000	1	100,000,000	1
4.58NC1.08	15,000,000	1	15,000,000	1
5.00NC0.25	705,000,000	10	705,000,000	10
5.00NC1.00	5,795,000,000	4	5,795,000,000	4
5.00NC2.00	720,000,000	5	720,000,000	5
5.00NC2.75	15,000,000	1	15,000,000	1
5.50NC0.25	10,000,000	1	10,000,000	1
5.50NC1.00	25,000,000	1	25,000,000	1
7.00NC1.00	1,000,000,000	1	1,000,000,000	1
7.00NC2.00	25,000,000	1	25,000,000	1
10.00NC1.00	41,000,000	2	41,000,000	2
15.00NC0.25	115,000,000	4	115,000,000	4
30.02NC1.00	275,000,000	2	275,000,000	2
TOTAL			\$ 12,191,000,000	70

Benchmark Repo Lending Facility Auction Results

Auction Date	REPO Maturity	CUSIP	Maturity	Amount Loaned (\$MM)	WAVG Yield	# of Bids
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2009 Debt Redemptions

Callable Debt Redeemed (in billions)

January	\$	13.3
TOTAL	\$	13.3

Summary Breakdown of 2009 Benchmark Notes Issuance

Fannie Mae Noncallable Benchmark Notes

Maturity	Jan 09 Par Amount	# Issues	YTD 2009 Par Amount	# Issues
2 Years				
3 Years				
5 Years	6,000,000,000	1	\$6,000,000,000	1
10 Years				
TOTAL	\$6,000,000,000		\$6,000,000,000	1