

FTA Revenue Estimating and Tax Research Conference

Economic Update

By Doug Duncan
Vice President and Chief Economist

Fannie Mae

October 17, 2011

Disclaimer

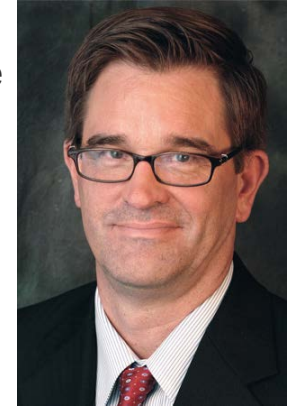
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Speaker Biography

Douglas G. Duncan is Fannie Mae's Vice President and Chief Economist. He is responsible for managing Fannie Mae's Strategy Division and Economics & Mortgage Market Analysis Groups. In this leadership role, Duncan provides all economic, housing, and mortgage market forecasts and analyses, and serves as the company's thought leader and spokesperson on economic and mortgage market issues.

Prior to joining Fannie Mae, Doug was Senior Vice President and Chief Economist at the Mortgage Bankers Association. His experience also includes service as a LEGIS Fellow and staff member with the Committee on Banking, Finance, and Urban Affairs for Congressman Bill McCollum in the U.S. House of Representatives, and work on the Financial Institutions Project at the U.S. Department of Agriculture. He has been elected to the Board of Directors for the National Association of Business Economists, is a member of the American Economics Association and the American Real Estate and Urban Economics Association, and is past president of the Housing Statistics Users Group.

Named one of the country's top four most accurate economists in 2010 by the *Wall Street Journal* and named one of Bloomberg / BusinessWeek's 50 Most Powerful People in Real Estate, Doug is a frequent speaker on national and state economic, housing, and mortgage market conditions. Duncan received his Ph. D. in Agricultural Economics from Texas A&M University and his B.S. and M.S. in Agricultural Economics from North Dakota State University.



Agenda

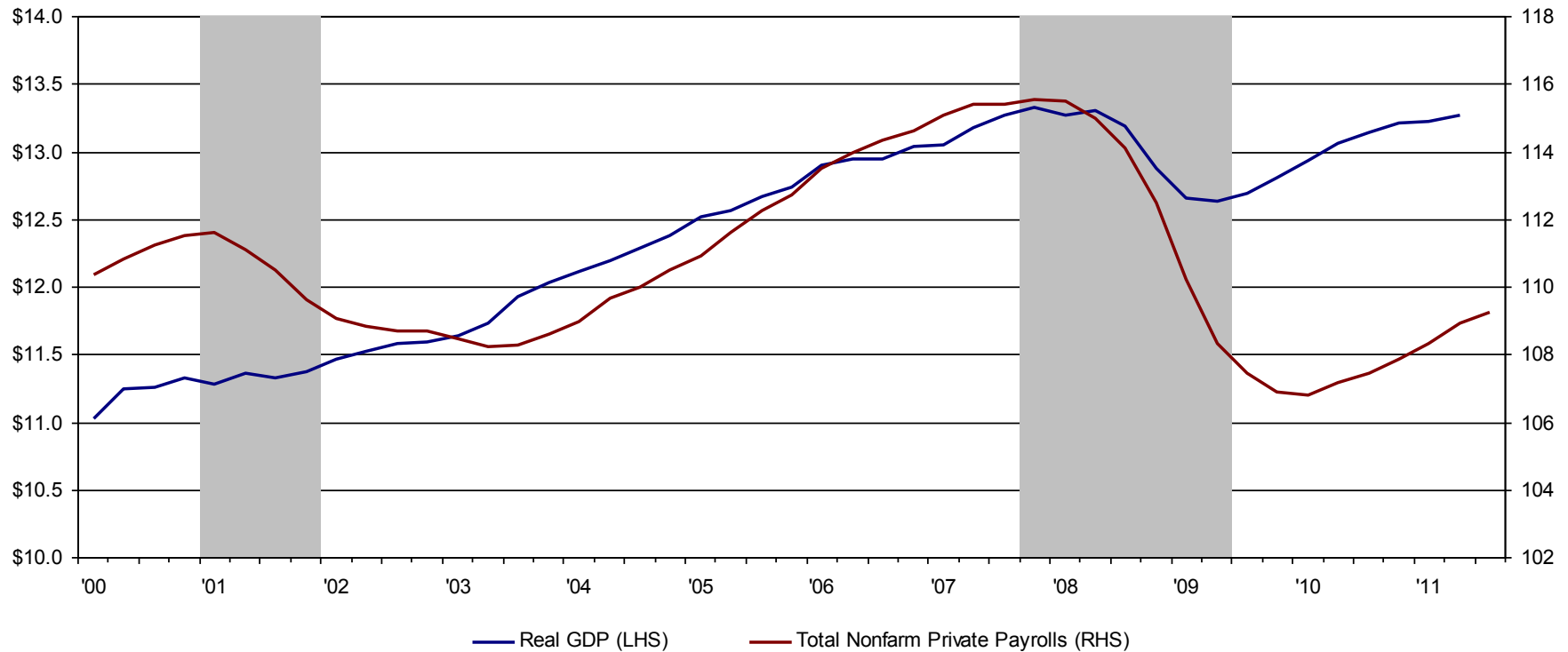
- The Macro Economy
- Consumer Attitudes
- Household Financial Condition
- The State of Housing
- Commercial Real Estate
- The Banking Sector and Real Estate Finance
- Some Historical Perspective
- Policy

The Macro Economy: Slowing Growth and Employment Struggles

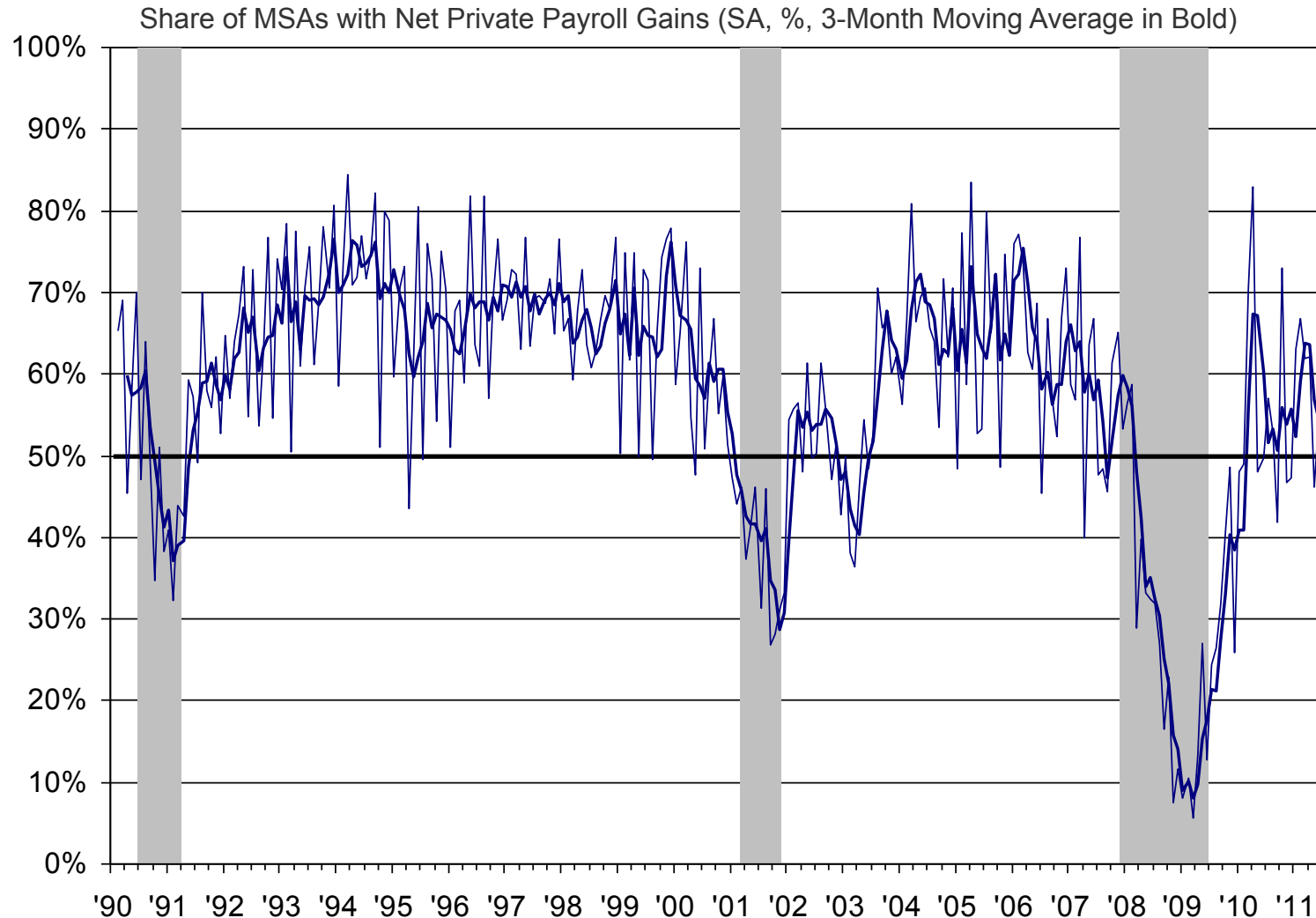
Employment activity is not matching economic activity.

SAAR, \$ trillions

SA, millions

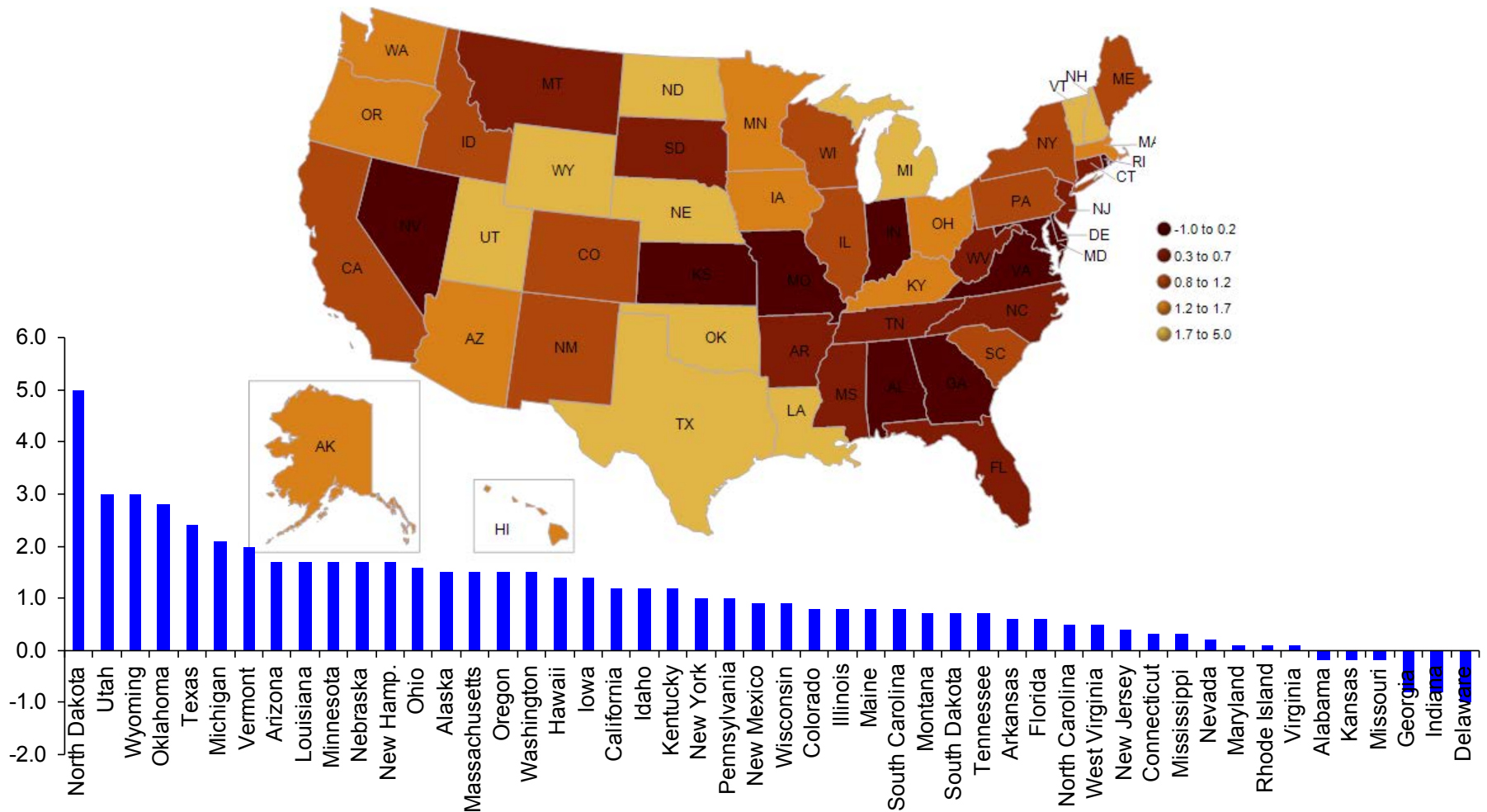


Metropolitan job losses were widespread during the recent recession.

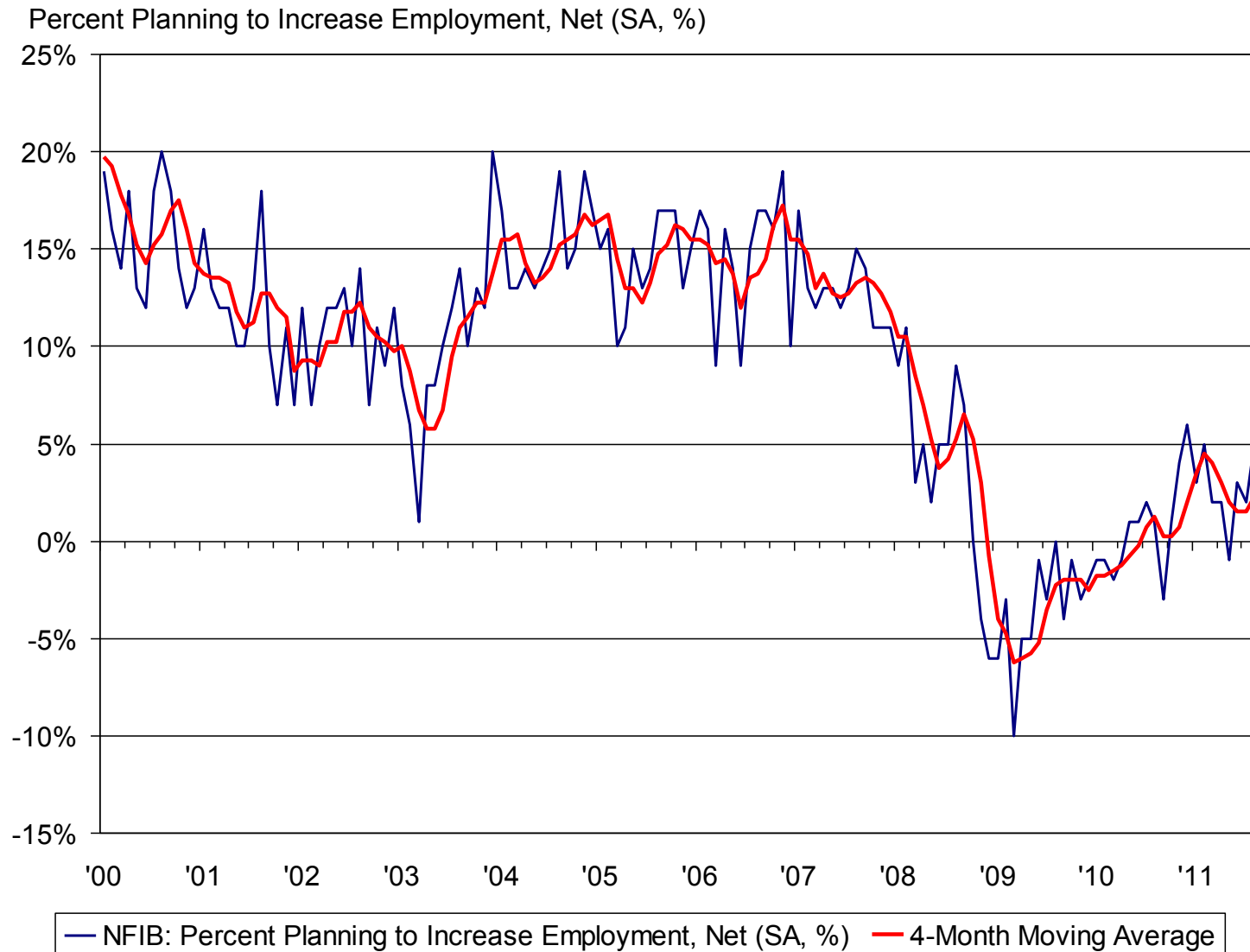


Employment recovery varies by region.

Year-over-Year Employment Growth (Total Nonfarm Employment, % Change)

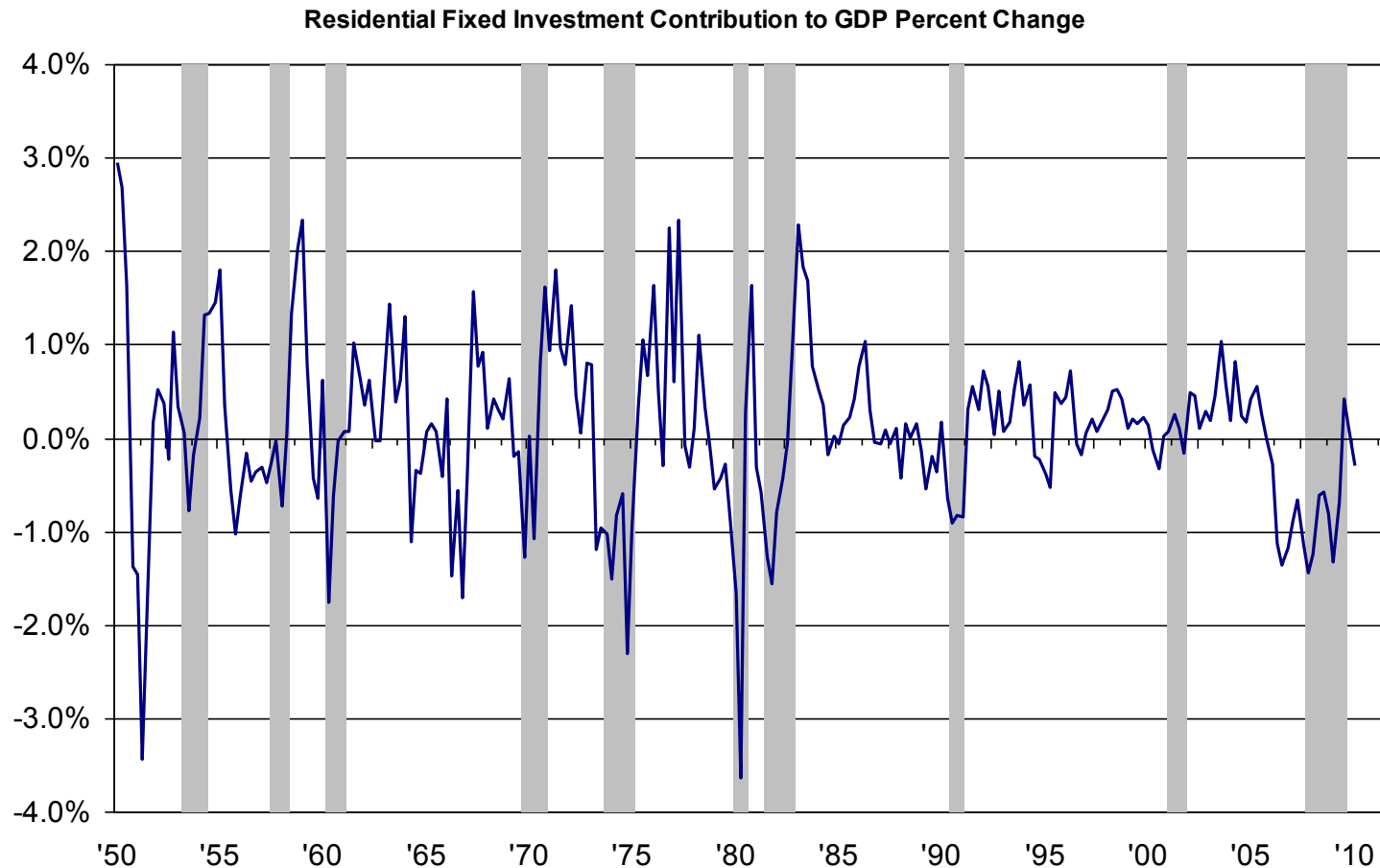


Small firms remain reluctant to hire.



