Note 7. Investments in Government-Sponsored Enterprises

Investments in GSEs as of September 30, 2024

(In billions of dollars)	Gross Investments	Cumulative Valuation Gain/(Loss)	Fair Value
Fannie Mae senior preferred stock	207.8	(43.7)	164.1
Freddie Mac senior preferred stock	125.7	8.1	133.8
Fannie Mae and Freddie Mac warrants common stock	5.4	2.5	7.9
Total investments in GSEs	338.9	(33.1)	305.8

Investments in GSEs as of September 30, 2023

(In billions of dollars)	Gross Investments	Cumulative Valuation Gain/(Loss)	Fair Value
Fannie Mae senior preferred stock	190.4	(55.9)	134.5
Freddie Mac senior preferred stock	114.4	(12.7)	101.7
Fannie Mae and Freddie Mac warrants common stock	5.4	(1.2)	4.2
Total investments in GSEs	310.2	(69.8)	240.4

Congress established Fannie Mae and Freddie Mac as GSEs to provide stability and increase liquidity in the secondary mortgage market and to promote access to mortgage credit throughout the nation. A key function of the GSEs is to purchase mortgages, package those mortgages into securities, which are subsequently sold to investors, and guarantee the timely payment of principal and interest on these securities.

Congress passed the *Housing and Economic Recovery Act of 2008* (P.L. 110-289) in July 2008 in response to the financial crisis that year and the increasingly difficult conditions in the housing market which challenged the soundness and profitability of the GSEs and thereby threatened to undermine the entire housing market. This Act created FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary of the Treasury with certain authorities intended to ensure the financial stability of the GSEs, if necessary. In September 2008, FHFA placed the GSEs under conservatorship and Treasury invested in the GSEs by entering into a SPSPA with each GSE. These actions were taken to preserve the GSEs' assets, ensure a sound and solvent financial condition, and mitigate systemic risks that contributed to market instability.

The purpose of such actions is to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the mortgage market while the Administration and Congress determine what structural changes should be made to the housing finance system. Draws under the SPSPAs would result in an increased investment in the GSEs as further discussed below. Under SFFAS No. 47, *Reporting Entity* criteria, Fannie Mae and Freddie Mac were owned or controlled by the government only as a result of: a) regulatory actions (such as organizations in receivership or conservatorship); or b) other government intervention actions. Under the regulatory or other intervention actions, the relationship with the government was and is not expected to be permanent. These entities are classified as disclosure entities based on their characteristics as a whole. Accordingly, these entities are not consolidated into the government's consolidated financial statements; however, the value of the investments in these entities, changes in value, and related activity with these entities are included in the government's consolidated financial statements. The net change in valuations of the GSEs include both liquidation preference adjustments and changes in FV, both of which are discussed below and are included on the Statement of Net Cost (as earned revenue).

Senior Preferred Stock Purchase Agreements

In return for committing to maintain the GSEs' solvency by making a quarterly advance of funds to each GSE in an amount equal to any excess of the GSEs' total liabilities over its total assets as of the end of the previous quarter, Treasury initially received from each GSE: 1) 1,000,000 shares of non-voting variable liquidation preference senior preferred stock with a liquidation preference value of $1,000 per share; and 2) a non-transferable warrant for the purchase, at a nominal cost, of 79.9 percent of common stock on a fully-diluted basis. The warrants expire on September 7, 2028. Treasury was entitled to distributions on the senior preferred stock equal to 10.0 percent per annum fixed rate dividend on the total liquidation preference (as discussed below). This dividend structure was changed in the third amendment in August 2012 to a variable equivalent to the GSEs' positive net worth above a capital reserve amount. The capital reserve amount was initially set at $3.0 billion for calendar year 2013 and, upon nearing its scheduled decline to zero, was reset at $3.0 billion in calendar year 2017. On September 27, 2019, Treasury and FHFA amended the SPSPAs to increase the capital reserve amounts of Fannie Mae and Freddie Mac to $25.0 billion and $20.0 billion, respectively. In exchange, Treasury's liquidation preference in each GSE was scheduled to gradually increase quarterly up to the adjusted capital reserve amounts based on the quarterly earnings of each GSE.

