

FNMA PREFERRED SHARES "S" SERIES

Dec 2013



+ Event-driven investment opportunity
in Fannie Mae “S” preferred shares
with an asymmetric payoff profile



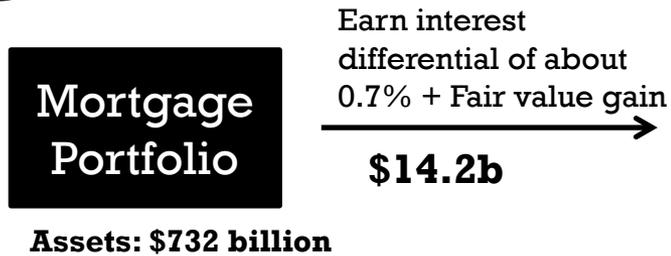
Background: FNMA founded in 1938



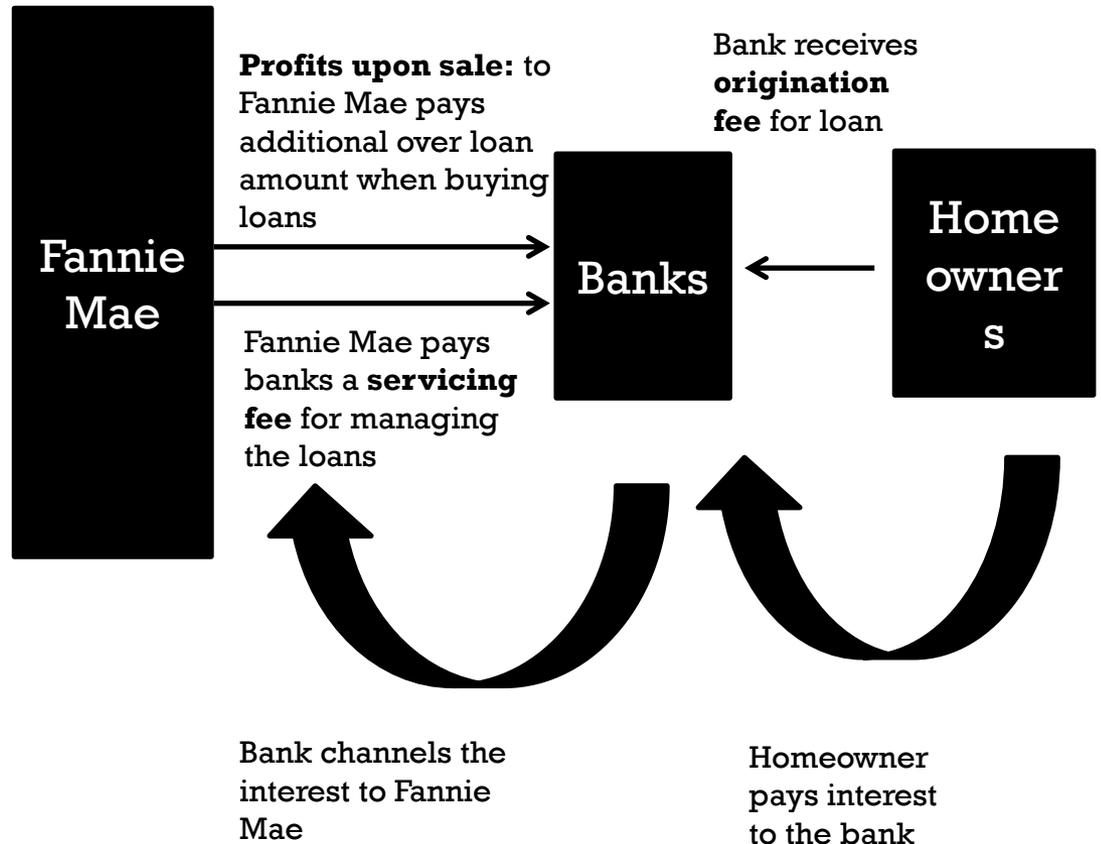
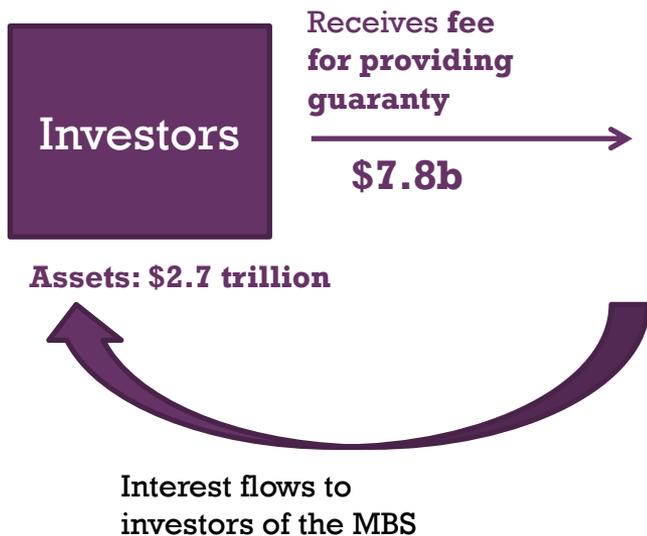
- Federal National Mortgage Association (FNMA), commonly known as “Fannie Mae”, founded in 1938
- Government-sponsored enterprise (GSE)
 - Publicly traded company since 1968
- Purpose is to expand the secondary mortgage market
 - To do so, Fannie Mae purchases mortgages from banks
 - Small portion of mortgages retained under Fannie Mae’s investment portfolio
 - The rest are packaged into “Agency MBS” that are sold to Investors
- This provides banks fresh money to make new loans
 - Gives the housing and credit markets flexibility and liquidity

