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# Fannie Mae Housing Goals Briefing for HUD

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April 11, 2007

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# Agenda

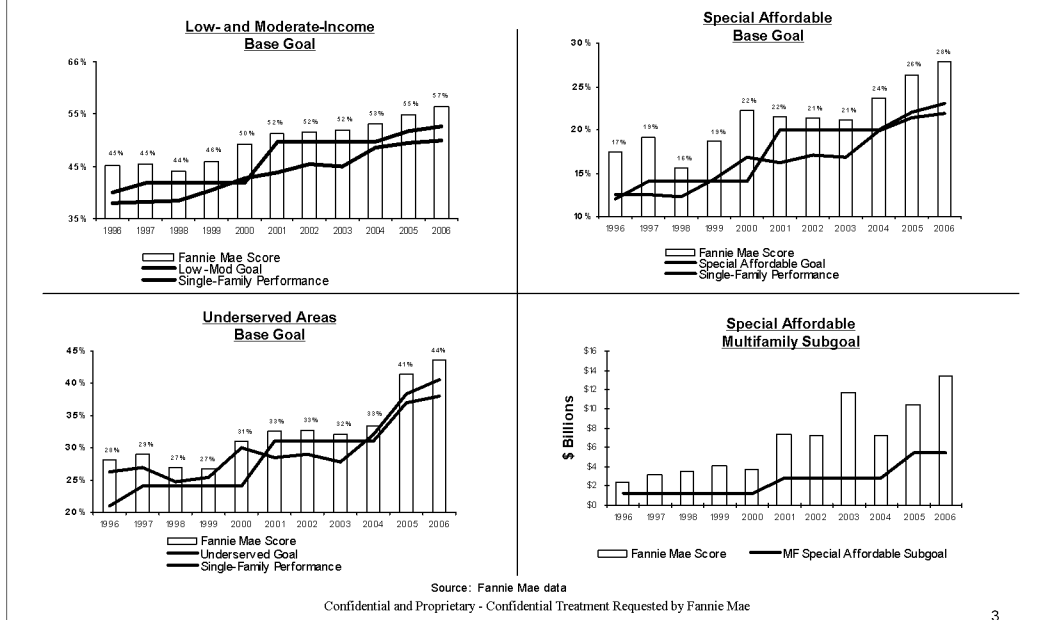
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- Overview of the Goals
- Goal and Subgoal Levels
- Single-Family Market Overview
  - Strategies to Meet the Goals & the Implications
  - Subprime Market Turmoil
- Multifamily Market Overview
- Suggestions for Revised Regulations

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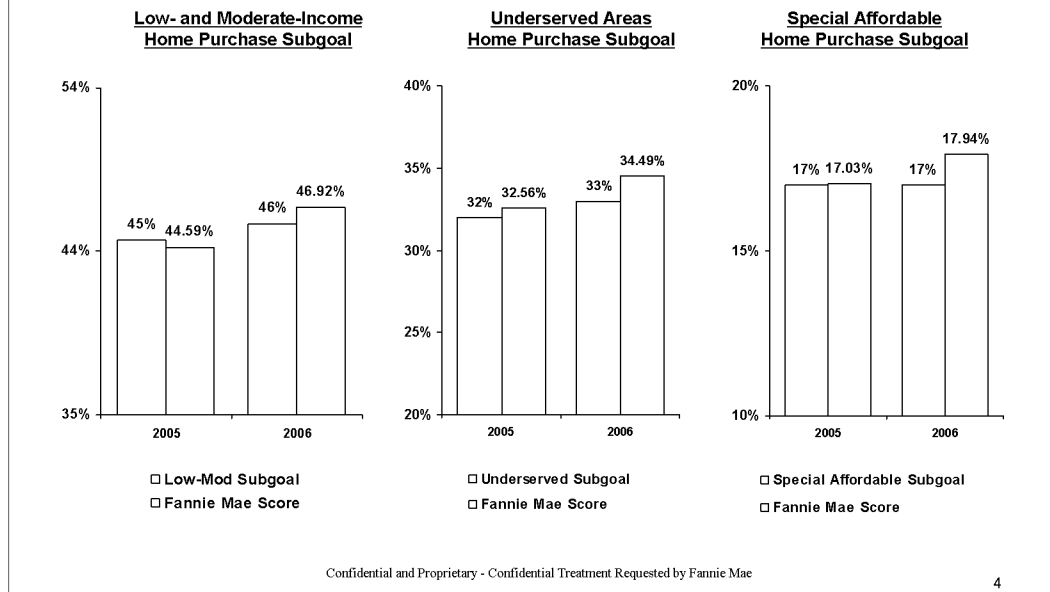
# Fannie Mae Has Met Increasing Goals



