September 3, 2004

To: **Brian Graham**

From: **Paul Weech**

Subject: **Mission Legislation**

In an e-mail earlier this week, you asked for a package of weekend reading on the mission legislation. Attached is the most recent version of the options paper that was developed for Tom Donilon over the summer, the Executive Summary from our housing goals comment letter, and a variety of other analyses/thought pieces developed over the years on the issue of alternatives to our current goals – most of which focus on CRA as the alternative model.

You also asked for a précis on what is wrong with the current housing goals. A partial list of the problems with the current percent-of-business goals follows:

- Reasonable goals can become unreasonable if market conditions change. Volatility in housing markets changes the market opportunity year to year. This risk is particularly acute when rapidly declining interest rates drive lender liquidity needs toward single-family rate and term refinance mortgages that are less goals rich. High levels of single-family acquisitions also change the balance of single-family and multifamily units in our deliveries and exacerbate goals attainment challenges.

- Meeting the goals in difficult markets imposes significant costs on the Company and potentially causes market-distorting behaviors. In 1998, 2002, and 2003 especially, the Company has had to pursue certain transactions as much for housing goals attainment as for the economics of the transaction. The effort to meet the goals has also imposed significant costs on the Company in management and staff time, and in hiring outside contractors to collect missing income or rent data.

- Percent-of-business goals risk credit allocation. If the goals are set inconsistent with the opportunities in the marketplace, there is a danger that Fannie Mae would have to manage the denominator and turn away business that did not meet the goals. This is bad public policy as it would reduce the liquidity and increase the costs of mortgages for households who did not meet the goals.

- Data on the size of the affordable housing market is quite limited. Multifamily market data, in particular, is lacking, as is data on the number of single-family rental units financed each year. Setting the appropriate goals levels (such that Fannie Mae can lead

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the affordable market without causing market distortions) is more of an art than a science.

- Goal set by regulations create a political imperative to regularly ratchet up the levels. Housing goals are set every 3 to 4 years; increasing their levels has become the way in which to ensure that Fannie Mae and Freddie Mac "do more" for affordable housing.

- Fannie Mae's affordable housing goals are not completely aligned with those of our lender customers. For example, lender CRA goals use targeting standards that are different from the targeting standards for the housing goals (for example, CRA focuses on borrowers at 80 percent of area median income; our low-mod goal focuses on borrowers at 100 percent of area median income). Alternatively, because lenders are not also subject to percent-of-business goals, they have no compelling reason to conform their deliveries to our goals.

- Meeting the housing goals does provide not significant franchise or reputational value. Achievement of all of the affordable housing goals over the last 10 years has not diminished the widely held opinion that Fannie Mae can and should do more to support affordable housing.

- HUD housing goals do not measure the breadth of our contributions to affordable housing in America. The affordable housing goals only include units financed by "mortgage purchases." Important activities like Low Income Housing Tax Credit and ACF equity investments or other qualitative leadership like lowering the costs of mortgage originations or promoting anti-predatory lending policies and initiatives do not count for the goals.

cc: Barry Zigas
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