+ 2 main sources of income

1 Retain loan for investment



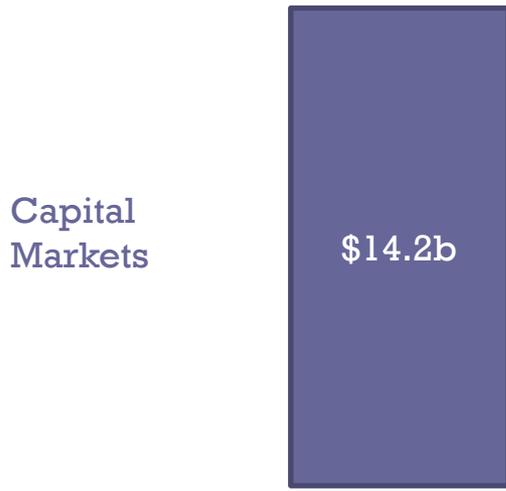
2 Package loans into MBS



+ Annual earnings expected to remain strong over next few years

Year end Dec 31, 2012

Segments Net Income



1

Guaranty Fees from Single family and Multi family business segment

- Expect to increase due to better quality loans and increase in guaranty fees from 27.9bp to 53.1bp
- Expected to be the **primary source** of revenue in the future

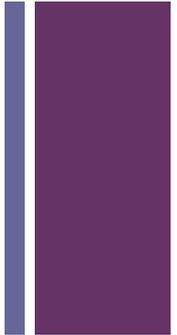
2

Net interest income from Capital Markets

- Derived from difference between interest earned on mortgage investments and interest on debt
- Expected to **decrease** as mortgage investments reduce (*due to conservatorship agreement*)



