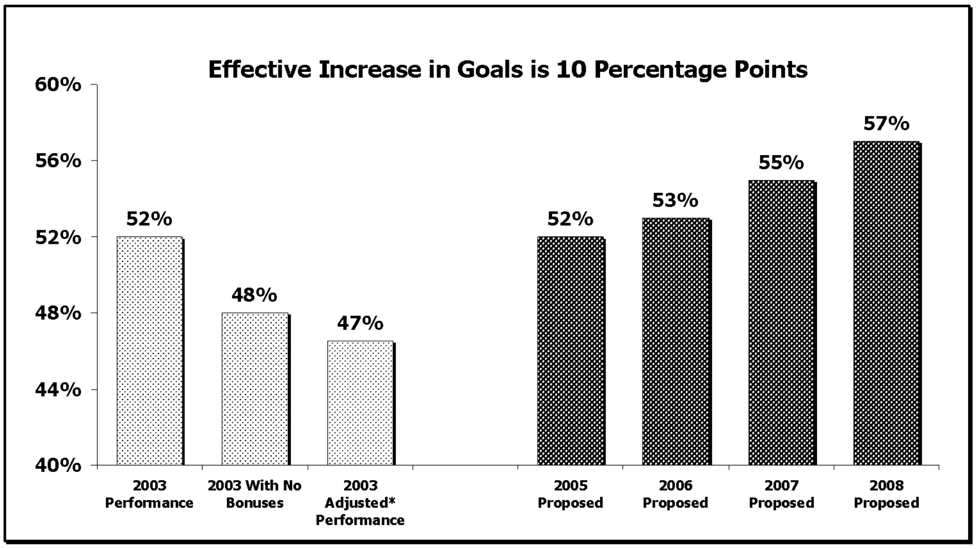
Discussion of HUD's Proposed Housing Goals

Presentation to the
Department of Housing and Urban Development
June 9, 2004

Key Points

- We are committed to market leadership and we welcome and will support HUD goals that stretch us to lead the market
- Goals should be based on the right market assumptions
- Proposed goals raise concerns about potential for market distortions and unintended consequences
  - Goals could lead to overinvestment in rental housing
  - Goals could deny Fannie Mae benefits to millions of middle-income borrowers
- Other issues raised by the proposed rule merit discussion
  - We support the Department's objective to assure confidence in data integrity
  - Scoring adjustments raise legal issues that merit separate discussion
  - Recommending no change mortgage purchase definition or scoring of large, seasoned transactions
  - Supportive of changes to address multitude of missing data issues
- We are optimistic that with certain changes, the proposed rule can stretch us to do more and avoid unintended consequences

Proposed Goals Require Significant Increases in Our Performance



* Excludes Bonuses, Adjusted for Census and MSA Changes

Alternative Assumptions Greatly Reduce Market Size Estimates

Changes in HUD Assumptions To Reflect Historical Precedents	Impact on Proposed Goal	Cumulative Impact
HUD's Proposed Low-Mod Goal	**57%**	
Increase SF refinance share from 35% to 52% consistent with 10-year average from HMDA	-1.6%	-8.0%
Reduce MF share of units from 16.5% to 12.3% consistent with alternative estimates of MF market	-1.8%	
Decrease rental low-mod share from 95% to 90% consistent with recent census survey data	-1.6%	
Decrease SF investor-owned share of loans from 12% to 8% consistent with HMDA data	-2.2%	
Account for missing data in calculating low-mod performance of SF owner-occupied properties	-1.4%	
Adjusted Goal Level	**49%**	

