Now That We've Got That Recession Out of the Way, What's Next?

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What goes into a forecast?

Topics to be covered:

- The growth of the economy
- Employment
- Home prices, sales and delinquencies
- Interest Rates
- The future of the GSEs

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The Economy

Economic Recovery Meets Sesame Street: Will the Recovery be a V, W or U?

Arguments for a V-shaped recovery:

Very deep recession will result in quick recovery due to pent-up consumer demand and low inventories.

Arguments against a V:

No evidence of strong demand and, unlike past deep recessions, much smaller component of GDP is manufacturing.

Alphabet Economics (continued)

Arguments for a W-shaped recovery (another recession):

The recovery we have seen is not sustainable. Stock market and home price declines have destroyed $14 trillion in consumer wealth and left them unlikely to buy big-ticket items without “Cash for clunkers”-type programs. Commercial real estate problems will further hurt the banks. The Federal Reserve has no more tools left to help the recovery we can’t afford another fiscal stimulus.

Arguments against a W:

While the recovery is likely to slow in the first half of 2010 and consumers have been slow to come back, they have gained back $4 trillion in wealth. The financial system is in much better shape than it was a year ago.

Alphabet Economics (continued)

Arguments for a U-shaped recovery:

Remaining economic weakness in the economy, especially consumer confidence tied to employment. Big drops in home prices are behind us, but employment gains and jumps in consumer spending and new home construction are about a year away. Capital constrained banks and credit constrained households and businesses result in limited ability to increase spending.

Arguments against a U:

See **V** and **W**

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MBA forecasts a modified U

	2008	2009				2010				Q4-over-Q4		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009	2010
Percent Change, Annual Rate												
Real Gross Domestic Product	-5.4	-6.4	-0.7	3.5	2.9	2.6	2.4	2.8	3.3	-1.9	-0.3	2.8
Personal Consumption Exp.	-3.1	0.6	-0.9	3.4	1.4	2.0	1.3	1.8	2.4	-1.8	1.1	1.9
Business Fixed Investment	-19.5	-39.2	-9.6	-2.5	-0.9	0.2	1.2	5.6	8.3	-6.0	-14.6	3.8
Residential Investment	-23.2	-38.2	-23.3	23.4	12.1	7.3	8.3	14.6	14.4	-21.0	-10.0	11.1

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How balanced are the risks that the forecast is wrong?

The risks are clearly on the downside:

- Will inflation be a problem?
- Will the Federal Reserve be forced to increase interest rates earlier than expected?
- Is the increase in the savings rate permanent?
- The Fed is out of tools to use and we can’t afford another stimulus package.

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But what about the stimulus package?

Amount appropriated: $787 Billion

Amount spent through 9/30/09: $161 Billion

Estimated $184 billion in FY2009, $399 billion in FY2010, and $91 billion in FY2011-2015

How spent so far?

- Expansion of child tax credit, homebuyer tax credit and other tax credits and tax cuts 26%
- State fiscal relief 25%
- Extension of unemployment benefits and COBRA subsidy 20%
- Expanded net loss carrybacks and other business tax breaks 11%
- Direct spending on transportation and other infrastructure 11%
- AMT relief 6%

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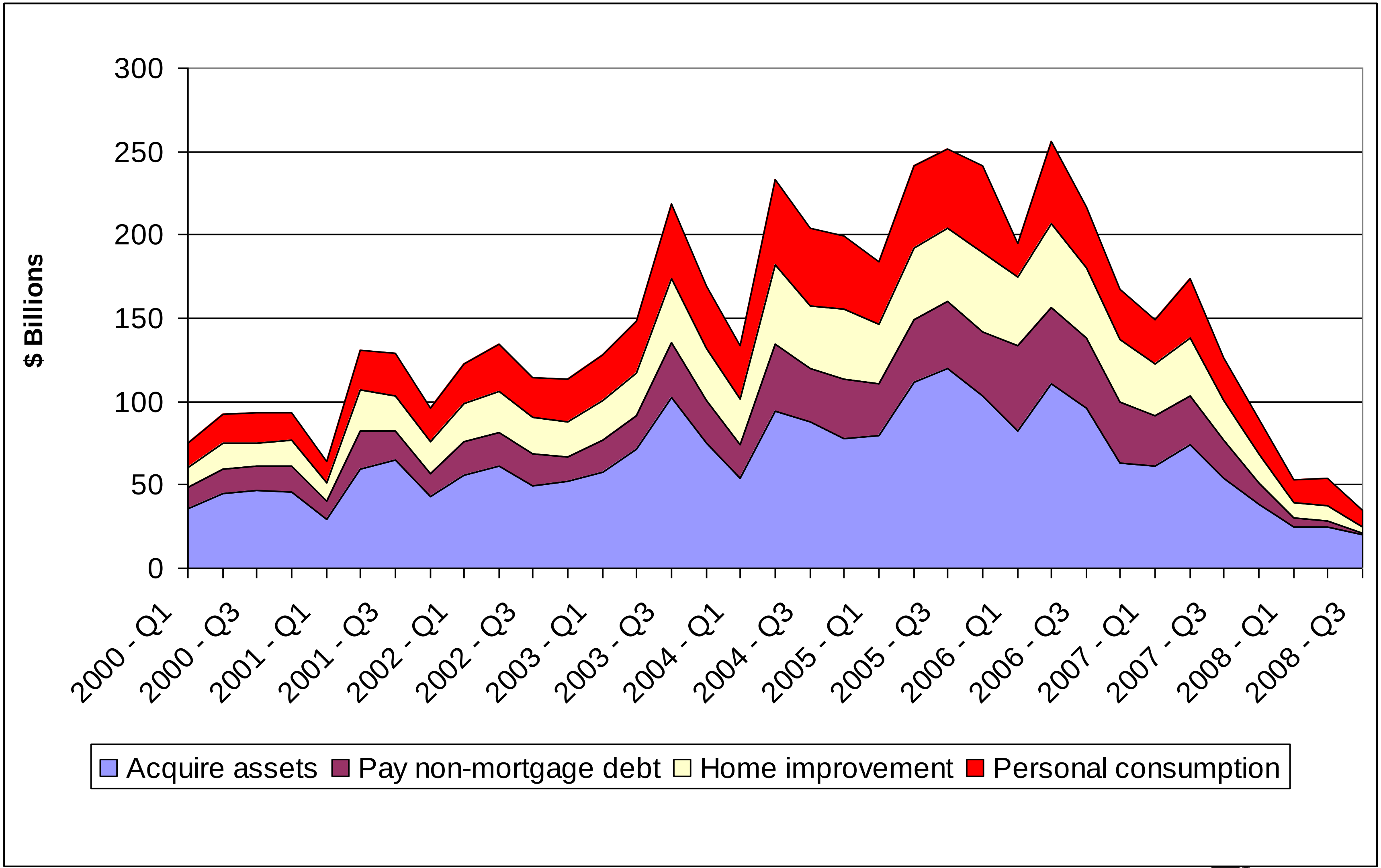
Size and Use of Home Equity Extraction 2000- 2008