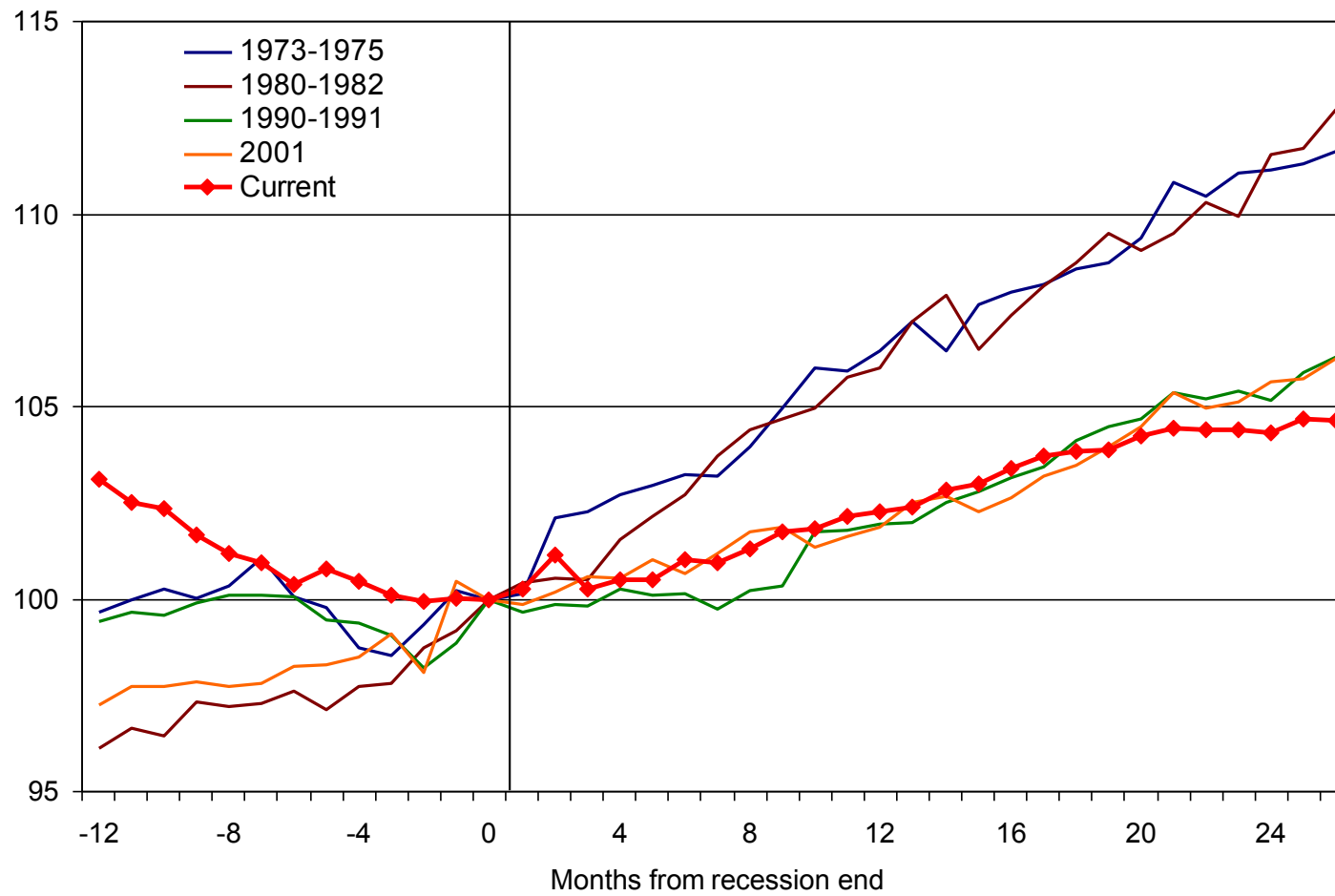
Importance of residential investment to the economy declines to record lows.

Residential Fixed Investment as a Share of GDP



Consumer income trend lags previous economic recoveries.

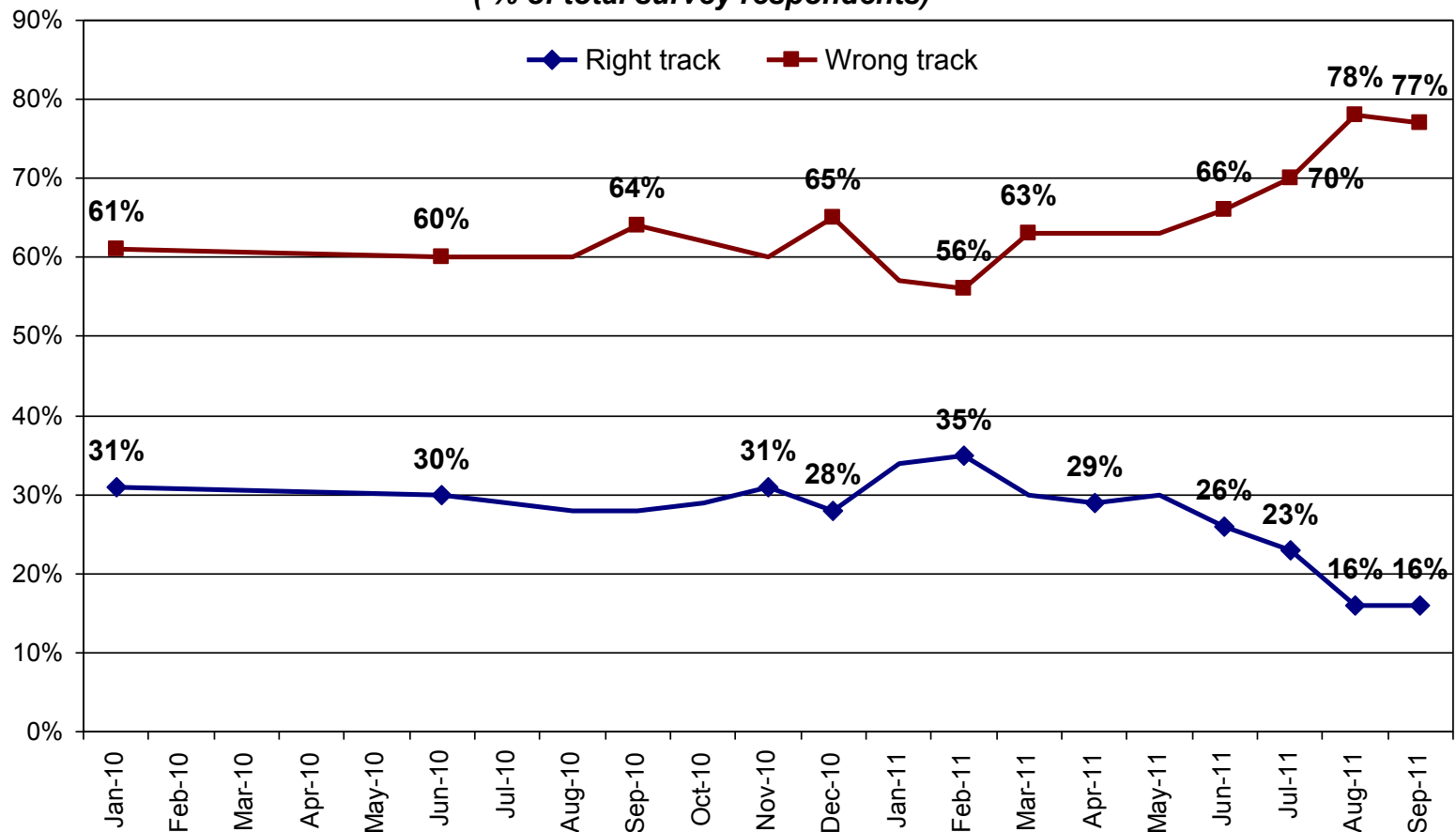
Real disposable personal income; levels are rebased and set equal to 100 at the end of the recession



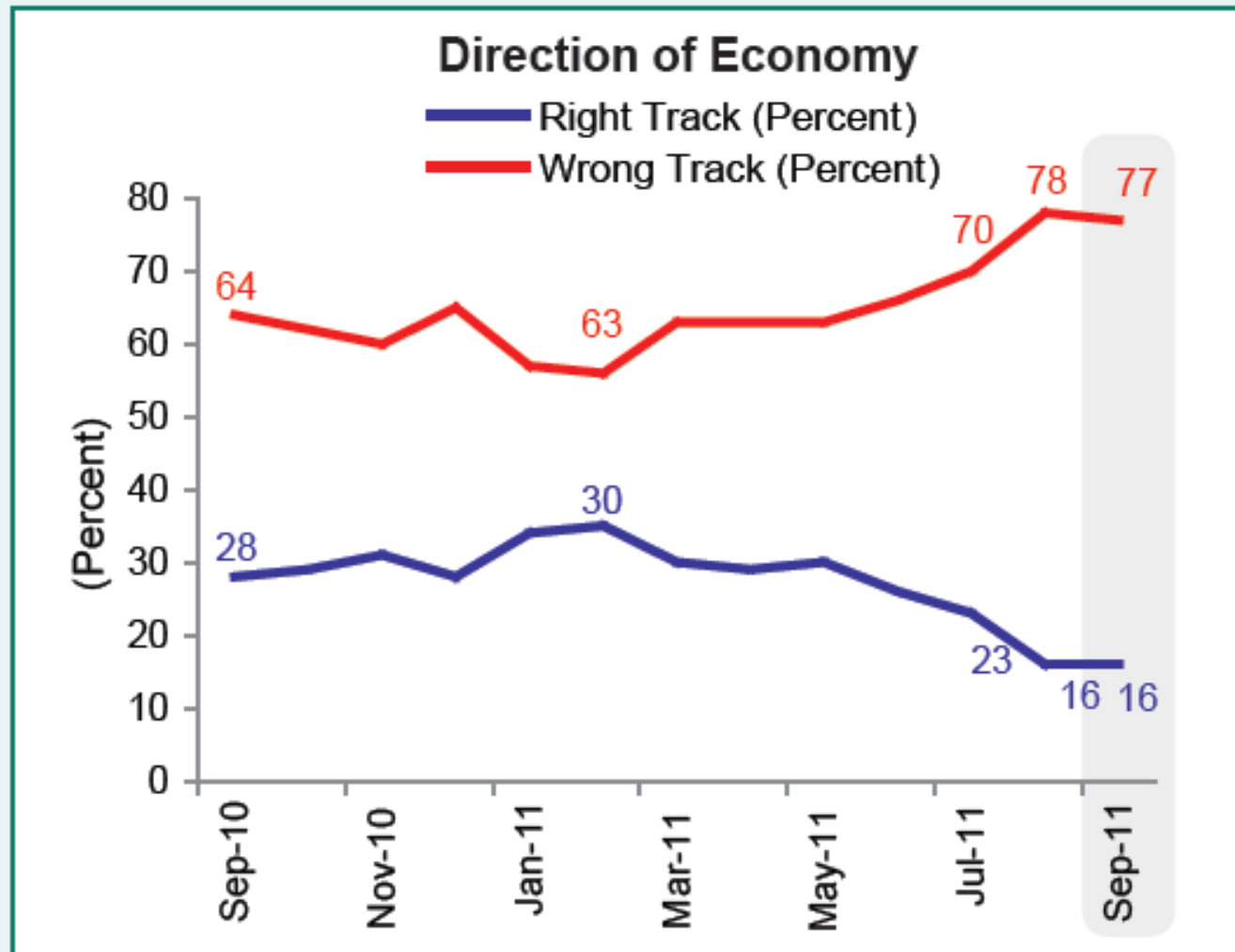
**Consumer Attitudes:
Why Do You Think This is a Good Time To
Borrow \$200K to Buy a House?**

Consumers are growing more pessimistic about the economy.

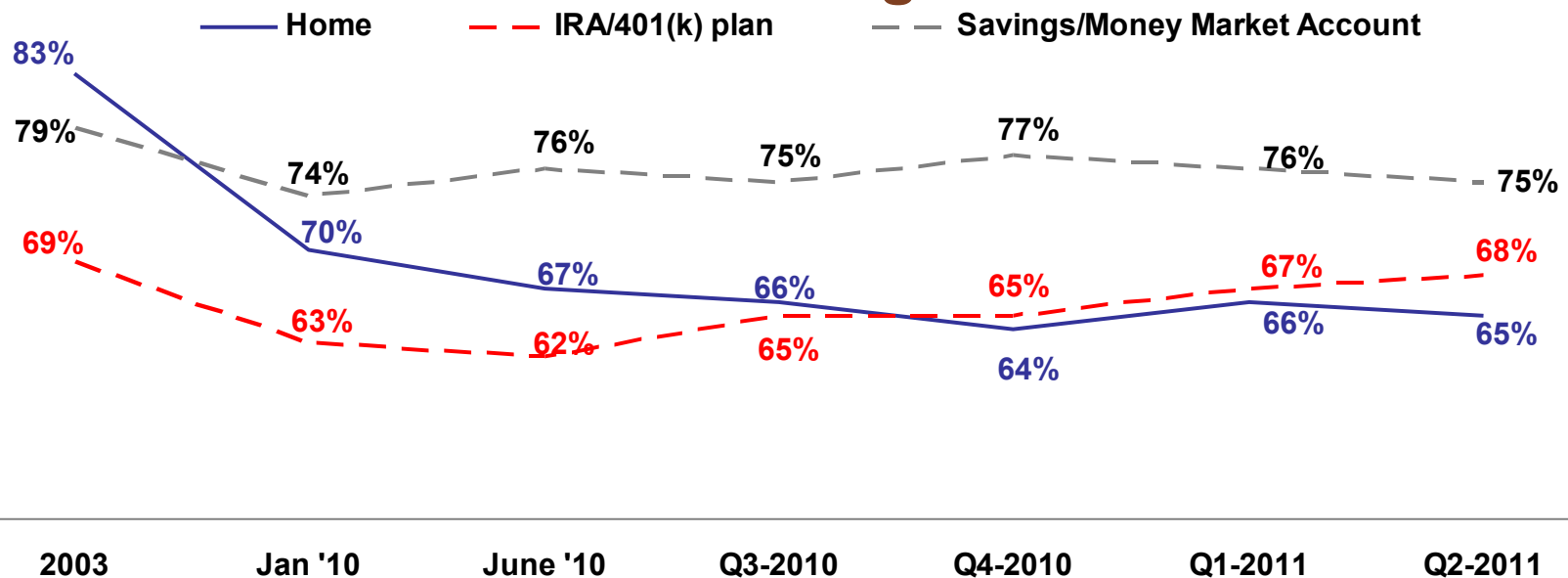
*In general, do you think our economy is on the right track or is it off on the wrong track?
(% of total survey respondents)*



77% say the economy is off on the wrong track (down by 1 percentage point since August), while just 16% think the economy is on the right track (the same as in August).



Decline in perception of safety of homeownership may be ending.



Do you think this investment is...	GP %						
	Q2-2011	Q1-2011	Q4-2010	Q3-2010	June '10	Jan '10	2003
Putting money into a savings or money market account	75	76	77	75	76	74	79
Putting money into an IRA or 401(k) plan	68	67	65	65	62	63	69
Buying a home	65	66	64	66	67	70	83
Buying an insurance annuity	51	48	49	47	48	50	-
Investing in a mutual fund	47	48	47	45	45	46	53
Buying government or corporate bonds	48	47	49	46	48	50	-
Buying stocks	15	16	17	16	15	17	25

Borrowers still value choice and personal responsibility.

Which is closer to your view regarding different types of home mortgage choices?

Having lots of choices means people can find just the one that suits their needs

More choices just raises the likelihood that people will be too overwhelmed to find a plan that meets their needs

Wave (% Can find the right one/ too overwhelming)	GP %	Mortgage %	Underwater %	Owner %	Renter %
Q2-2011	62/33	63/34	64/34	59/33	64/31
Q1-2011	62/34	62/35	65/32	59/33	63/33
Q4-2010	61/33	64/32	63/34	55/34	62/34
Q3-2010	63/31	63/32	62/35	61/31	66/29
June '10	61/33	59/36	63/35	59/32	63/30
January '10	64/29	65/30	64/31	62/25	64/29

When people get home loans that are more than they can afford, whose fault do you think it is:

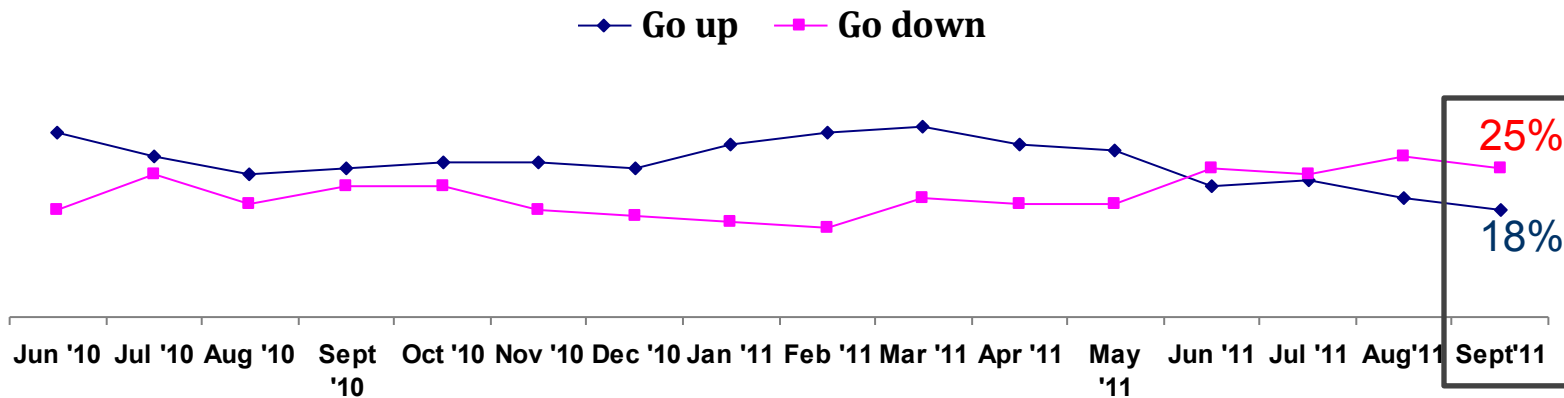
The person taking out the mortgage, because it's their own responsibility to know if they can pay their bills or not

The mortgage company, because they know better what people can afford and should help guide people

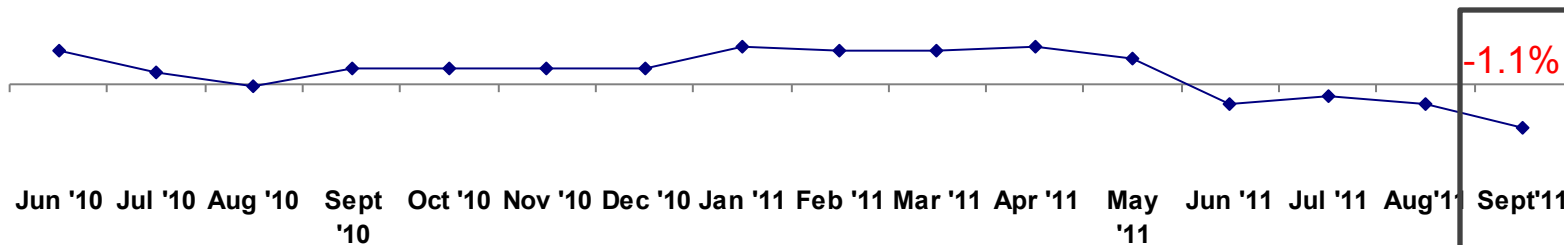
Wave (% the person/ the mortgage company)	GP %	Mortgage %	Underwater %	Owner %	Renter %
Q2-2011	57/35	54/37	50/43	54/36	59/33
Q1-2011	56/35	54/37	50/43	54/36	59/33
Q4-2010	55/38	56/35	58/35	50/43	56/39
Q3-2010	55/36	56/34	56/35	53/36	54/38
June '10	56/35	57/33	60/31	54/37	56/36
January '10	53/39	54/37	51/39	50/42	55/39

House Prices: Consumers more cautious now than 6 months ago.