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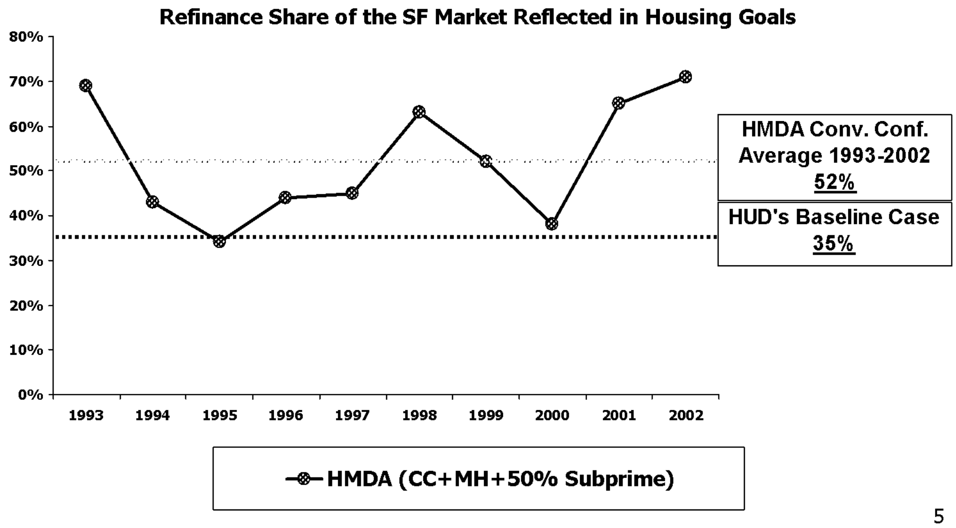
SF Refinance Share Has Fallen to 35% Only Once During Last 10 Years



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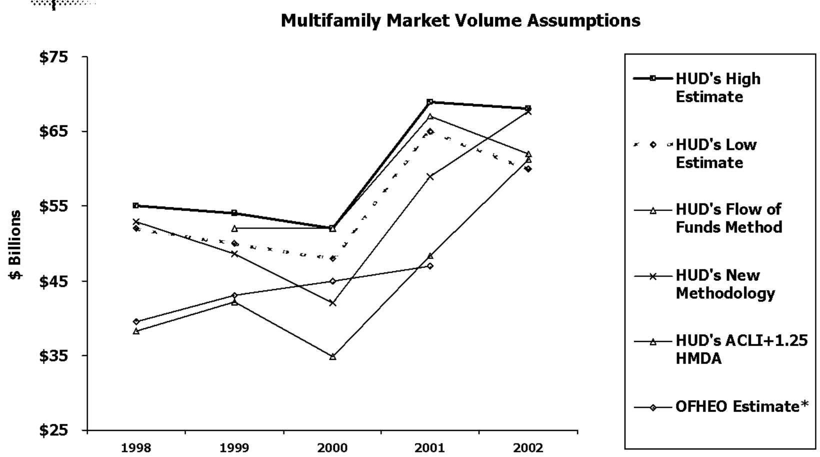
MF Market Originations are Unknown and Market Estimates Are Inconsistent



* Data represents mid-points of estimated market ranges used by HUD in the Proposed Rule and OFHEO estimates published in the 2003 Systemic Risk study.

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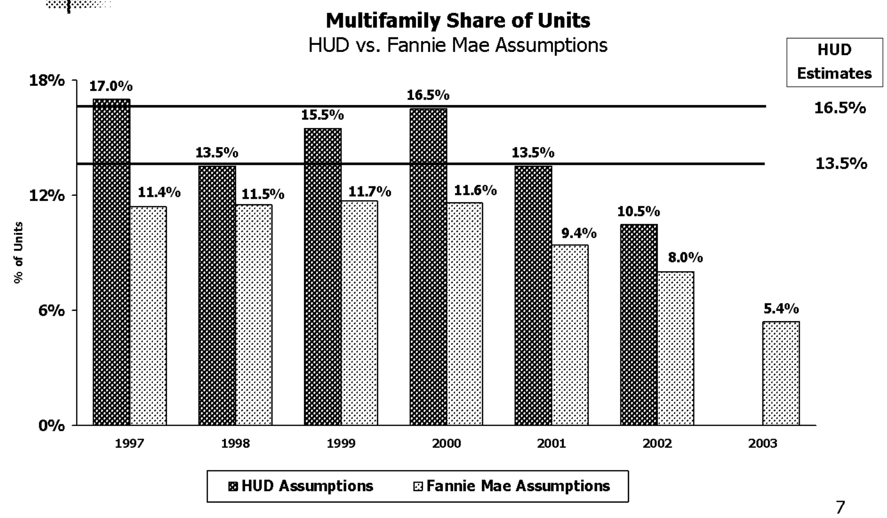
MF Market Share Scenarios are High by Historical and Recent Standards



