Fannie Mae First Quarter 2017 Earnings Media Call Remarks Adapted from Comments Delivered by Timothy J. Mayopoulos, President and CEO, Fannie Mae, Washington, DC

Operator:

Welcome and thank you for standing by. At this time all participants are in a listen-only mode. During the question and answer session of today's call, you may press star followed by 1 to ask a question. Today's conference is being recorded, if you have any objections you may disconnect at this time.

I would now like to turn over to your host, Maureen Davenport, Fannie Mae's Senior Vice President and Chief Communications Officer.

Maureen Davenport:

Thank you, Operator. And thank you all for joining the media call and webcast to discuss Fannie Mae's first quarter 2017 financial results. Please note that this call may include forward-looking statements, including statements about the company's future performance, business plans, and strategy. Future events may turn out to be very different from these statements. The "Risk Factors" and "Forward-Looking Statements" sections in the company's First Quarter 2017 Form 10-Q filed today and its 2016 Form 10-K filed February 17, 2017 describe the factors that may lead to different results.

As a reminder, this call is being webcast and recorded by Fannie Mae and the recording may be posted on the company's website. We ask that you do not record this call for public broadcast and that you do not publish any full transcript thereof.

I'd now like to turn the media conference call over to Fannie Mae President and CEO, Tim Mayopoulos.

Tim Mayopoulos:

Thanks, Maureen. Good morning, everybody. Thanks for joining us on this call this morning as we discuss our first quarter 2017 financial results. Our business this past quarter reflects two

ongoing trends for Fannie Mae. First, the mortgage market and our business continue to perform solidly. And second, our stronger business model, our customer-centric strategy, and our focus on innovation are delivering real value to customers, to the mortgage market, to homeowners and renters, and to taxpayers.

This morning I'll provide a high-level overview of our quarterly financial results. Then, I will share some examples of the ways we're advancing our business strategy in 2017.

First, let me review the quarter. In this quarter, interest rates had less of an impact on our results than they did in the fourth quarter of 2016. And we continued to see ongoing improvement in our credit performance.

We reported net income of $2.8 billion and comprehensive income of $2.8 billion. This compares with net income of $5 billion and comprehensive income of $4.9 billion for the fourth quarter of 2016. The main driver of the difference in net income between the last two quarters was a significantly smaller increase in long-term interest rates in the first quarter as compared to the fourth quarter.

Large increases and longer-term interest rates in the fourth quarter resulted in substantial fair value gains on the company's risk management derivatives for the quarter, as well as credit-related expenses that partially offset those gains. By contrast, interest rates increased only slightly in the first quarter of 2017, and therefore did not have a substantial impact on these items.

Detailed information regarding the drivers of our results is in our press release and our quarterly report on Form 10-Q, which we filed today.

As you know, we do not control a number of factors that drive our financial results, including long-term interest rates. As I've said on past calls, these factors can cause volatility in our financial results and may have a positive or negative effect on any given quarter or year. The difference in our results from the fourth quarter to the first quarter this year reflect this dynamic.

These variables aside, our guaranty business remained strong in the first quarter. Our guaranty business is the main driver of our revenues, accounting for more than 75 percent of our net interest income in the first quarter. We expect that percentage to continue to grow.

Our acquisition volume in the first quarter of 2017 was down from the last quarter of 2016. This was expected. And it's important to note that this current quarter's volume was higher than we saw in the first quarter of 2016. So some of what we are seeing is seasonal variation in the market. Decreased refinance volumes due to interest rate increases also played a role. All in all, however, our credit book is stable and it actually grew slightly from where it ended 2016.

Lastly, the credit metrics in our Single-Family business continued to improve. Our single-family serious delinquency rate has decreased for 28 consecutive quarters, and was 1.12 percent as of the end of March. Our first quarter demonstrates strong earnings in a quarter where we did not see significant volatility, and this is a reflection of our stable and strong book of business.

We remained the largest provider of secondary mortgage market liquidity in the first quarter, providing approximately $136 billion in mortgage financing that helped families buy, refinance, or rent a home.

We expect to pay another $2.8 billion in dividends to the Treasury in June, which will bring our total dividend payments to Treasury and the taxpayers to $162.7 billion since 2008.

While we expect to remain profitable on an annual basis for the foreseeable future, we could experience a net worth deficit in a future quarter. As we have discussed before, this is due to our limited and declining capital reserves and the potential for significant volatility in our financial results due to factors that we do not control, such as interest rates and home prices.

In addition, as we describe in our filing, future legislative or regulatory changes also could result in a net worth deficit in a future period. For instance, the Administration has proposed a significant reduction in the corporate tax rate. If Congress enacts such a reduction, it would

negatively affect the value of our deferred tax assets and, we expect, result in a significant net loss and net worth deficit for the quarter in which the legislation is enacted. Such a deficit would require us to draw additional funds from Treasury.