Source: Greenspan & Kennedy, Federal Reserve

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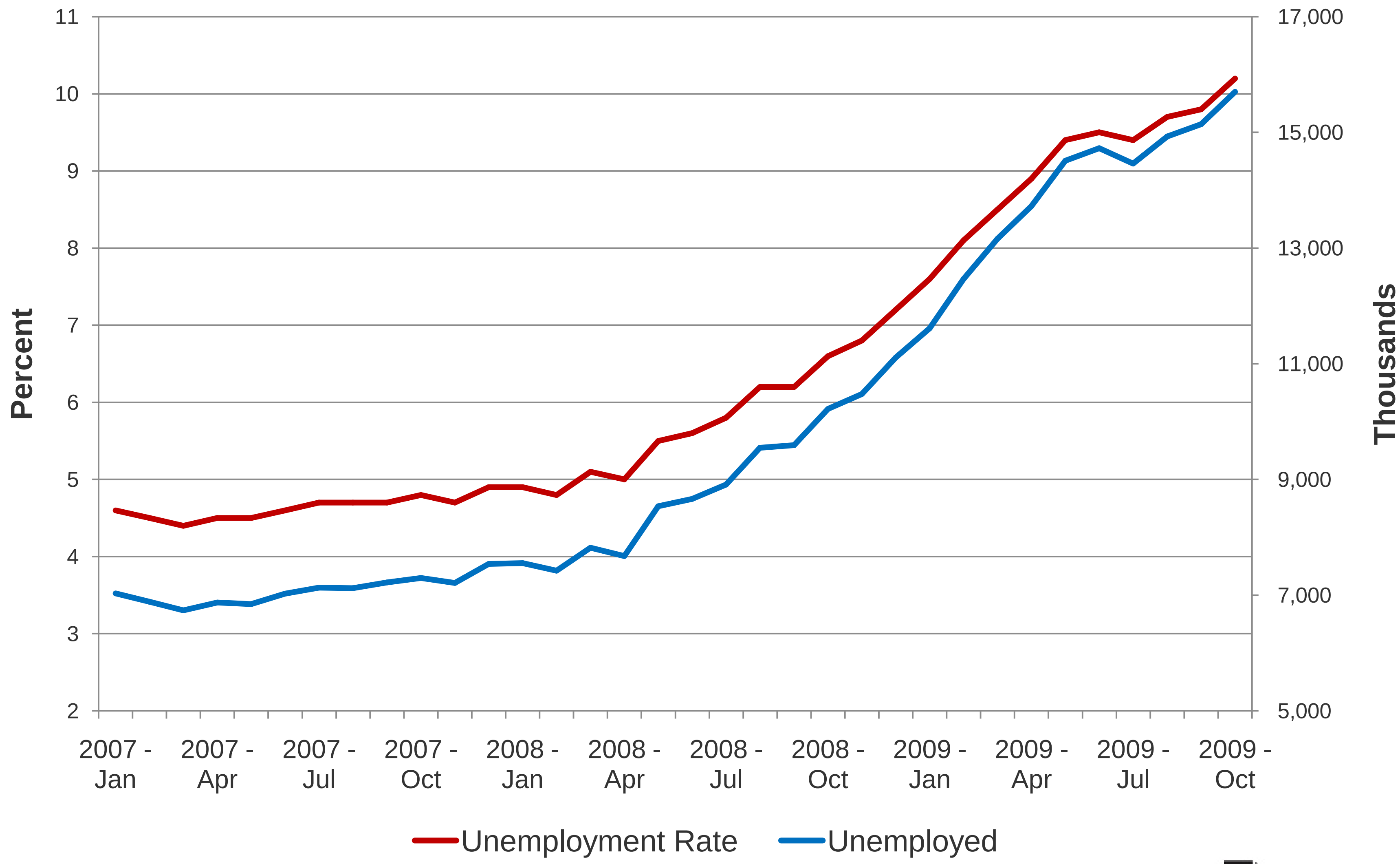
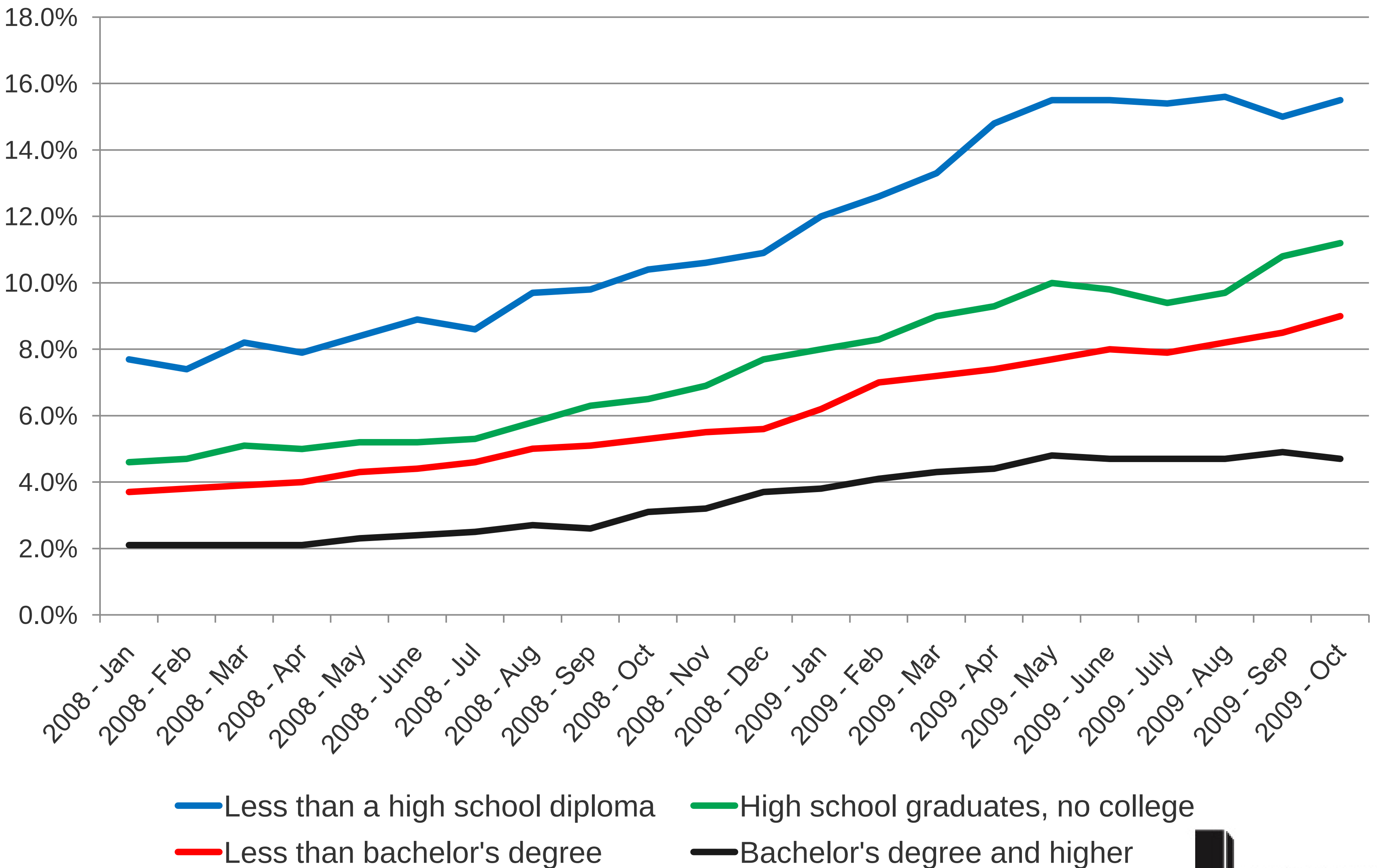
Unemployment



Unemployment Rates by Education



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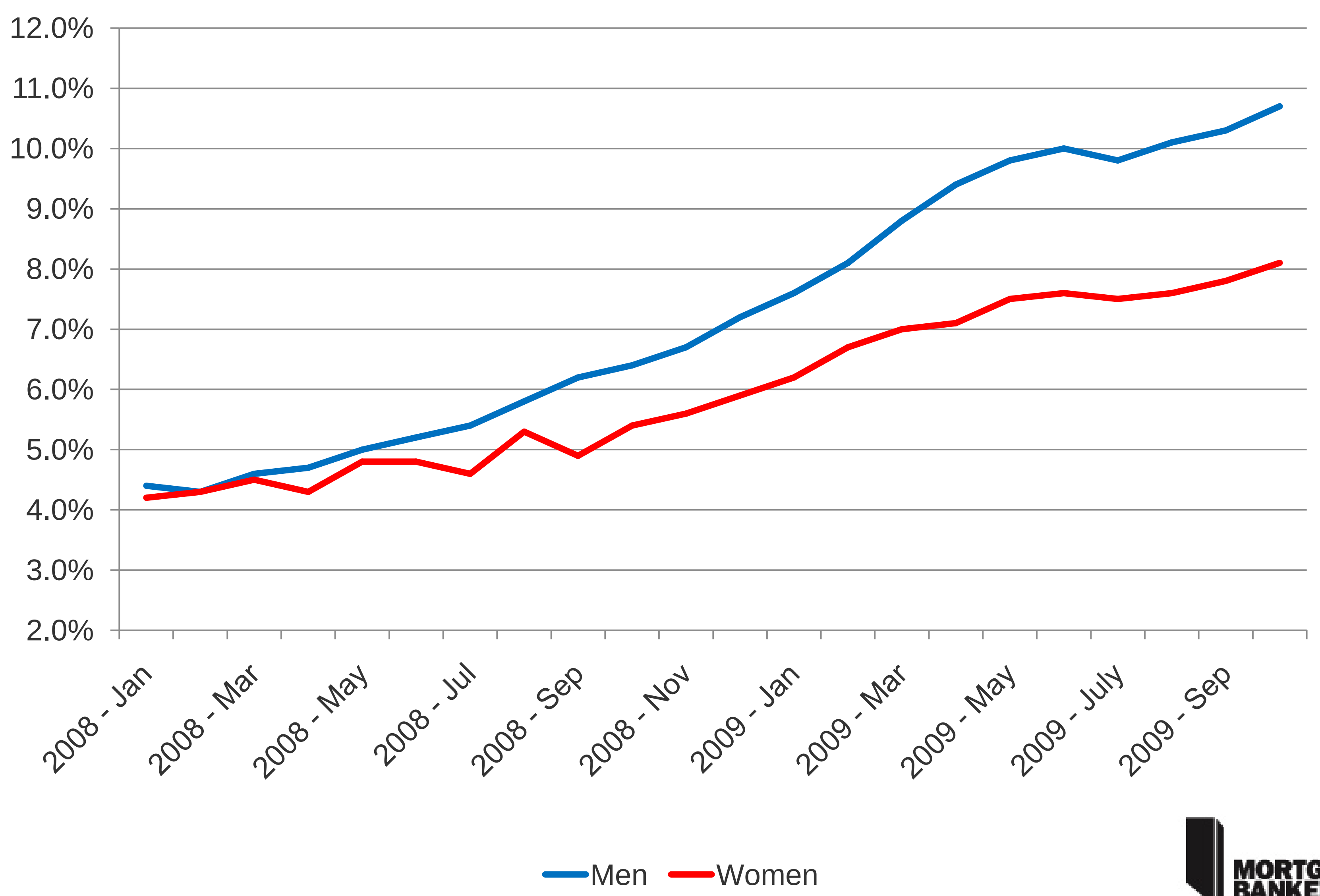
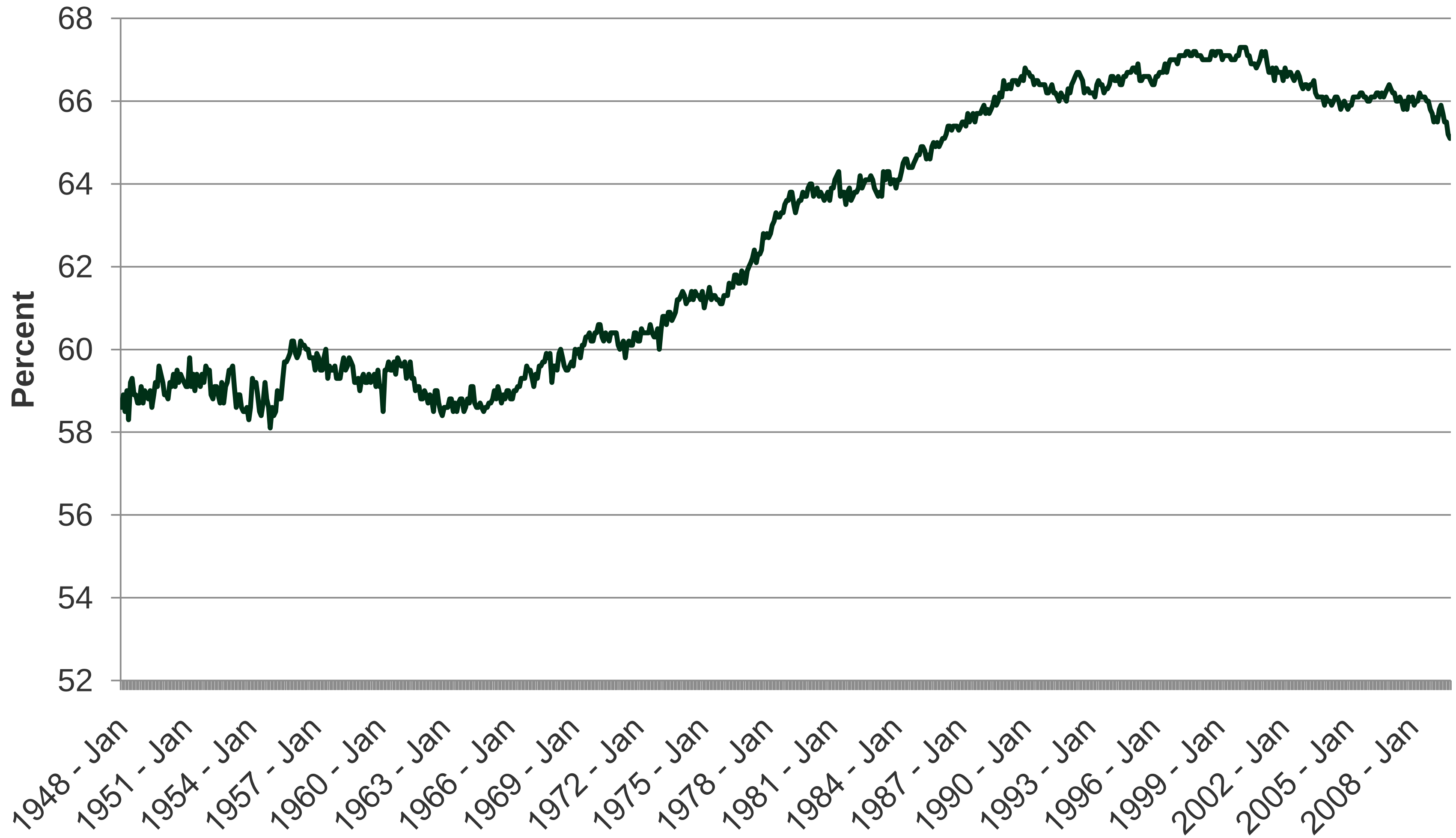
Unemployment Rate by Gender