During the next 12 months, do you think home prices in general will go up, go down, or stay the same as where they are now? Showing % General Population

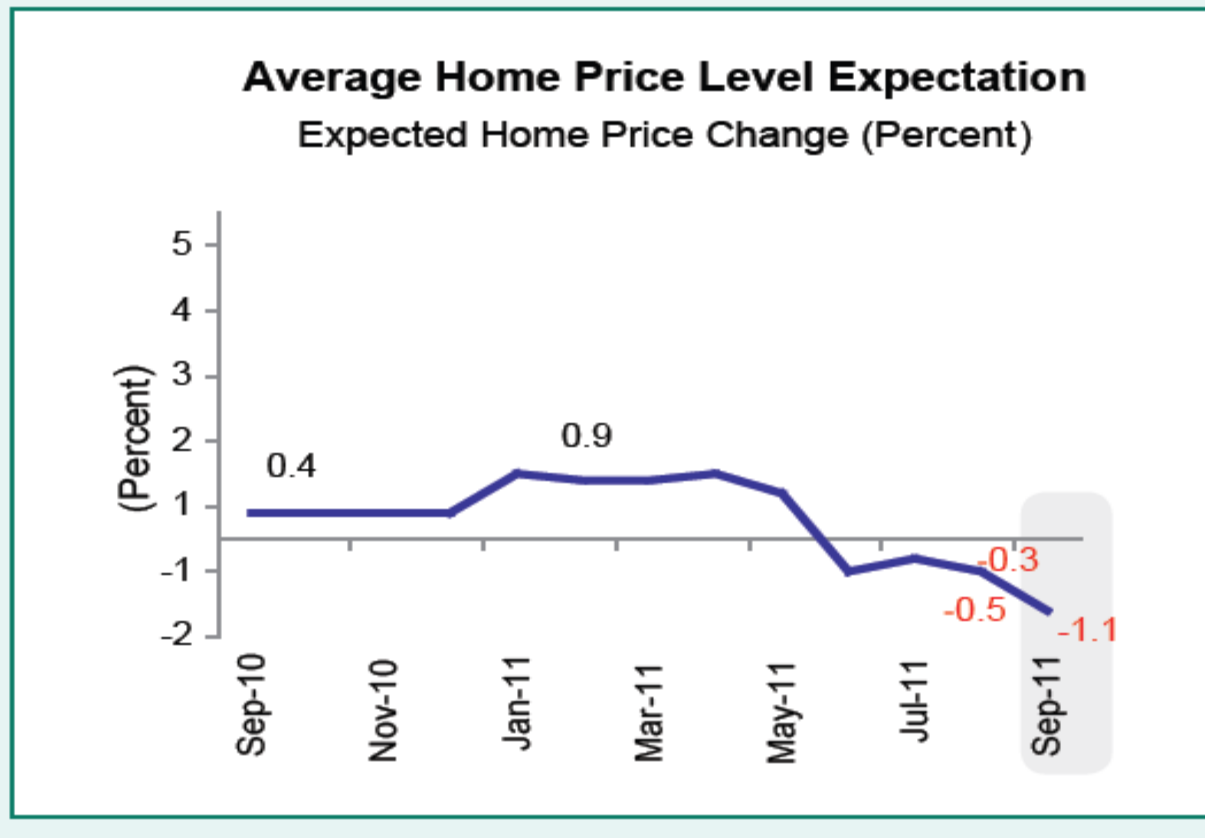


- Respondents who said house prices would go up or go down were asked to estimate by what percent.



Expectations: Pessimism Persists

For the fourth month in a row, Americans expect home prices to decline over the next 12 months. On average, respondents expect home prices to decline by 1.1%, the highest expected decline to date.

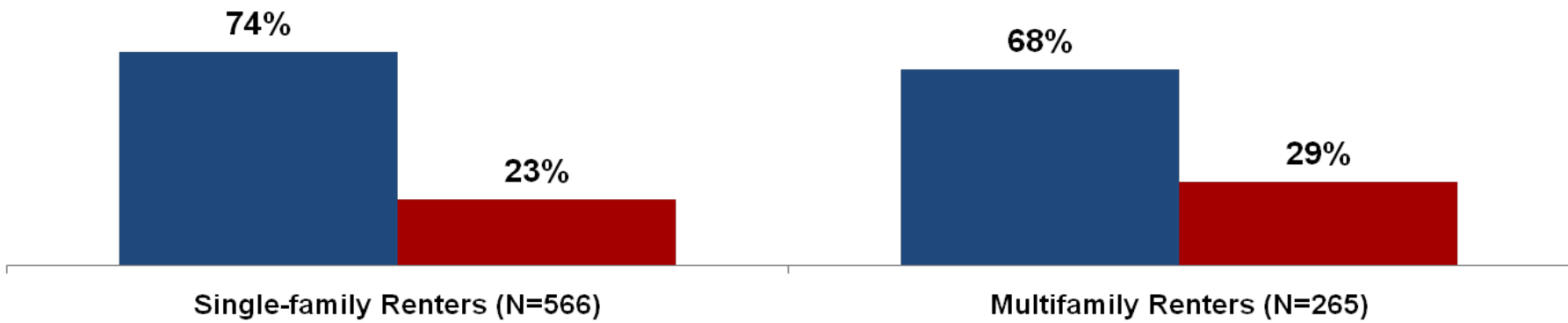


Though 3 in 4 Single-family home renters say owning makes more sense than renting, most say they would rent their next home...

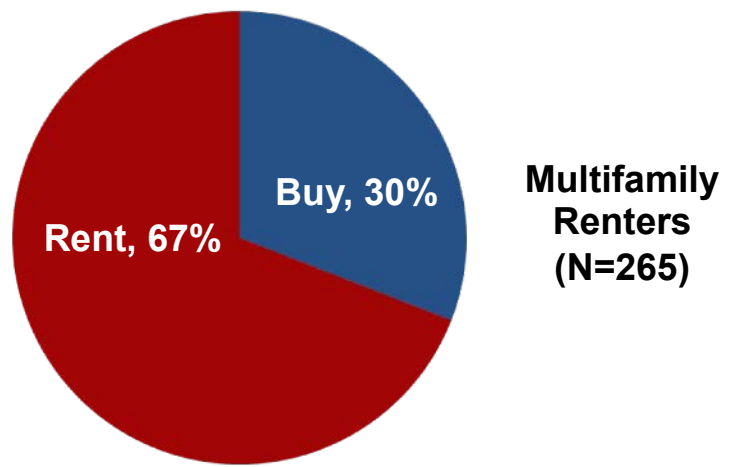
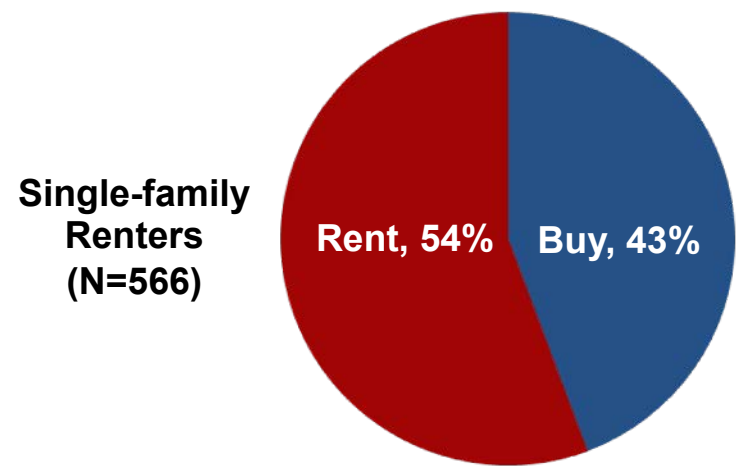
Which is closer to your view?

Owning makes more sense because you're protected against rent increases and owning is a good investment over the long term

Renting makes more sense because it protects you against house price declines and is actually a better deal than owning



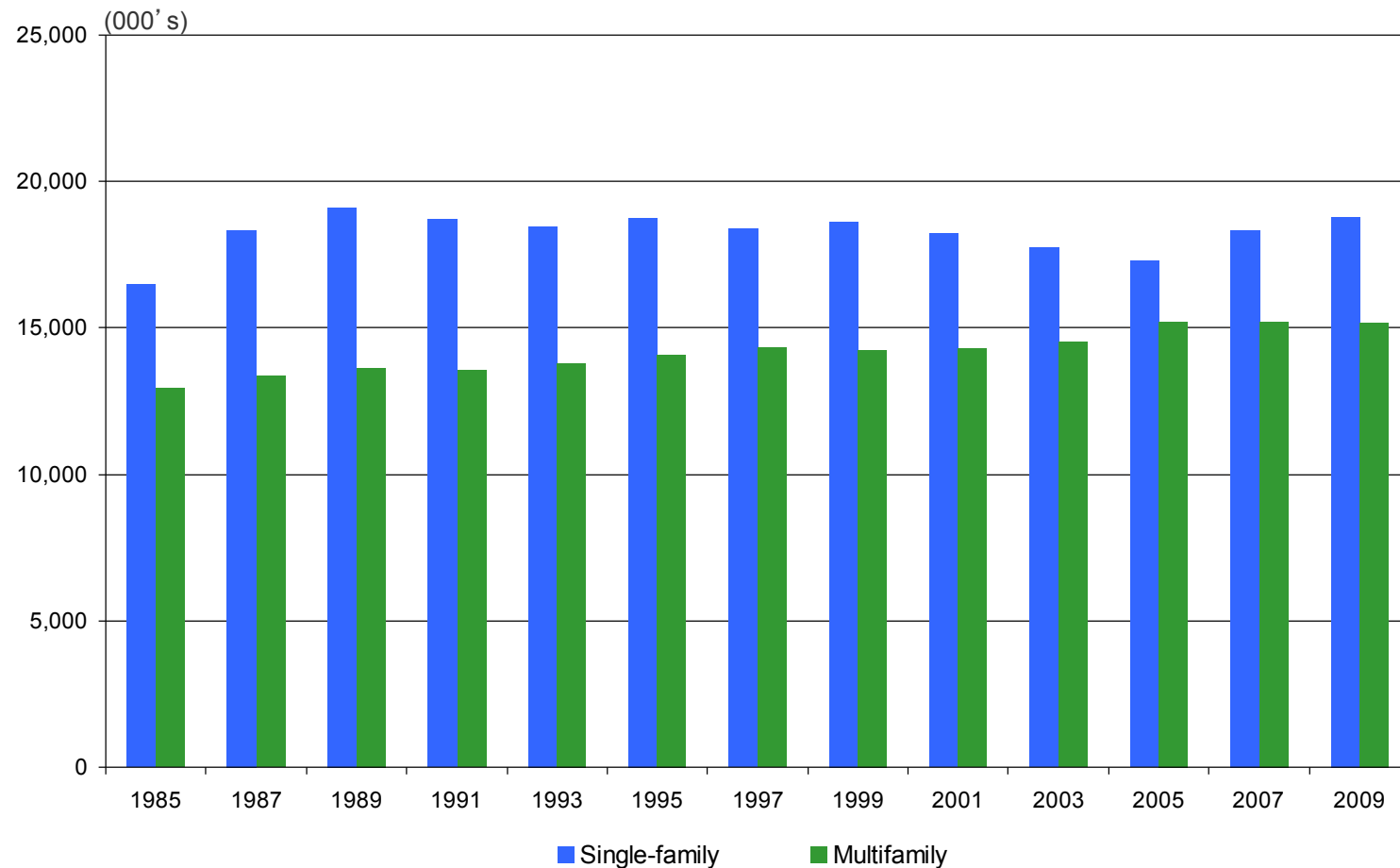
If you were going to move, would you be more likely to:



Please note that Single-family Renters are defined as those renters who live in a building with 1-4 units and Multifamily Renters are defined as those renters who live in a building with 5 and more units.

...and as a result, we are seeing more single-family homes moving back into rental stock.

Renter-occupied Housing Units

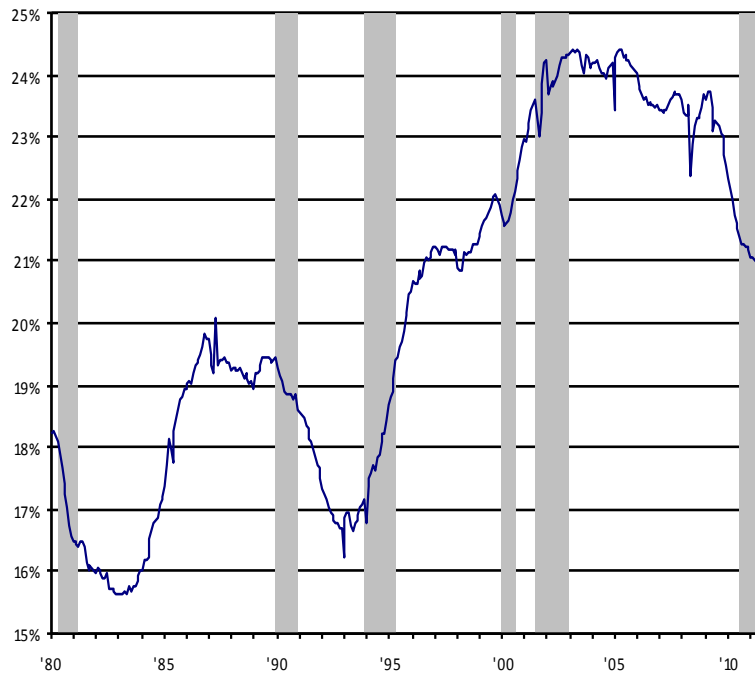


Note: Single-family includes properties consisting of up-to 4 units

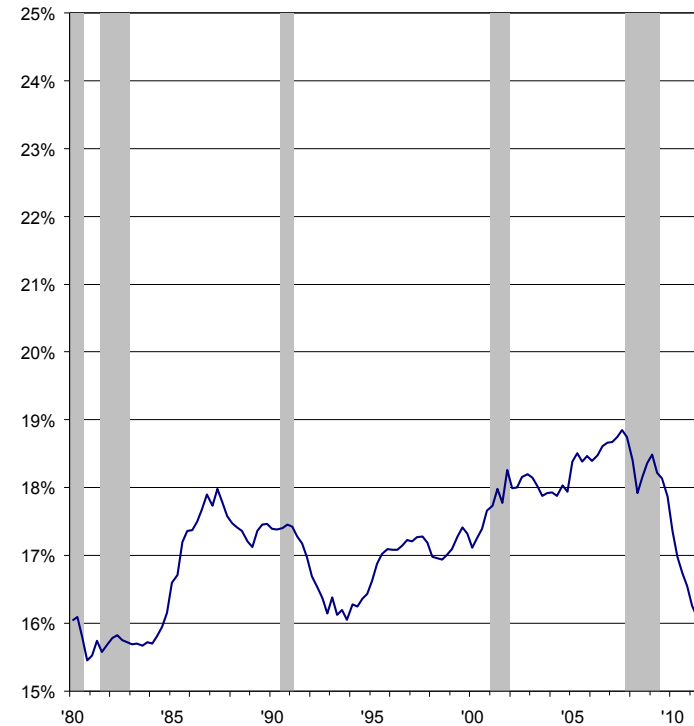
Household Financial Condition: Done Reducing Leverage?

Household debt is declining and still has a way to go.

Consumer Credit / Disposable Personal Income (%)



Household Financial Obligation Ratio (Financial Obligations / Disposable Personal Income, %)

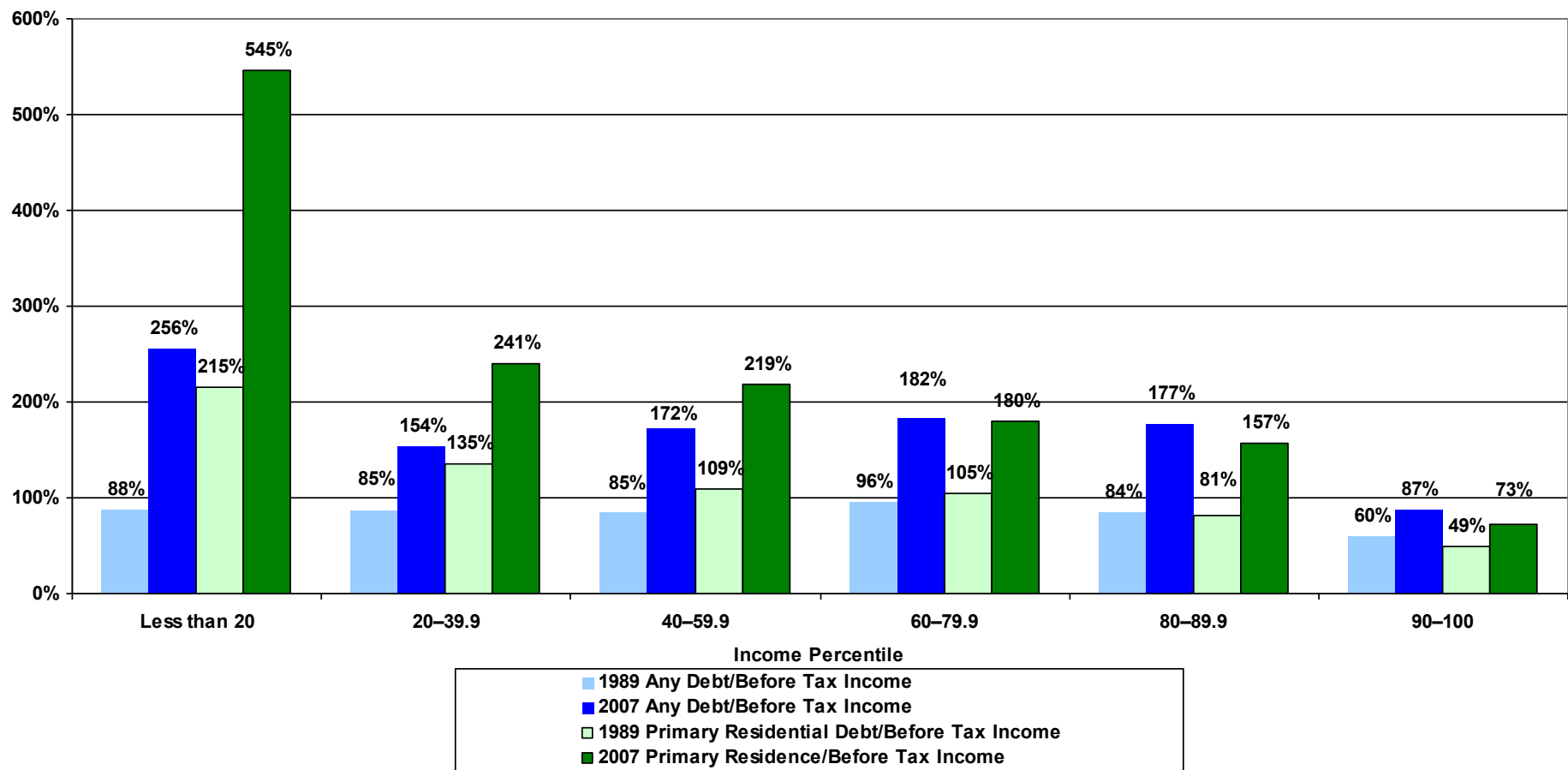


Covers most short- and intermediate-term credit extended to individuals, excluding loans secured by real estate.

*Financial Obligations include monthly mortgage payments, consumer debt payments, automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments.

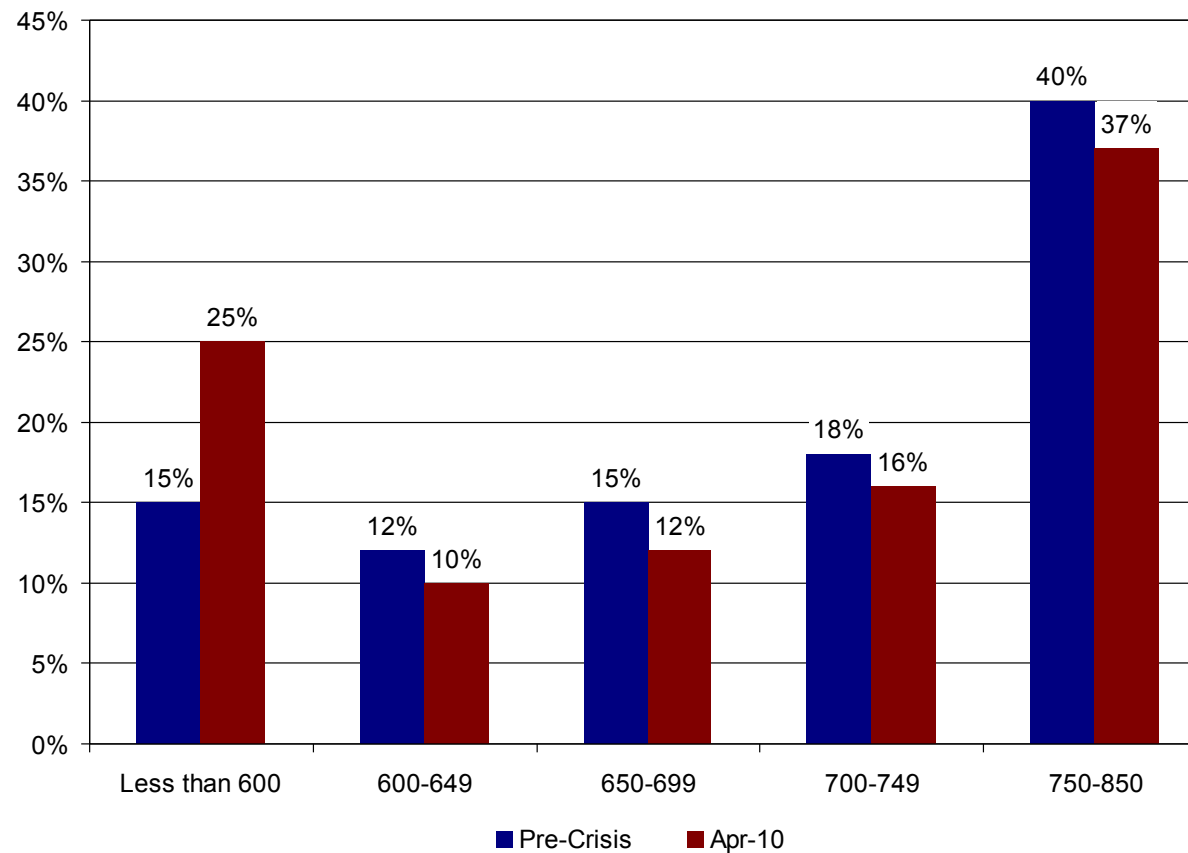
Over-leveraged households at lower income levels indicate stronger rental demand relative to ownership.