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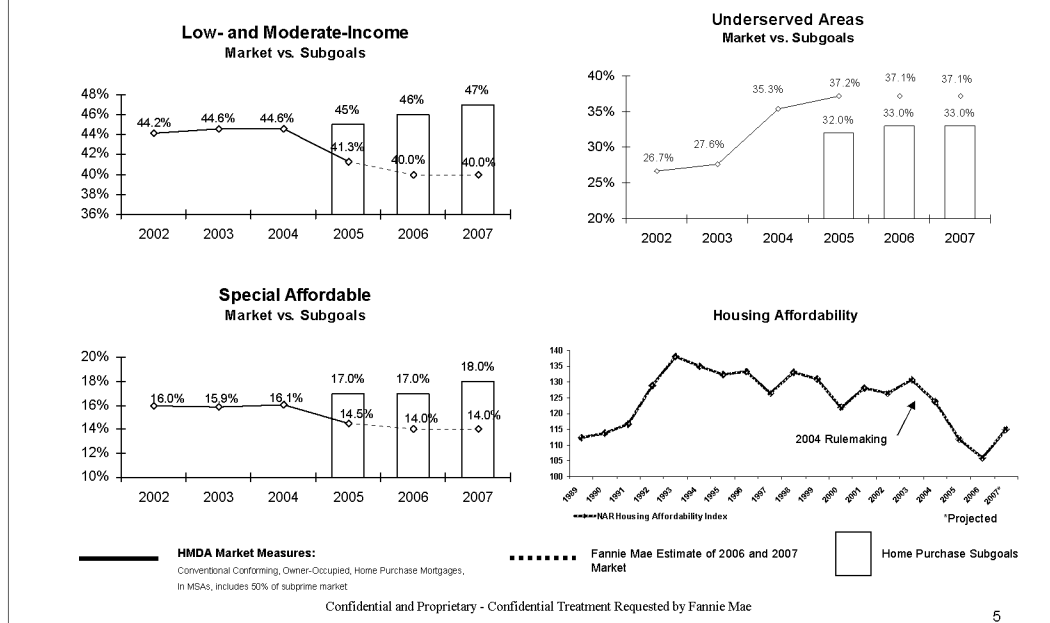
1. This first slide shows the history of our performance against the three affordable housing goals and the Special Affordable Multifamily Housing Subgoal.
2. Three main points.
3. We take the housing goals very seriously. Even as the goals have increased consistently over the years since the 1992 Act that authorized the goals – as shown by the black line – our performance has consistently exceeded the goals – as shown by the green bars. As you can see we have met every goal, every year since 1994.
4. 2007 Goals for low mod and special affordable are higher. The second point I want to make is that the goals have gone up again this year to 55 percent for low and moderate income and to 25 percent for special affordable. These represent significant 2 percentage point increases over last year's goals levels. It is early in the year and when we send you are first quarter data you will see we are running a little behind these increased goals. We exceeded the new levels with our performance last year, and we are optimistic we can meet these goals, but expect a tough year.
5. Role of multifamily. Third, emphasize the I wanted to your attention to the yellow line on the slide which represents the showing the performance of our single-family business in each of the years. We have done this to emphasize how important the multifamily business is toward our meeting the two income based goals. We could not meet the low-mod and special affordable housing goals without the contribution of multifamily housing as the single-family performance runs well below the goal number for these goals.

## Subgoals Have Been Very Challenging



1. This next slide shows our performance against the Home Purchase Subgoals which the Department put into place in beginning in 2005.
2. As we have discussed with the Department on numerous occasions over the past two years, the subgoals are an extraordinary challenge.
3. We missed the low- and moderate-income home purchase subgoal by less than 5,000 loans in 2005.
4. In 2006, the data we submitted to you all on March 16<sup>th</sup> shows that subject to your verification of our numbers, we believe we were able to exceed all of the three home purchase subgoals, But achieving this result occurred after the company did some extraordinary things. Following my introduction, Tom Lund will talk about these efforts in his remarks following this overview.
5. So far this year, we have found that the home purchase market for 2007 is no different than the prior two years. Three months into the year, we are behind on two of the three subgoals and facing some market challenges. We've put in place a plan that we will continue to refine, but meeting the home purchase subgoals at increased levels will be very, very difficult.

