

REPORT ON FANNIEMAE (FNMA) AND FREDDIEMAC (FHLMC)



Mortgage Market Stress – December 2007

Summary:

The second half of 2007 has seen a lot of stress in the credit markets, and particularly in the mortgage markets. FNMA and FHLMC make up more than 70% of the mortgage market. Recently both announced asset write-downs due to increased defaults and overall price declines in their mortgage portfolios. In an effort to inform our clients of the current situation and our analysis, we present this review of currently available information on the situation.

FNMA Analysis

Senior Credit Ratings

Moody's	Aaa
S&P	AAA
Fitch	AAA

On November 9, 2007, FNMA reported \$1.5 billion in net income for the first three quarters of 2007, down from \$3.5 billion for the first three quarters of 2006. The decrease in net income is due mainly to an increase in defaults, delinquencies and other credit-related expenses of \$2 billion.

FNMA is now current with all regulatory filings with the SEC, a requirement set forth in their formal agreement with their regulator the Office of Federal Housing Enterprise Oversight (OFHEO) in 2004.

FNMA's minimum core capital exceeded the minimum capital requirement mandated by OFHEO by \$2.3 billion.

On November 21, 2007, FNMA raised \$500 million in new capital in a preferred stock offering to increase working capital and for general corporate purposes.

On December 4, 2007, FNMA announced a reduction in their stock dividend to 35 cents per quarter from 50 cents and will sell \$7 billion of preferred stock to help "maintain a solid capital position." These actions should help maintain the high credit quality of FNMA.

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FHLMC Analysis

Senior Credit Ratings

Moody's	Aaa
S&P	AAA
Fitch	AAA

On November 20, 2007, FHLMC reported a net loss of \$2.0 billion in the third quarter. The company also reported a decrease in the fair value of net assets of approximately \$8.1 billion. The company's reported declines in both net income and fair value primarily due to increased defaults, delinquencies and other credit-related expenses.

Unlike FNMA, FHLMC is not current with its SEC regulatory filings. The company has stated that it is committed to timely quarterly earnings filings with the SEC and expects to be current in early 2008. This was a requirement set forth in the formal agreement with OFHEO in 2004.

FHLMC's minimum core capital exceeded to requirement in the third quarter by \$600 million mandated by OFHEO.

On November 29, 2007, FHLMC raised \$6 billion in new capital in a preferred stock offering to bolster capital and help meet their minimum capital requirements in light of the losses suffered in their investment portfolio.

Conclusion:

It is inevitable that FNMA and FHLMC will periodically receive critical review from analysts regarding their creditworthiness. Nonetheless, we believe they currently have adequate capital and liquidity to meet their debt obligations. Over the past three years both FNMA and FHLMC have increased capital by 30% to meet new regulatory requirements mandated by OFHEO in 2004. We will continue to monitor the housing agencies and provide you with our analysis periodically.

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