Costs and Benefits of Mission Activities

Project Phineas

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Mission Activities are Generally Considered the *Quid Pro Quo* of the Charter Benefits

Charter Benefits

- **Agency status**
  - Securities worth more than otherwise comparable AAAs
  - Liquidity under all market conditions
  - Scale
- **Capital advantage**
  - AAA regardless of "actual" rating
- **Process advantages**
  - Debt / MBS SEC exemption (except anti-fraud provisions)
  - Use of Federal Reserve facilities
- **State and local income tax exemption**
- **Competitive advantages that result from scale**
  - Broad network of industry relationships
  - Focused expertise in risk management
  - Wealth of market data and information
  - Ability to set market standards
  - Strong and respected brand

Charter Costs/Constraints

- **Opportunity cost of explicit constraints on business activities**
  - US residential secondary mortgage markets
  - Conforming loan limits
  - Credit enhancements
- **Opportunity cost of Implicit constraints on business activities**
  - Regulatory, political, customer conflict avoidance, etc.
- **Cost of explicit regulatory requirements**
  - Compliance and reporting costs
  - Economic cost of goals business, potential fund
- **Cost of self-defined mission activities**
  - Costs associated with self-imposed goals (*American Dream Commitment*, minority lending, etc.)
  - Corporate Contributions/Philanthropy (other than imposed fund)
  - Partnership Offices, ACF, National Community Lending Center

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•"Agency" status – Phineas securities trade better then comparable AAA companies due to implicit government support

•Capital advantage – ability to act as AAA guarantor irrespective of actual rating

•Process advantages

•SEC exemption

• (except anti-fraud provisions)

•Obligations issuable and payable thru Federal Reserve facilities

•State and local income tax exemption

•A direct (although not explicitly stated) consequence of charter benefits is Phineas's scale. This drives several competencies / advantages including:

•Broad network of relationships in industry

•Focused expertise in risk management

•Wealth of market data and information

•Ability to set market standards

•Strong and respected brand

But, the Company Also Benefits from these Mission Activities

- Incentives for innovation and risk-taking
- Product and business development value
- Produce revenues (albeit sometimes below hurdle rates)
- Significant corporate cultural benefits:
  - Employee morale
  - Recruitment and retention
- Brand name recognition, good will

Conceptualizing Mission Costs

Organizing Mission Costs

- Explicit Mission Costs:
  - Affordable Housing Goals
    - Administrative costs: Compliance and reporting
    - Transactions to meet goals
    - Subsidies within business to meet goals
  - Fund at 5% of net earnings (Anticipated)
- Implicit Costs:
  - Market Leadership Goals
    - Administrative Costs
    - Transactions to meet goals
  - Other Mission Activities: American Dream Commitment
    - Administrative costs
    - Non-economic mission business opportunity costs
    - Corporate contributions, relationship work

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Conceptualizing Housing Goals Mission Costs

	Sources of Costs	2000-2004	2005-2008	Expected Legislation
Housing Goals: **Explicit costs: Meeting the goals required by HUD regulations** **Consequences of missing goal is reputation risk primarily. HUD has enforcement authorities. It can compel a compliance plan and impose cease and desist authorities for failure to produce an approved plan or comply with the approved plan.**	Transactions to close gaps Administrative costs of compliance and reporting Product subsidies Prospect of an underserved markets fund	High SF refinances lowered market opportunity below goals levels in 2002 and 2003, requiring extraordinary activities to meet goals Investor channel deal costs were significant vs. model fees/opportunity costs Multifamily housing 2003 WAMU and World Savings deals came with large costs and significant administrative expenses Flow contribution to costs hard to discern Ongoing administrative costs for housing goals compliance are minimal	HUD has increased goals that reach likely unsustainable levels by 2008 Increasing goals also mean susceptibility to costs incurred during another single-family refinance boom Need to maintain MF production volumes even in midst of uneconomical market conditions Possibility that HUD will regulate to diminish effects of single-family refinances Increased compliance costs from new certification requirements embedded in regulations	Increased targeting of percent-of-business goals to CRA levels; New regulator to set goals based on new definitions, but also with arguably more limited discretion Prospect of relief on percent-of-business goals: House bill excludes SF refinances, separates single-family and multifamily goals, and has SF goals set based on market standard New compliance costs for meeting "duty to serve"; increased use of enforcement penalties 5% underserved markets fund comprised of net after-tax earnings