Percent of Population Employed



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State Unemployment Rates (Seasonally Adjusted)

Highest 5 States	Sep-08	Sep-09
Michigan	8.9	15.3
Nevada	7.3	13.3
Rhode Island	8.5	13.0
California	7.8	12.2
S. Carolina	7.5	11.6

Lowest 5 States		
Virginia	4.1	6.7
Utah	3.4	6.2
Nebraska	3.4	4.9
South Dakota	3.2	4.8
North Dakota	3.3	4.2

Other Large States	Sep-08	Sep-09
N. Carolina	6.8	10.8
Ohio	6.8	10.1
Florida	6.7	11.0
Illinois	6.7	10.5
Arizona	6.0	9.1
New York	5.8	8.9
Texas	5.1	8.2

Source: BLS, Regional and State Employment Report

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Metro Unemployment Rates (NSA)

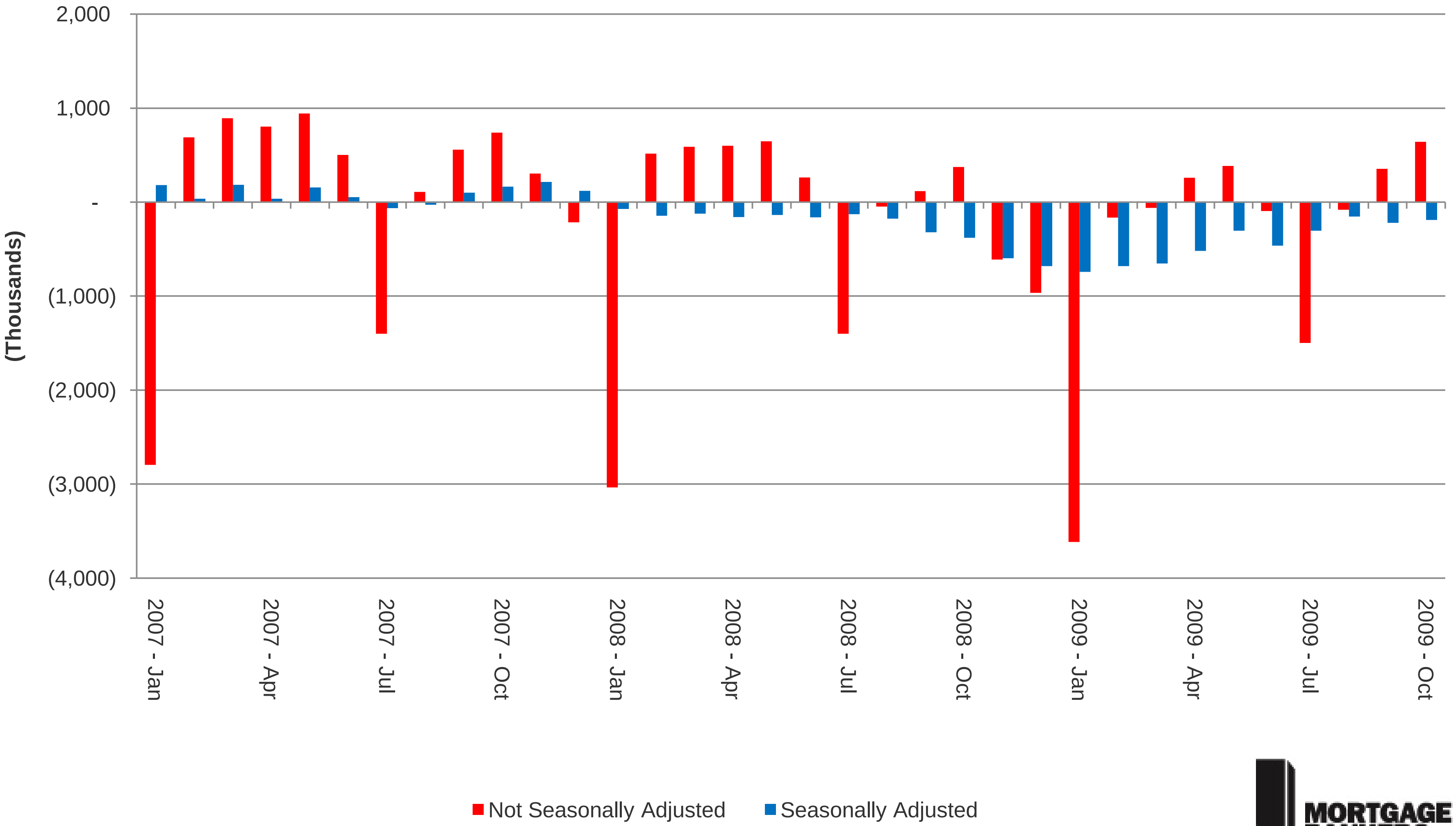
Highest 5 Metros	Sep-08	Sep-09
Detroit	10.6	18.5
Warren, MI	8.4	17.0
Riverside, CA	9.0	14.1
Las Vegas	7.5	13.7
Los Angeles	8.3	12.7

Lowest 5 Metros		
Austin	4.8	7.3
Denver	5.3	7.3
San Antonio	5.0	7.2
Virginia Beach	4.4	6.8
DC Metro	4.2	6.5

Other Large Metros	Sep-08	Sep-09
Charlotte	7.2	12.0
Miami	6.1	10.9
Orlando	6.5	11.5
San Diego	6.6	10.4
New York City	6.0	10.0
Chicago	6.4	10.5
San Francisco	5.4	9.4
Seattle	4.7	8.9
Boston	5.6	9.1
Houston	5.0	8.5
Dallas	5.4	8.5

Source: BLS, Metro Area Employment Report. Ranking based upon 50 largest CBSAs by population.

Monthly Changes in Payroll Employment



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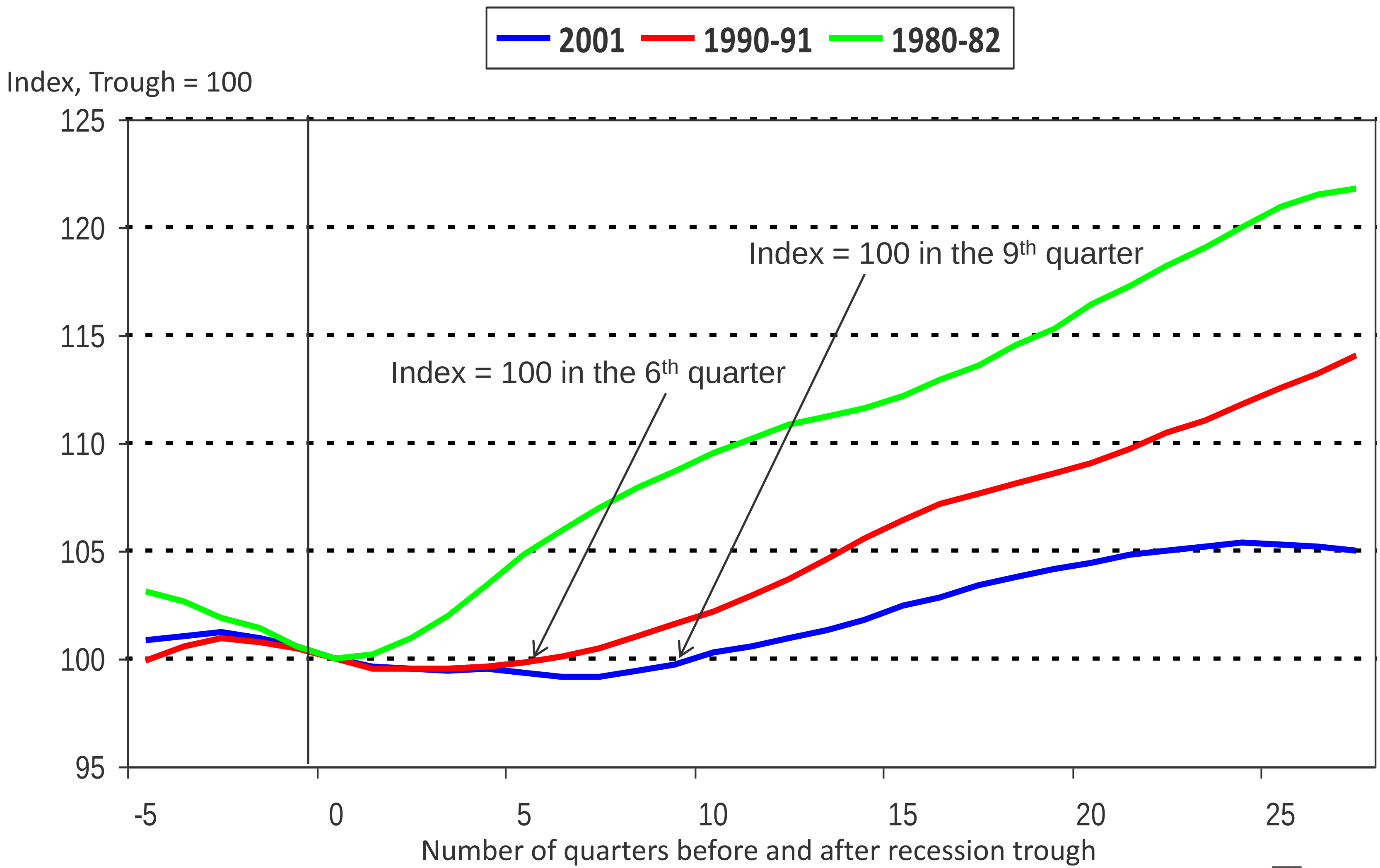
Payroll Employment – Time to Recovery after End of Recession



