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Multifamily MBS Highlights in 2010

In 2009, Fannie Mae made it a priority for its multifamily business to reinvigorate the MBS DUS® business and broaden the investor base for these securities. Continuing this focus in 2010, Fannie Mae took the next step in broadening the investor base through the issuance of multifamily REMICs, which adds to the many ways that investors can participate in our multifamily securities. As Fannie Mae continues to shift our primary role from portfolio lending to providing liquidity to the market through securitization, we are working to increase the investor base for multifamily securities. The expansion of the investor base may be attributable to traditional investors in the multifamily DUS fixed-rate pass-through product as well as new investors who may have interest in the multifamily DUS floating-rate pass-through product, which has experienced increased issuance in 2010. Potentially, more investors find Fannie Mae multifamily mortgage-backed securities to be attractive on a relative value basis in today's markets, especially compared to similar duration high credit quality corporates. Concurrently, market making by the dealer community, including Wall Street firms as well as regional dealers, has improved facilitating increased liquidity. This edition of *MBSenger* highlights the expanded Fannie Mae multifamily investor base, the investor benefits of Fannie Mae MBS/DUS and multifamily REMICs, and an overview of Fannie Mae multifamily REMIC classes.

Investors Can Participate in Fannie Mae Securities in Many Ways

Expansion of the Multifamily Investor Base

In 2009, approximately 81 percent of total multifamily production was an MBS execution, compared to only 17 percent in 2008. Year-to-date through September 30, 2010, Fannie Mae remains a constant source of liquidity in the multifamily market with approximately $64.9 billion in multifamily Fannie Mae MBS outstanding as well as issuing over $11.2 billion in multifamily MBS in the first nine months of 2010, and financing approximately 199,000 units in multifamily properties. The majority, approximately 89.3 percent, of multifamily MBS issued by Fannie Mae through the first nine months of 2010 are backed by DUS bonds delivered through the 25 DUS lenders.[1] MBS/DUS remains the primary multifamily MBS execution, which results in its enhanced liquidity.

With increased multifamily Fannie Mae MBS issuance over the past two years and with improved liquidity and increased participation by market makers, the multifamily investor base has broadened. A diverse group of fixed-income investor segments, including insurance companies, money managers, commercial banks, and state and local governments, support Fannie Mae multifamily MBS/DUS. Long-duration investors appreciate the

[1] DUS lenders: Through the DUS program, approved lenders have the ability to underwrite, close and sell loans on multifamily properties without prior Fannie Mae review. These DUS lenders must abide by rigorous credit and underwriting criteria and are continuously subject to ongoing credit review and monitoring. Additionally, DUS lenders usually retain a risk position of the loans that they sell to Fannie Mae.

MBS/DUS definitive final maturity of the DUS 10/9.5 bonds that may meet requirements in their investment guidelines as well as the prepayment protection provided by the yield maintenance feature accompanying the bond. Additionally, intermediate-term investors may find the DUS 7/6.5 and DUS 5/4.5 bonds appealing because of the stated maturities that complement their respective portfolios. In the current low rate environment, investors may find that Fannie Mae multifamily bonds offer a yield pick-up on a relative basis compared to certain highly-rated corporates. Insurance companies and pension funds appreciate that MBS/DUS provides certain stable cash flow features that allow these institutions to more easily match their liabilities. Money managers find the positive convexity of multifamily MBS to be valuable in mitigating somewhat their exposure to negatively convex single-family MBS. For commercial banks, MBS/DUS share the same weighting of 20 percent for bank risk-based capital requirements as is the case with single-family Fannie Mae MBS. State and local governments value DUS bonds because these instruments may adhere to their strict investment guidelines regarding eligible final maturities.

Fixed-income investors who traditionally invest in intermediate-to-longer-term noncallable agency debentures may find the MBS/DUS product to be a suitable alternative term investment since there is currently a dearth of new issuance agency noncallable debt with maturities that extend past five years. Investors may find the DUS 7/6.5 and/or the DUS 10/9.5 product as a compelling surrogate in the absence of new issue intermediate-to-longer-term agency noncallable debt greater than five years in maturity.

Reinvigoration of MBS/DUS and Reemergence of Multifamily REMICs

Investors can participate in our multifamily securities in many ways, including direct investment in MBS/DUS bonds and multifamily REMICs. Although the traditional Fannie Mae multifamily pass-through product is the fixed-rate DUS pool, in 2010 Fannie Mae increased issuance of floating-rate DUS pools. The rise in the number of floating-rate DUS pools provides another option in which investors can be involved in Fannie Mae multifamily securities. DUS pools are not restricted to a minimum or maximum unpaid principal balance or to a set number of loans allowed into the DUS pools at issuance. Typically, each DUS pool contains one DUS loan, but may include multiple DUS loans made by the same lender to the same or affiliated borrowers. Investors may find one of the most attractive structural benefits of multifamily MBS is the prepayment protection, which usually falls under yield maintenance for Fannie Mae multifamily DUS loans. Yield maintenance allows for full prepayments along with a yield maintenance prepayment premium payable by the borrower. Fannie Mae will pass through to the investor a portion of the yield maintenance prepayment premium actually received from the servicer of the prepaid loan based on a predetermined calculation. This requirement to pay a prepayment premium fosters strong prepayment stability to investors and potentially compensates investors for unexpected prepayments.

