Securitizing Reperforming Loans into Agency Mortgage Backed Securities: A Program Primer

Fannie Mae recently announced plans to securitize single-family, fixed-rate reperforming loans (RPLs) into Agency Mortgage Backed Securities (MBS) beginning in the second half of 2016. RPLs are conventional mortgage loans that are current, but had been delinquent in the past. RPLs may have become current as a result of a modification. We intend to securitize eligible RPLs into Agency MBS to increase balance sheet liquidity and to provide additional investment options for investors.

This edition of the *MBSenger* explains how RPL securitization completes our credit risk management life cycle and how it provides transactional flexibility for our retained portfolio. First, we review Fannie Mae's role in the mortgage market and introduce the RPL securitization program. Second, we discuss Fannie Mae's approach to loan modifications. Third, we provide details around our RPL securitization program and the enhanced disclosures to support the program. Finally, we highlight the upcoming release of a new historical dataset for a subset of our reperforming loan population.

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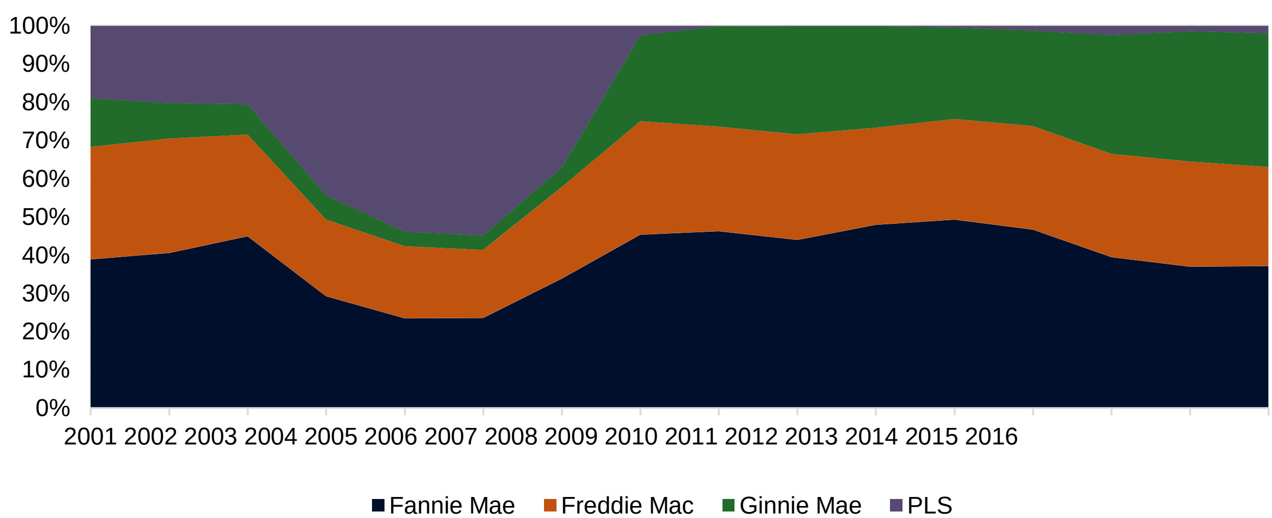
Fannie Mae's Role in the Market

Our mission is to provide liquidity and stability to the secondary mortgage market. As part of our continuous efforts to achieve this mission, we are transitioning from a portfolio-focused business to a guaranty-focused business. The transition entails a continued reduction in the size of our retained portfolio. However, we continue to make short-term use of our retained portfolio to provide liquidity to lenders through the purchase of loans through the whole loan conduit business, which we subsequently securitize. Fannie Mae's securitizations continue to comprise a substantial portion of the

Market Share for Mortgage-Related Securities (%)



secondary market. During Q1 2016, Fannie Mae accounted for approximately 37% of new single-family mortgage-related securities issuance.

We are creating the capability to securitize RPLs from the retained portfolio. The following diagram illustrates how RPL securitization fits into the loan life cycle at Fannie Mae.