The level of payrolls in the quarter when the recession ended is set to 100

Source: The Bureau of the Labor Statistics, MBA calculation

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Projected Unemployment Rate

2008	2009				2010				2011			
Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
6.9	8.1	9.2	9.6	10.2	10.3	10.2	10.1	10.0	10.0	9.8	9.5	9.2

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The Outlook for Single-Family Housing

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Home Prices and Sales

What factors drive demand?

- Jobs growth
- Job-related relocations
- Demographics – age and immigration
- Shift out of rentals
- Bringing forward demand from later periods
- Investor conversion from owner-occupied to rental

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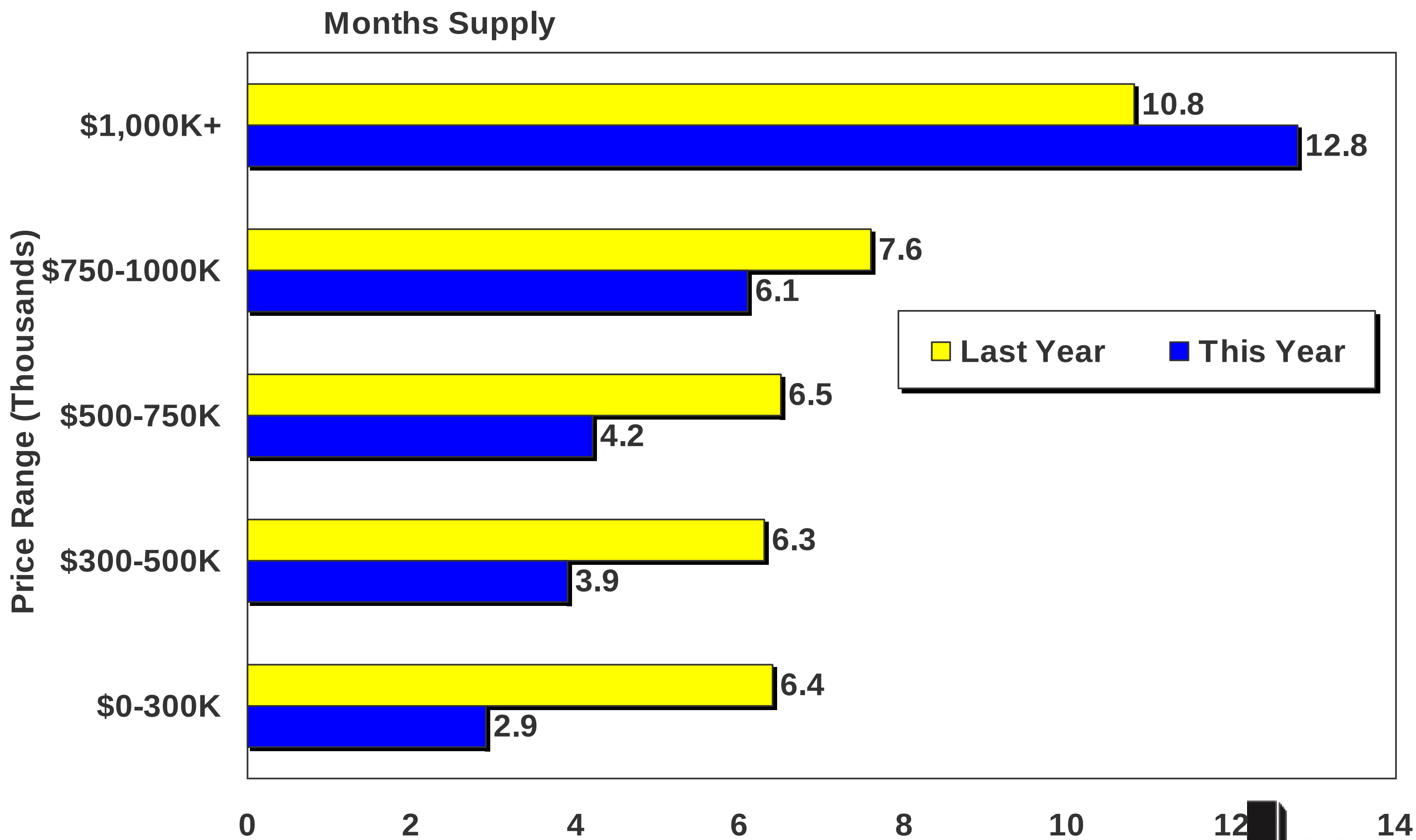
Homebuyer Tax Credit

- 1.4 million homebuyers claiming the first-time homebuyer tax credit as of 9/30/09.
- Estimates of the marginal impact of the credit on home sales range from 150,000-400,000
- How many of these 150,000 to 400,000 buyers were brought forward from 2010 and 2011?
- Recall that US auto sales fell 23% in September after the end of the cash for clunkers program.

Lower-priced homes are moving

- California - Existing Homes August 2009 vs. August 2008



SOURCE: California Association of REALTORS®

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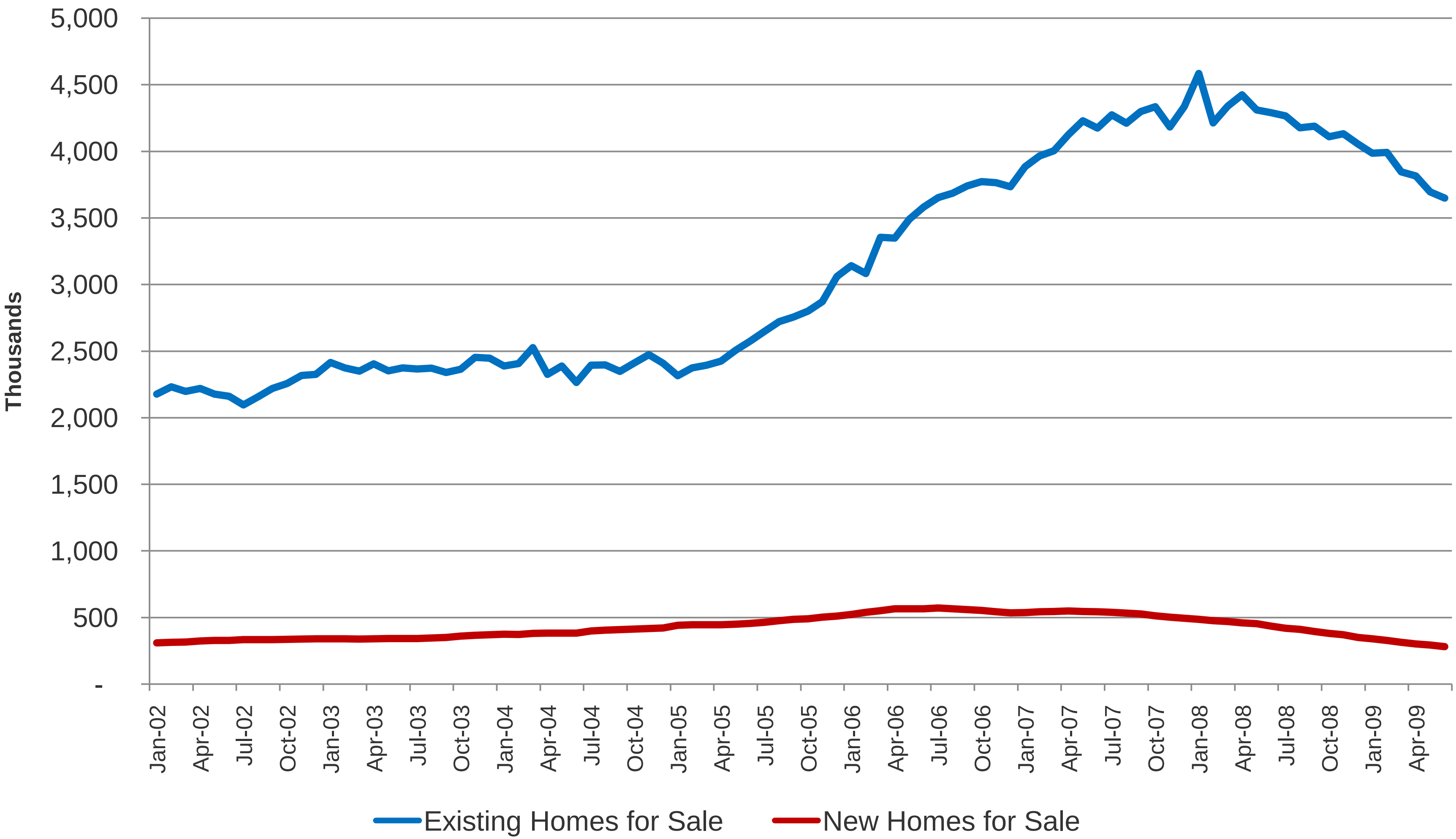
Home Prices and Sales

What factors drive supply?

- Voluntary move up or move down
- Jobs relocation
- Demographics – age and migration
- New construction
- Conversion from rental to owner-occupied
- REO, short sales and similar distressed sales

Inventory of Homes for Sale



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Inventory Overhang from Foreclosures

Approximate number of loans seriously delinquent:

2006 - Q2	893,000
2007 - Q2	1,214,000
2008 - Q2	2,271,000
2009 - Q2	3,960,000

Impact on inventory will depend on cure rates.