On January 14, 2021, Treasury and FHFA further amended the SPSPAs to replace the prior variable dividend with an alternative compensation plan for Treasury that permits the GSEs to continue their recapitalization efforts, as prescribed by the GSE capital framework finalized by FHFA in 2020. Under the amended SPSPAs, each GSE is permitted to retain capital until the GSE has achieved its regulatory minimum capital requirement, including buffers (i.e., the capital reserve end date), at which point its cash dividend obligations will resume along with the obligation to pay a periodic commitment fee. As compensation to Treasury for the replacement of the variable dividend, the liquidation preference of Treasury's senior preferred stock in each GSE will increase quarterly by the amount of retained capital until each GSE has achieved its capital reserve end date.

Additionally, the January 14, 2021 amendment, among other things, imposed restrictions on certain GSE business activities, including purchases of loans backed by investment properties, second homes, and multifamily properties, and on purchases of loans with multiple high-risk characteristics or for cash consideration. On September 14, 2021, Treasury and FHFA agreed to suspend certain business activity restrictions added to the SPSPAs by the January 14, 2021 amendment while FHFA undertakes a review of the extent to which these requirements are redundant or inconsistent with existing FHFA standards, policies, and directives. The suspension will terminate six months after Treasury notifies the GSEs. As of September 30, 2024, Treasury has not provided notice to GSEs to terminate the suspension.

For the fiscal year ended September 30, 2024, Treasury's liquidation preference in Fannie Mae and Freddie Mac increased by $17.4 billion and $11.3 billion, respectively. For the fiscal year ended September 30, 2023, Treasury's liquidation preference in Fannie Mae and Freddie Mac increased by $12.6 billion and $7.9 billion, respectively. The GSEs will not pay a quarterly dividend until after the capital reserve end date. Treasury received no cash dividends for the fiscal years ended September 30, 2024, and 2023, as the GSEs had not achieved their capital reserve end date as of September 30, 2024, and their positive net worth was below the permitted capital reserve amounts as of September 30, 2024.

The SPSPAs, which have no expiration date, require that Treasury will disburse funds to either GSE if, at the end of any quarter, the FHFA determines that the liabilities of either GSE exceed its assets. Draws from Treasury under the SPSPAs are designed to ensure that the GSEs maintain positive net worth, with a fixed maximum amount available to each GSE under this agreement established as of December 31, 2012 (refer to the "Contingent Liability to GSEs" section below and Note 21—Contingencies). Draws against the funding commitment of the SPSPAs do not result in the issuance of additional shares of senior preferred stock; instead, they increase the liquidation preference of the initial 1,000,000 shares by the amount of the draw. The combined cumulative liquidation preference totaled $334.0 billion and $305.0 billion as of September 30, 2024, and 2023, respectively. There were no payments to the GSEs for the fiscal years ended September 30, 2024, and 2023.

Senior Preferred Stock and Warrants for Common Stock

In determining the FV of the senior preferred stock and warrants for common stock, Treasury relied on the GSEs' public filings and press releases concerning their financial statements, as well as non-public, long-term financial forecasts, monthly summaries, quarterly credit supplements, independent research regarding preferred stock trading, independent research regarding the GSEs' common stock trading on the Over-The-Counter Market, discussions with each of the GSEs and FHFA, and other information pertinent to the valuations. Because the senior preferred stock is not publicly traded, there is no comparable trading information available. The fair valuation of the senior preferred stock relies on significant Level 3 unobservable inputs that reflect assumptions about the expectations that market participants would use in pricing.

The FV of the senior preferred stock considers forecasted cash flows to equity holders and the traded prices of the other equity securities, including the GSEs' common stock and junior preferred stock. The FV of the senior preferred stock-as measured by unobservable and observable inputs-increased as of September 30, 2024, when compared to September 30, 2023. The increase in the GSEs' senior preferred stock is primarily driven by a decreased discount rate, higher projected cash flows, and a decrease in credit-related expenses.