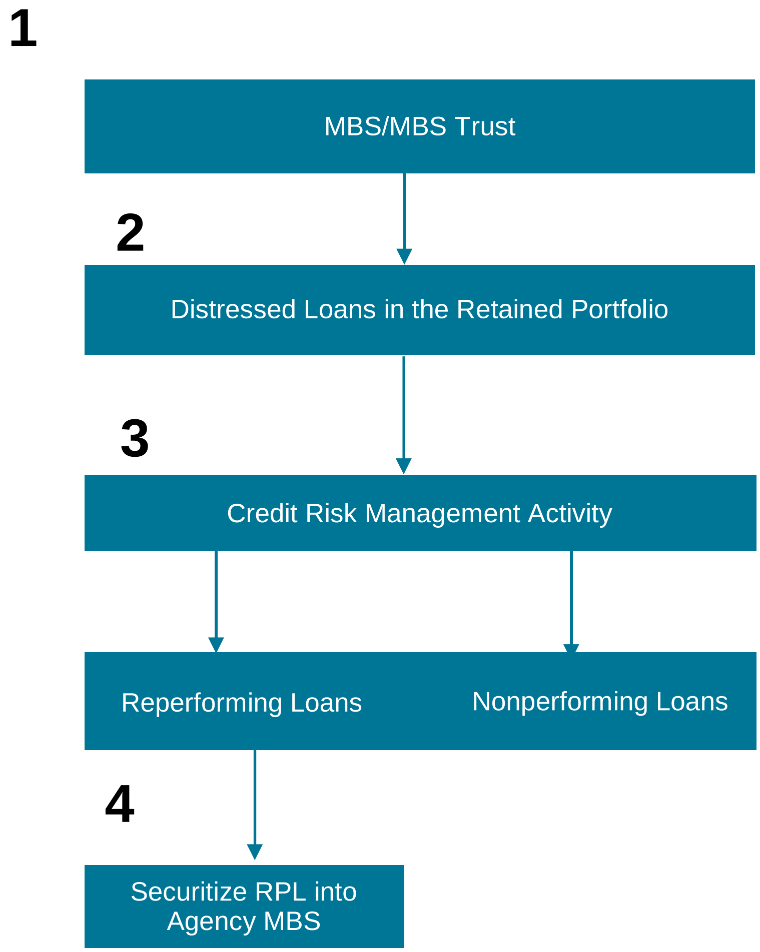
Single-Family Reperforming Loan Life Diagram

1) When loans are securitized, they are placed in an MBS trust guaranteed by Fannie Mae. The guaranty ensures that Fannie Mae will supplement amounts received by the trust to permit timely payment of principal and interest to the MBS investor.

2) If a loan becomes four or more months delinquent, Fannie Mae has the option to purchase the loan from the MBS trust and hold it in its retained portfolio as a distressed asset. As of December 31, 2015, the total of distressed loans and modified loans in our retained portfolio was about $184 billion[1].

3) We employ a comprehensive credit risk management approach to manage distressed loans and explore opportunities to help borrowers of these loans become current. A thorough loan evaluation determines the appropriate loss mitigation effort potentially resulting in a loan modification. A modification provides favorable loan terms assisting these loans to perform again. In the following section, we explain some of our more prominent loan modification programs. Not all distressed loans reperform.

4) Once performing, these loans may be eligible to be securitized into a new security. We are creating the functionality to securitize a segment of our RPL population. Later in this edition of the *MBSenger*, we discuss the populations that are currently eligible for the program and provide details on the types of pools we intend to create.



[1] As of December 31, 2015, UPB of Nonaccrual loans were about $47 billion and UPB of trouble debt restructured loans on accrual status were about $137 billion

Modifications and Reperforming Loans

To reduce the credit losses Fannie Mae ultimately incurs, the company has been focusing its efforts on several strategies, including reducing defaults through loan modifications. Servicers must evaluate the most appropriate workout program (including modification) for a borrower in need of assistance based on the hardship type, duration of delinquency, and his or her intention to remain in the property. To help with this process, Fannie Mae offers servicers a workout decisioning tool called Servicing Management Default Underwriter™ (SMDU™). Through SMDU, servicers can offer the best available solutions to homeowners to facilitate loan reperformance and loss mitigation.

Workout options available to borrowers are different based on whether the borrower is experiencing temporary or permanent hardship. Currently, reperforming modified loans that will be securitized into Agency MBS only reflect modifications made under permanent hardship.