Mean Debt to Before-Tax Income Ratio



Recession impaired consumers' ability to qualify for credit.

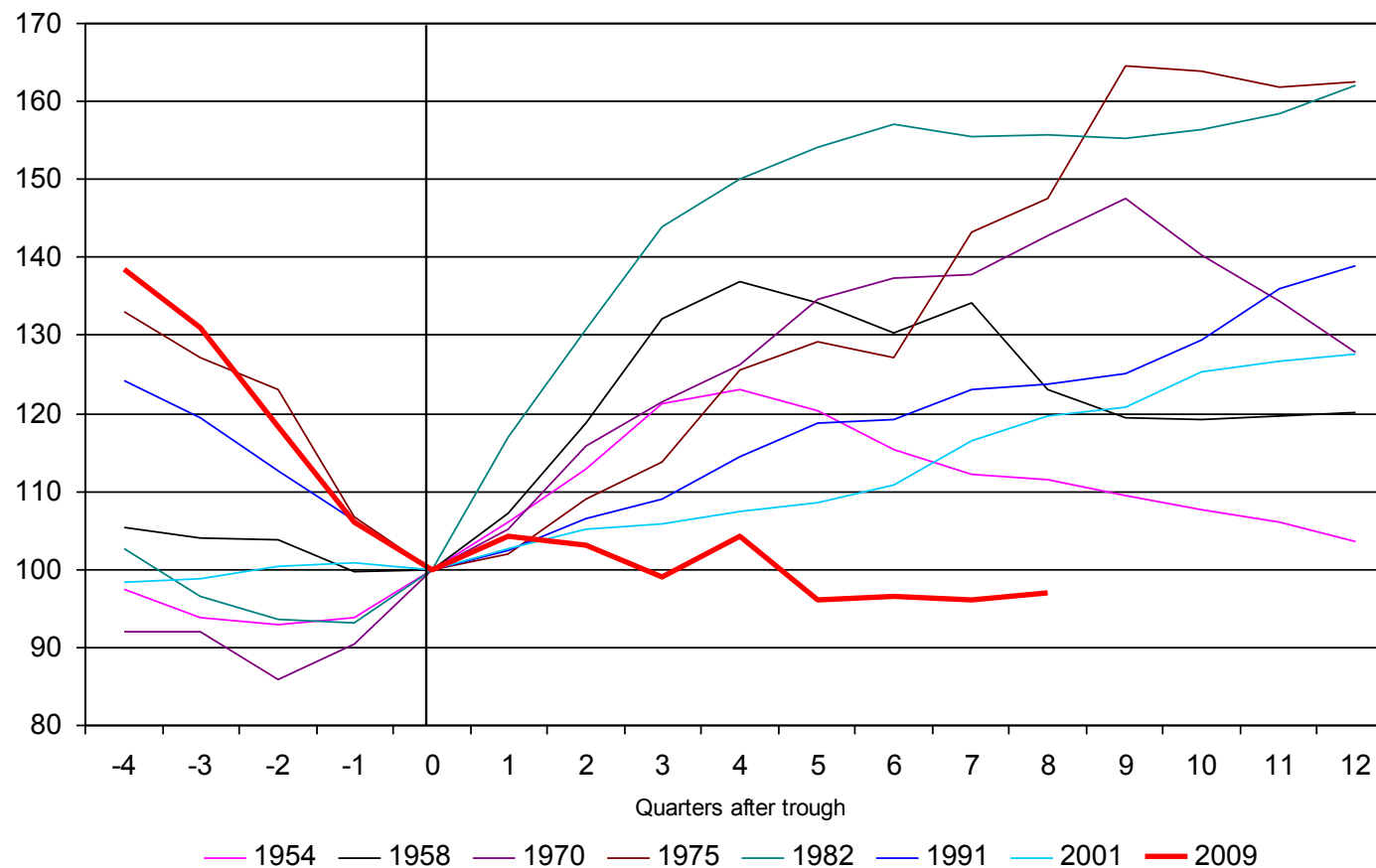
Distribution of Credit Scores Across the Population (%)



The State(s) of Housing: Weakest In Decades

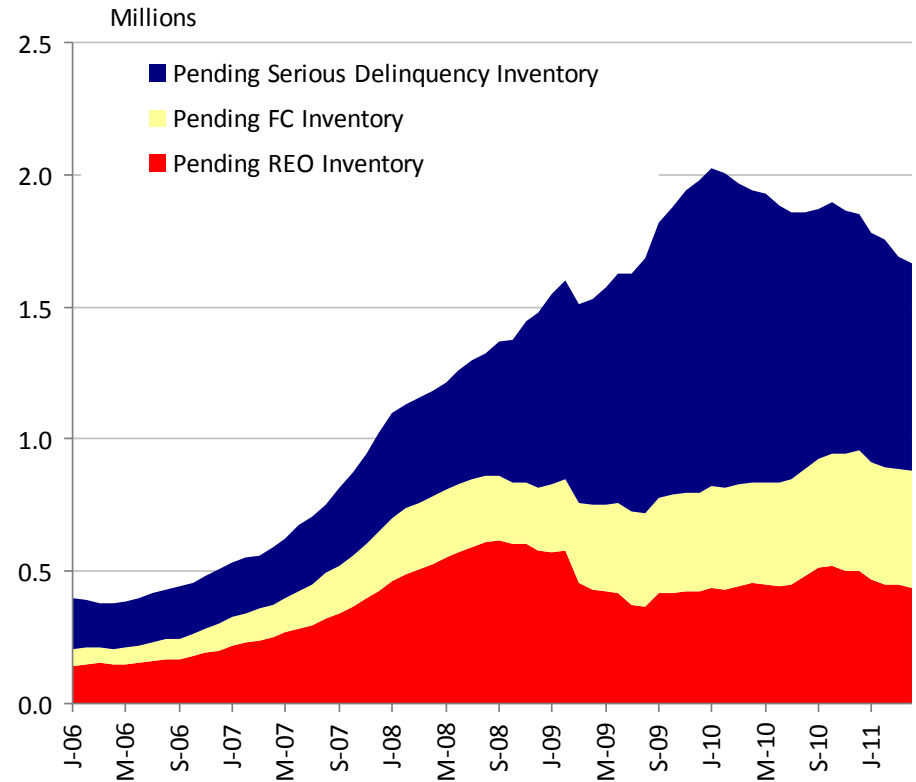
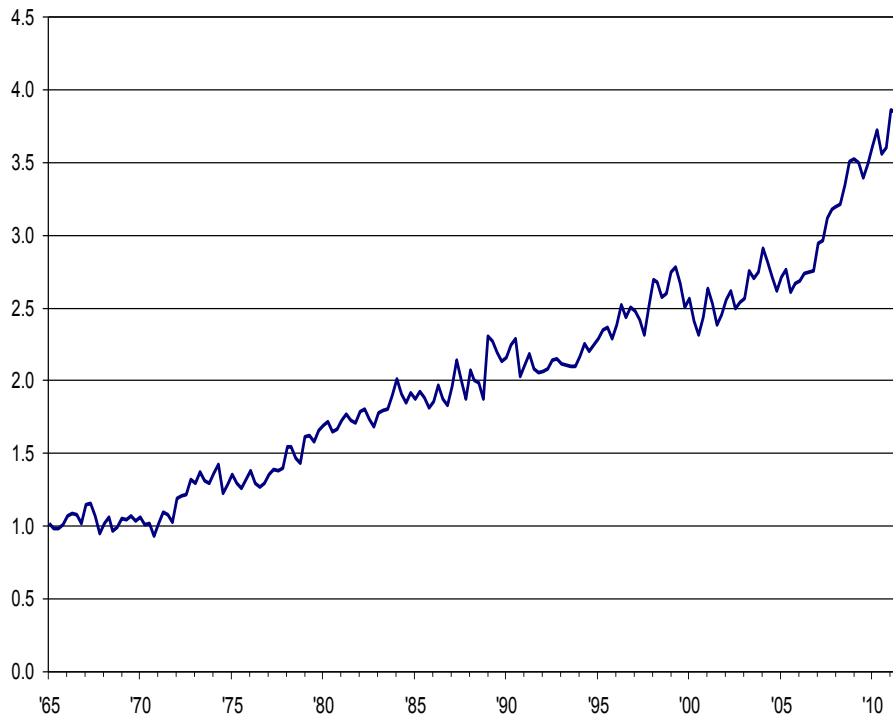
Current housing recovery underperforms previous recoveries.

Real Residential Fixed Investment (Index, recession trough = 100)



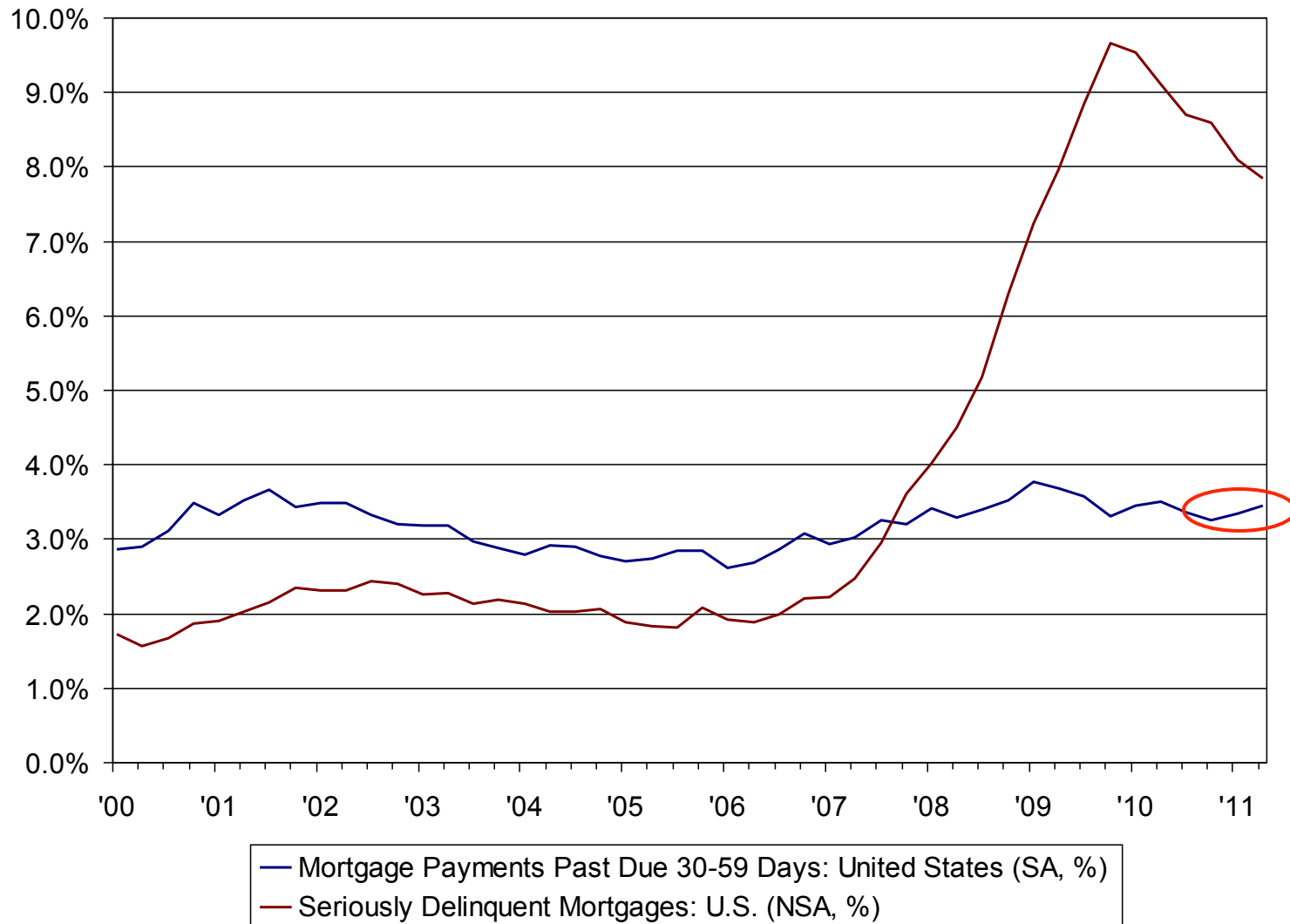
Shadow supply of housing has remained elevated.

Vacant homes held off the market for other reasons* (Millions)



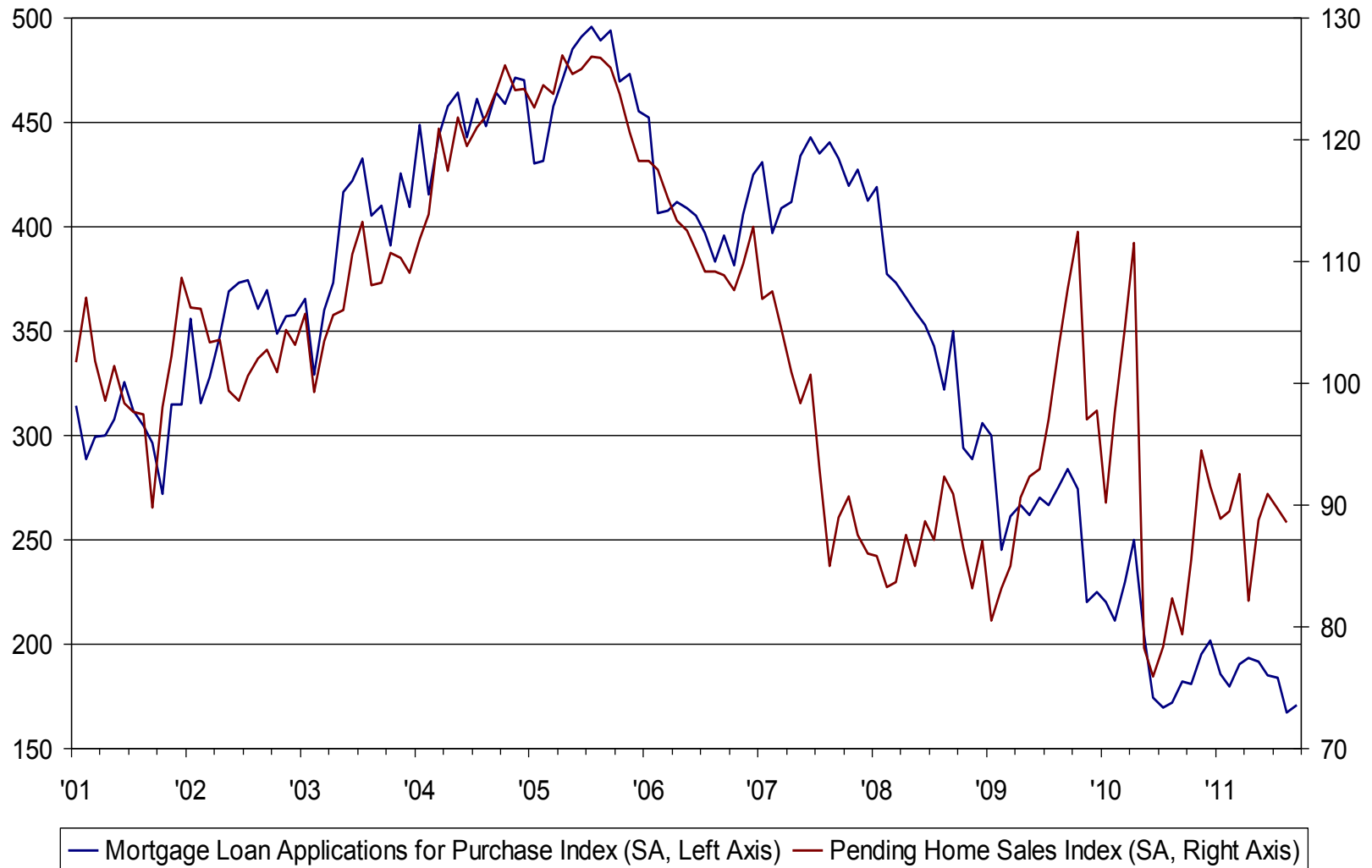
*Held off the market for reasons other than occasional use or temporarily occupied by persons with usual residence elsewhere.

Improvement in SDQs to persist?

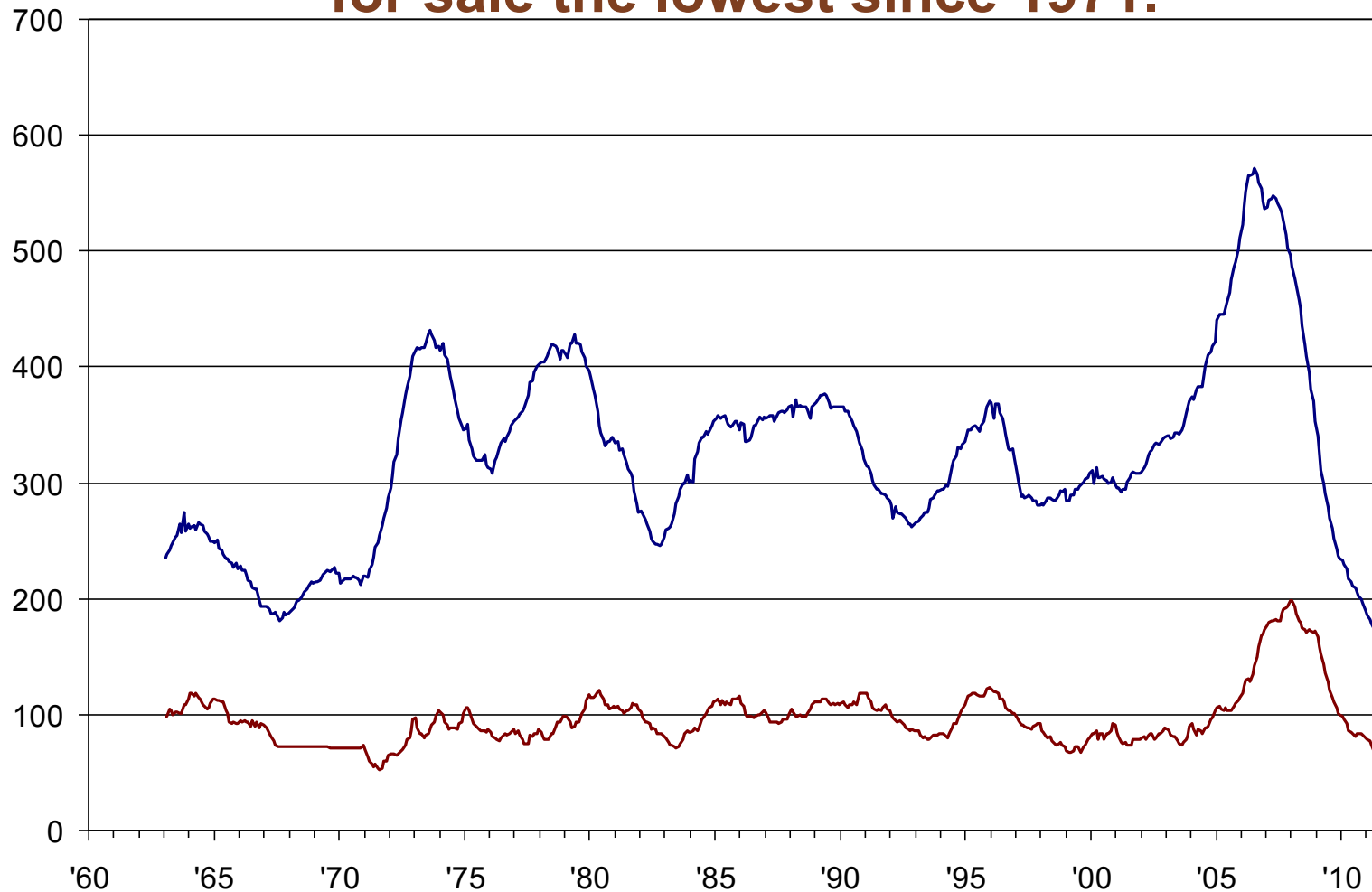


MBA defines “seriously delinquent mortgages” as mortgages with payments 90 days and over past due in addition to mortgages in the foreclosure process.