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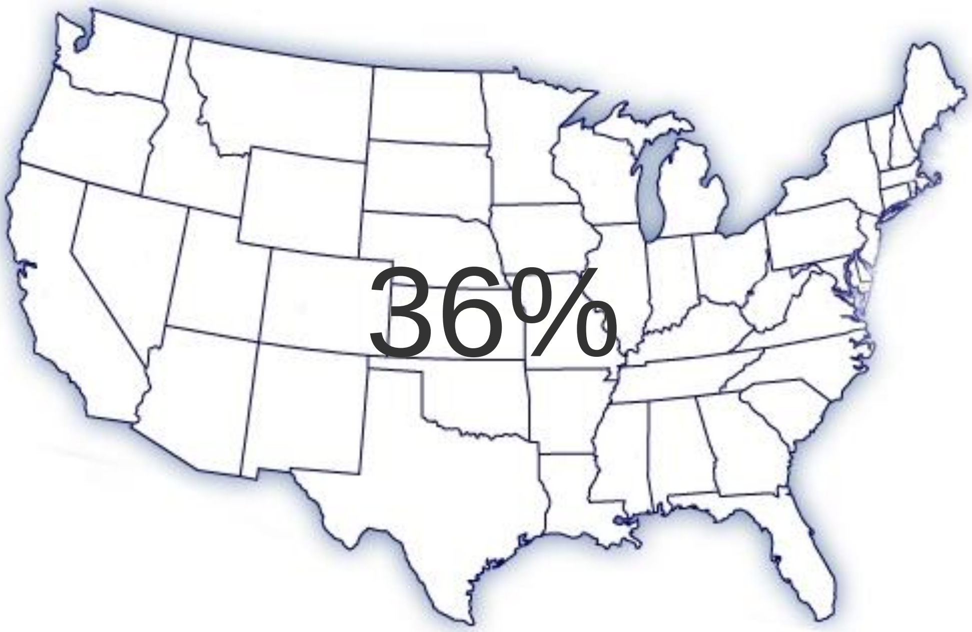
Data from Freddie Mac on Vacant Properties and Foreclosures

Vacancy Rate for Key States[1]

(Overall Rate for 90+Foreclosure Loans for 07/31/2009)

State	Percent Vacant
Arizona	41
California	32
Florida	56
Georgia	41
Illinois	34
Michigan	41
Nevada	45
New York	34
Ohio	46
Pennsylvania	39
Texas	44



1: Vacancy Rate based on vacant/unknown properties, excludes any REO acquisitions.

Source: Freddie Mac

Foreclosures by Loan Type

Q209

Product	**Percent of US Loans Outstanding**	**Percent of US Foreclosures Started**
Prime Fixed	65.5%	32.4%
Prime ARM	12.4%	25.1%
Subprime Fixed	6.3%	13.2%
Subprime ARM	5.0%	20.2%
FHA	10.7%	9.1%
Total	**100%**	**100%**

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Four States Have Largest Shares of Foreclosures

Q209 — Prime Fixed

State	Percent of US Loans Outstanding	Percent of US Foreclosure Starts
California	12.1%	13.8%
Florida	7.3%	16.8%
Nevada	1.0%	3.0%
Arizona	2.5%	5.1%
Total	**22.9%**	**38.8%**

Q209 — Prime ARM

State	Percent of US Loans Outstanding	Percent of US Foreclosure Starts
California	28.8%	36.0%
Florida	11.7%	18.6%
Nevada	2.4%	5.2%
Arizona	3.6%	5.7%
Total	**46.4%**	**65.5%**

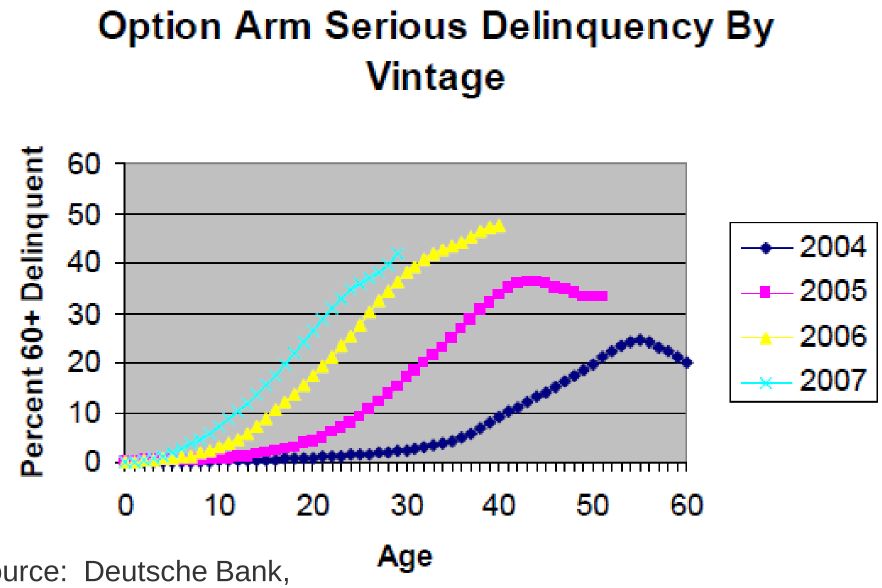
Q209 — Subprime Fixed

State	Percent of US Loans Outstanding	Percent of US Foreclosure Starts
California	10.1%	12.2%
Florida	9.2%	13.9%
Nevada	1.1%	2.0%
Arizona	2.3%	3.7%
Total	**22.6%**	**31.7%**

Q209 — Subprime ARM

State	Percent of US Loans Outstanding	Percent of US Foreclosure Starts
California	17.3%	21.3%
Florida	13.8%	16.2%
Nevada	2.5%	4.3%
Arizona	4.3%	6.0%
Total	**37.9%**	**47.9%**

Option ARMs: Tidal Wave or Ripple?



Source: Deutsche Bank,

Table 1: Non-agency modifications by product type
August remittance

Product Type	Number of Mods Aug	Jul	% Chg	Total to Date	% of Out
Prime Fixed	211	214	-1%	8,369	2%
Prime Hybrid	424	448	-5%	17,335	3%
Alt-A Fixed	2,291	2,170	6%	46,079	4%
Alt-A Hybrid	3,208	2,960	8%	53,856	6%
Option ARM	1,696	1,562	9%	171,231	26%
Subprime Fixed	6,061	6,690	-9%	150,055	10%
Subprime Hybrid	12,262	13,367	-8%	458,455	20%
Total	26,153	27,411	-5%	905,380	12%

Source: JPMorgan, Loan Performance

- Worst performing among prime products
- Lower short-term rates mitigate recast risk
- Seasoning – default rates may have peaked
- Benefits of refi and mod activity – 26% of outstanding Option ARMs have been modified.

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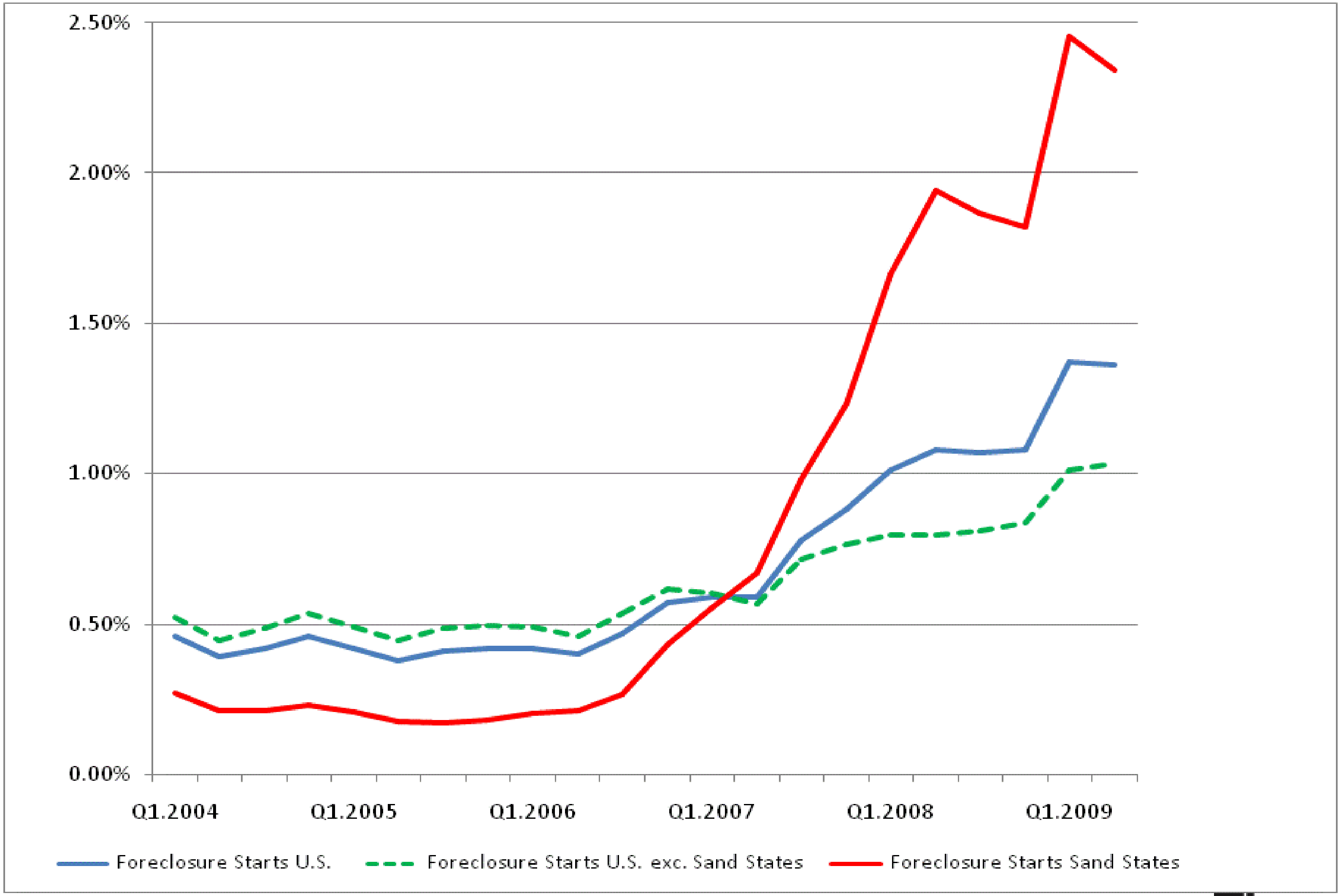
Impact of CA, FL, NV and AZ on US Foreclosure Rate