Temporary Hardship

Temporary hardship is a situation that has resulted in a short-term decrease in a borrower's income or increase in expenses. For temporary hardship, Fannie Mae offers short-term workout options such as forbearance and repayment plans. Forbearance plans provide a period of reduced or suspended payments followed by either full reinstatement, mortgage loan payoff, or additional workout options. Repayment plans are arrangements made to repay delinquent installments or advances. These options do not result in a legal modification of the loan's contractual terms.

In 2015, we completed repayment and forbearance plans on nearly 6,000 loans [2].

Permanent Hardship

Permanent hardship is a situation that has resulted in a permanent or long-term decrease in a borrower's income or increase in expenses.

For permanent hardships, we offer loan modification options as well as foreclosure alternatives. Loan modifications typically involve changes to the original mortgage terms such as product type, interest rate, amortization term, maturity date and/or interest-bearing unpaid principal balance. Our primary loan modification initiatives include the Home Affordable Modification Program (HAMP), and our standard and streamlined modification initiatives. Streamlined modifications were introduced in July 2013 to offer a loan modification solution to borrowers who had not fully responded to early outreach efforts by servicers.

The number of HAMP-eligible borrowers has declined in recent years; HAMP modifications represented only 10% of the approximately 94,000 modifications completed in 2015. The HAMP program sunsets at the end of 2016.

Below is a summary of our primary loan modification programs.

Loan Modification Type	Description
Home Affordable Modification Program (HAMP)	HAMP modifications include capitalization of interest and non-interest arrearages, extension of the mortgage term, reduction of interest rates (to a floor of 2%), and in some instances forbearance, but no reduction of principal. The HAMP program applies to mortgage loans originated on or before January 1, 2009 and expired on December 31, 2016.
Regular (Standard) Modification	Regular modifications represent a variety of workouts that were typically utilized prior to Fannie Mae's implementation of its more recent standardized modification programs. These workouts allowed for a variety of modification types including capitalization of interest and non-interest arrearages, extension of the mortgage term, change in interest rate, and forbearance, but no reduction of principal. Many, but not all, of these modifications are no longer utilized.
Streamlined Modification	Streamlined modifications include several programs that generally allow capitalization of interest and non-interest arrearages, extension of the mortgage term, change in interest rate, and forbearance. These programs, started in July 2013 (with earlier adoption permitted) and include Fannie Mae Standard Modifications and Fannie Mae Streamlined Modifications as referenced in Fannie Mae's *Servicing Guide.*

[2] Repayment plans reflect only those plans associated with loans that were 60 days or more delinquent. Forbearance reflects loans that were 90 days or more delinquent.

RPL Program Details

The following section describes key attributes of our RPL securitization efforts, such as population details, prefixes, and disclosures. Loans that become current, either after receiving a modification or not, are considered RPLs. Historically, RPLs remained in our retained portfolio until they prepaid or matured. Through our RPL securitization program, we are creating functionality to securitize these RPLs into Agency MBS

Currently, we are only considering a portion of our RPL population for securitization. The table below lists the attributes of the loans that will be included and excluded in this population at program implementation.

Current criteria for RPL securitization	Excluded from RPL securitization
• Must be loans that have been performing for at least six months • Must be single-family, fixed-rate loans • Must be first liens • Can be modified or unmodified loans • Can be step rate modified loans in their final step	• Loans that have been performing for less than six months • Interest-only loans • ARM loans • Government loans • Balloon loans • Loans in trial modification periods • Step rate modified loans that have not yet reached their final step • Loans with forbearance • Loans under repayment plans

As the program evolves and develops, we may expand the loan population to include different loan structures and modification programs, such as loans that have not yet reached their final step or loans with forbearance. The Agency MBS prefixes described below have been created with this flexibility in mind.

Pool Prefixes

We have created 11 new prefixes to support the pools collateralized by RPLs. All of the prefixes are single-family, fixed-rate pools, none of which will be TBA-eligible. Similar to the existing MBS program, the pools will benefit from the Fannie Mae guaranty of timely principal and interest payments. Investors will not assume credit risk with these pools. The table below maps the populations to the appropriate prefixes and definitions.