Leading indicators point to stalled market ahead.



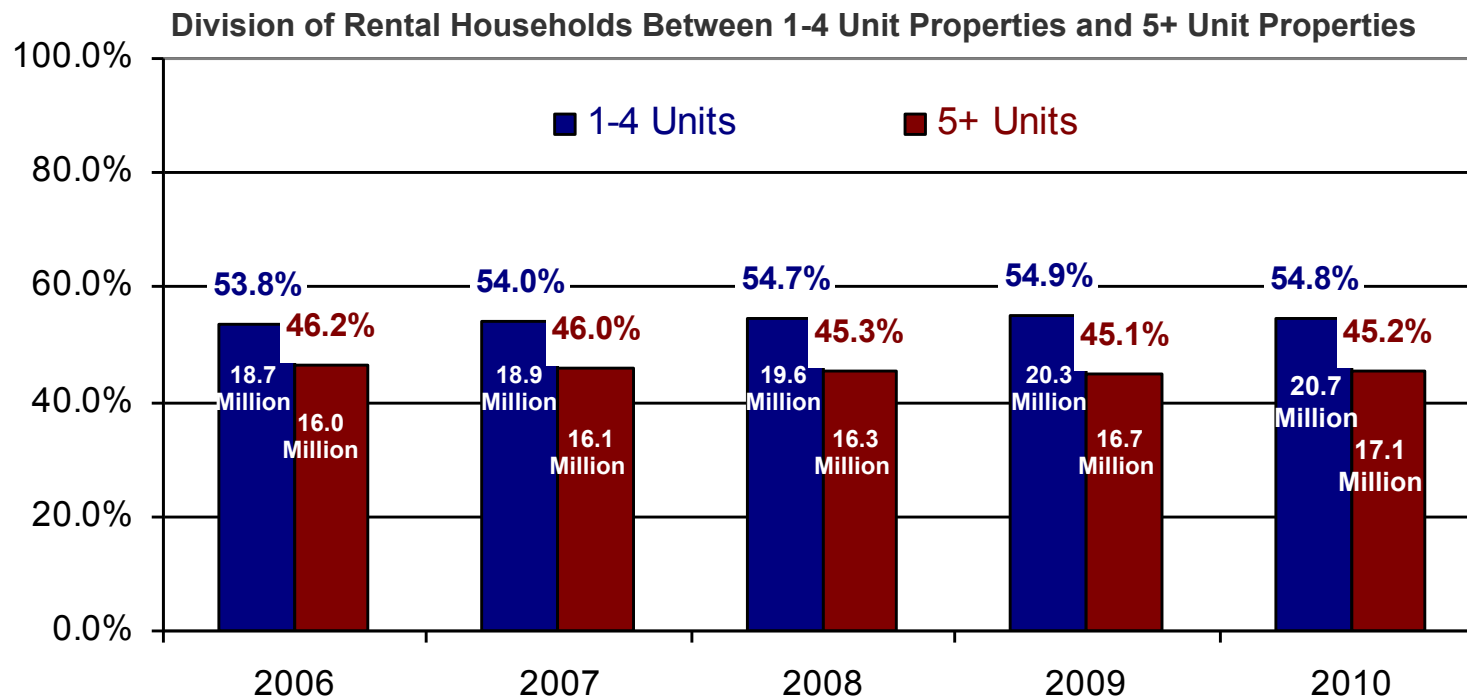
New homes for sale at all-time low, new completed homes for sale the lowest since 1971.



— New 1-Family Houses For Sale: United States (SA, Thous)
 — New 1-Family Houses For Sale: Completed Units (NSA, Thous)

More rental households live in properties with 1-4 units than 5+ units.

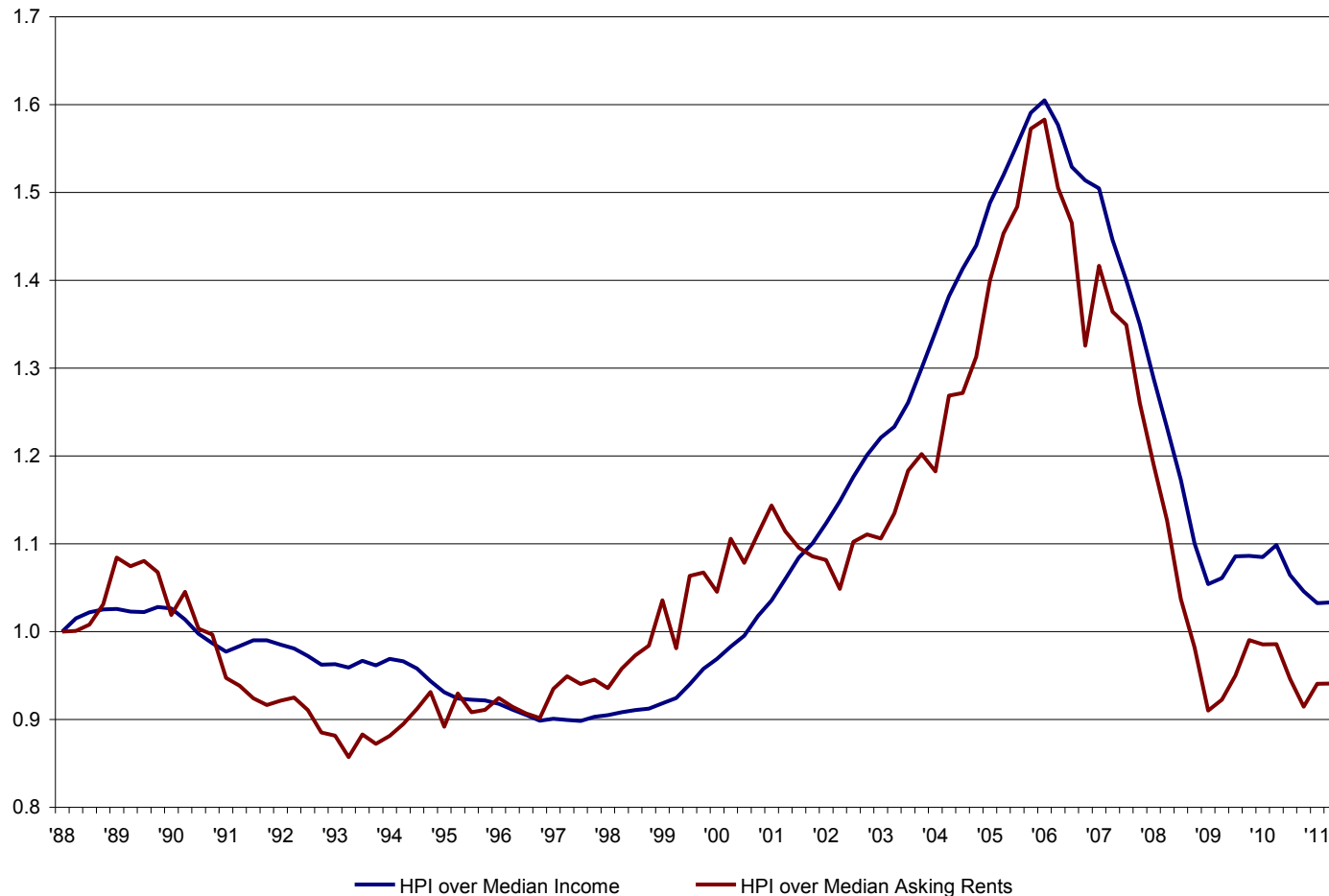
1-4 unit properties are the predominant source of rental housing



Note: A condominium is classified according to number of units in the entire structure, even if eligible for mortgage financing as single-family property

Ratios of national HPI to income* and rents approach historical norms

(Indexed, 1988 Q1 = 100)

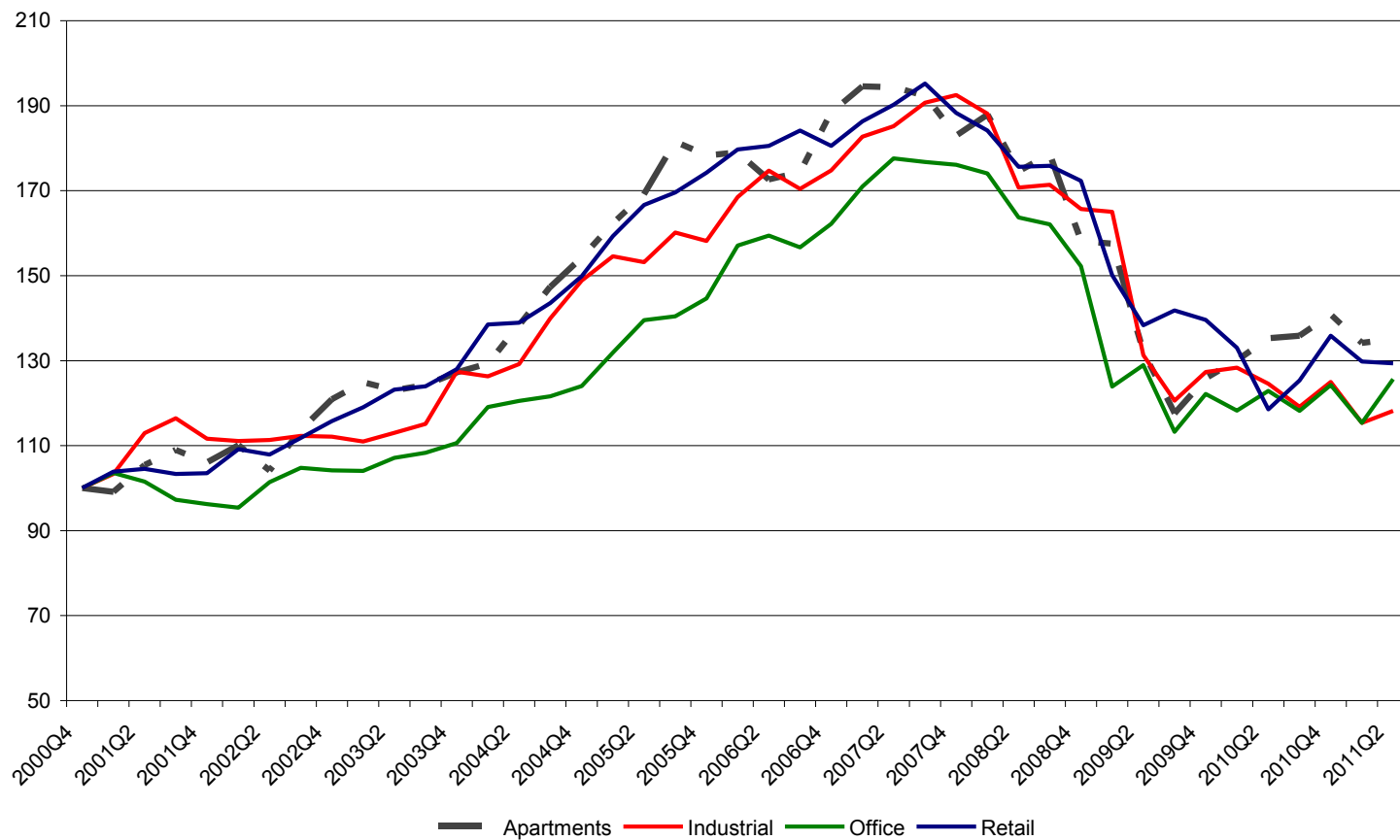


*Median household income estimated by Fannie Mae from 2009 on.

Commercial Real Estate: Signs of Recovery?

Apartment prices leading commercial real estate recovery.

Moody's/REAL Commercial Property Price Index
(2000Q4=100, NSA)



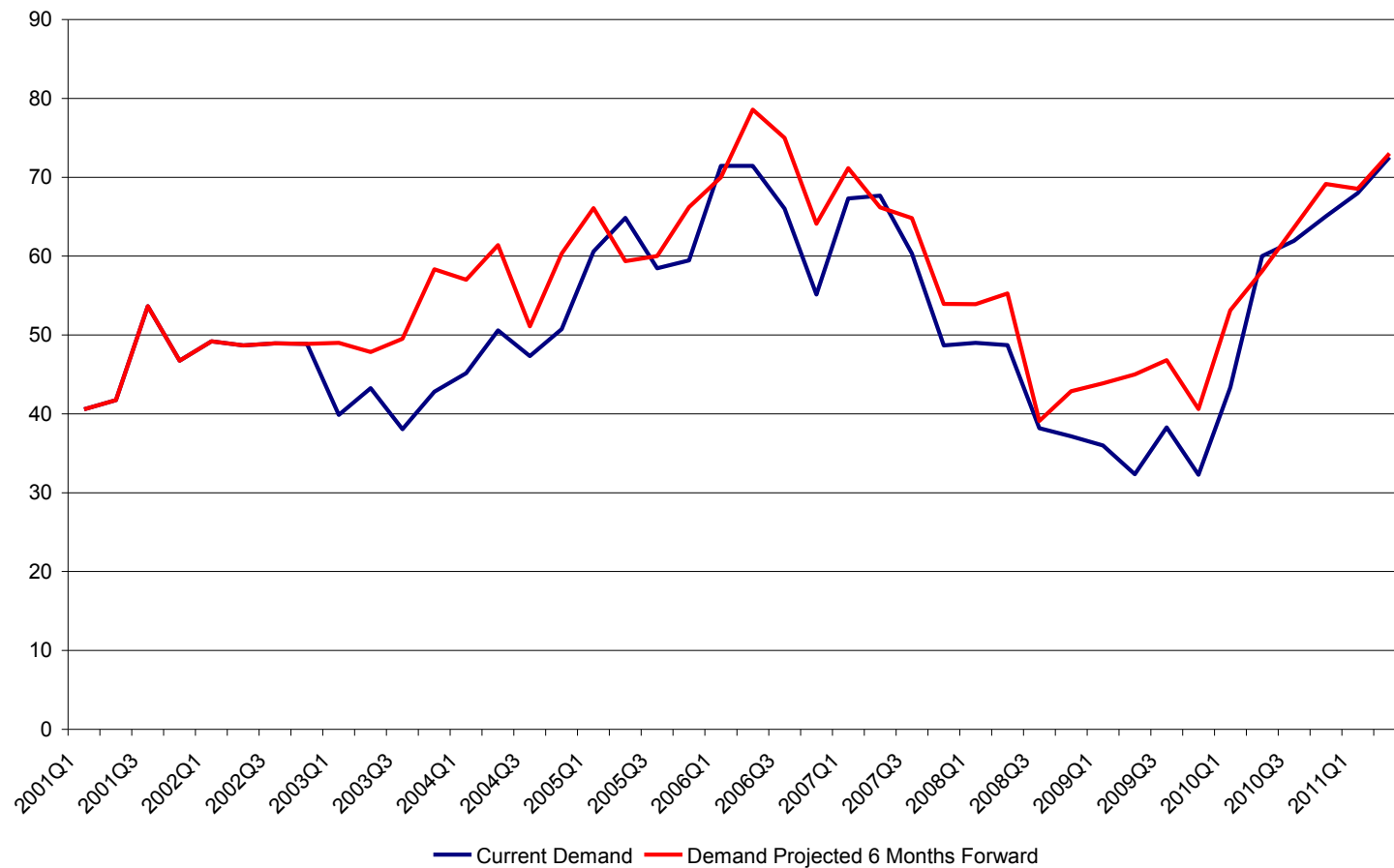
Multifamily housing starts remain near record lows...

Multifamily Housing Starts (Thousands of Units, SAAR)



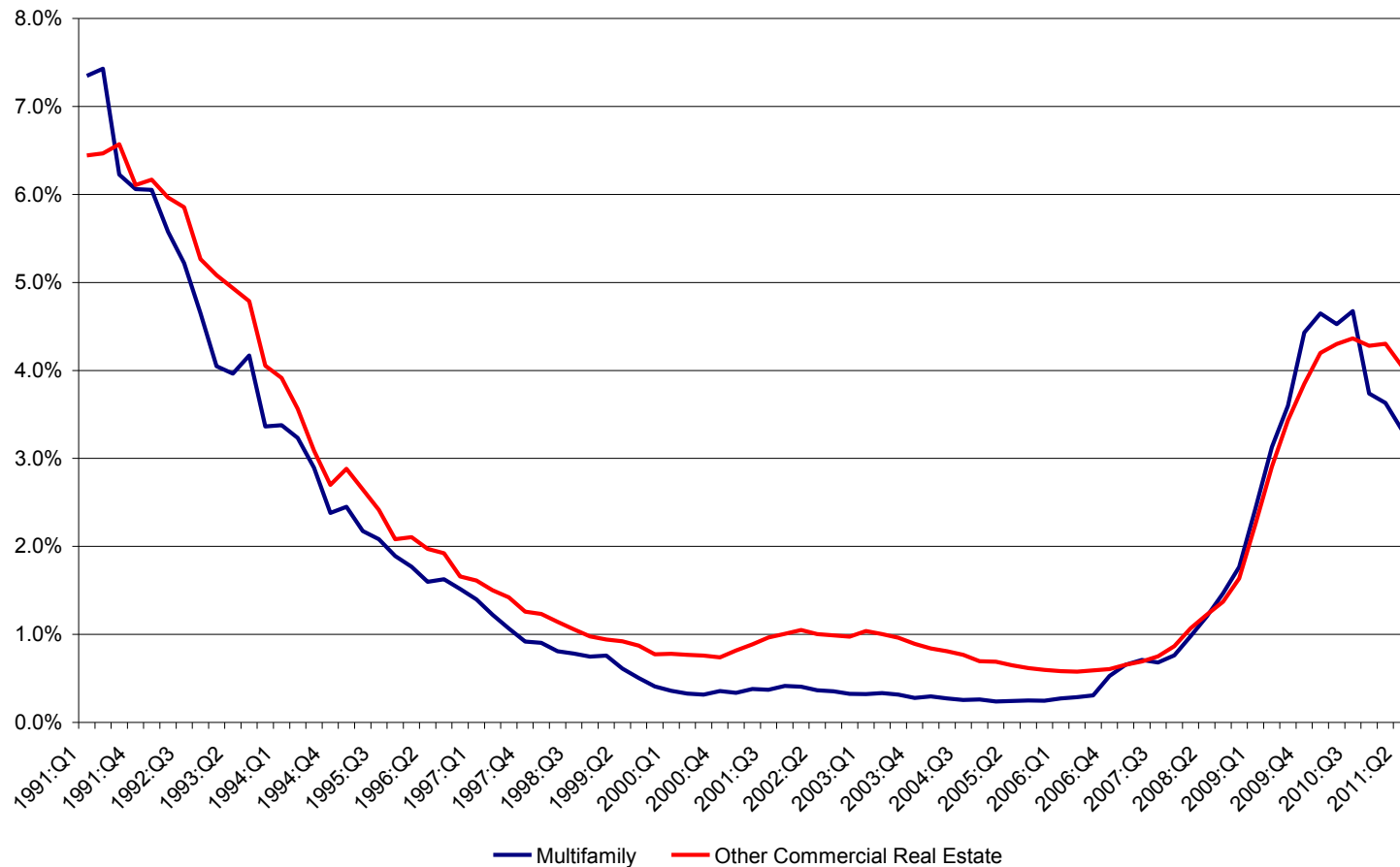
...while rental occupancy demand has picked up.

Multifamily Housing Market Index: Rental Occupancy: Class B Apartments



Commercial real estate loan performance improving at banks.