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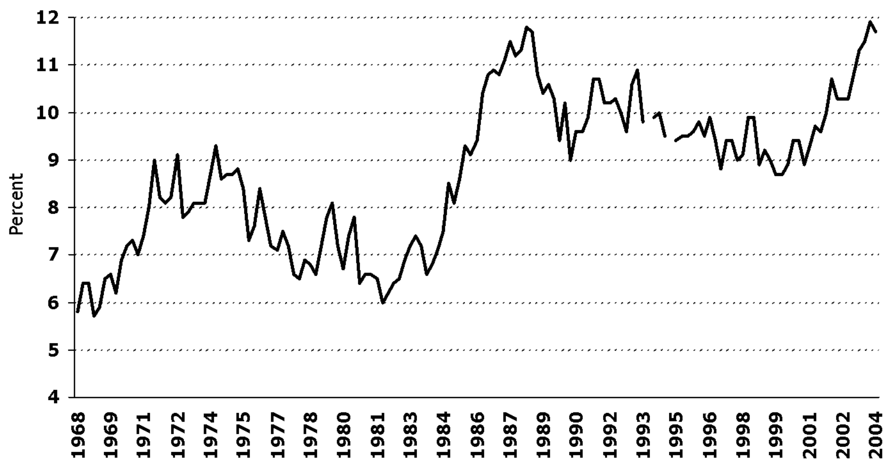
Rule Calls for Increased MF Finance Despite Highest Vacancy Rates in Recorded History

Rental Vacancy Rate for Five or More Unit Structures



Source: Housing Vacancy Survey

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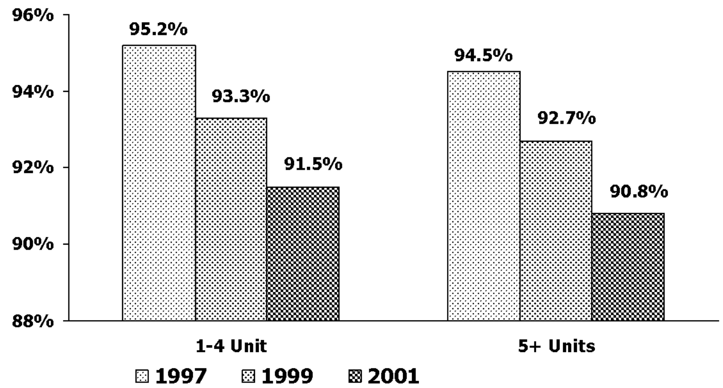
Recent Trends Show Declining Rental Affordability

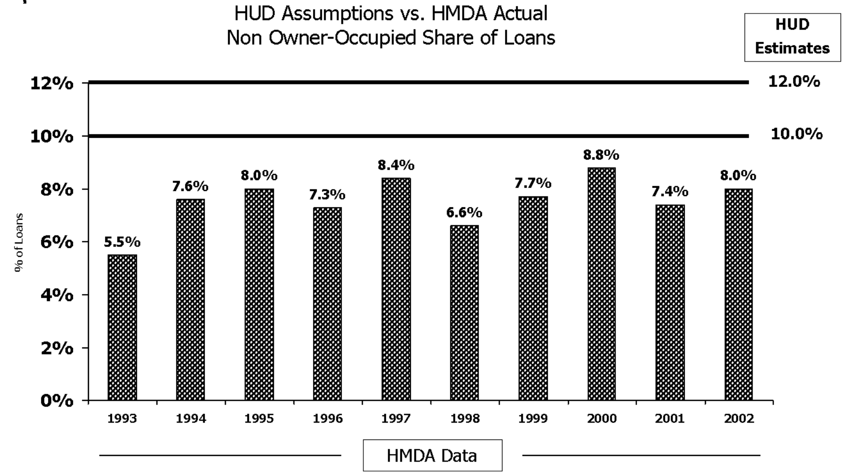
Low-Mod Share of Total Rental Housing Stock

HUD's three cases assume 85%, 90%, and 95% rental low-mod shares



Source: Fannie Mae estimates from American Housing Survey data.

Single-Family Investor Share in HMDA Falls Well Below Market Size Assumptions



* HUD estimates consistent with market sizes to justify 57% goal. HUD justifies higher investor shares by citing the 1991 Residential Finance Survey, which showed a range from 14% to 18%.