Population	Prefix	Description	Modification Program
Reperforming loans that became current without a modification (R Series)	R1	Conventional Intermediate-Term, Non-Modified Reperforming, Level-Payment Mortgages; Single-Family; maturing or due in 15 years or less.	No Modification
	R2	Conventional Intermediate-Term, Non-Modified Reperforming, Level-Payment Mortgages; Single-Family; maturing or due in 20 years or less.	
	R3	Conventional Long-Term, Non-Modified Reperforming, Level-Payment Mortgages; Single-Family; maturing or due in 30 years or less.	
Reperforming loans that became current with a modification (I Series)	I1	Conventional Intermediate-Term, Reperforming Modified, Level-Payment Mortgages; Single-Family; maturing or due in 15 years or less.	• HAMP • Regular (Standard) • Streamlined • Other[3]
	I2	Conventional Intermediate-Term, Reperforming Modified, Level-Payment Mortgages; Single-Family; maturing or due in 20 years or less.	
	I3	Conventional Long-Term, Reperforming Modified, Level-Payment Mortgages; Single-Family; maturing or due in 30 years or less.	
	I4	Conventional Extra Long-Term, Reperforming Modified, Level-Payment Mortgages; Single-Family; maturing or due in 40 years or less.	
Reperforming loans that became current with a step rate modification (U Series)	U1	Conventional Intermediate-Term, Reperforming Modified Step Rate Mortgages; Single-Family; maturing or due in 15 years or less.	Step rate modification under these programs: • HAMP • Regular (Standard) • Streamlined • Other
	U2	Conventional Intermediate-Term, Reperforming Modified Step Rate Mortgages; Single-Family; maturing or due in 20 years or less.	
	U3	Conventional Long-Term, Reperforming Modified Step Rate Mortgages; Single-Family; maturing or due in 30 years or less.	
	U4	Conventional Extra Long-Term, Reperforming Modified Step Rate Mortgages; Single-Family; maturing or due in 40 years or less.	

[3] Includes cash flow modifications and bankruptcy modifications

Increasing Transparency: Disclosures

In support of this program and to provide continued transparency to the market, Fannie Mae is enhancing its loan-level disclosures for this population. The loan level disclosure (LLD) file layout contains over 30 additional attributes for RPLs, including updated credit scores and LTV at issuance of the RPL MBS, performance history, delinquency status, and modification details. Both at-issuance and monthly LLD files are updated to support the program.

Due to borrower privacy considerations, we will provide rounded original unpaid principal balances (UPB) for RPLs for the life of the loan and rounded scheduled UPB for the first six months after the loan is originated or modified. In addition, the format for all loan-level date fields will only provide month and year.

These pools will also be included in the New Issue Pool Statistics (NIPS) disclosure and the MBS Statistics disclosure. Because these RPL MBS pools will be disclosed in the same manner as existing MBS pools, changes to the format of the files will not be necessary and no additional pool level details will be provided.

The LLD files and PoolTalk Glossary® defining the new attributes can be found on PoolTalk. Additional information on how to use PoolTalk can be found in the related MBSenger, which references video tutorials on how to get the most out of PoolTalk.

Historical Data Release

Ahead of the implementation of the RPL securitization program, we plan to release a historical dataset on a subset of our reperforming modified loan population. This will provide the market with a greater ability to analyze the performance of modified loans. The dataset will include over 700,000 loans, focusing on those loans in Fannie Mae's book of business that were modified due to delinquency. This population will include loans that are current, delinquent, and liquidated post-modification.

We anticipate this being a one-time release that will be available for a minimum of six months. The loans included in the historical dataset are subject to the following limitations:

- Modified between January 1, 2010 and December 31, 2015
- No Interest-only, ARMs, or government loans
- No current forbearance
- Must be whole loans owned 100% by Fannie Mae
- Must be first-lien loans

Reperforming loans that became current without a modification will not be represented in this data release although they are included in the population of loans that may be securitized.

The attributes that will be disclosed in the historical data release will be generally comparable to the attributes that are disclosed in the loan level disclosure file for single-family MBS.

Summary

This edition of *MBSenger* aims to provide additional insight into Fannie Mae's credit risk management practices and its RPL securitization program. RPL securitization not only enhances the credit risk management life cycle, but also allows us to continue to provide liquidity as we manage our retained portfolio. RPL securitization provides Fannie Mae flexibility to potentially sell these securities and offer our investors additional investment opportunities. To facilitate analysis of loans in the RPL securitization program, we are providing enhanced disclosures and a new historical dataset.

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