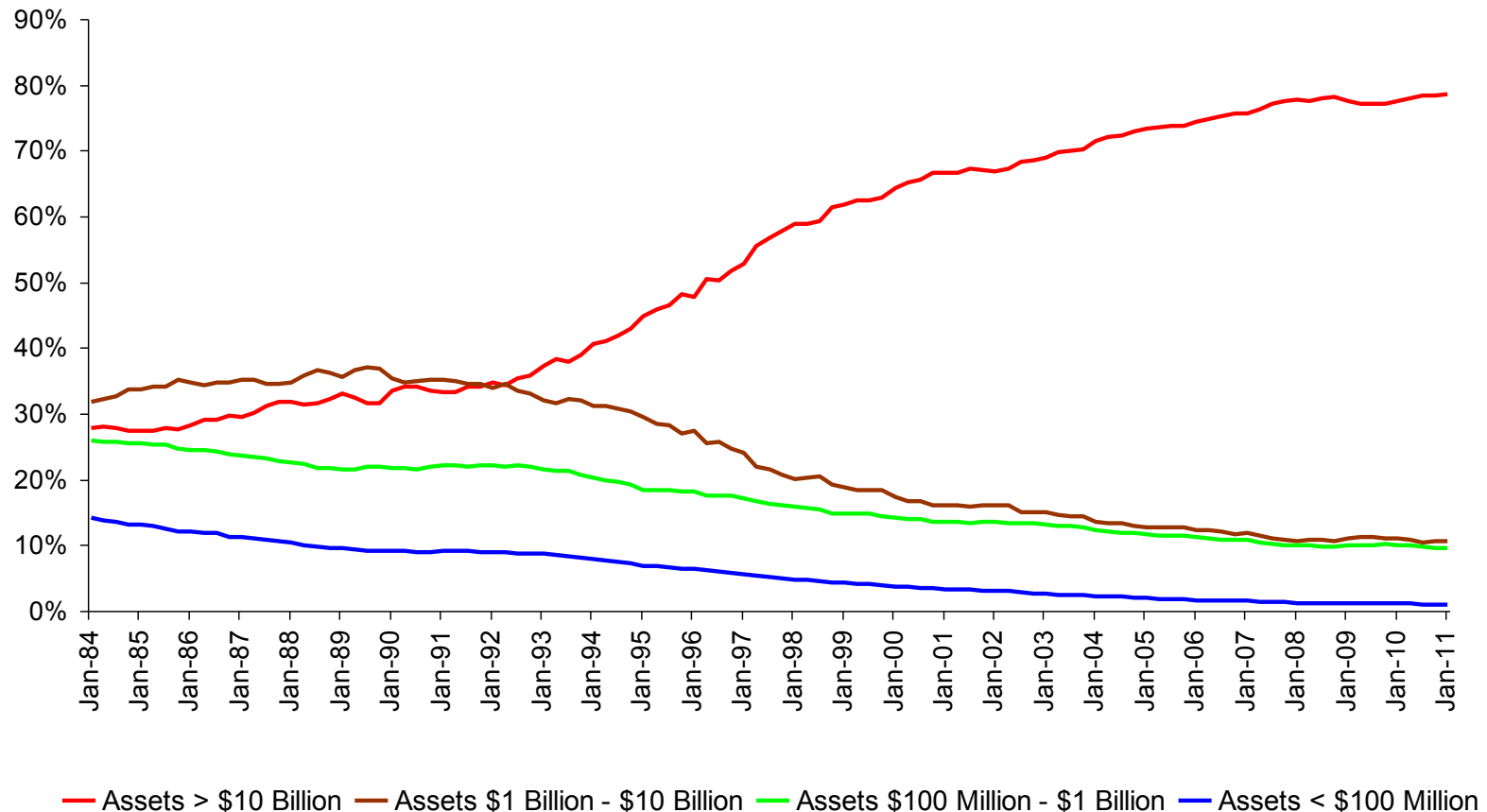
Commercial Real Estate Loans Non-current Rate



The Banking Sector and Real Estate Finance: Bank Consolidation

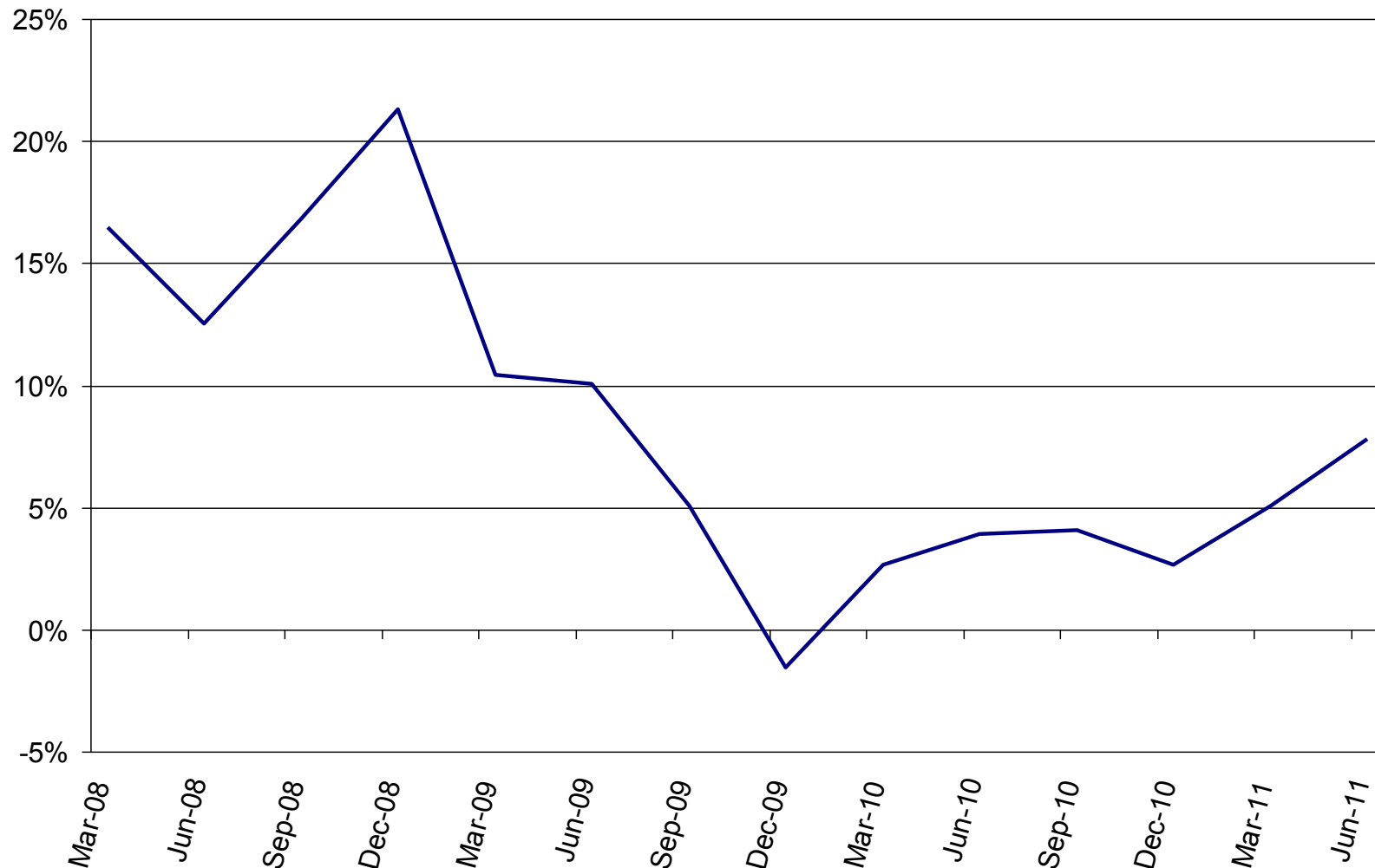
Consolidation of the banking industry that started in the nineties remains in place.

Share of Industry Assets

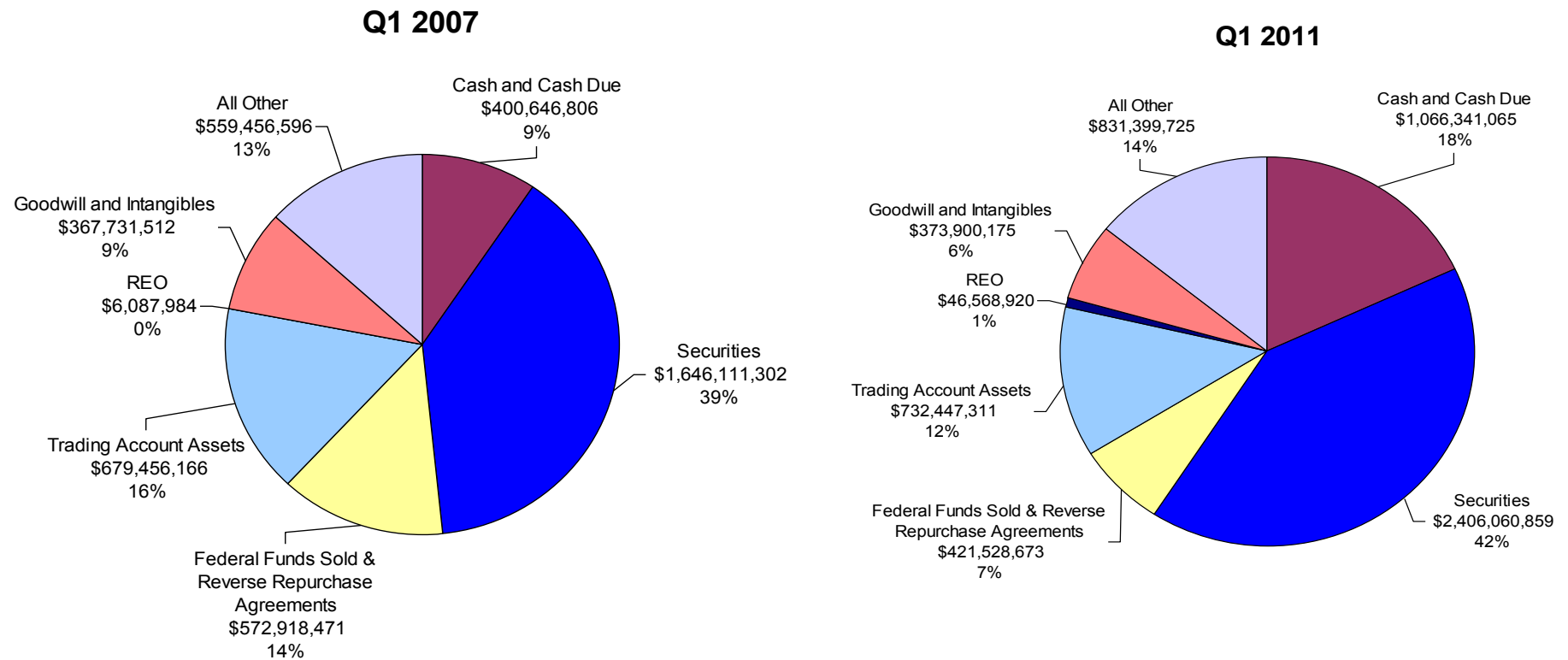


Non-loan asset growth positive, but very slow.

Year-over-Year Growth in Nonloan Assets

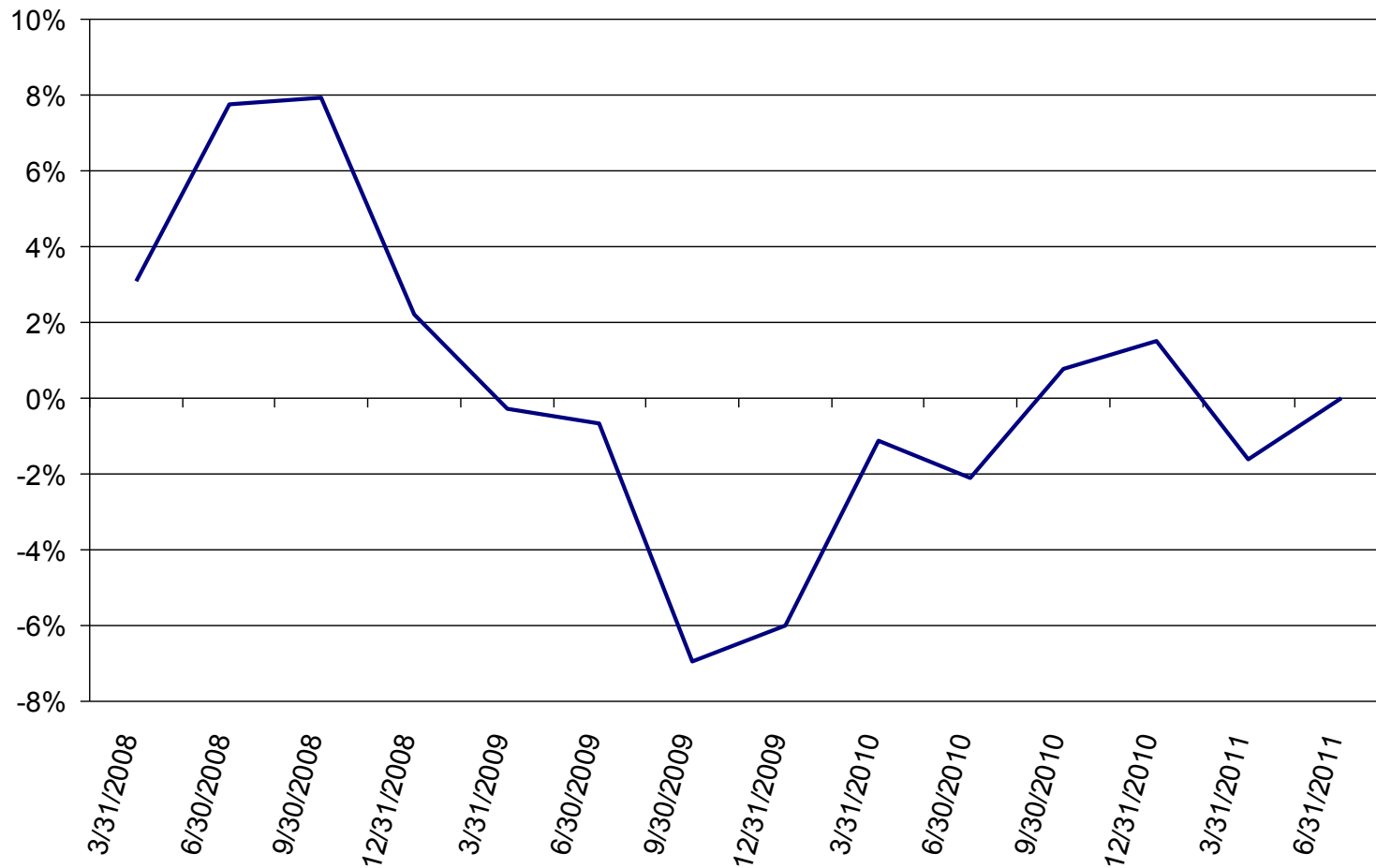


Banks bulk up on liquid assets after the crisis.

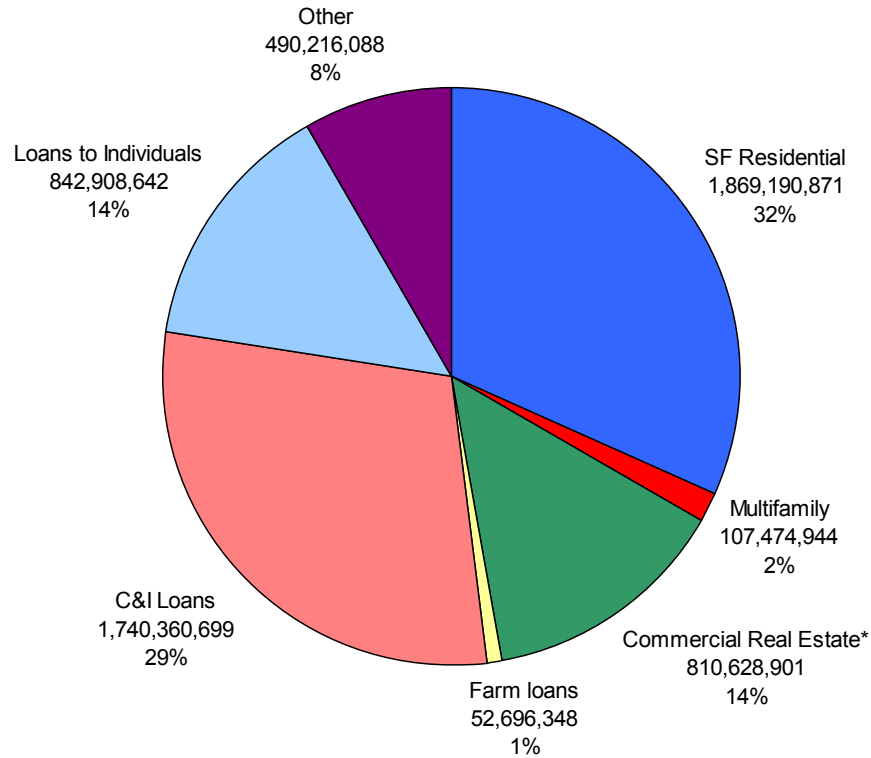
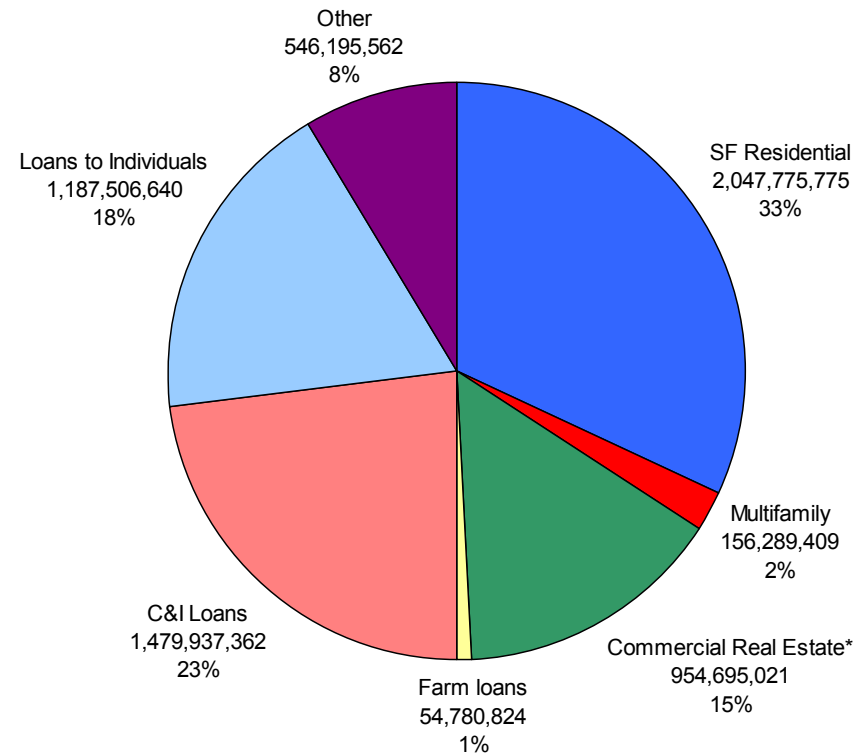


Bank loans still in decline.

Year-over-Year Growth in Loan Assets

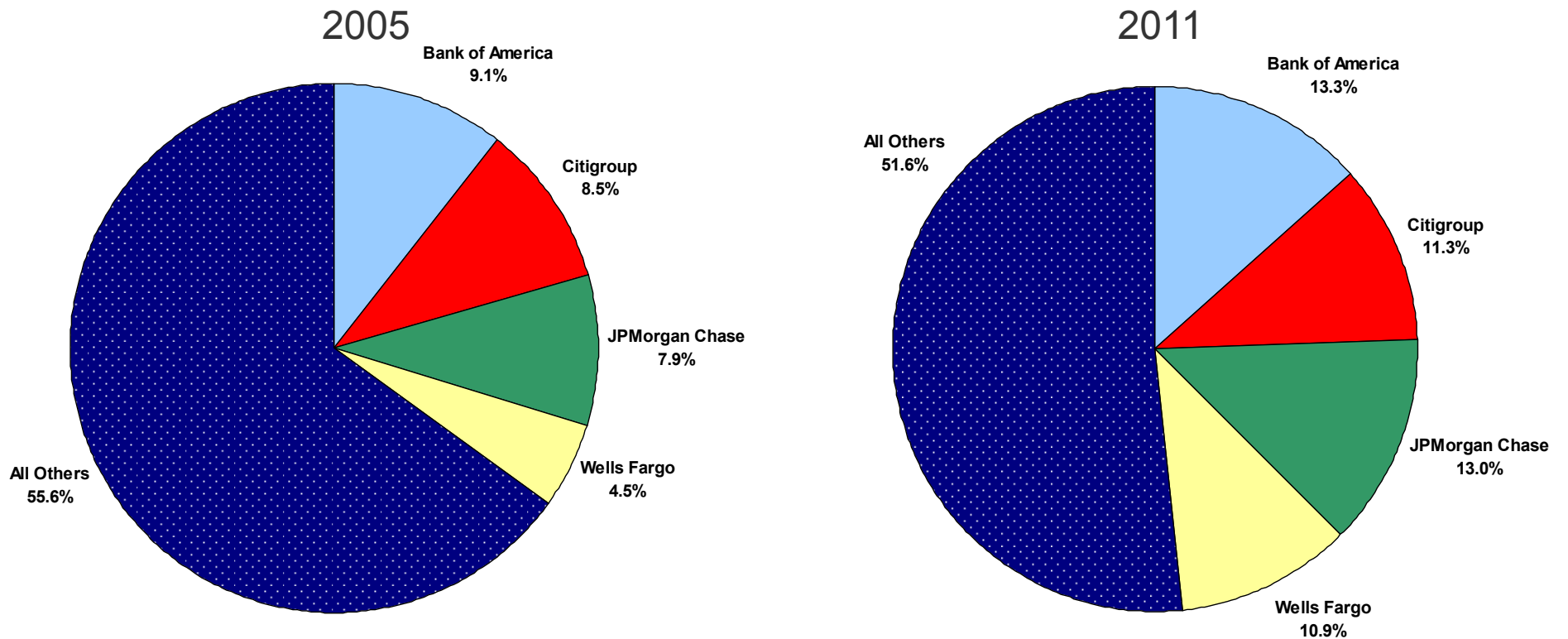


Real estate loan share is flat since the beginning of the crisis.