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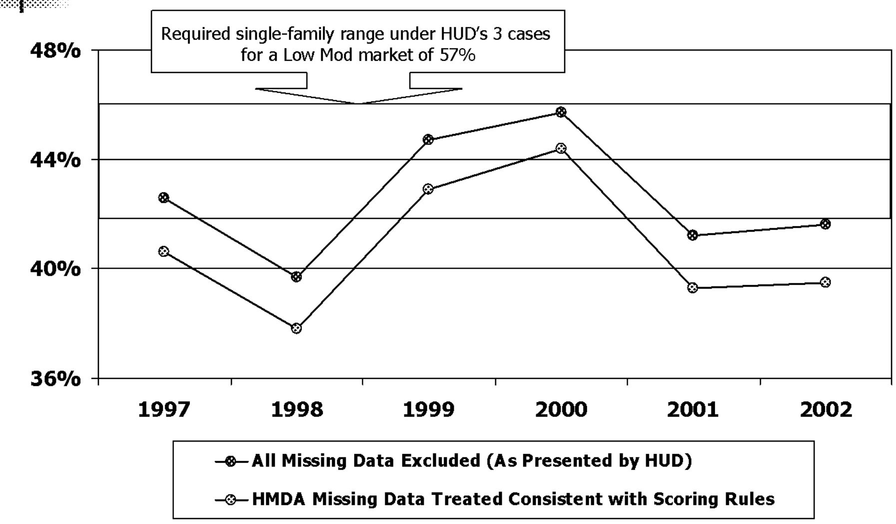
Estimate of Future SF Low-Mod Richness Falls Outside Range for 4 of 6 Past Years



Note: HMDA data for Conforming Conventional + Manufactured Housing + 50% Subprime

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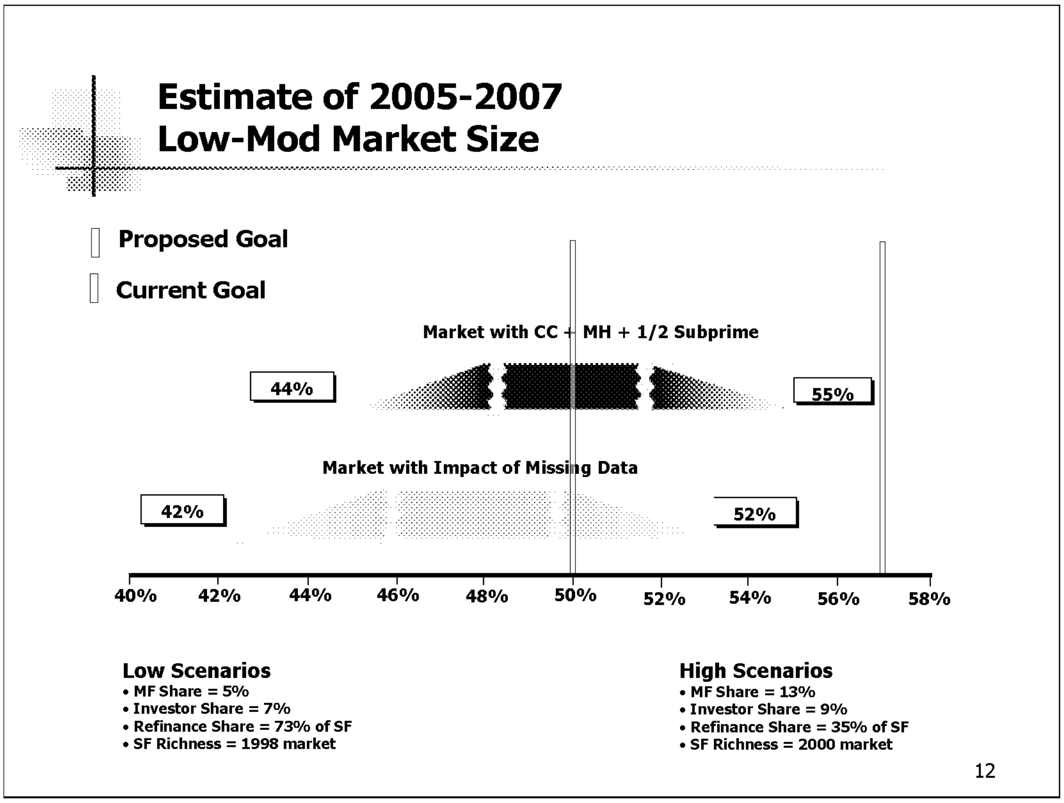
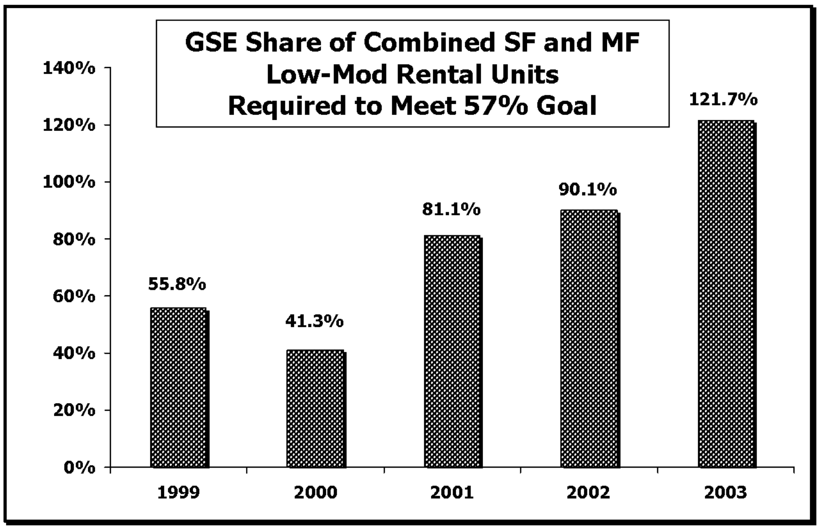