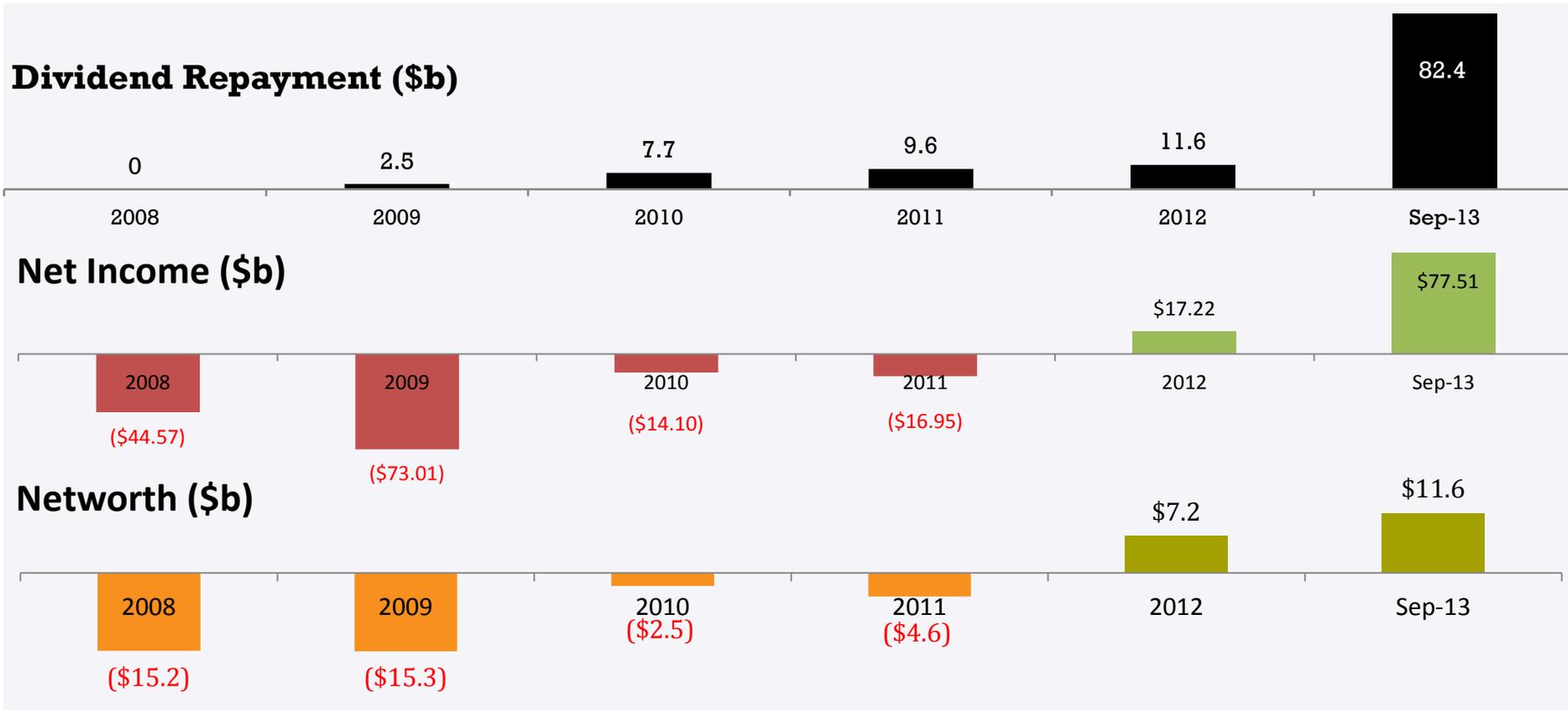
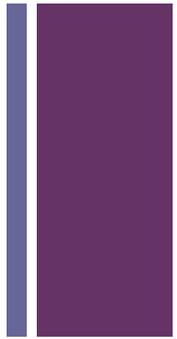
Under conservatorship of US treasury since 2008



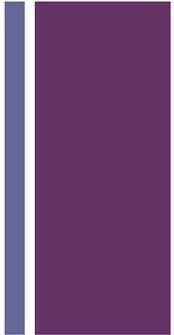
- Under conservatorship of Federal Housing Finance Agency (FHFA)
 - Powers of directors, officers, and shareholders transferred to FHFA
- US Treasury promised up to \$200b in exchange for 10% senior preferred shares to fund any deficits
 - Also get warrants to purchase up to 80% of common stock
 - In total, \$117b capital was injected
- 10% dividends was replaced by a “full income sweep” in 2013
 - Quarterly sweep of every dollar of profit earned from Jan 2013 onwards
 - No profits distributed to other shareholders

+ Reported annual profits of \$17.2b in 2012, first time since 2008

- Enabled Fannie Mae to make dividend repayments of \$114b to US treasury (almost equivalent to the amount injected of \$117.6b)
- However, sweep amendment still in effect. Uncertain whether US treasury would allow distribution of profits to other shareholders



+ US Housing Market shows some signs of recovery



	<u>2012</u>	<u>2011</u>	<u>2010</u>
Home sales (units in thousands)	5,027	4,566	4,513
New home sales	367	306	323
Existing home sales	4,660	4,260	4,190
Home price change based on Fannie Mae Home Price Index ("HPI") ⁽²⁾	4.7%	(3.7)%	(4.4)%
Annual average fixed-rate mortgage interest rate ⁽³⁾	3.7%	4.5 %	4.7 %
Single-family mortgage originations (in billions)	\$ 1,925	\$ 1,498	\$ 1,679
Type of single-family mortgage origination:			
Refinance share	72%	66 %	68 %
Adjustable-rate mortgage share	5%	6 %	5 %
Total U.S. residential mortgage debt outstanding (in billions) ..	\$10,790	\$11,008	\$11,259

Source: Fannie Mae

+ Why series “S” preferred shares?