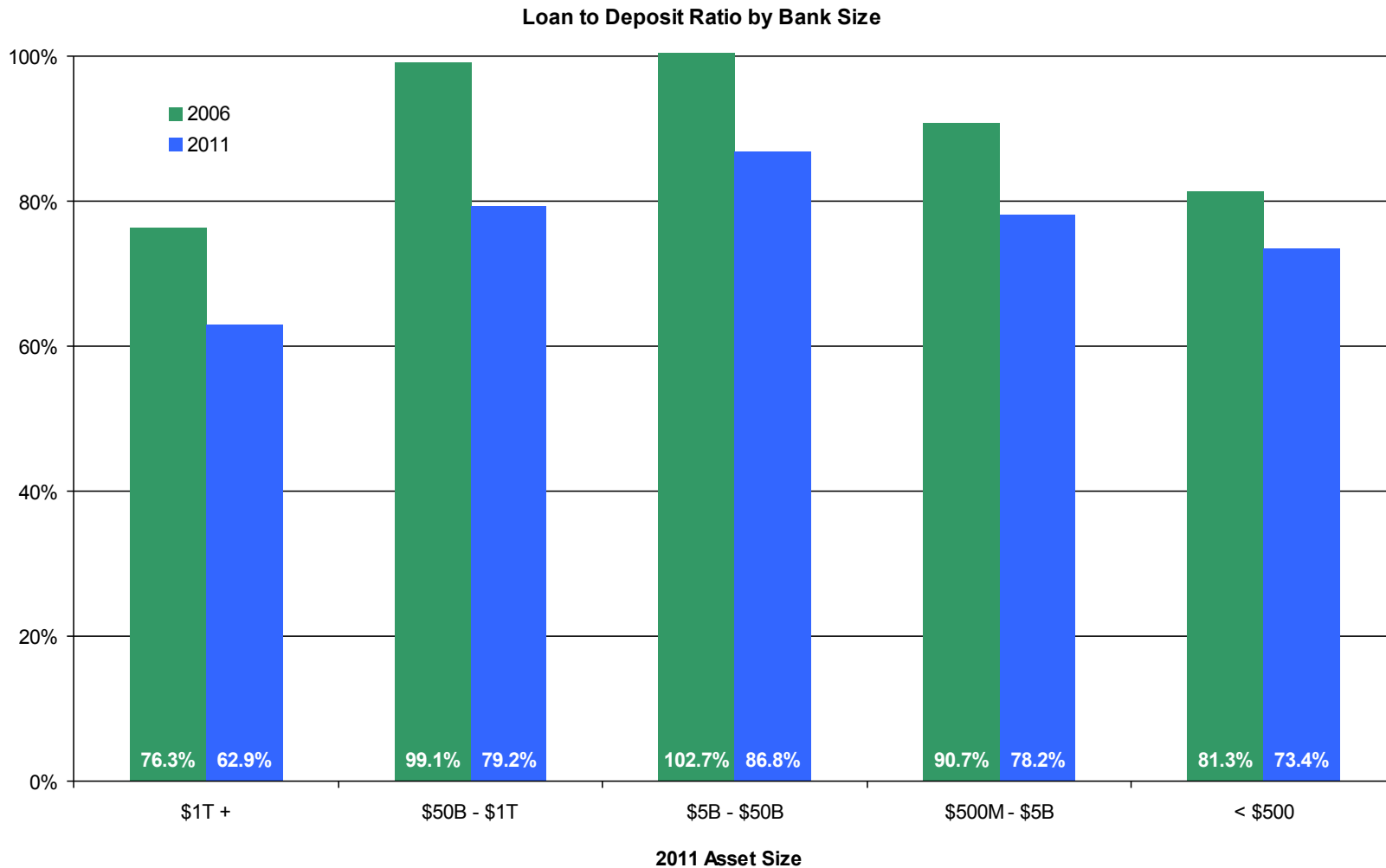
Q1 2007

Q1 2011


Market concentration in the banking industry has increased.

Total Deposits, Market Share



Increased liquidity needs and reduced risk appetite lowers bank loan to deposit ratios.



Mortgage production has consolidated through the crisis.

Originator Market Share

2006			2010		
Rank	Lender	Share%	Rank	Lender	Share (%)
1	Countrywide	15.5%	1	Wells Fargo	23.4%
2	Wells Fargo	13.3%	2	Bank of America	18.3%
3	WaMu	6.6%	3	Chase	9.7%
4	Citi	6.2%	4	Ally/ResCap (GMAC)	4.1%
5	Chase	5.8%	5	CitiMortgage, Inc.	4.0%
6	GMAC/ResCap	5.8%	6	U.S. Bank Home Mortgage	3.3%
7	Bank of America	5.6%	7	PHH Mortgage	2.9%
8	Wachovia (& Golden West)	3.5%	8	SunTrust Mortgage, Inc.	1.7%
9	IndyMac	3.0%	9	Quicken Loans, Inc.	1.7%
10	EMC Mortgage	2.4%	10	Provident Funding Assoc	1.6%
Top 5		47.4%	Top 5		59.4%
Top 10		67.7%	Top 10		70.7%

Mortgage servicing is highly concentrated.

2005			
Rank	Bank	FV of MSR (\$000)	Market Share
1	Wells Fargo & Company	\$ 12,511,000	33.0%
2	JPMorgan Chase & Co.	\$ 6,452,000	17.0%
3	Citigroup Inc.	\$ 4,339,000	11.4%
4	Citicorp	\$ 4,338,000	11.4%
5	Bank of America Corporation	\$ 2,806,433	7.4%
6	First Horizon National Corporation	\$ 1,314,629	3.5%
7	U.S. Bancorp	\$ 1,118,000	2.9%
8	SunTrust Bank Holding Company	\$ 657,604	1.7%
9	BB&T Corporation	\$ 451,287	1.2%
10	Fifth Third Bancorp	\$ 438,797	1.2%
Top 5		\$ 30,446,433	80.3%
Top 10		\$ 34,426,750	90.7%

2011			
Rank	Bank	FV of MSR (\$000)	Market Share
1	Wells Fargo & Company	\$ 17,071,000	25.6%
2	Bank of America Corporation	\$ 15,560,011	23.4%
3	JPMorgan Chase & Co.	\$ 13,093,000	19.7%
4	Citigroup Inc.	\$ 4,690,000	7.0%
5	Ally Financial Inc.	\$ 3,774,000	5.7%
6	U.S. Bancorp	\$ 2,073,000	3.1%
7	PNC Financial Services Group, Inc.	\$ 1,755,555	2.6%
8	SunTrust Banks, Inc.	\$ 1,537,569	2.3%
9	BB&T Corporation	\$ 1,043,878	1.6%
10	MetLife, Inc.	\$ 1,028,759	1.5%
Top 5		\$ 54,188,011	81.3%
Top 10		\$ 61,626,772	92.5%

Consolidation has increased among Ginnie Mae issuers post-crisis.

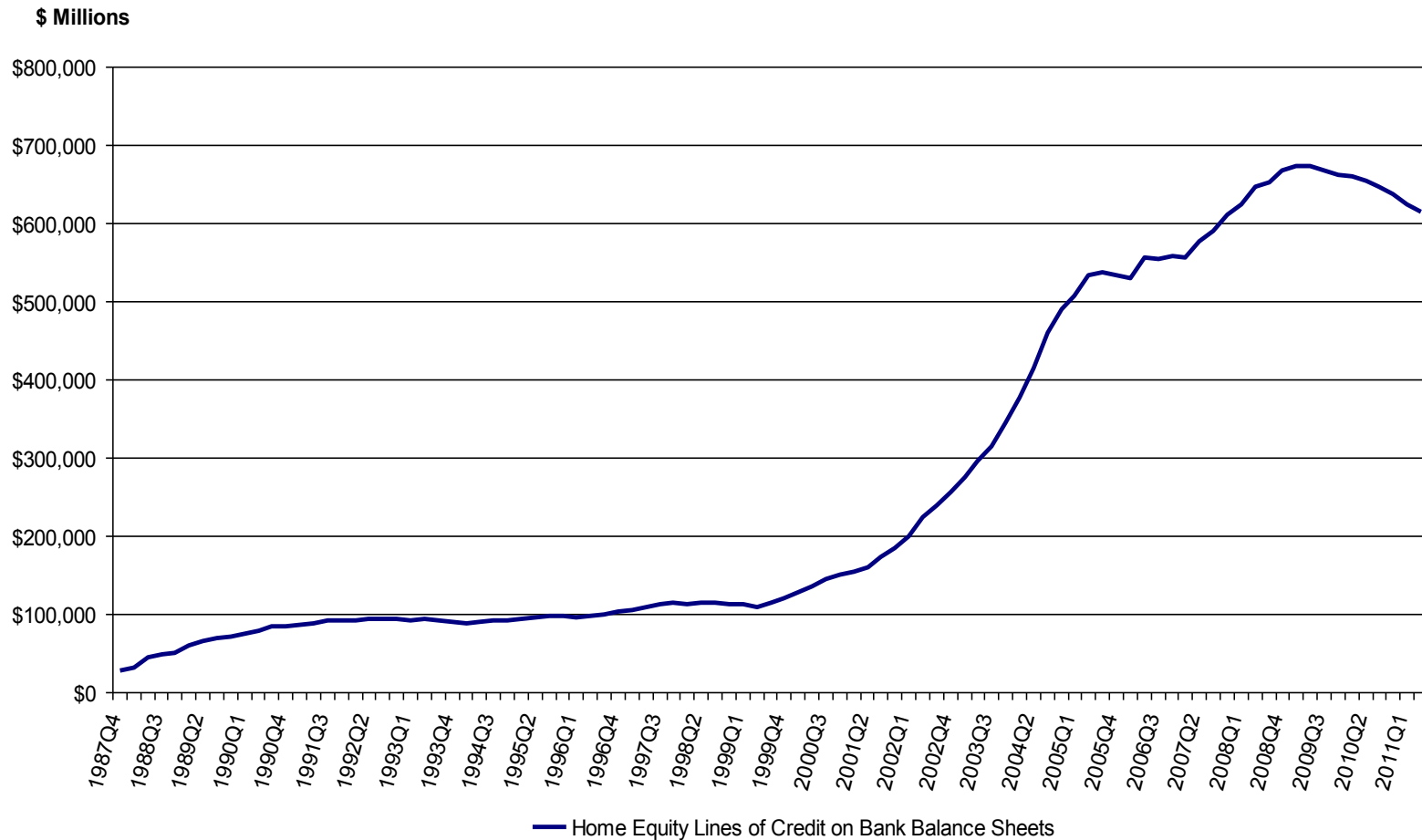
Top Ginnie Mae Issuers

2006		
Rank	Issuer	Share%
1	Wells Fargo Home Mortgage	30.4%
2	Countrywide	15.3%
3	CitiMortgage	9.4%
4	JP Morgan Chase	6.0%
5	GMAC Mortgage Corp.	4.6%
6	U.S. Bank/Firststar Bank	3.9%
7	National City Mortgage Co.	3.5%
8	WaMu	3.3%
9	Taylor, Bean & Whitaker	2.4%
10	SunTrust Mortgage	2.2%
Top 5		65.7%
Top 10		80.9%

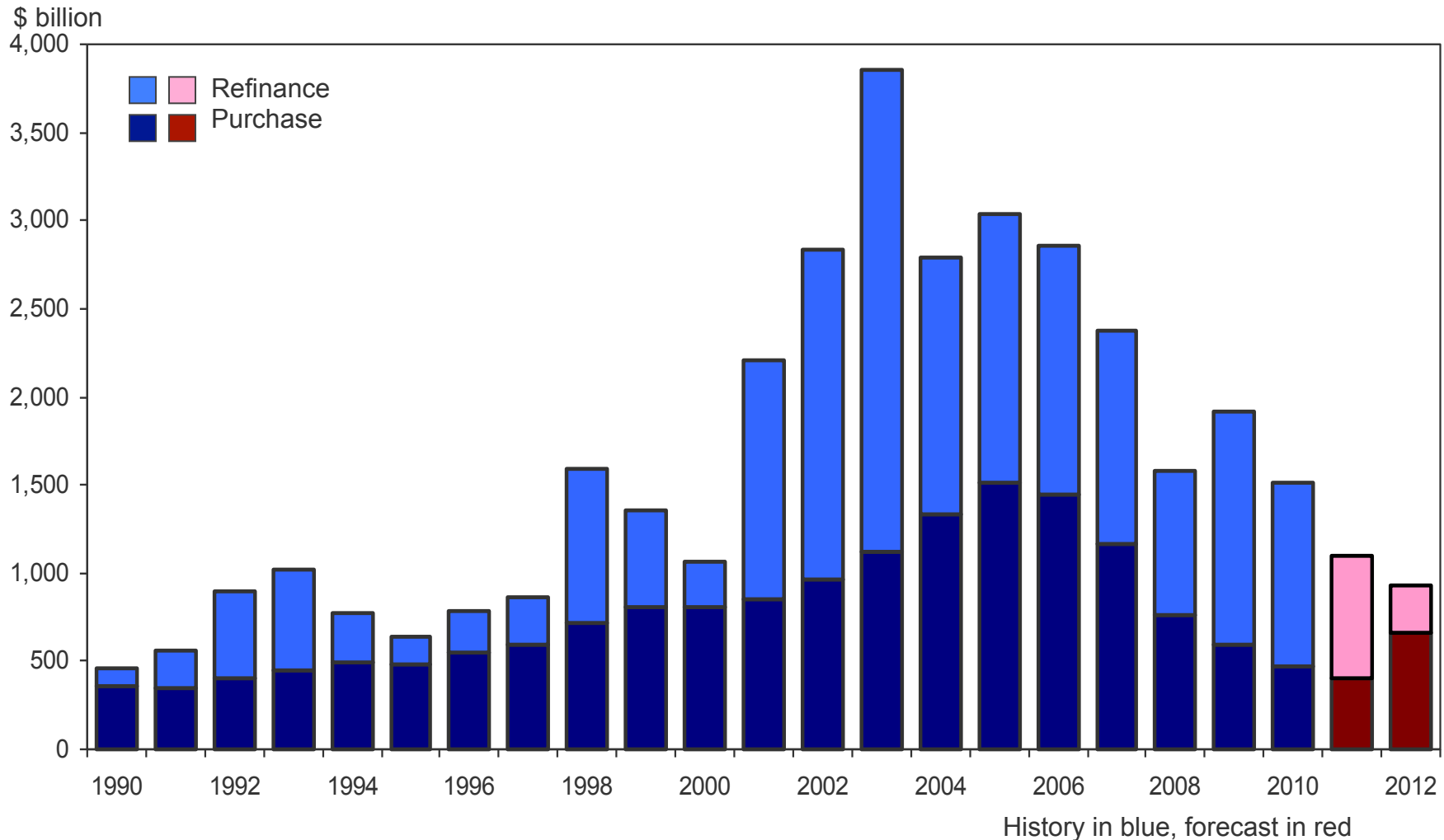
2010		
Rank	Issuer	Share (%)
1	Bank of America, NA	33.6%
2	Wells Fargo Home Mortgage	31.2%
3	JP Morgan Chase	8.5%
4	GMAC Mortgage	4.4%
5	U.S. Bank	3.6%
6	PHH Mortgage	2.8%
7	MetLife Bank	1.7%
8	Flagstar Bank	1.7%
9	CitiMortgage	1.5%
10	SunTrust Mortgage	1.3%
Top 5		81.2%
Top 10		90.2%

Top 5 GNMA issuers more concentrated than top 5 originators even though all are eligible GNMA issuers

Banks are gradually reducing home equity lines from their balance sheets.

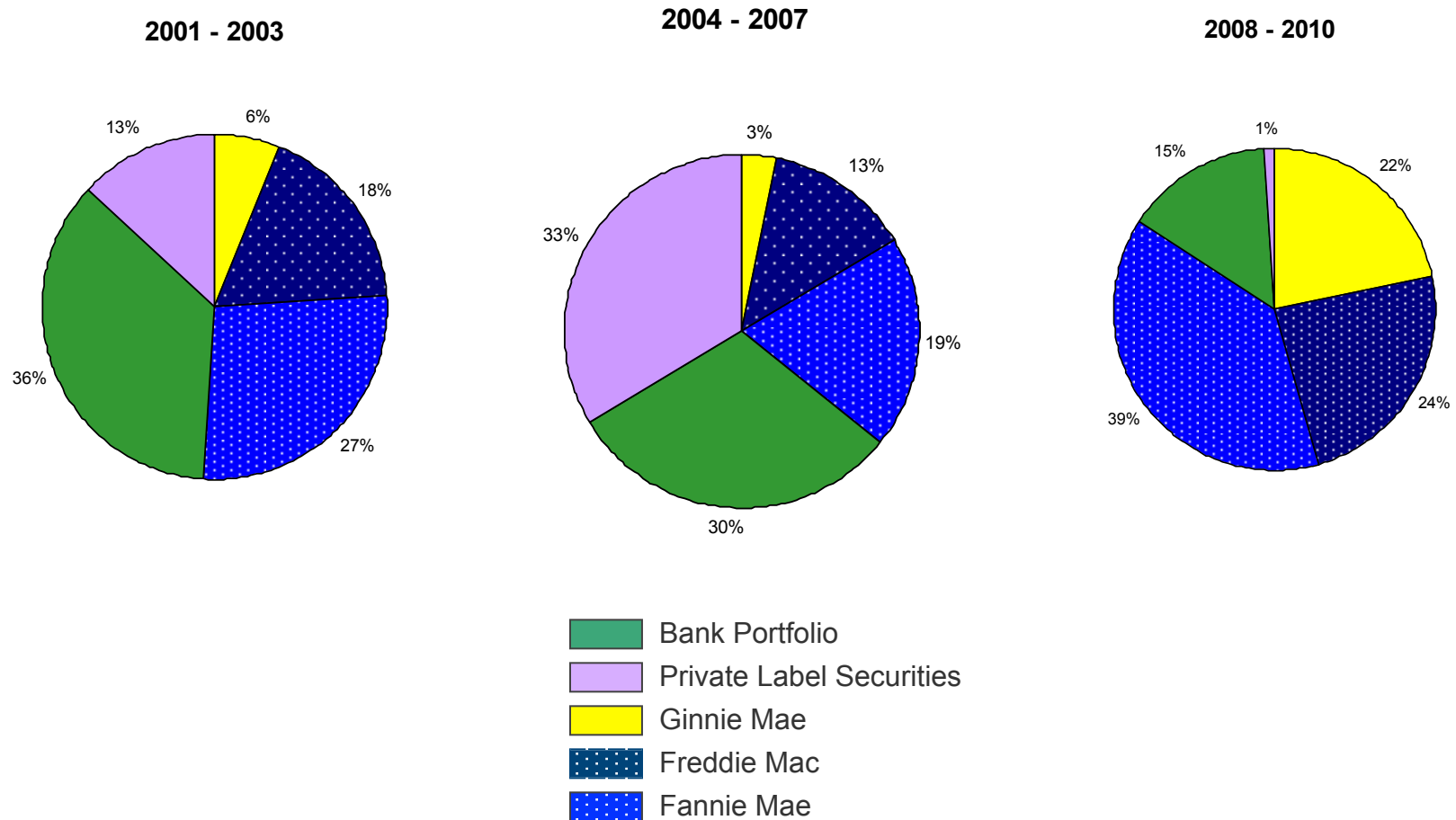


Distressed and cash sales combined with lower risk appetite reduces purchase mortgage volumes.



Market composition returning to the “Old Normal”?