- These market size estimates show the range of potential markets that we are likely to be confronted with over the next few years. Some years the market will fall above the goals, but some years it will fall substantially below.
- This wide variation in potential market opportunities implies that the current goals are just about right on average, if not too high in certain years.

Higher Goals Could Force GSEs to Acquire Unrealistic Share of Low-Mod Rental Market



Assumes 90% low-mod shares for multifamily and single-family rental for market and GSE business. Single-family low-mod shares for market and GSEs are based on HMDA. SF rental market size based on HMDA for 1999-2002, and projected for 2003. MF market ranges from $46 to $75B.

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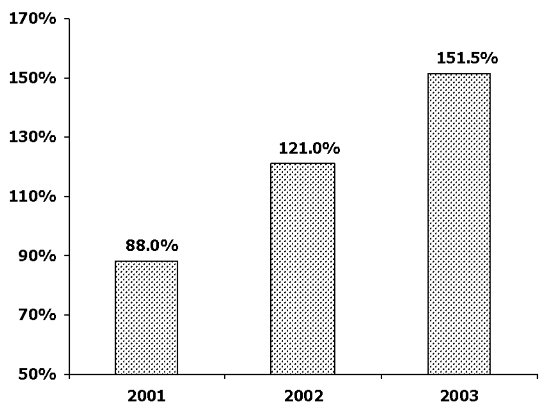
Proposed Goals Require Inordinate Share of Low-Mod Loans in Subprime Markets

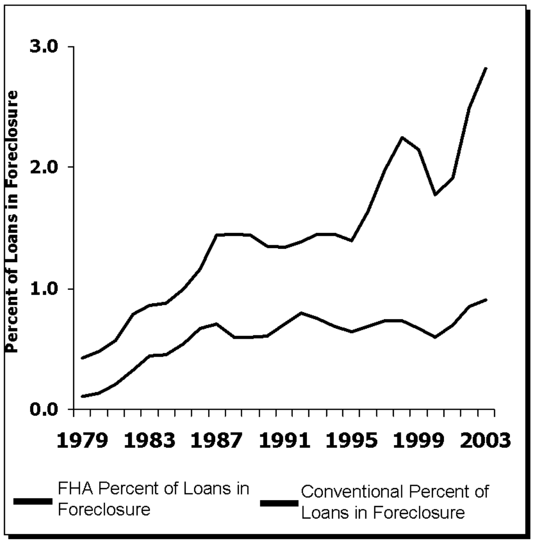
Share of Low-Mod Subprime Loans Required to Meet 57% Low-Mod