Conceptualizing Market Leadership Costs

	Sources of Costs	2000-2004	2005-2008	Expected Legislation
Market Leadership: **Lead the Market in Minority Lending** **Implicit Costs: Not required by regulation but goal is embedded in HUD's analysis supporting housing goals requirements** **Consequences of missing goal is reputation risk**	Transactions to close gaps Administrative costs Special marketing and product efforts MF not relevant	High levels of uncertainty with respect to size of the market. Effort follows poor performance vs. 1999 HMDA HUD compares Fannie Mae to a market that included more subprime than our extant business Investor channel costs vs. model fees/opportunity costs Some identifiable and costly flow channel efforts to meet these goals Administrative costs for planning and strategy are significant	High levels of uncertainty with respect to size of the market. Fannie Mae has caught up to market since 1999 and exceeded HUD's standard in most recent years Business has significantly closed gap with market: costs of attainment may drop depending upon future of PLS market. Decline in FHA market share and rapid growth in PLS market has made this goal more daunting in 2005 Additional flow strategies, new channels, new products under consideration	Unclear if new regulator will continue to place emphasis on minority lending, but legislation to include new concepts of leadership in MH, preservation, and subprime Will likely remain part of our corporate culture and goals.

Conceptualizing Other Mission Activities Costs

	Sources of Costs	2000-2004	2005-2008	Post-Legislation
Other Mission Activities: **Implicit costs: Includes those other activities undertaken in the spirit of meeting our self-defined public purposes to expand homeownership, create affordable rental housing opportunity, and serve comunities**	Transactions to meet toughest housing challenges Administrative costs Product subsidies Grants and Subsidies	*American Dream Commitment:* Most of the goals embedded in the business ACF: Increased efforts to manage business to cover costs NCLC: Have central mission focus without dedicated P&L. Drive business through special affordable housing outreach to lenders, relationships with non-traditional partners, and pilots, and experiments. Partnerships & Partnership Offices: Have central mission focus, with no dedicated revenue source Fannie Mae Foundation	*American Dream Commitment* Most of the goals embedded in the business ACF: Moving to generate sufficient revenue to make money NCLC: Moving to closer alignment with single-family business objectives and strategies Partnerships & Partnership Offices: Merged with ACF Moving to more explicitly cover these costs with new revenues within 2 years Fannie Mae Foundation: Diminished support while building capital	Revitalized *ADC 3.0*. On-going mission focus as part of core values. Can new business opportunities in the mission space cover ACF, NCLC, and PO costs? Will legislation limit these activities through bright lines and/or program approvals? Levels of cross-subsidization, corporate contributions, and charitable work should be open question for the organization if the 5% fund is enacted

Quantifying Mission Costs:
Base Case Analysis, 2000-2003

Annual Mission-Related Costs Averaged $95 million, 2000-2003

Costs of Meeting Mission: Administrative Costs, Expenses, Contributions

	2000	2001	2002	2003
Affordable Housing/Minority Leadership Goals				
Non-NCLC Goals Regulatory Compliance Costs	2,632,500	2,827,500	3,412,500	5,947,500
WaMu Incremental Expenses (2003)				2,346,451
MF Costs of Managing Cal Fed, WAMU, etc.		100,000	300,000	1,653,549
Leadership Goals (assume 15 FTEs, data costs)		3,500,000	3,500,000	3,500,000
Subtotal Housing Goals Costs	**2,632,500**	**6,427,500**	**7,212,500**	**13,447,500**
Other Mission Activities				
American Communities Fund 1/	*8,000,000*	6,448,000	8,641,000	10,874,000
HCD Regions, POs, NCLC				
Regions, POs			39,469,700	44,239,100
NCLC			19,852,100	22,270,400
Regions, POs, NCLC Combined	53,300,000	54,500,000	-	
Other Allocated Costs	8,700,000	10,500,000	13,078,200	12,814,500
Corporate Contributions 2/	*5,000,000*	18,858,616	7,961,553	14,002,854
Contributions to the FNM Foundation		300,000,000	35,000,000	44,375,000
Total Admin, Expenses, and Charitable	$77,632,500	$ 396,734,116	$ 131,215,053	$ 162,023,354
Total w/o Foundation	$77,632,500	$ 96,734,116	$ 96,215,053	$ 117,648,354

NOTES

1/ Includes some administrative costs associated with Historic Tax Credits

2/ Includes Local Leadership Fund, Law and Policy, Executive Offices, and Others

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Administrative Costs, Expenses, and Contributions: Considerations and Caveats