- Most liquid preference shares
 - Largest preference share issuance of \$7b
 - Comparatively, the rest of the preference shares issuance ranges from \$150m to \$2.5b
- Second highest dividend rate
 - Fixed to floating rate: 7.75% or 3m LIBOR+4.32%, whichever is higher
- Trading at \$7.9 per share (as at 6 Dec 2355H)
 - Stated value of \$25 per share
 - Effective dividend rate of about 24%





Key question is whether the US Treasury will allow profits to be distributed

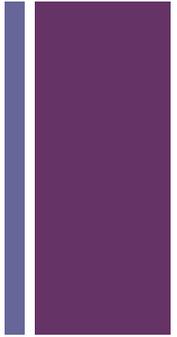


- If US treasury allows distribution of profits:
 - Pref shares likely to increase in value (max increase to par (\$25) from current price \$7.9)
 - 24% effective dividends
- With return to profitability, more and more pressure for US Govt to distribute profits
 - Especially when Fannie Mae has more than fully paid back the amount injected (likely to be in Q12014)
- Already, some large preferred shareholders (Fairholme Fund and Perry Capital) are suing US Govt over sweep amendment
 - If successful, sweep amendment could be overturned and profits distributed



Downside risks depends on the larger discussion on how to restructure the GSEs

- General intent of US Treasury to reduce the role of public capital in housing market
- However, no consensus in Senate or Congress on how to restructure the GSEs
 - Discussions are still preliminary
 - No firm solutions on how to replace Fannie Mae's role yet
- Overall, would take some time before new role of GSEs in housing market is decided
 - Not likely to decide before Congressional elections in Nov 2014
 - Debate on restructuring would likely continue for some time beyond that
 - Even if GSEs are restructured, not certain that US Govt would do so in a way that wipes out shareholder value (Fannie Mae has already returned to positive networth)





CONCLUSION

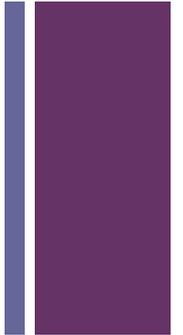


- Fannie Mae will continue to generate profits as US housing market recovers
- Debate on role of GSEs would likely continue for some time
- Meanwhile, pressure to distribute profits will increase
- Event driven investment opportunity with an asymmetric payoff profile
 - If profits are distributed: 23.5% effective dividends + capital gain
 - If decide to wind down: risk losing entire investment (but depends on how GSEs are restructured)



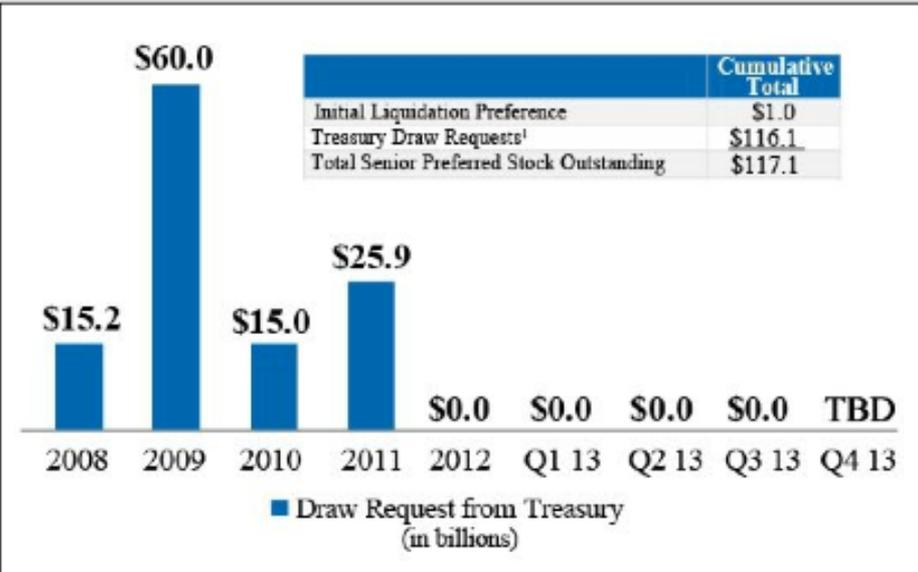
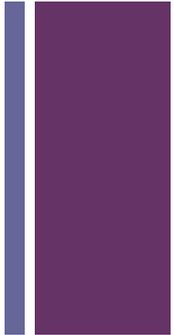
Thank you