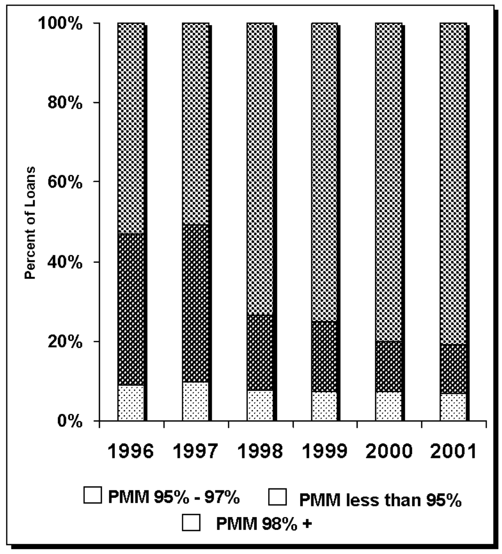


Predatory lending concerns and availability of mortgage insurance could impede significant increases in our penetration of market serving credit-impaired borrowers

Share of low-mod units required for Fannie Mae alone. Assumes subprime market average score of 57% low-mod based on HMDA. Subprime market size based on *Inside B&C* estimates. Assumes that other lines of business match the market at 90% low-mod for rental and HMDA low-mod shares for owner-occupied.

FHA Faces Increased Risk Concentration and Loan Performance Issues





Source: FHA Consolidated Single Family Statistical System Data
Source: MBA

Lower Loan Limit is a Possible Allocation Mechanism if Goals Are Set at Wrong Level

Mortgages Fannie Mae Would Have Been Unable to Purchase if Higher Goals Were in Effect 2001-2003

	Loan Limit Required to Meet Higher Goals				Actual Conforming Loan Limit
	Low-Mod Goal		**Special Affordable Goal**		
	55%	57%	**26%**	**28%**	
2001 Market	**$205,000**	**$190,000**	**$110,000**	**$100,000**	**$275,000**
2002 Market	**$215,000**	**$195,000**	**$120,000**	**$110,000**	**$300,700**
2003 Market	**$215,000**	**$195,000**	**$125,000**	**$110,000**	**$322,700**

Goals Set Inappropriately Risk Allocation of Credit Away from the Middle Class

State	2002 Low-Mod Score (HMDA)	2002 Median Family Income	Police Officer and Teacher	Teacher and Nurse	Teacher and Retail Salesperson
California	29.3%	$60,800	$106,060	$84,540	$66,410
Texas	30.4%	$51,400	$79,270	$70,400	$56,940
New Jersey	30.5%	$73,400	$108,500	$85,390	$65,250
Louisiana	33.1%	$39,600	$59,210	$60,560	$50,340
New Mexico	33.8%	$42,800	$68,240	$66,960	$52,150
Hawaii	34.2%	$59,300	$79,380	$72,060	$57,300
New York	35.3%	$61,800	$108,480	$90,770	$75,370
Mississippi	35.7%	$40,200	$57,040	$56,020	$47,410
Arkansas	35.9%	$39,800	$62,110	$59,820	$49,620
West Virginia	36.2%	$37,200	$65,410	$62,400	$52,230
Florida	36.8%	$51,800	$80,880	$70,810	$57,040
Oklahoma	36.9%	$40,800	$63,870	$58,890	$48,950
Montana	37.0%	$41,700	$66,910	$59,240	$49,140
Arizona	37.0%	$51,900	$77,630	$67,480	$52,420
Rhode Island	37.7%	$54,500	$97,670	$93,580	$71,660
Delaware	38.0%	$67,500	$94,950	$88,770	$68,590
Nevada	38.5%	$57,500	$91,800	$77,470	$60,050
Alabama	38.6%	$47,000	$70,400	$65,490	$56,510
North Dakota	39.4%	$46,600	$63,680	$59,800	$49,060
Alaska	39.5%	$54,000	$103,690	$85,050	$70,550
Maine	39.7%	$43,100	$71,590	$70,320	$56,980
2008 Proposed Goal	**57.0%**				

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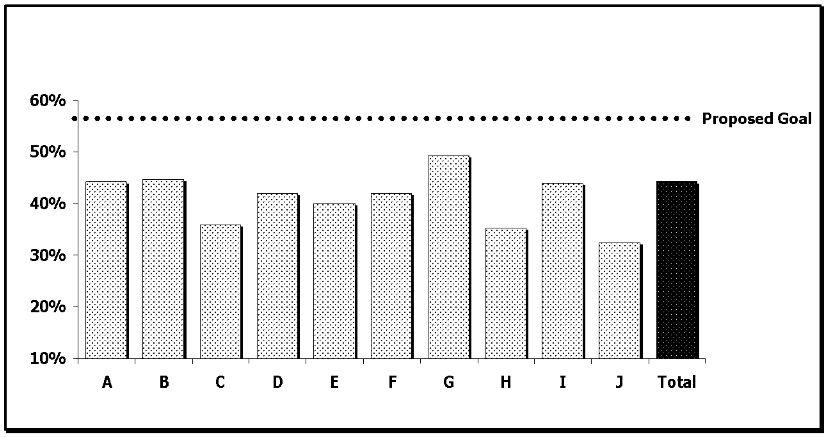
Goals Are Set to Exceed Single-Family Originations