Our capital reserve now stands at $600 million. Under the terms of the senior preferred stock purchase agreement with Treasury, our capital will go to zero in 2018.

Against this backdrop, our focus has not changed. That focus remains fixed on our strategy and our role to provide a continuous, reliable source of liquidity for housing finance. Our strategy is built around our customers making it easier for them to do business with us and helping them solve some of their most important business challenges.

Before I open up the call to questions, I want to briefly highlight a few areas of progress and innovation where Fannie Mae is delivering for our customers.

First, we continue to see a very positive response from customers on our Day 1 Certainty Initiative. Day 1 Certainty helps our customers verify borrower assets, income, and employment on the front end of the loan process. Day 1 Certainty tools also enable lenders to have more certainty on home appraisals.

It is still early but already more than 1,000 customers have activated one or more of the Day 1 Certainty data validation services. Uptake of the tools has increased steadily and we expect it to continue to grow as we continue to make them better and more accessible. Feedback from our customers has been positive, with lenders reporting significant reductions in closing times and fewer burdens on borrowers.

Fully implementing all of the Day 1 Certainty tools will take time, but we are pleased with the progress so far and we believe that Day 1 Certainty is an important step on the path towards a digital mortgage process.

We are also bringing an innovation mindset to our Multifamily business. Fannie Mae's Multifamily business continues to lead the market in green financing, which helps multifamily owners preserve and upgrade affordable rental properties.

We provided $3.6 billion in green financing in 2016. This fills a significant need in the marketplace, as property owners look to upgrade older properties and make them more energy- and water-efficient. We were recognized for this innovative program last month when we received the Energy Star Partner of the Year Award for the third year in a row.

A third example of how we are innovating to deliver greater value to the market is our recent expansion of solutions to help borrowers burdened by student debt. This is an illustration of our willingness to be creative across our business in introducing new options for borrowers that are flexible, safe, and affordable.

Student debt levels are up 70 percent in the last decade. Forty-four million Americans have some amount of student debt and recent graduates are leaving school with an average of $34,000 in debt. Many borrowers say their student debt is a hurdle when financing a home. With mortgage rates still near record lows, we have developed a new way to convert student debt into lower-cost mortgage debt. We enhanced this product last month to provide more tools for lenders to serve new and first-time homebuyers and help people pay down student debt.

These are just three examples of how we are creating new ways to make business easier and more efficient for our customers and helping our customers better serve their customers – the millions of Americans who are looking for a better mortgage process and housing options that are affordable and sustainable. We look forward to taking more strides on this journey throughout the course of 2017 and beyond.

With that, let me reiterate that our business fundamentals are strong and our business strategy is delivering results for our customers and the housing finance market. I appreciate your time this morning and I'm happy to open this up for your questions.

Joe Light, Bloomberg:

Hi. Thanks for taking the question. So I just wanted to ask, I guess the same question that somebody asked Don on the Freddie call a few days ago, and that's given that your capital is now at $600 million, and going to zero in 2018 if everything stays the same, is there anything that you guys are doing differently, any risks you're not taking or products you're not offering or fees you're not lowering as a result of that? Thanks.

Tim Mayopoulos:

Thanks, Joe, for the question. No, we continue to serve the market. It's our mission to provide liquidity in all markets at all times and we're continuing to do that. I am glad to see that policy makers are starting to refocus on housing finance reform, including the issue of the lack of capital at Fannie Mae and Freddie Mac. But we continue to serve the market and we will continue to do that.

Joe Light:

Got it. So if you had capital of $20 billion versus the $600 million or zero that you'll have next year, you're saying the product line-up and the size of the credit box and the fees you're charging would be exactly as they are now?

Tim Mayopoulos:

I think that's generally correct. We wouldn't foresee any major changes if we had substantially more capital sitting at Fannie Mae then not. Of course, we have access to the preferred stock purchase agreement funds pursuant to our agreement with Treasury. And we continue to focus on serving the market and that's what we're doing.

Bonnie Sinnock, National Mortgage News:

Hi, good morning. I was wondering what is left to implement in Day 1 Certainty? It sounded like to me from past discussions that the four forms of possible rep and warrant relief have been rolled out?

Tim Mayopoulos:
They have been rolled out. Obviously different lenders have different timetables for adoption. And we've been working hard with lenders to try to make that adoption process as easy and smooth and quick as possible. So we've done what we need to do in terms of rolling out these services, but we are obviously working with lenders closely to make sure that they can adopt them as efficiently as possible.

Richard Leong, ThomsonReuters:
Hi. Good morning. I have a question just regarding about your general outlook on further trends in the mortgage market. How do you feel that the rate and trending of default and delinquency for both single-family and also your multifamily assets?

Tim Mayopoulos:
Thanks for the question. We feel good about overall credit trends in both the single-family and multifamily markets. As I noted in my remarks, our serious delinquency rates in the single-family business have declined for 28 straight quarters. We do not see any change in that overall trend, although I think it may moderate somewhat.