In addition to the MBS/DUS product, the reintroduction of the Fannie Mae multifamily REMIC in 2010, also referenced in the marketplace as the ACES[2] program or FNA[3], allows the creation of securities with cash flows that can meet the needs of a wide range of investors through the various classes within the REMIC that differ in duration, average life, coupon, convexity profile, yield and price. Additionally, investors may value the potential geographic diversification and assortment of characteristics of the underlying collateral as well as the variety of lenders represented in the collateral backing a REMIC.

[2] ACES: Alternative Credit Enhancement Structures

[3] FNA: Pneumonic on Bloomberg

Fannie Mae Multifamily REMIC Classes

Fannie Mae REMICs backed by multifamily MBS are created with customized cash flows by taking the principal and interest from underlying collateral and allocating these cash flows to different classes. In 2009, Fannie Mae issued two multifamily REMICS, 2009-M1 and 2009-M2. Year-to-date through November 30, 2010, Fannie Mae has more than tripled its multifamily REMIC issuance from the prior year, issuing seven multifamily REMICs: 2010-M1, 2010-M2, 2010-M3, 2010-M4, 2010-M5, 2010-M6, and 2010-M7. A snapshot of these REMIC deals is provided in **Figure 1**.

Figure 1. 2010 Fannie Mae Multifamily REMIC Issuance

REMIC	Original Class Balance ($ millions)	REMIC Classes	Yield	Lead Managers	Co-Managers
2010-M1	$72.3	A1	3.305%	Deutsche Bank Securities	Amherst Securities Group, L.P. and Bank of America Merrill Lynch
	$445.1	A2	4.450%		
	$517.4	X	0.714%		
2010-M2*	$115.0	A1	3.020%	Deutsche Bank Securities	-
	$751.1	A2	4.104%		
	$866.1	X	1.015%		
2010-M3*	$86.5	A1	2.587%	Credit Suisse	Jefferies and JP Morgan
	$33.3	A2	3.818%		
	$406.1	A3	4.332%		
	$525.9	X	0.671%		
2010-M4*	$76.1	A1	2.520%	Credit Suisse	Citi and Deutsche Bank Securities
	$50.6	A2	3.690%		
	$415.5	A3	3.819%		
	$542.2	X	1.061%		
2010-M5*	$158.3	A1	2.259%	Bank of America Merrill Lynch	Credit Suisse
	$70.4	A2	2.806%		
	$32.0	A3	3.243%		
	$320.0	A4	3.394%		
	$580.7	X	1.243%		
2010-M6*	$67.6	A1	2.210%	Amherst Securities Group, L.P. and Credit Suisse	-
	$349.1	A2	3.314%		
	$110.3	FA	0.866%		
	$110.3	SA	6.134%		
	$527.0	X	0.418%		
2010-M7**	$44.6	A1	2.448%	Deutsche Bank Securities and Amherst Securities Group, L.P.	-
	$14.7	AI	3.655%		
	$389.3	A2	3.655%		
	$131.4	FA	0.853%		
	$131.4	SA	6.147%		
	$565.3	XI	< 1.0%		

* R and RL classes not listed.
** X and SX classes not listed.

Multifamily REMICs provide investors with bonds priced at close to par and feature diverse pool collateral characteristics that contribute to the credit quality for which Fannie Mae multifamily loans are known. Through its issuance of multifamily REMICs, Fannie Mae is able to respond to the market and customize highly-liquid securities. As the multifamily REMIC program becomes increasingly active, Fannie Mae is adding different structural characteristics to the classes that are designed to appeal to a broad spectrum of investors. For example, in the two most recent multifamily REMICs, 2010-M6 and 2010-M7, Fannie Mae structured two floating-rate classes, the floater (FA) and the inverse floater (SA). **Figure 2** details characteristics in a more traditional fixed-rate Fannie Mae REMIC (2010-M5) and in a recent Fannie Mae REMIC with both fixed- and floating-rate classes (2010-M7).