+ Industry

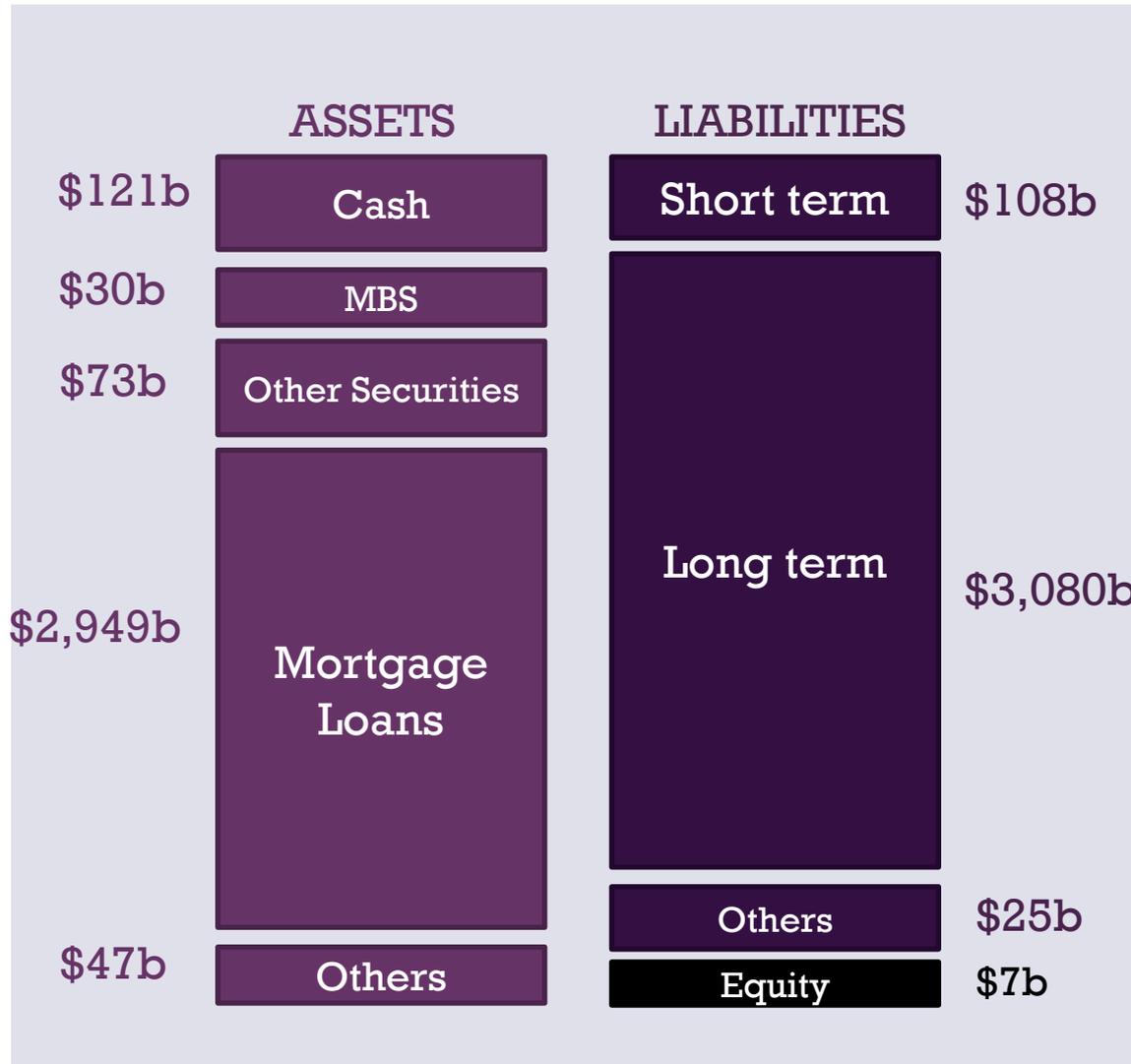


- Ginnie Mae and Fannie Mae began as one organization more than 70 years ago, known as the Federal National Mortgage Association (FNMA).
- In 1968, Congress partitioned FNMA into two entities: Fannie Mae and Ginnie Mae.
- Fannie Mae was charged with supporting the conventional mortgage market and Ginnie Mae was charged with supporting the market for FHA, VA, RD, and PIH loans.
- Freddie Mac was later created in 1970 and also supports the conventional mortgage market.
- Only Ginnie Mae securities are explicitly backed by the full faith and credit of the U.S. Government. Ginnie Mae, Fannie Mae, and Freddie Mac guarantee mortgage-backed securities (MBS) for timely payment of principal and interest.