- Administration and expense costs of meeting mission are overstated:
  - Some portion of costs should be considered business sourcing, business development, and/or research and development for the business:
  - Some portion – if not all -- of the NCLC, ACF, and PO costs are covered by revenues generated from the activities of these personnel
  - Some portion of these types of costs would be part of the make up of any financial institution – Foundation, corporate contributions, outreach, relationship management.
- Costs of meeting mission are potentially understated:
  - Does not quantify significant senior management time spent on managing housing and market leadership goals.
  - Does not include Law and Policy costs related to defending the Charter benefits: (Most public corporations would incur some level of government relations costs to manage it relationships with the public sector)

Housing Goals In Flow Channel Only Became More Costly that Non-Goals Business in 2003

- For the baseline period, it is hard to discern a fundamental marginal cost to meeting the housing goals on the single-family business side.
- Loans that met the low-mod and special affordable housing goals actually had a smaller negative gap than did the loans that did not meet the housing goals over the 2000-2002 period.
- This picture changed only slightly for the low-mod goal in 2003.
- The picture will change going forward as goals are ratcheted upward.

	2000		2001		2002		2003		2004	
	Vol $	**Gap**	**Vol $**	**Gap**	**Vol $**	**Gap**	**Vol $**	**Gap**	**Vol $**	**Gap**
Low Mod										
Meets	*69,966,765,110*	*-6.08*	*180,961,359,168*	*-8.83*	*261,592,201,146*	*-3.26*	*434,449,672,630*	*-1.26*	*208,691,007,808*	*-0.86*
Does NOT Meet / Missing	*141,255,799,672*	*-7.52*	*357,233,355,084*	*-9.83*	*485,785,245,509*	*-3.70*	*802,064,428,270*	*-1.00*	*339,466,985,152*	*-0.06*
Special Affordable										
Meets	*19,321,748,567*	*-4.89*	*53,440,471,817*	*-7.79*	*79,468,726,434*	*-2.68*	*133,090,763,679*	*-1.04*	*69,300,262,718*	*-1.28*
Does NOT Meet / Missing	*168,886,536,005*	*-8.09*	*483,164,315,065*	*-9.64*	*665,847,893,992*	*-3.59*	*1,099,725,100,000*	*-1.05*	*476,624,414,892*	*-0.23*
Underserved										
Meets	*51,984,086,680*	*-6.76*	*126,963,675,736*	*-9.48*	*177,141,909,973*	*-4.26*	*290,832,321,154*	*-1.84*	*152,724,029,767*	*-1.33*
Does NOT Meet / Missing	*160,987,305,873*	*-6.78*	*410,688,043,348*	*-9.03*	*570,249,100,545*	*-2.85*	*942,418,048,396*	*-0.40*	*396,326,975,229*	*0.39*

NOTE: Volume $'s reflect some double counting of units that are reflected in both the Meet & Missing categories.

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Difficult to Assign Costs to SF Flow Business

-- Cross-subsidies exist throughout the business to meet various business objectives
-- Prominent goals-rich business lines are gap positive

GAP AND GOALS PERFORMANCE BY CHANNEL AND PRODUCT
JAN - DEC 2003 (PRELIM)
SUBSET: TOTAL SF (EXCLUDES PRIVATE LABEL SECURITIES)
Note: Minority scores are for the primary market subset only (PMM, owner-occ. loans in MSAs, excuding gov't & reverse).