2003 Goals Performance of Top Single-Family Lenders



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Changes Could Mean More for Affordable Housing While Avoiding Credit Allocation

- Reaching goals at the high end of HUD's estimated market range would require changes in goals structure or scoring
- Various potential changes could ameliorate the problem while still requiring a stretch to increase goals activities
- Solutions for the Department to consider include:
  - Focus goals on homeownership and affordable rental housing by excluding single-family refinance loans from the calculation
  - Address missing data issues to create more accurate picture of Fannie Mae performance and better match estimates of market opportunities

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Improve Focus on Policy Priorities: Eliminate Single-Family Refinances from Goals Scoring

- Focuses SF elements of housing goals on home purchases and homeownership
- Obviates need for purchase money mortgage subgoals
- SF refinances are driven more by rate changes than effort
- Remove source of volatility in the market and in meeting the goals year-over-year and lessens potential for market-distorting behaviors
- Lessens the potential tension between mission to expand affordable housing opportunity and mission to provide liquidity

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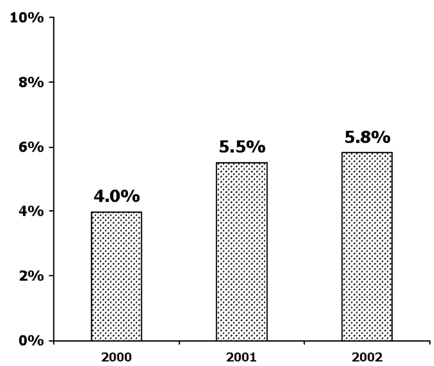
Proxies for Missing Data Would Account for Market Realities

Percent Missing Data in HMDA Loan Originations



Includes PMM, Refinance, Conforming Conventional, Manufactured Housing, Subprime

- Current treatment understates Fannie Mae's performance
- Changes would align measures of our performance with market size estimates
- We support an econometrically-based model to provide more accurate representation of our score
- Intermediate steps are needed while model is in development
  - Use MF proxy for SF rental
  - Exclude owner-occupied units or score to average for similar census tracts
  - Increase missing data caps

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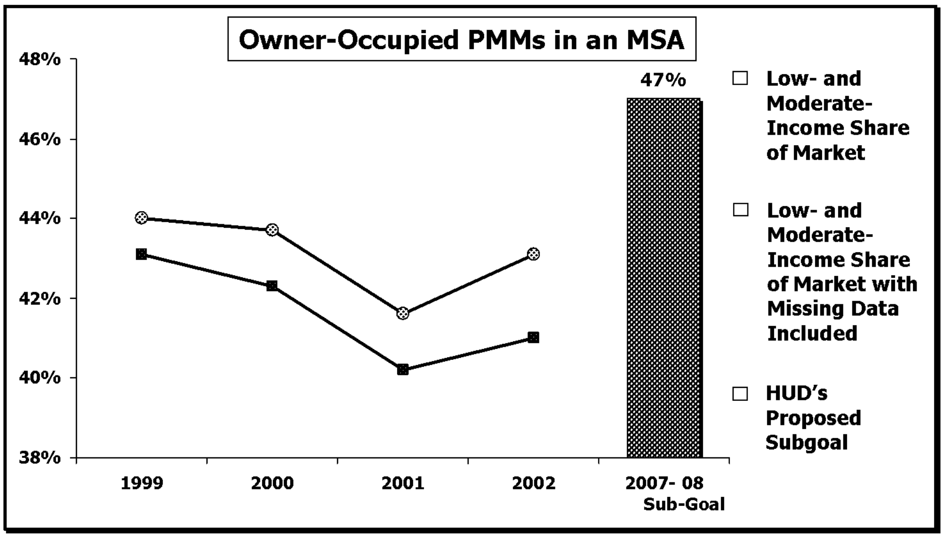
Proposed Low-Mod PMM Subgoal Appears Higher than Market Opportunity Over Time



Conventional conforming market with manufactured housing and 50% subprime, rescored using 2000 Census incomes and new MSAs.