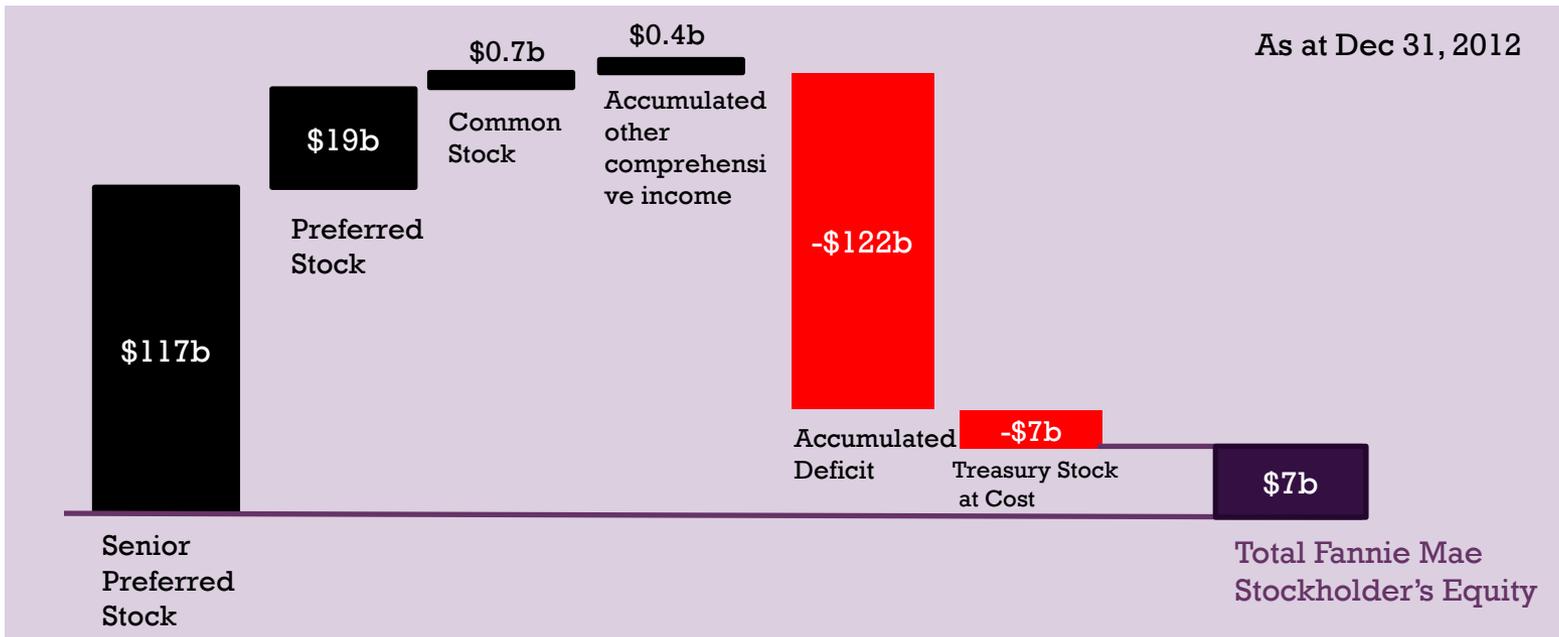
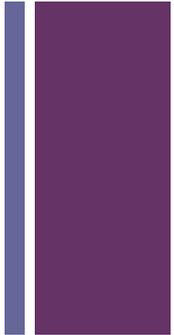
+ Treasury Draws and Dividends