Average percent shares of dollars of originations

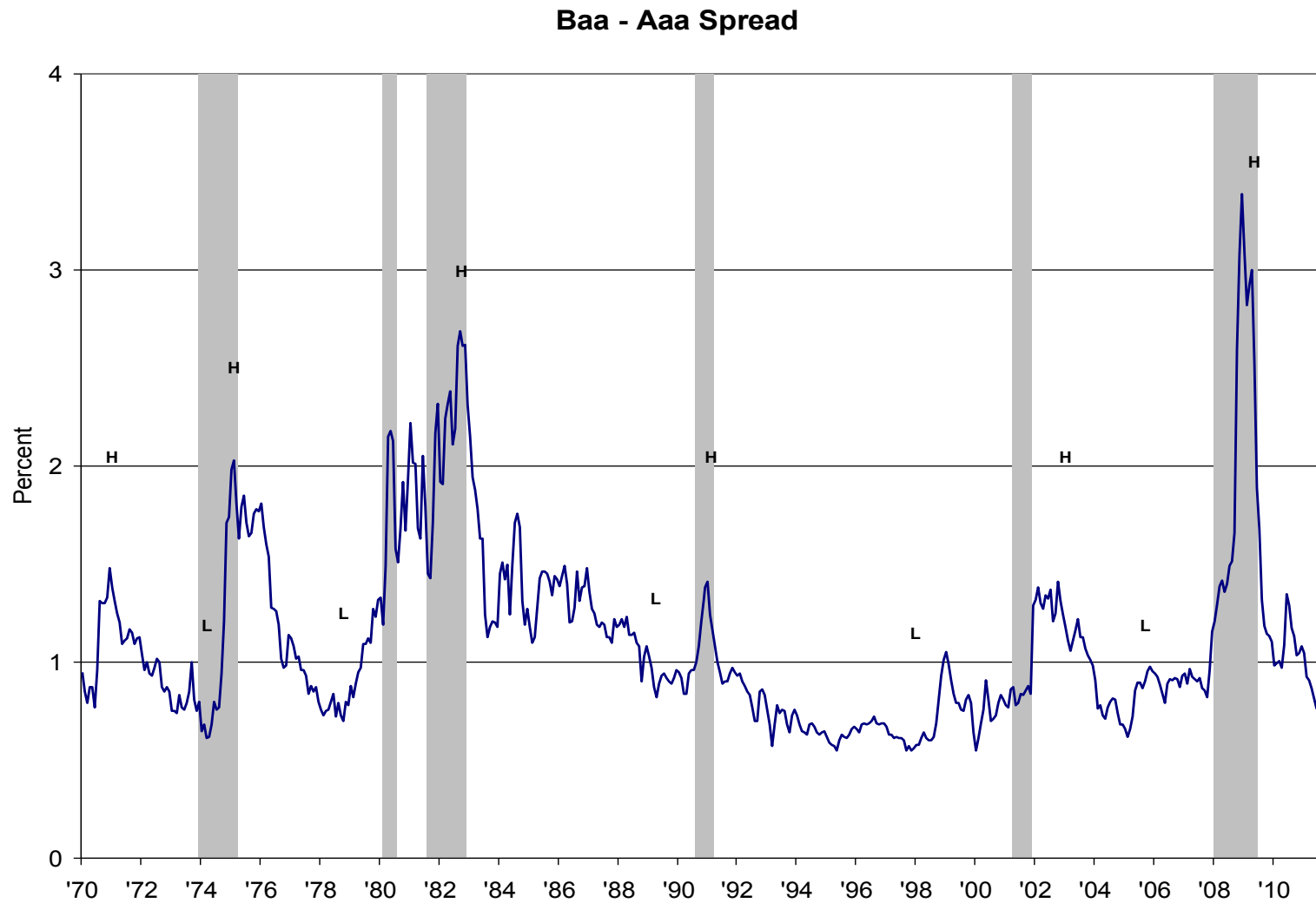




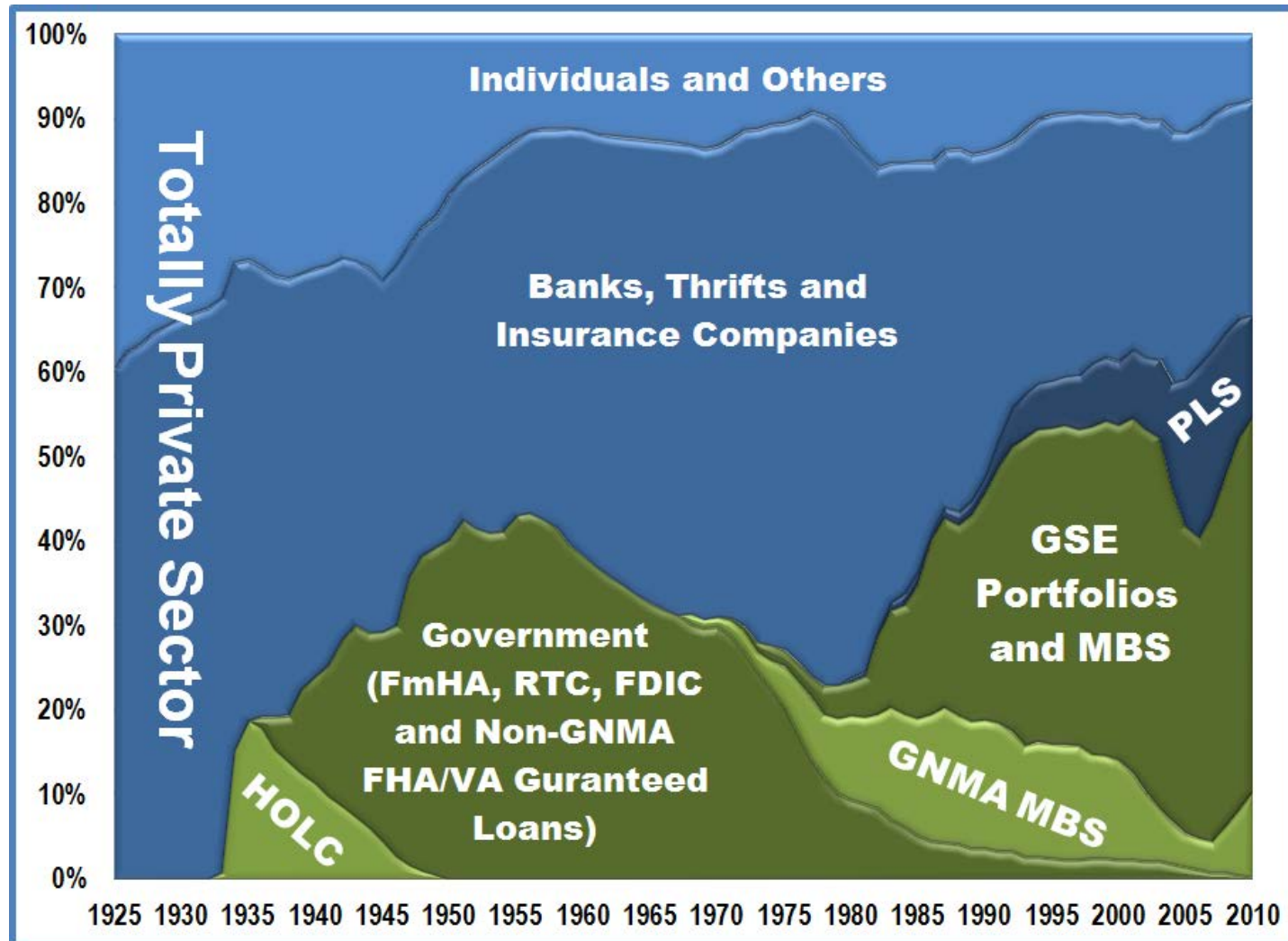
Some Historical Perspective

**Each Cycle is a Little Different...
but Human Nature is the Same**

Credit cycles... Fear, greed, and reaching for yield.



Market shares of residential mortgages 1925-2010: role of government as credit risk holder is increasing again.



Amortization grew after the depression.

Life Insurance Companies

Period	Non-Amortized	Partially Amortized	Fully Amortized
1920-1924	19.7%	58.8%	21.3%
1925-1929	24.1%	61.5%	14.3%
1930-1934	20.1%	52.8%	26.4%
1935-1939	2.2%	21.0%	76.7%
1940-1946	0.9%	3.5%	95.4%

“Much of this change came during the late thirties when the adoption of fully amortized loans in HOLC and FHA operations increased the popularity of this type of mortgage and when both lenders and borrowers, in the wake of depression experience with straight loans, began to recognize the importance of regular amortization.”

Commercial Banks

Period	Non-Amortized	Partially Amortized	Fully Amortized
1920-1924	41.0%	44.1%	14.9%
1925-1929	51.0%	38.7%	10.3%
1930-1934	50.7%	35.7%	13.6%
1935-1939	10.3%	20.7%	69.0%
1940-1944	3.7%	27.3%	69.0%

Savings and Loan Associations

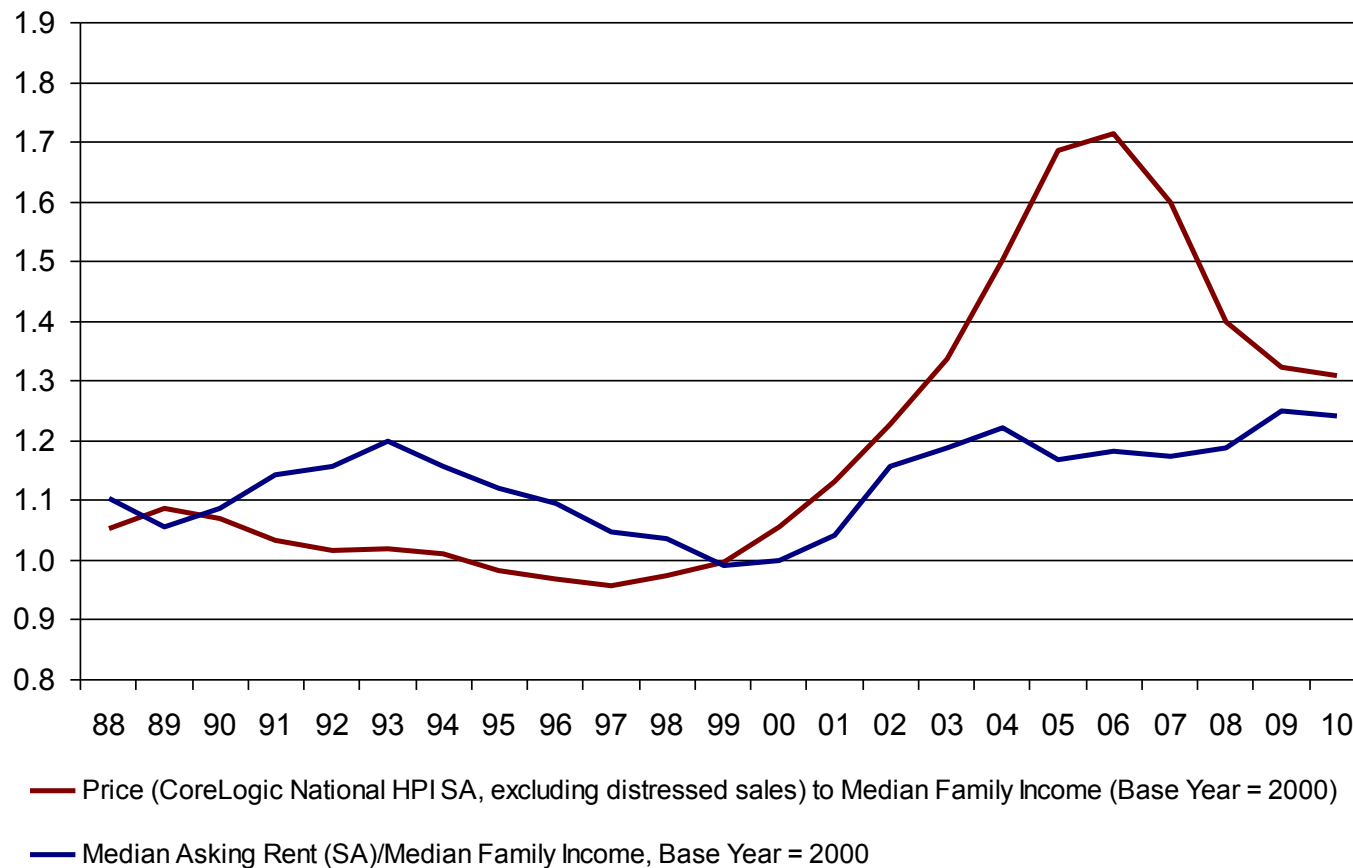
Period	Non-Amortized	Amortized
1920-1929	5.1%	94.9%
1930-1934	6.7%	93.3%
1935-1941	0.3%	99.7%
1942-1945	0.2%	99.8%
1946-1947	0.8%	99.2%

Regional importance on average interest rates for residential mortgages outstanding diminished between 1890 and 1940.

Region	1890	1920	1934	1940
New England	5.5%	5.8%	5.93%	5.38%
Middle Atlantic	5.5%	5.7%	5.65%	5.47%
East North Central	6.8%	6.1%	6.18%	5.45%
West North Central	7.8%	6.5%	6.09%	5.48%
South Atlantic	6.3%	6.3%	6.25%	5.63%
East South Central	7.0%	6.4%	6.59%	5.64%
West South Central	9.0%	7.9%	6.99%	5.97%
Mountain	9.3%	7.5%	7.02%	5.79%
Pacific	8.6%	6.8%	6.34%	5.73%
United States	6.2%	6.1%	6.18%	5.55%
Difference: Maximum Less Minimum	380bp	220bp	137bp	59bp

“Perhaps the most important long-term change in the structure of residential mortgage interest rates has been the decline in regional differentials.... It has resulted both from the improvement of lending facilities and the decrease in risks of mortgage lending in what were young regions in 1890 and from greater mobility of mortgage funds, through which local markets became less isolated.”

Today - return of private capital depends on private sector expectation for house prices...



...and clarity regarding capital and risk.

- The boundaries of the government's implicit and explicit assumption of mortgage credit risk
- Favored consumer products, allowable products, and demand for hard money / private lenders
- Capital requirements by
 - Product type
 - Function
 - Type of entity
- Timing

**Policy:
All You Ever Asked For – And More**

Monetary policy is easy.

Short rates remain low and yield curve is steep.



Fiscal policy – unpalatable choices from here on.

Federal Government

Receipts and Outlays as a Percent of GDP

	Receipts	Outlays	Deficit
<u>Historical</u>			
1946 to 2010	17.7	19.7	-2.0
Standard deviation	1.2	2.5	
<u>Forecast</u>			
2011 to 2016	17.7	23.1	-5.4

Policy Choices

- Higher Taxes
- Less Spending
- Growth
- Inflation

U.S. fiscal policy threatens our economic status.

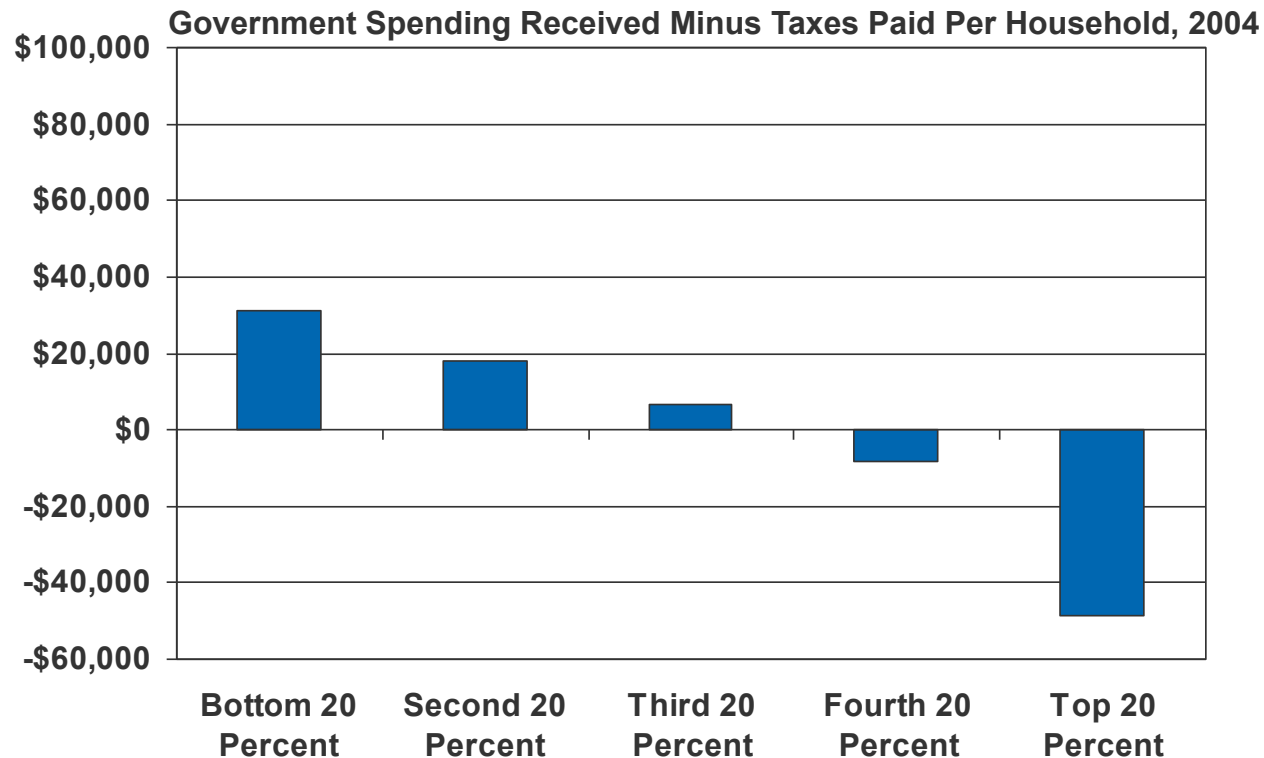
Losing ground relative to other developed economies

OECD projections of fiscal balances and debt assuming modest cuts

As percentage of nominal GDP (unless otherwise specified)

	Underlying fiscal balance 2012	Financial balances			Net financial liabilities			Gross financial liabilities			Long term interest rate (%)		
		2007	2010	2026	2007	2010	2026	2007	2010	2026	2007	2010	2026
Greece	-1.4	-6.7	-10.4	-4.4	80	114	117	113	147	146	4.5	9.1	7.9
Iceland	-1.0	5.4	-7.8	-2.5	-1	43	41	53	120	118	9.8	5.0	6.6
Ireland	-4.0	0.1	-32.4	-4.0	0	59	81	29	102	131	4.3	6.0	6.9
Italy	-1.3	-1.5	-4.5	-3.1	87	99	93	113	127	122	4.5	4.0	6.5
Japan	-5.9	-2.4	-8.1	-5.0	81	116	162	167	200	248	1.7	1.1	4.9
Portugal	-0.9	-3.2	-9.2	-1.1	50	69	59	75	103	95	4.4	5.4	5.9
Spain	-1.2	1.9	-9.2	-2.4	19	40	52	42	66	78	4.3	4.2	4.7
United Kingdom	-5.7	-2.8	-10.3	-3.7	28	56	83	47	82	109	5.0	3.6	5.6
United States	-8.2	-2.9	-10.6	-6.0	43	67	122	62	94	148	4.6	3.2	7.2
Euro Area	-1.9	-0.7	-6.0	-2.4	42	58	61	72	93	96	4.3	3.6	5.4
OECD	-5.0	-1.3	-7.6	-3.5	38	58	83	73	98	122	4.8	3.5	6.2

Net benefit to tax payers by income quartile shows strong progressivity in current tax system.



Income Quintile	Bottom 20%	Second 20 %	Middle 20%	Fourth 20%	Top 20%
2004 Upper Income Bound	\$23,700	\$42,305	\$65,001	\$99,502	No Upper Bound

State and local fiscal challenges also are significant.

Cyclical Challenges

Recession led to a decline in

- Income taxes
- Sales taxes
- RE taxes and fees

Increased demand for

- Healthcare
- Education
- Social services

Close the gap with

- One-time cuts and funds
- Federal stimulus
- Tax and fee increase

Structural Problems

Pension Liability

- Union contracts with defined benefit plans
- Decline in share of plans that are fully funded
- Aggressive return assumptions

Healthcare costs are ballooning

- Flexibility under Medicaid rules
- State and local employees

Impact on future tax rates and services affects current ability to attract jobs

James Madison writing in Federalist 62 (1788):

In another point of view, great injury results from an unstable government. The want of confidence in the public councils damps every useful undertaking, the success and profit of which may depend on a continuance of existing arrangements. What prudent merchant will hazard his fortunes in any new branch of commerce when he knows not but that his plans may be rendered unlawful before they can be executed? What farmer or manufacturer will lay himself out for the encouragement given to any particular cultivation or establishment, when he can have no assurance that his preparatory labors and advances will not render him a victim to an inconstant government? In a word, no great improvement or laudable enterprise can go forward which requires the auspices of a steady system of national policy.

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