On the multifamily side, we continue to see strong performance there. Obviously we're monitoring that market carefully, but we continue to see very strong credit performance and delinquency rates remain quite low there. So we don't foresee any major changes in either of those trends.

Richard Leong:
Can I follow up with a question just on the multifamily side of things in terms of some of the newer securities that's been introduced?

Tim Mayopoulos:
Sure, go ahead.

Richard Leong:

There was a deal that was done I think a week or two ago that was with – I believe with Invitation Homes. And I was wondering if that is the first time that Fannie have done this sort of deal with a non-bank, non-mortgage lender entity per se? And on single-family rentals. I was wondering more – wanted to get your sense in terms of the thinking behind such a deal, and are we going to see many more of this type of deal with other companies like Invitation Homes in the next 12 to 18 months?

Tim Mayopoulos:

Okay, so thanks for that question. Let me give you a little context for the Invitation Homes transaction. First of all, obviously coming out of the housing crisis there's been an increased need for single-family rental housing. And while many people may not appreciate it, the fact is that single-family rental homes make up more than half of all the rental units in the United States. So typically when people think about rental properties, they think about apartment buildings. But more than half of all the rental units in the United States are actually single-family homes. Fannie Mae has long been in the single-family rental financing business. Our Single-Family business finances properties – investor properties – that can be rented out and are rented out from 1 to 4 units. So that's a business that we've been in for a very long time and so we have supported the single-family rental market for decades.

What you saw in the Invitation Homes transaction was an opportunity for us to work with a party that actually operates at large scale in the single-family rental market. And we saw this as a real opportunity to learn more about how to better support the overall single-family market. This market traditionally has been very fragmented, made up of mostly mom-and-pop investors. And here was an opportunity to work with a large and sophisticated investor in this space because we really want to learn more about how we could, you know – what the opportunities were to better support the market.

So, I won't speak as to whether we'll do additional transactions like this or not and how many; but we are interested in better understanding this market and we're interested in better serving this market overall since it does provide more than half of all the rental properties in the country.

And we see remarkable demand for this kind of rental property in the marketplace. While there's lots of talk about Millennials wanting to move to big cities and live in apartment buildings, the fact is that all of our research indicates that many renters want to rent single-family homes because they like the lifestyle, they like living in communities where they have access to yards and bigger houses. Very often they want access to the schools in those communities. So it's a big market, it's one that we – I don't think we have served as well as we might. And this is a real opportunity to explore that.

Lorraine Woellert, Politico:
Thank you. I have another market question. It's slightly off topic. Can you talk a little bit about, and you alluded to it just now, about the inventory problem that we keep hearing about that there, you know, we're not producing enough homes for sale. Are you all seeing this as a potential headwind down the road? What's your take on it?

Tim Mayopoulos:
There's certainly a challenge in the market in terms of lack of supply, especially for first-time homebuyers, kind of that entry-level part of the market. And that's a product of a number of things, including the many of the people who currently occupy those entry-level homes are not trading up as we've seen in previous times to a bigger, more expensive property. And so their homes are not available for sale to new first-time homebuyers.

Also, the rate of production of new single-family homes is still somewhat depressed. You know, our estimate is that it would take about 250,000 to 300,000 units a year more, more production, to be kind of at normal production rates. And for a variety of reasons, we're not at those levels.

I think land acquisition costs are high, labor costs are high, and builders are obviously conservative given the cycle they've just gone through over the last 10 years or so. So, you know, I think all those factors and maybe some others are contributing to this challenge. But what it's doing is that it's driving up prices of entry-level homes and it's making it difficult for first-time homebuyers to find housing that they can buy.

Lorraine Woellert:

And what does that mean, big picture, if we have this problem, what does it mean for the market writ large in the long term? Is it something that you guys are worried about?

Tim Mayopoulos:

You know, I don't know that it forecasts a major disruption in the market. I think over time these things will find their own equilibrium. As prices of homes go up it may be that some of those people who currently live in entry-level homes will say that they can now afford to sell their house and move into a different house because they now have regained a lot of equity in their home.

Obviously, I think current conditions are stimulating homebuilders to put their crews to work and build new homes. But I think it'll just take time for this market to find its equilibrium. But I don't know that it forebodes a major disruption in the market.

One of the things we're focused on is trying to figure out how to make financing more readily available to first-time homebuyers. So we have focused on our HomeReady product, which allows borrowers to borrow up to 97 percent of the loan-to-value of the home. That's been a successful program, and we've been pleased with the results there. Also, as I alluded to earlier, we've been focused on making some adjustments to our underwriting standards with respect to student debt in order to make sure that people who have student debt can get access to home mortgages.

So, we're trying to do what we can at our end of the market to try to address some of these issues, but coming up with more supply is not something that we control.