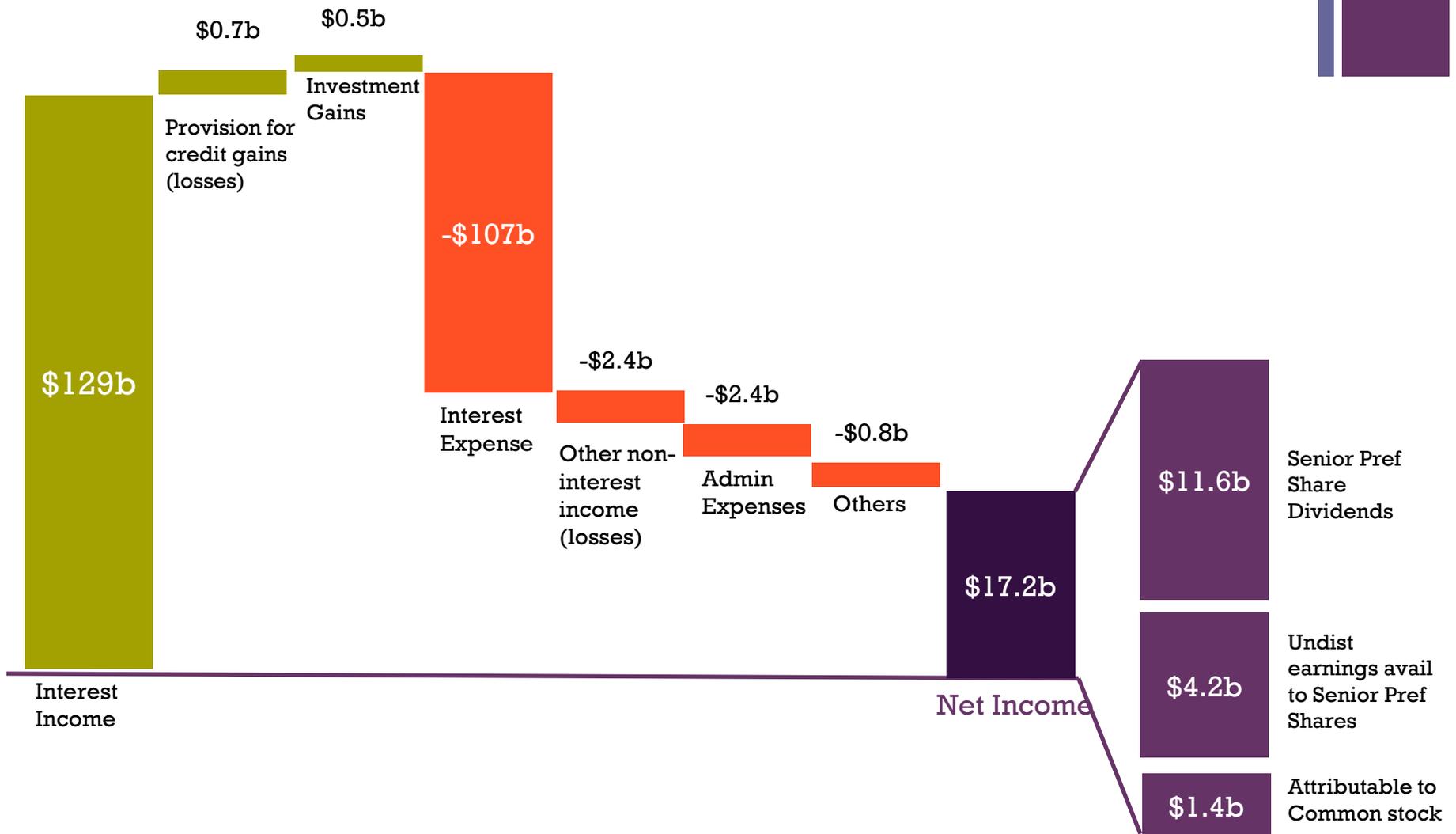
+ Balance Sheet Structure (as at Dec 31, 2012)



+ Stockholder's Equity

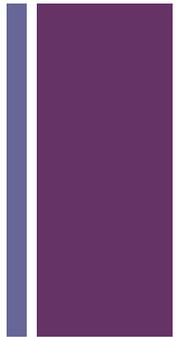


+ Breakdown of Net Income





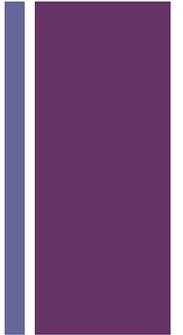
FANNIE MAE VS GINNIE MAE / FREDDIE MAC



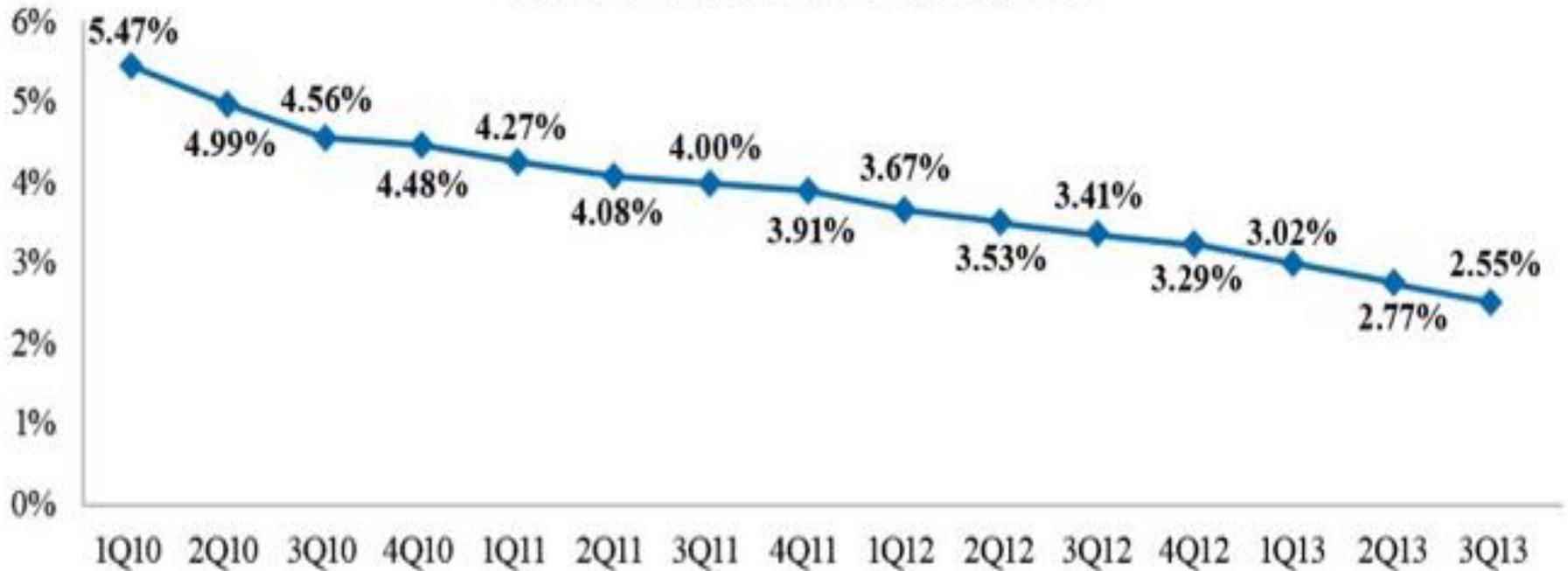
GINNIE MAE	FANNIE MAE AND FREDDIE MAC
» Wholly-Owned Government Corporation	» Shareholder-Owned,* Publicly Traded
» Explicit Guarantee to Investors	» Implicit Guarantee to Lenders and Investors
» Government-Insured Loans (FHA, VA, PIH and RD)	» Conventional Loans
» MBS Only	» MBS and Whole Loan Portfolio
» Issuer/Servicer Risk	» Borrower Credit Risk, Interest Rate Risk and Servicer Risk