			TOTAL		GUARANTEE FEES (BPS) (MCM CW 2.0, REST CW 1.0)						MINORITY SUBSET		
CHANNEL	PRODUCT	PMM / REFI	UPB ($000)	UNITS	MODEL	CHARGED	GAP	LOW/ MOD %	SPC AFF %	UNDS %	AFR AMER %	HISP %	TOTAL MIN %
TOTAL	TOTAL	TOTAL	1,322,360,045	9,067,147	21.58	20.90	-0.68	44.2%	16.3%	27.3%	5.7%	11.0%	26.0%
LENDER	TOTAL	TOTAL	1,140,130,651	7,692,843	20.16	19.65	-0.51	43.2%	15.7%	25.8%	4.3%	8.8%	22.6%
	CLOSER LOOK	TOTAL	26,533,348	200,800	84.93	89.92	4.99	60.6%	26.4%	38.0%	16.2%	17.4%	39.3%
	LOW DOWN PMT	TOTAL	12,814,132	94,239	33.12	41.16	8.03	55.6%	20.4%	32.8%	8.5%	13.6%	26.9%
	ALT-A	TOTAL	12,673,516	83,165	29.13	33.49	4.36	38.5%	14.6%	34.8%	2.7%	11.3%	32.3%
	30-YEAR FRM	TOTAL	617,907,128	3,884,855	21.34	17.05	-4.28	46.5%	17.1%	25.9%	3.8%	8.4%	20.6%
		PMM	152,425,245	969,550	20.45	17.03	-3.42	46.5%	17.1%	25.7%	3.8%	8.4%	20.6%
		REFI: CASH	190,807,626	1,195,104	29.14	20.01	-9.14	50.9%	20.1%	29.4%			
		REFI: R & T	274,674,257	1,720,201	16.39	15.01	-1.38	43.3%	15.0%	23.4%			
	15-YEAR FRM	TOTAL	302,054,713	2,364,059	10.91	15.39	4.47	36.4%	12.6%	25.1%	1.7%	6.7%	28.8%
		PMM	16,024,121	129,095	12.40	16.68	4.28	41.9%	17.1%	28.7%	1.7%	6.7%	28.8%
		REFI: CASH	107,631,787	839,496	14.38	17.62	3.23	38.2%	13.3%	27.8%			
		REFI: R & T	178,398,805	1,395,468	8.69	13.93	5.24	34.7%	11.7%	23.2%			
	OTHER FRM	TOTAL	71,170,712	499,199	17.75	20.18	2.44	42.5%	14.2%	23.9%	2.1%	6.0%	16.7%
	ARM	TOTAL	91,617,682	518,257	22.93	25.27	2.34	39.3%	12.4%	21.4%	2.5%	5.9%	20.9%
	ALL OTHERS	TOTAL	5,359,421	48,269	16.98	23.26	6.28	86.8%	80.1%	38.6%	3.6%	3.6%	15.5%

Lender Channel Excerpt from Year-End Goals/Gap Report

Business Mission Costs Were Significant in 2003, but Annual Average is Considerably Less

Costs of Meeting Mission: Business Opporunity Costs

	2000	2001	2002	2003
Affordable Housing/Minority Leadership Goals				
Single-Family Business				
Investor Channel Goals Transactions (HIGH) 1/	$ -	$ -	$52,000,000	$ 237,000,000
Investor Channel Goals Transactions (LOW) 2/			$26,000,000	$ 80,000,000
RBMG Channel 3/				$ 342,000,000
Multifamily Transactions				
WaMu (2003) 4/				8,600,000
World Savings (2003)				-
2002 Deals 5/			4,467,382	
Other Mission Activities				
American Communities Fund 6/				
Debt (Revenues)		(5,910,000)	(7,217,000)	(6,587,000)
Equity (Losses)		3,639,000	5,722,000	7,359,000
CDFIs 6/	162,667	117,405	5,935,965	940,621
Total Business Costs (HIGH)	162,667	(2,153,595)	60,908,347	589,312,621
Total Business Costs (LOW)	162,667	(2,153,595)	34,908,347	432,312,621

NOTES

1/ Investor Channel High Costs 2002/2003: Based on model fee at 11% ROC vs. charged fee for negative gap deals
2/ Investor Channel Low Costs 2002/2003: Based on model fee at 11% ROC vs. charged fee regressed for goals richness of deal
3/ RBMG: based on 10% loss on sale of certain RBMG assets applied to entire production
4/ WaMu 2003 Transaction. Economic Cost of Transaction Estimated at $8.6 million based on difference with market Gfee
5/ Multifamily Deals 2002: Independence Community Bank, National Cooperative Cons, NCB FSB, World Savings.
Based on difference with 26 bps gfee.
6/ From ACF P&L. Excludes Historic Tax Credit Investments
7/ Losses after taxes

Cost of Goals Business Through Investor Channel Estimated at $25-70 million per Year

Costs of Investor Channel Deals

1/ 2/	**2002**	**2003**
Cost of deals with fees at negative gap 3/	$26 million	$80 million
Costs of individual goals loans in deals with positive gap 4/	$0-26 million	$0-157 million
Range	$26-52 million	$80-237 million
Average Annual Cost 2000-2004 5/	$25-70 million	

1/ Assumes price paid for by third party seeking risk at 11% return on capital (per Citigroup cost of funds analysis) vs. 14% return on capital (ROC) assumed in Fannie Mae models

2/ Assumes third party evaluates risk using models similar to to Fannie Mae's models, except for lower expected ROC

3/ Assumes costs only for those transactions where the deal showed negative gap (charged fee less than model fee)

4/ Based on regression using negative gap against percent of affordable unit in the investor channel deal to price negative gap on units acquired in otherwise gap positive deals. The lower end of the range assumes deal price reflects concessions for other than goals considerations; high end of range assumes prices attributable entirely to goals business.