Figure 2. Recent REMIC Class Characteristics

REMIC	Class	Weighted Average Life	Coupon	Size	Characteristics
2010-M5	A1	4.98	2.26%	$158.3	• Fixed rate amortizing front sequential • Principal window months 1 to 80 at 0 CPY • Receives 30% of prepayment premiums received during principal window
	A2	6.70	2.81%	$70.4	• Yield Maintenance upside compensates investors for average life variability • Fixed rate, 7 year tight window • Principal window months 80 to 82 at 0 CPY • Receives 30% of prepayment premiums received during principal window
	A3	8.55	3.24%	$32.0	• Fixed rate amortizing sequential • Principal window months 82 to 114 at 0 CPY • Receives 30% of prepayment premiums received during principal window
	A4	9.77	3.39%	$320.0	• Fixed rate, tight window, last cash flow sequential • Principal window months 114 to 118 at 0 CPY • Receives 30% of prepayment premiums received during principal window • A1 to A3 classes limit avg. life variability of A4, agency guarantee prevents extension
	X	N/A	1.24%	$580.7	• Interest only • Notional principal window months 1 to 118 at 0 CPY • Receives 70% of prepayment premiums received during principal window
2010-M7	A1	5.33	2.45%	$44.6	• Fixed rate amortizing front sequential • Principal window months 1 to 100 at 0 CPY • Receives 9% of prepayment premiums received times ratio of principal paid to A1 (equivalent to 30/70 split used for other FNA IO splits of prepayment premium)
	AI	5.33	3.66%	$14.7	• Interest only off front sequential • Notional principal window months 1 to 100 at 0 CPY • Receives 21% of prepayment premiums received times ratio of principal paid to A1 (equivalent to 30/70 split used for other FNA IO splits of prepayment premium)
	A2	9.31	3.66%	$389.3	• Fixed rate last cash flow sequential • Principal window months 100 to 120 at 0 CPY • Receives 30% of any prepayment premiums received on a pro rata basis • A1 and FA classes limit average life variability of A2, agency guarantee prevents extension
	FA	8.62	0.85%	$131.4	• Floating rate coupon = 1mL + 60 bps, 7% cap • Principal window months 1 to 120 at 0 CPY
	SA	9.01	6.15%	$131.4	• Inverse interest only tranche • Floating rate coupon = 6.40 - 1mL • Notional principal window months 1 to 120 at 0 CPY • Receives 70% of prepayment premiums received times ratio of principal paid to A1 and A2 and 100% of prepayment premiums received times ratio of principal paid to FA
	X	8.84	0	$565.3	• Interest only, excess interest strip • Notional principal window months 1 to 120 at 0 CPY

Multifamily MBS Investor Information Sources Have Been Updated

MBS/DUS

Approximately two years ago, Fannie Mae first published an MBS/DUS tutorial so that investors can review the scope of Fannie Mae multifamily MBS product evolution, particularly the DUS program. Since the initial publication, on a quarterly basis, Fannie Mae updates the MBS/DUS *MBSenger* as well as the Multifamily Mortgage-Backed Securities Abstract. The MBS/DUS *MBSenger* details the growth and development of the Fannie Mae DUS program as well as highlights the MBS/DUS product, reviews notable characteristics, and explores the performance feature of these securities. The Multifamily Mortgage-Backed Securities Abstract provides timely information regarding MBS issuance and outstanding volumes over the past two quarters, recent MBS/DUS 10/9.5-year spread-to-swaps, multifamily serious delinquency rates since January 2006, and highlights notable news from Fannie Mae's multifamily business activities.

Multifamily REMICs

Additionally, in the first quarter of 2010, Fannie Mae published an *MBSenger* focused on Multifamily REMICs. This publication reviews the structures and collateral incorporated into Fannie Mae multifamily REMICs, discusses the investor benefits of these securities, and provides market participants with valuable resources that can be used to easily analyze these securities and evaluate the underlying collateral. Investor resources regarding Fannie Mae MBS/DUS, multifamily REMICs and other aspects of our multifamily business have been updated to incorporate issuance and activity through October 2010.

Online Resources

All of these publications have been updated and are available on Fannie Mae's web site at the following locations:

MBS/DUS *MBSenger* and
Multifamily REMICs *MBSenger*
www.fanniemae.com -> Investors -> Mortgage-Backed Securities -> MBSenger
http://www.fanniemae.com/mbs/index.jhtml?p=Mortgage-Backed+Securities

Multifamily Mortgage-Backed Securities Abstract
www.fanniemae.com -> Investors -> Mortgage-Backed Securities -> Monthly Reporting Data -> Multifamily -> Multifamily Mortgage-Backed Securities Abstract (PDF)
http://www.fanniemae.com/mbs/index.jhtml?p=Mortgage-Backed+Securities

Conclusion

Fannie Mae remains a consistent and growing source of liquidity to the multifamily mortgage market. A diverse group of investors appreciate the high credit quality of Fannie Mae multifamily MBS, the prepayment protection, and the pickup in yield over similar high credit quality corporates. By responding to market demand, Fannie Mae has reintroduced the Fannie Mae multifamily REMIC product, which provides customized cash flows that meet the needs of the investors. Fannie Mae continues to reinvigorate the MBS/DUS business and broaden the investor base for these securities.

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