Source: Mortgage Bankers Association National Delinquency Survey

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Sales and Originations Forecast

	2005	2006	2007	2008	2009	2010	2011	2012
Housing Measures (Thous)								
Housing Starts	2,068	1,801	1,355	906	574	750	1,025	1,337
Single-Family	1,716	1,465	1,046	622	447	610	840	1,087
Two or More	352	336	309	284	127	140	185	250
Home Sales								
Total Existing Homes	7,075	6,478	5,652	4,913	5,012	5,575	6,017	6,305
New Homes	1,283	1,051	776	485	398	484	609	749
Med Price Existing Homes	219.6	221.9	219.0	198.1	172.2	173.6	178.2	185.5
Med Price New Homes (000s)	240.9	246.5	247.9	231.9	211.0	212.0	217.9	226.4
Mortgage Originations								
Total 1- to 4-Family (Bil $)	2,912	2,726	1,954	1,509	1,963	1,493	1,482	1,550
Purchase	1,513	1,400	966	731	718	811	894	980
Refinance	1,399	1,326	988	777	1,245	681	589	570
Refinance Share (%)	48	50	37	52	63	46	40	37

Interest Rate Outlook

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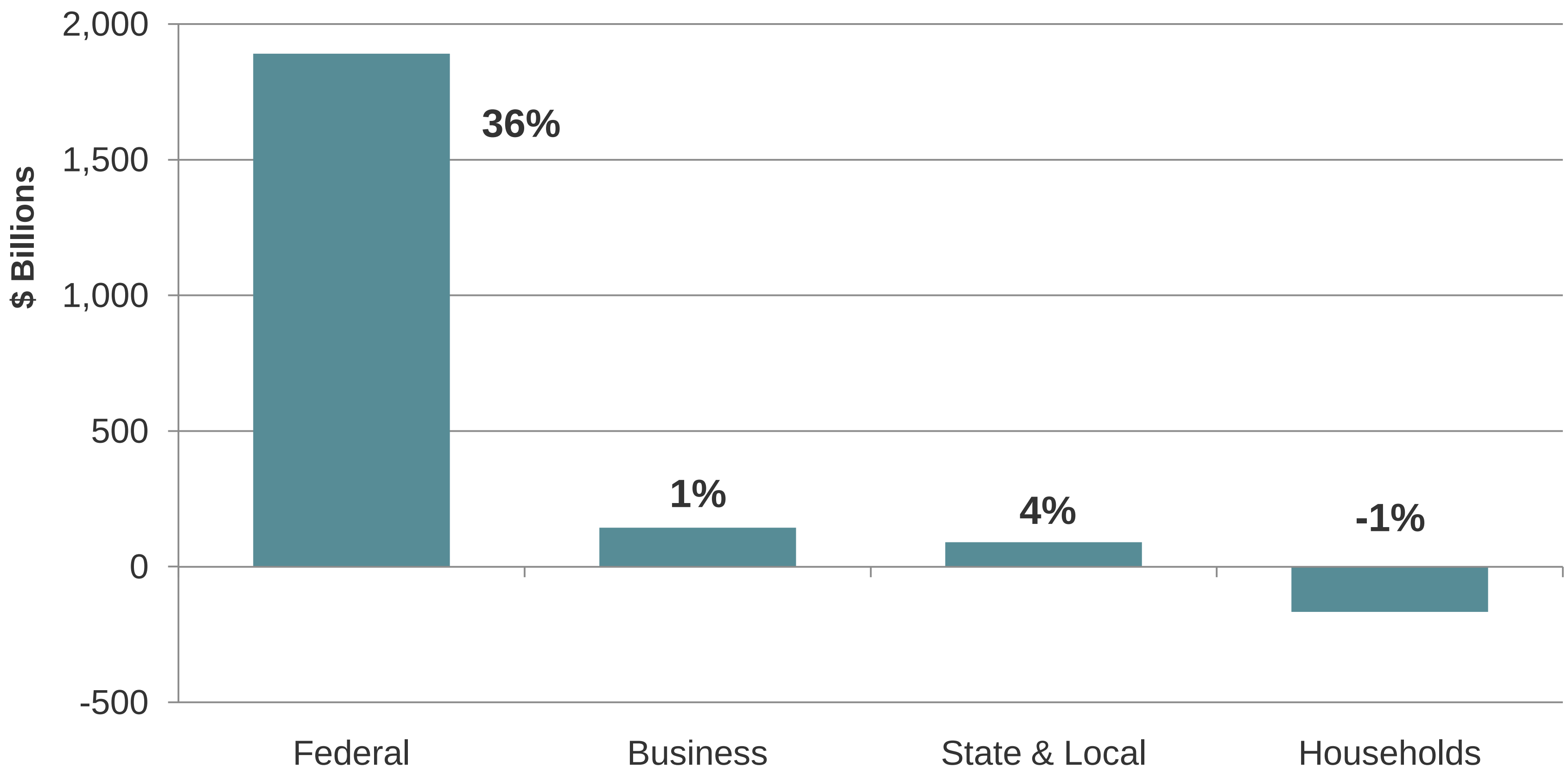
Interest Rates

	2009				2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
10-Year Treasury	2.7	3.3	3.5	3.3	3.4	3.5	3.6	3.8	4.0	4.2	4.3	4.3
30-Year FRM	5.1	5.0	5.2	5.0	5.2	5.3	5.4	5.6	5.8	6.0	6.1	6.1
Spread	233	172	165	170	180	180	180	180	180	180	180	180
Fed Funds	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.5	0.8	1.0
1-Year Treasury	0.6	0.5	0.4	0.3	0.3	0.4	0.5	0.6	0.9	1.2	1.5	1.8

Changes in Debt Outstanding 2008 Q2 to 2009 Q2



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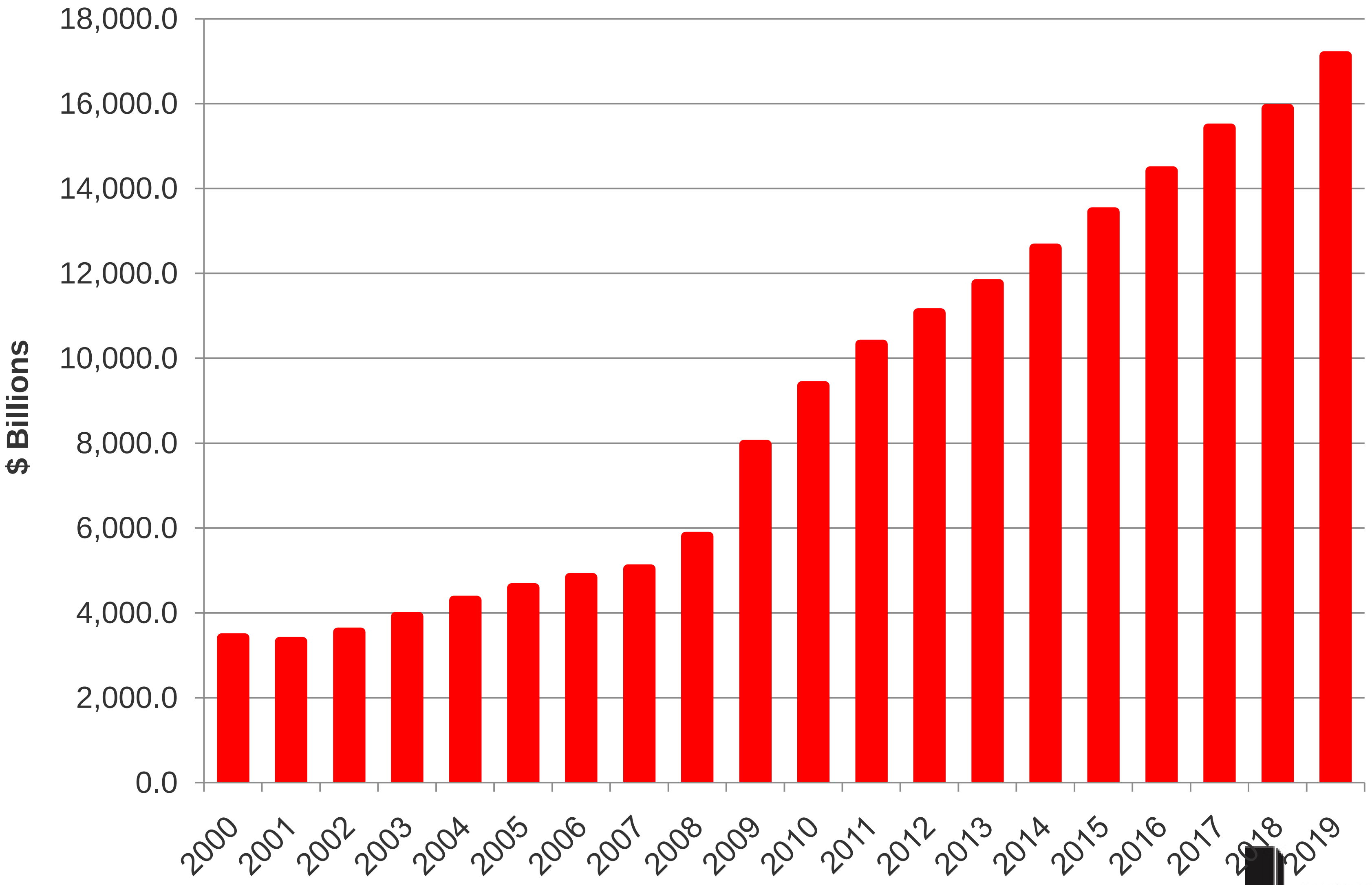
Who is Financing the Big Increase in Federal Debt?