Factors impacting the FV of the warrants include the nominal exercise price and the large number of potential exercise shares, the market prices and trading volumes of the underlying common stock as of September 30, the principal market, and the market participants. Other factors impacting the FV include, among other things, the holding period risk related directly to the assumption of the amount of time that it will take to sell the exercised shares without depressing the market. The FV of the warrants-as measured by observable inputs-increased at the end of FY 2024, when compared to FY 2023, primarily due to increases in the Level 1 FV measurement of the market price of the underlying common stock of each GSE.

Estimation Factors

Treasury's forecasts concerning the GSEs may differ from actual experience. Estimated senior preferred values and future draw amounts will depend on numerous factors that are difficult to predict including, but not limited to, changes in government policy with respect to the GSEs, the business cycle, inflation, home prices, unemployment rates, interest rates, changes in housing preferences, home financing alternatives, availability of debt financing, market rates of guarantee fees, outcomes of loan refinancings and modifications, new housing programs, and other applicable factors.

Contingent Liability to GSEs

As part of the annual process undertaken by Treasury, a series of long-term financial forecasts are prepared to assess, as of September 30, the likelihood and magnitude of future draws to be required by the GSEs under the SPSPAs within the forecast time horizon. Treasury used 25-year financial forecasts prepared through years 2049 and 2048 in assessing if a contingent liability was required as of September 30, 2024, and 2023, respectively. If future payments under the SPSPAs are deemed to be probable within the forecast horizon, and Treasury can reasonably estimate such payment, Treasury will accrue a contingent liability to the GSEs to reflect the forecasted equity deficits of the GSEs. Treasury does not discount this accrued contingent liability, nor take into account any of the offsetting dividends that could be received, as the dividends, if any, would be owed directly to the General Fund. Treasury will adjust such recorded accruals in subsequent years as new information develops or circumstances change.

Based on Treasury's annual assessment, there were no probable future funding draws as of September 30, 2024, and 2023, and thereby no accrued contingent liability. However, as of September 30, 2024, it is reasonably possible that a period of sustained economic and housing market volatility could potentially cause the GSEs to generate quarterly losses of sufficient magnitude to result in future funding draws against the funding commitment. Due to challenges quantifying future market volatility or the timing, magnitude, and likelihood of such events, Treasury could not estimate the total amount of this reasonably possible future funding liability as of September 30, 2024, and 2023. There were no payments to the GSEs for fiscal years ended September 30, 2024, and 2023. At September 30, 2024, and 2023, the maximum remaining contractual commitment to the GSEs for the remaining life of the SPSPAs was $254.1 billion. Subsequent funding draws will reduce the remaining commitments. Refer to Note 20—Commitments for a full description of other commitments and risks.

In assessing the need for an estimated contingent liability, Treasury relied on the GSEs' public filings and press releases, including their financial statements, monthly business summaries, and quarterly credit supplements, as well as non-public, long-term financial forecasts, the FHFA House Price Index, discussions with each of the GSEs and FHFA, and other information pertinent to the liability estimates. The forecasts prepared in assessing the need for an estimated contingent liability as of September 30, 2024 and 2023, include two potential scenarios, with varying assumptions regarding the continuation of the GSEs' new business activities, including purchasing mortgage loans and issuing new guaranteed MBS. The forecasts as of September 30, 2024 and 2023, also assumed the maintenance of the GSEs' retained mortgage portfolios below the maximum permitted under the amended SPSPAs.

Regulatory Environment

To date, Congress has not passed legislation nor has FHFA taken action to end the GSEs' conservatorships. The GSEs continue to operate under the direction of FHFA as conservator.

The *Temporary Payroll Tax Cut Continuation Act of 2011* (P.L. 112-78) was funded by an increase of ten basis points in the GSEs' guarantee fees (referred to as "the incremental fees") which began in April 2012 and extended by the *Infrastructure Investment and Jobs Act of 2021* (P.L. 117-58) through September 30, 2032. The incremental fees are remitted to Treasury and not retained by the GSEs and, thus, do not affect the profitability of the GSEs. For fiscal years ended 2024 and 2023, the GSEs remitted to Treasury incremental fees totaling $6.3 billion and $6.2 billion, respectively.