5/ Assumes no mission-specific transactions in 2000, 2001, 2004 at negative gap given relative performance of business against housing goals targets in those years.

Assumes PV Factor of 3.5X

Business Projections for Phineas Preview
Significant Future Gaps Under Current HUD Goals

Summary Scenario Projection of HUD Goal Gaps (Preliminary)

	Actual 2000	Actual 2001	Actual 2002	Actual 2003	Actual 2004	Projection 2005	Using YTD 2005 MF Share	Projection 2006	Projection 2007	Projection 2008
SF Acquisitions	224.0	564.1	798.9	1323.3	583.9	445.0	445.0	402.4	392.3	417.2
MF Acquisitions	10.1	18.7	18.3	33.3	19.4	16.2	24.0	15.4	15.7	17.5
Total Fannie Mae Acquistions	234.1	582.8	817.2	1356.6	603.3	461.2	469.0	417.8	408.0	434.7
MF Share	4.3%	3.2%	2.2%	2.5%	3.2%	3.5%	5.1%	3.7%	3.8%	4.0%
Special Affordable										
Fannie Mae Score	22.2%	20.1%	19.7%	19.2%	23.4%	21.8%	23.6%	22.4%	23.0%	23.7%
HUD Goal	14.0%	20.0%	20.0%	20.0%	20.0%	22.0%	22.0%	23.0%	25.0%	27.0%
Gap in Units	151,311	2,689	-14,647	-72,783	136,528	-5,417	49,381	-16,138	-48,480	-82,119
Affordable										
Fannie Mae Score	49.5%	48.8%	48.7%	48.4%	53.0%	51.2%	53.5%	51.4%	51.6%	51.9%
HUD Goal	42.0%	50.0%	50.0%	50.0%	50.0%	52.0%	52.0%	53.0%	55.0%	56.0%
Gap in Units	157,187	-53,291	-77,725	-145,688	118,819	-24,047	47,217	-42,797	-82,658	-102,305

Note: Drivers of Fannie Mae projected scores include MF share, richness by property type, property share, goal share of SF/MF segments, and average UPB. "Actual" numbers do not tie to officially reported numbers due for the most part to treatment of missing data and bonuses.

Meeting Future HUD Goals Appear Quite Daunting and Potentially Costly

- Analysis on following page based on Phineas business projections suggests a 102,000-unit shortfall on the low-mod goal, a 82,000 shortfall on the special affordable goal
- Based on 2003 experience where goals acquisition costs (relative to Fannie Mae model fees) cost between $65 per goals unit in the first quarter to $370 per unit in the fourth quarter, meeting the shortfall could cost the company $6.5-$36.5 million to purchase sufficient units
- The goals scenario does not model the potential for market imbalance between single-family and multifamily – usually triggered by a single-family refinance boom – that could widen the gaps and the costs of goals attainment
- Current HUD goals structure, then, requires an on-going, fairly high level of multifamily volumes
- **Potential Mitigants:**
  - Legislation, if enacted, is very likely to replace current housing goals regime
  - Fannie Mae could adopt strategies now to increase richness of single-family business in the future – e.g. greater participation in subprime lending – that could work to close gaps
  - HUD has put on the regulatory agenda a rule-making that could potentially limit the effects of single-family refinances on the housing goals process
  - Fannie Mae always has the option to not make the goals and appeal to HUD that the market makes the goals infeasible.

Summary Comments

- Cost of mission activities – explicit and implicit – over the 2000-2004 period likely averaged approximately $200 million per year
  - Many of the costs were covered by revenues related to the expenses or brought other less tangible benefits to the Company
  - Largest components of the direct costs were a costly experiment with RBMG to meet leadership goals and the costs related to meeting 2003 housing goals challenge
- Mission costs also need to be considered relative to the costs of mission activities in other alternative structures for the Company (e.g. How do these costs compare to CRA regulatory costs?)
- Imposition of a 5% tax on earning to fund underserved markets fund in addition to an on-going housing goals regime, is likely a very significant step up in costs imposed by the mission activities of the company.