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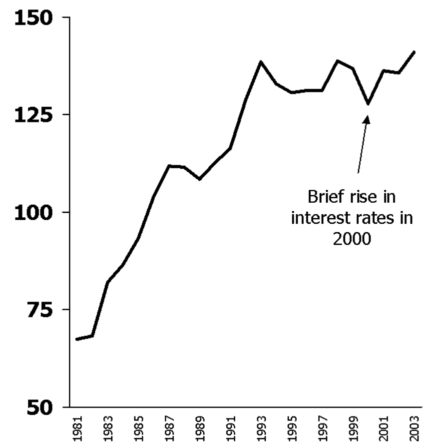
Subgoals Are Not Necessary to Support Homeownership

- Subgoals are unnecessary
  - Fannie Mae leads the market and has aggressive internal targets, even during refinance booms
  - Current and proposed goals, with suggested changes, are sufficient
- Subgoals add undue complexity
  - Doubling number of goals exacerbates current conflicts between goals
  - Subgoals can conflict with overall goals
  - Tracking will challenge lenders' pipeline management systems
- Levels are not market-based
  - Levels are set above market experience
  - Affordability trends may render subgoals infeasible

Housing Affordability Index



Source: National Association of Realtors. Average annual index value is shown.

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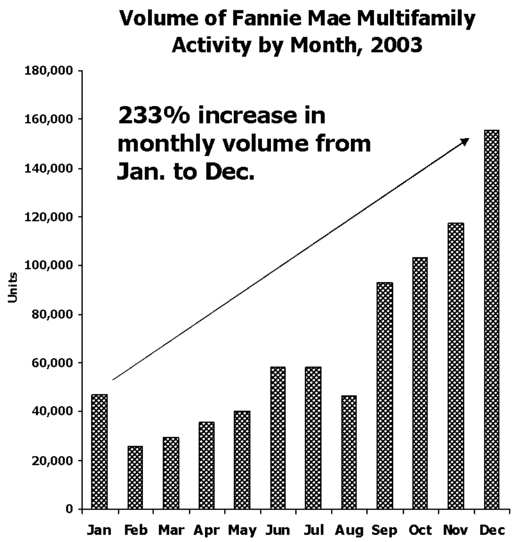
Goals Success in 2003 Required Extreme and Unrepeatable Actions



- Targeted Efforts Needed to Reach Goals Have Been Costly and Market-Distorting
  - $33 Billion total Fannie Mae MF volume was equivalent to two-thirds of the estimated MF market originations for 2003
  - Many lenders' portfolios are now depleted of multifamily loans and will not be available to fill future refinance-induced goals gaps
  - Efforts to purchase multifamily and goals-rich single-family loans resulted in tremendous missing data collection effort and cost

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We Support HUD's Goal to Affirm the Integrity of our Data

- Policy repository is needed to provide transparency and avoid policy disagreements in the scoring process
- Scoring adjustments should focus on intentional material matters related to data integrity that effect performance scoring
- Prior year adjustment or additional enforcement provisions raise a number of legal issues
- Separate discussion is necessary to focus on these issues

Large and Seasoned Transactions Perform a Valuable Function in the Market

- No need for artificial constraints on how we do business with the primary market
  - Large and seasoned transactions are among the many ways in which we support liquidity
  - Support lenders' needs to restructure balance sheets, alter risk profiles, and/or raise cash for additional investments
- Constraints may impede functioning of market
  - Risk creating undue regulatory complexity
  - Could upset relationship between Fannie Mae and our lender customers

Fannie Mae Welcomes HUD Goals that Will Stretch Us to Do More

- Fannie Mae supports a rule that:
  - Sets goals levels that stretch us to lead the market
  - Targets us at expanding homeownership
    - Limits the refinance loans that count toward goals
    - Fixes missing data problems, to account for market realities and accurately represent our performance
  - Accurately reflects market opportunity to avoid unintended consequences
- Subgoals are not necessary to encourage homeownership
- We support data certification, however proposals are too broad
- Large and seasoned transactions serve valuable purpose in market