Source: Ginnie Mae [Website](#)

+ Credit Quality of underlying loans is improving



Single-Family Serious Delinquency Rate



+ Current Price

Federal National Mortgage Association (FNMAS) - OTC BB ★ Follow

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7.95 ↑0.11 (1.40%) 3:50PM EST

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Week of Feb 11, 2013: ■ FNMAS 1.80



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■ Volume: 2,788,880

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Preferred Stock Issuances

Title	Issue Date	2012		2011		Stated Value per Share	Annual Dividend Rate as of December 31, 2012	Redeemable on or After
		Shares	Amount	Shares	Amount			
(Dollars and shares in millions, except per share amounts)								
Senior Preferred Stock								
Series 2008-2	September 8, 2008	1	\$ 117,149	1	\$ 112,578	\$ 117,149 ⁽¹⁾	10.000 % ⁽²⁾	N/A ⁽³⁾
Total		<u>1</u>	<u>\$ 117,149</u>	<u>1</u>	<u>\$ 112,578</u>			
Preferred Stock								
Series D	September 30, 1998	3	\$ 150	3	\$ 150	\$ 50	5.250 %	September 30, 1999
Series E	April 15, 1999	3	150	3	150	50	5.100	April 15, 2004
Series F	March 20, 2000	14	690	14	690	50	0.230 ⁽⁴⁾	March 31, 2002 ⁽⁵⁾
Series G	August 8, 2000	6	288	6	288	50	0.080 ⁽⁶⁾	September 30, 2002 ⁽⁵⁾
Series H	April 6, 2001	8	400	8	400	50	5.810	April 6, 2006
Series I	October 28, 2002	6	300	6	300	50	5.375	October 28, 2007
Series L	April 29, 2003	7	345	7	345	50	5.125	April 29, 2008
Series M	June 10, 2003	9	460	9	460	50	4.750	June 10, 2008
Series N	September 25, 2003	5	225	5	225	50	5.500	September 25, 2008
Series O	December 30, 2004	50	2,500	50	2,500	50	7.000 ⁽⁷⁾	December 31, 2007
Convertible Series 2004-I ⁽⁸⁾	December 30, 2004	—	2,492	—	2,492	100,000	5.375	January 5, 2008
Series P	September 28, 2007	40	1,000	40	1,000	25	4.500 ⁽⁹⁾	September 30, 2012
Series Q	October 4, 2007	15	375	15	375	25	6.750	September 30, 2010
Series R ⁽¹⁰⁾	November 21, 2007	21	530	21	530	25	7.625	November 21, 2012
Series S	December 11, 2007	280	7,000	280	7,000	25	7.750 ⁽¹¹⁾	December 31, 2010 ⁽¹²⁾
Series T ⁽¹³⁾	May 19, 2008	89	2,225	89	2,225	25	8.250	May 20, 2013
Total		<u>556</u>	<u>\$ 19,130</u>	<u>556</u>	<u>\$ 19,130</u>			