	Change 2008 Q2 to 2009 Q2		% of Treasuries Outstanding	% of Increase in Treasuries Outstanding
	$	%		
Households	237.8	65%	7%	13%
Business	11.6	12%	2%	1%
State & Local	6.1	1%	10%	0%
Rest of World	889.7	34%	49%	47%
Federal Reserve	177.7	37%	9%	9%
Banks & Thrifts	30.6	27%	2%	2%
Insurance & Pension	71	12%	11%	4%
Mutual Funds	468.3	94%	9%	25%
Total	1,893	36%	100%	100%

CBO Actual and Projected Federal Debt



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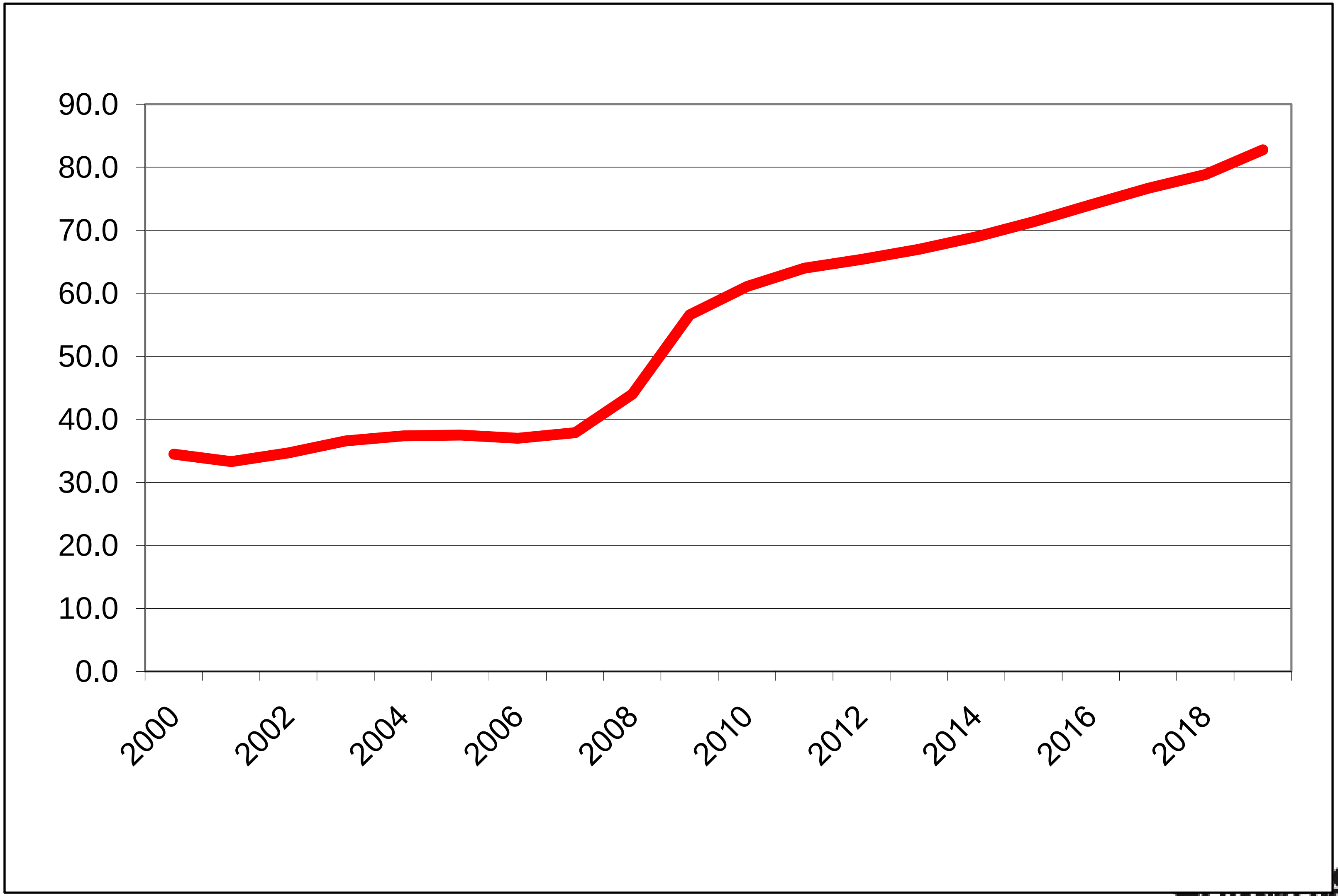
CBO Projected Federal Debt as % of GDP



Expectations of Inflation --- And Threats

Threats which could lead to increases in inflation:

- Concerns regarding the growing federal debt
- Potential for significant spike in oil prices and other commodity prices
- Significant drop in the value of the dollar due to portfolio reallocations by foreign investors and central banks

However, wage inflation will likely be low, productivity high, and overall economic growth low. Economic slack should limit price increases.

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Who is Buying GSE Paper?

	Change 2008 Q2 to 2009 Q2		% of Agency Paper - 2008 Q2	% of Agency Paper - 2009 Q2	% of Increase in Agency Paper
	$	%			
Households	(546)	-81%	10%	2%	-361%
Business	1	10%	0%	0%	1%
State & Local	(28)	-6%	6%	6%	-19%
Rest of World	(271)	-17%	23%	19%	-180%
Federal Reserve	710		0%	10%	470%
Banks & Thrifts	162	12%	19%	21%	107%
Insurance & Pension	(14)	-1%	16%	16%	-9%
Mutual Funds	138	8%	26%	27%	92%
Total	151.1		100%	100%	100%

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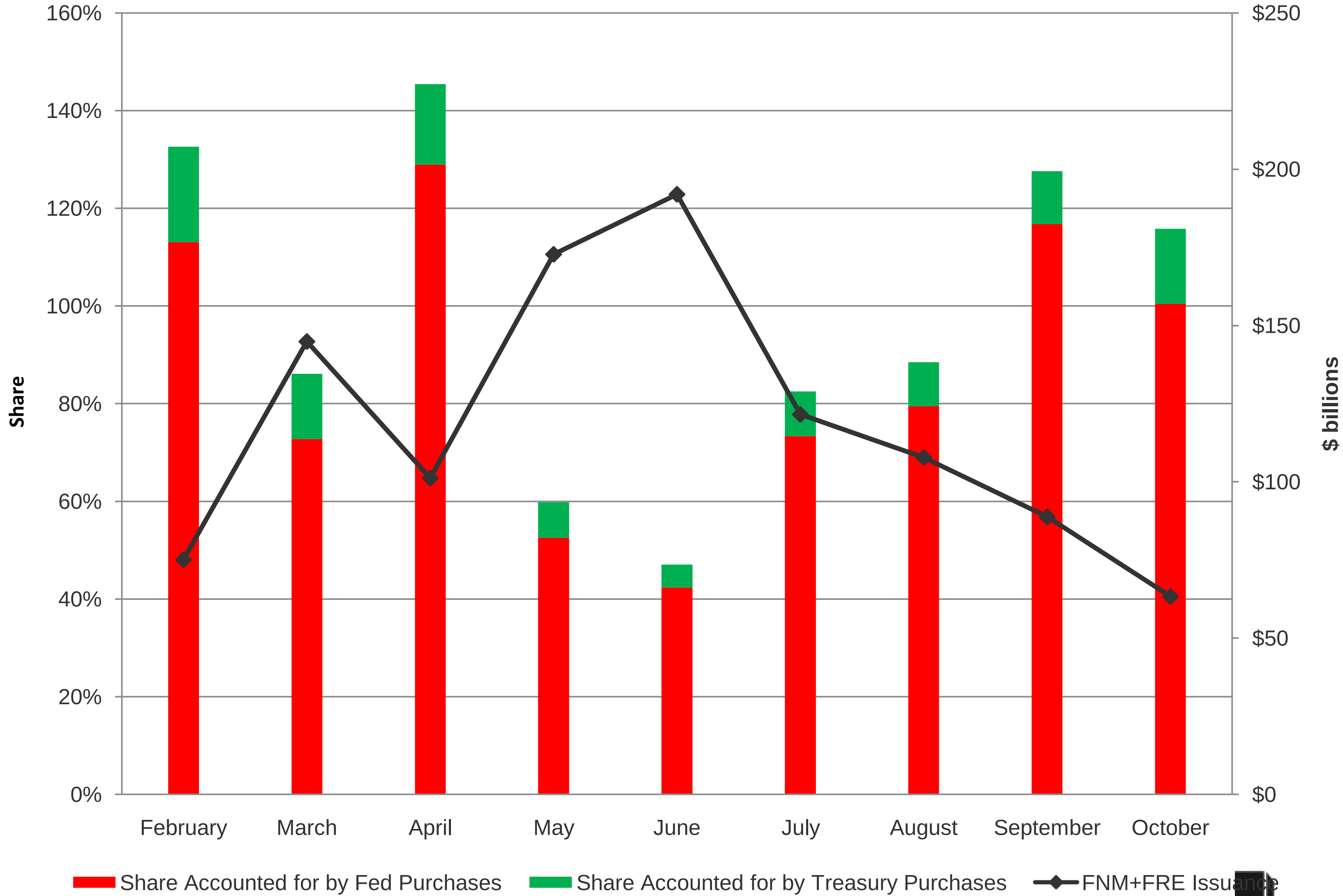
Change in Bank & Thrift Holdings of Agency Paper, Year over Year

