



ODEON

## REFERENCED COMPANIES

FNMA: \$3.94  
Rating: NR

FMCC: \$3.73  
Rating: NR

### Odeon Capital Group LLC

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SIPC, MSRB

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of this document.**

## Basics on Fannie and Freddie A Primer

### Basic Data

Apparently, there are a number of investors who are confused concerning the basic structure of Fannie Mae and Freddie Mac and the issues that they face at the present time. This commentary is a “barebones” primer on the companies’ current position.

### Common Equity

Fannie Mae has

- 1,158 million shares outstanding – these shares are owned by the public and trade in the public markets
- 131 million shares that could be issued related to a convertible preferred stock – the convertible preferred also trades in the public market.
- Estimated 4,600 million shares to be issued if the U.S. government converts the warrants it holds in the company – these warrants do not trade since they are owned solely by the United States government.

Freddie Mac has

- 650 million shares outstanding
- Estimated 2,600 million shares to be issued if the U.S. government converts the warrants it holds in the company – these warrants do not trade since they are owned solely by the United States government.

### Preferred Issues

Fannie Mae apparently has 16 preferred issues outstanding:

- The senior preferred is owned solely by the United States government and does not trade.
- The junior preferreds all trade in the public market
  - By Type
    - 10 junior preferreds have set rates ranging from 4.750% to 8.375%.
      - The Preferred S yields 8.375% and trades more than all of the other preferreds put together.
      - Its price has ranged from \$5.23 per share to \$14.30 per share in the past 52 weeks.
    - 4 are variable rate
    - 1 is a convertible preferred
  - Par Value
    - 9 of the junior preferreds have \$50 par values
    - 5 have \$25 par value.
    - The Preferred S is \$25 per value

Freddie Mac apparently has 26 preferred issues outstanding

- The senior preferred is owned solely by the United States government and does not trade.
- The junior preferreds all trade in the public market
  - By Type
    - 20 junior preferred issues have set rates from 5.000% to 8.375%.
      - The 8.375% issue trades more than all of the other preferred issues put together.
      - Its price has ranged from \$5.23 per share to \$14.30 per share in the past 52 weeks.
    - 5 are variable rate
  - Par Value
    - 6 of the junior preferreds have par values of \$25 per share
    - 18 have par values of \$50 per share
    - There is no data immediately available on 1 junior preferred
    - The 8.375% issue has a \$25 par value

## Treasury Relationship

Fannie Mae

- Borrowed \$119.8 billion from the Treasury;
- Paid \$181.4 billion in dividends; and
- Has an open line of credit with the Treasury for \$113.9 billion.

Freddie Mac

- Borrowed \$75.6 billion from the Treasury;
- Paid \$119.7 billion in dividends; and
- Has an open line of credit with the Treasury for \$140.2 billion.

## Business Operations

Both Companies

- Guarantee mortgages originated by others
  - Single family, and
  - Multi-family
- Own mortgages
  - Some secured by the government
  - Some not secured by the government
- Own investment securities

Fannie Mae's Q2 2019 pretax earnings were \$4,321 million. Freddie Mac earned \$1,898 million.

## **Administrative and Legal Actions**

### Administrative

- The United States Treasury
  - Released an outline of its proposals to eliminate the Fannie/Freddie conservatorship which includes:
    - Stop collecting the current dividend based on sweeping earnings;
    - Establish a specific plan to recapitalize and release these companies;
    - Guarantee the debt service payments on mortgage backed securities that they issue; and
    - Guarantee, in some fashion, the payments on 30-year fixed rate mortgages.
  - Obtain payment for the services provided by the Treasury

# Bove Briefing

- The Federal Housing Finance Agency
  - Agrees to eliminate the profit sweep to the Treasury this year.
  - Wants to establish capital requirements for these companies well -above the current levels.
  - Wants to authorize more companies like Fannie and Freddie.

## Congress

- House of Representatives has no live bills underway
- Senate
  - One outline for the recapitalization and release of the companies much like the Treasury Plan
  - No active legislation underway.

## Court Systems

- Fifth Circuit Court in New Orleans has
  - Directed a lower court to reconfigure the basis of Treasury dividends
  - Declared the FHFA unconstitutional.
  - Likely that the Supreme Court will step in
- Federal District Court in Washington DC
  - Requested 70,000 Discovery documents from the government
  - Requires a new trial on the issue of whether the FHFA and Treasury have acted illegally here
  - If so, penalties will be established
- Federal Claims Court
  - Scheduled a hearing on November 19.
  - Issue here is taking private property without just compensation.

## **Odeon Capital Group Estimate**

Our best guess at this time is that a recapitalization and release might look like this from a financial point-of-view.

	<b>Fannie Mae</b>		<b>Freddie Mac</b>	
	<b>Capital (mil)</b>	<b>Shares (mil)</b>	<b>Capital (mil)</b>	<b>Shares (mil)</b>
<u>Estimated Requirement</u>				
Required 4% of assets	\$140,000		\$85,000	
<u>Sources</u>				
Current	\$3,000	1,158	\$3,000	726
Retained Earnings Year 1	\$12,000		\$6,000	
Warrant exercise	\$47	4,735	\$25	2,508
Preferred Conversion @\$2.50/Share	\$19,130	7,652	\$14,109	5,644
Stock Offering @\$2.50/Share	<u>\$105,823</u>	<u>42,329</u>	<u>\$61,866</u>	<u>24,746</u>
Amount raised	\$140,000	55,874	\$85,000	33,624
Estimated EPS		\$0.21		\$0.18
Estimated Dividend		\$0.10		\$0.09
Estimated ROEs	8.6%		7.1%	

## **Recommendation**

There can be no forward movement anywhere until the junior preferred shareholders are compensated. Once this happens, most of the major lawsuits will be dropped and the Treasury and FHFA can proceed with their plans. Since I believe that the likelihood of this is quite high, because housing activity will not pick up without an agreement, my recommendation is to buy the preferred issues in these companies.

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Ratings definitions revised as of May 7<sup>th</sup>, 2013.

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