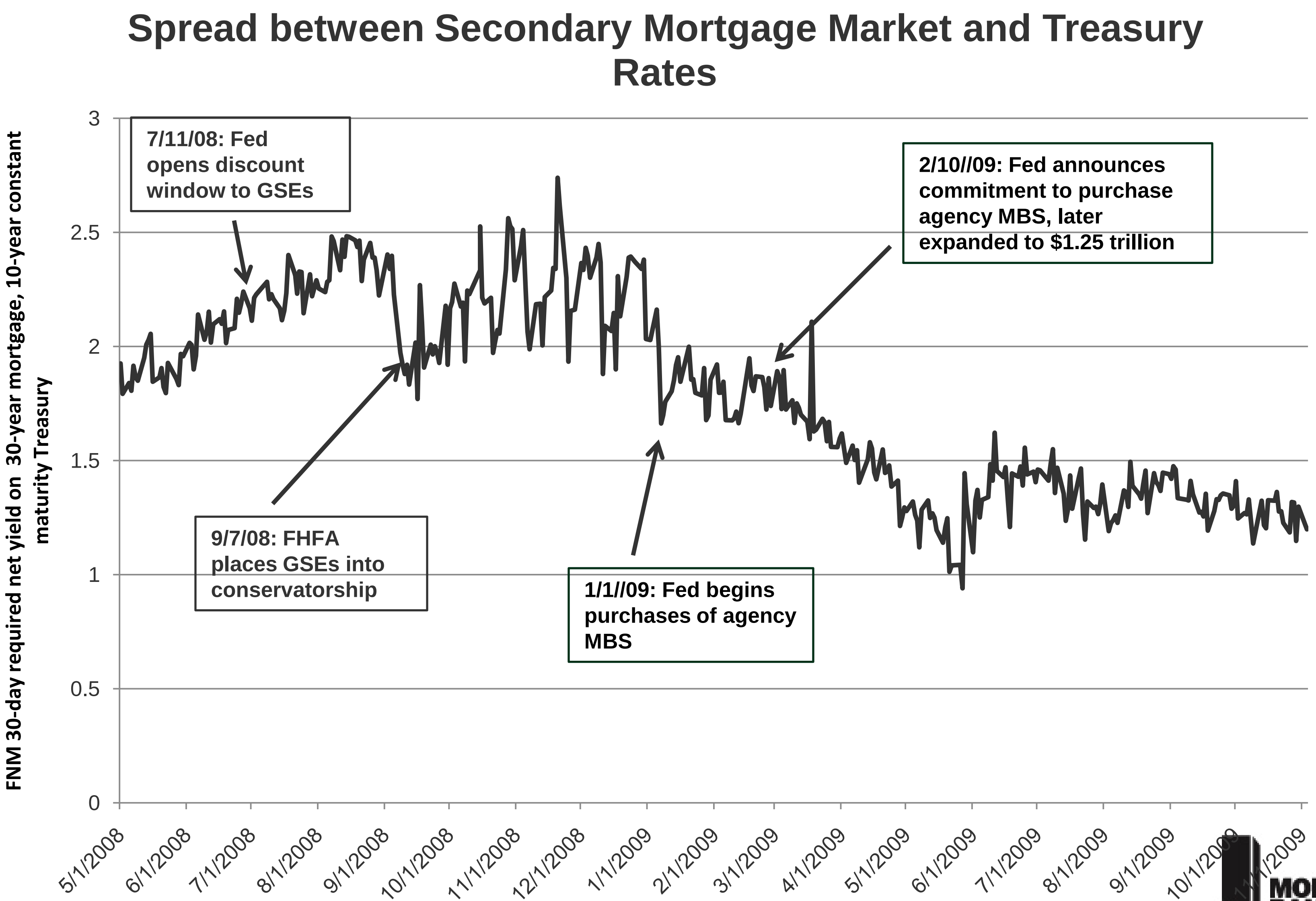
	2008 Q2	2009 Q2		Change	% change
Non GSE Agency Debt	6,037	10,634		4,597	76%
GSE Debt	178,651	196,411		17,760	10%
Fannie & Freddie MBS	639,538	673,936		34,398	5%
Ginnie Mae	43,010	118,971		75,961	177%
Fannie & Freddie CMO	194,847	229,049		34,202	18%
Total	1,175,073	1,337,514		162,441	14%

Fannie Mae and Freddie Mac MBS Issuance Data and Government Purchase Programs



Sources: Federal Reserve, FHFA, IMF, Treasury

Mortgage Spreads



Sources: Fannie Mae, Haver Analytics

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Where Will Spreads Be After the End of the Fed MBS Purchase Program?

1) The Fed is paying more than other investors are willing to pay, driving down option-adjusted spreads. Other buyers may come into the market with a relatively small increase in spreads.

2) Ambiguity over the duration of Federal support for Fannie and Freddie paper versus the duration of that paper was what led to the widening of spreads in the first place. What will be done to resolve that ambiguity before March 2010?

3) What is the impact on MBS prices going forward resulting from the overhang of $1.25 trillion in agency MBS in the hands of the Fed. Will the Fed need to be forthcoming on the initiation and pace of its selling strategy?

4) The Fed's action has limited the supply of long-term instruments for long-term investors, forcing down the yields on other instruments like Treasuries. The end of the purchase plan could raise all long-term yields as overall supply increases.

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What is Needed in a New Secondary Market Model

What Investors Need

1. Clearly defined federal credit support
2. Liquidity
3. Simplicity and/or information
4. Quality regulation of guarantors and systems

What Borrowers and Originators Need

1. Certainty of execution
2. Consistent offering of core products
3. Competitive pricing
4. Efficient means of hedging risk of interest rate locks

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Seeking the Right Balance- MBA's Plan for the GSEs

1) Make sure that private capital is the first line of defense against losses, with no institution too big to fail.

2) Establish an insurance fund as the second line of defense.

3) Make explicit what is or is not supported. Credit risk for MBS is supported, debt issued for held portfolios is not. 30-year fixed rate mortgages are allowed, pay-option ARMs are not.

4) Establish an explicit means of compensating the government for the guarantee.

5) Remove all indicia of implied federal support.

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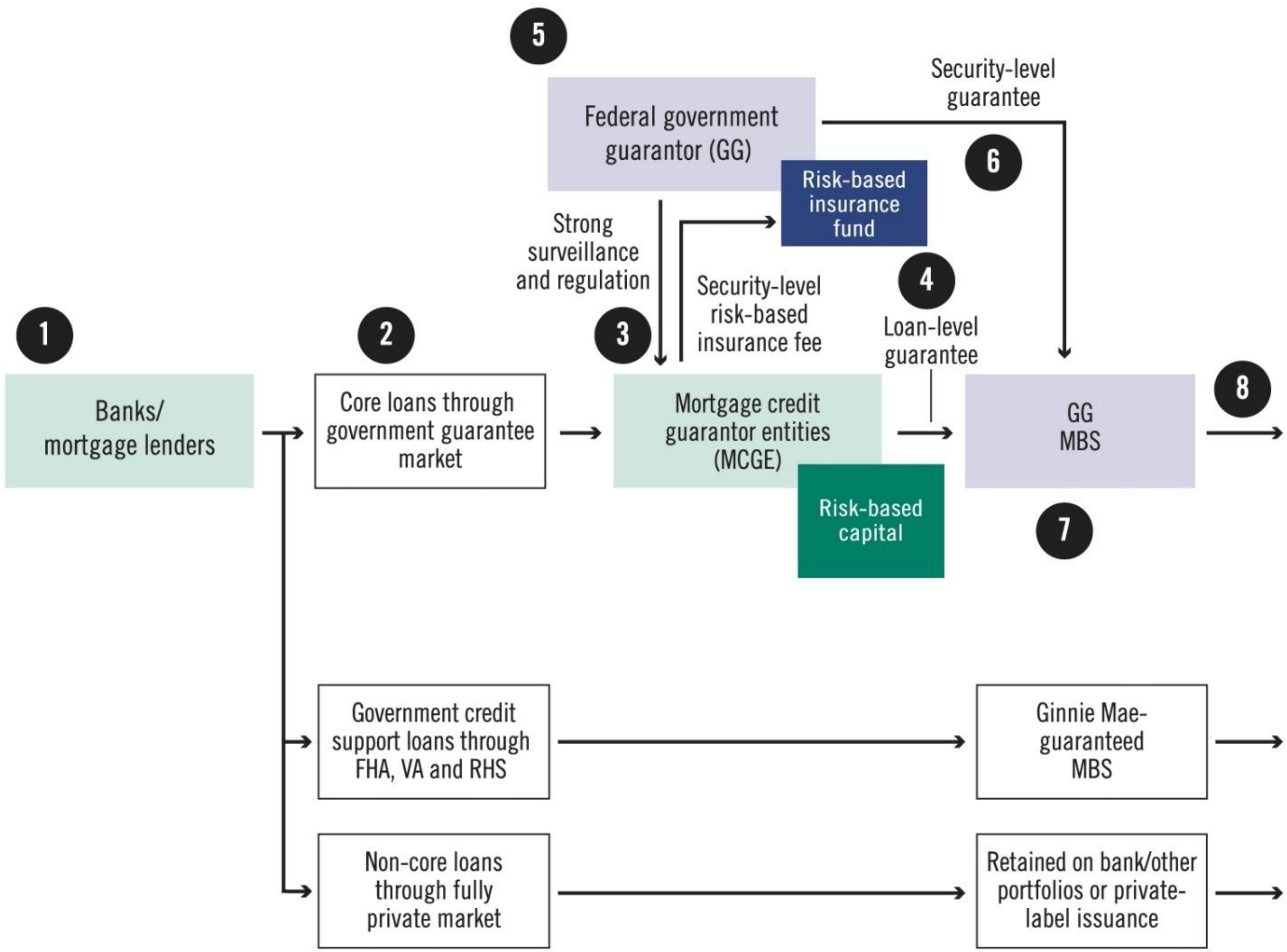
Core Secondary Mortgage Market: Recommendation

HIGH-LEVEL VIEW

TARGET STATE: POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN THE CORE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are submitted to MCGE for credit underwriting and pooling.
3. MCGE prices and holds capital for the credit risk of the loans.
4. MCGE guarantees timely payment of principal and interest of the loans.
5. Federal agencies provide oversight, regulation and security-level guarantee in exchange for risk-based fee.
6. GG guarantees timely payment of principal and interest of the security.
7. MCGE or mortgage lender issues GG security to the market.
8. Based on the GG guarantee, security trades in equivalence to full faith and credit of the U.S. government; security buyer takes all the interest rate risk.

The Problem – How Do We Get There From Here?

- We are looking at a three year process at a minimum.
- What interim solution supports the mortgage market while phasing out the GSEs and phasing in the new structure?
- What form of interim guarantees, if any, are needed?
- Will the interim steps make it easier or harder to achieve the reform needed?
- How do the taxpayers get paid back the $100 billion (as of November 6, 2009) already paid into the two firms?

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Now That We've Got the Recession Out of the Way, What's Next?

- Rebuilding the economy without putting a major drag on growth for years to come.
- Resolve the foreclosure and over-supply problems in markets that can be helped.
- Rebuilding the secondary market into one in which investors are eager to invest in mortgage paper.
- Rebuilding credit models and assumptions so we do not repeat the recent errors.
- Rebuilding consumer and regulator faith in the originations process.

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