# Subgoal Levels Don't Reflect Market



- We strongly believe that the Home Purchase Goals are out of synch with the market as this next slide shows.
- The 2005 HMDA data for home purchase lending showed a significant drop in the levels of low-mod and special affordable lending in the market and we believe that the 2006 market was smaller still as the conforming loan limits went up and affordability continued to decline. Of course, we cannot know precisely what the market opportunity was until we get the 2006 Home Mortgage Disclosure Data later this year.
- Now in fairness, the underserved market in HMDA is running above the home purchase subgoals. One of the interesting things we see in the HMDA data is that the role of subprime lending is less of a factor on the size of the market for low mod and special affordable, but has a profound impact on the size of the market for underserved.
- For 2007 we would surmise that the size of the market is similar to 2006, though early deliveries suggest some shrinkage. Affordability and measured by the NAR index has gone up some. Offsetting that is are two issues affecting the size of the market. The first is whether the turmoil in the subprime markets will shrink the number of low-income and underserved families in the market for loans as weak lenders and brokers close up and conventional lenders pull back. Another emerging concern with have about the new Median Income files that the Department just sent us. Our understanding is that HUD has rebench-marked incomes in 65% of the MSAs representing 56% of originations. We have not had an opportunity to assess the impact on our scores year to date, but we are concerned that the new incomes will shrink the size of the market available to us more.
- So this is what we're seeing let me turn it over to Tom.

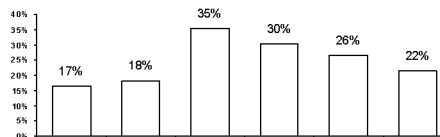
# Overview of Single-Family Market

Total Origination Volumes



Source: Fannie Mae's Economics and Mortgage Market Analysis

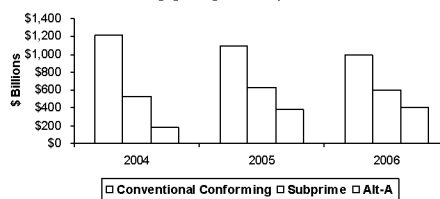
ARM Share of Total Originations



Source: Fannie Mae's Economics and Mortgage Market Analysis

- Originations will decline in 2007, with refinances up slightly and a drop in home purchase volumes
- Expect movement from ARM products back to fixed, with rate resets driving increase in refinance activity
- Home prices expected to begin to rise again by end of 2007
- **Subprime market is in turmoil; volumes are expected to drop nearly 30% this year; large loan volumes are hitting their rate reset dates**

Mortgage Originations by Product



Source: Inside Mortgage Finance March 2, 2007

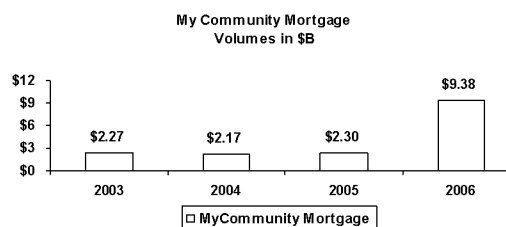
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1. Market turmoil
2. Need for liquidity – subprime participants have left and market is asking us to step in and provide liquidity. However, the housing goals may be a deterrent.
3. Shares of Alt-A and Subprime have increased greatly.

# Strategies to Meet the Housing Goals

- Flow strategies
  - Improved Pricing in DU
  - MyCommunityMortgage Enhancements
  - Housing Finance Agencies
  - Increased delegations to MF lender partners
- Large transactions
  - Manufactured Housing
  - California HFA
  - REMICs
  - Purchase of MF CMBS pools
  - Purchase of other bulk and seasoned deals, including Small MF loans



Source: Fannie Mae data

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## 1. Flow Strategies

- DU Bump – improves price recommendation on loans meeting the affordable subgoals
- MCM – became a standard selling guide product, improved price, removed requirements. Annual volumes tripled to \$9.3 billion.

## 2. Deals

- Our purchase of MH personal property in 2006 was the second major deal in two years – and it was also very expensive. We may have “cleaned off the shelves.” There may not be much more seasoned business available for purchase in 2007.
- Cal HFA – Deal comprised primarily of low balanced seconds. The loan is a simple interest, deferred-payment subordinate lien. Payments on the subordinate lien are deferred for the life of the first lien. The Fannie Mae transaction consisted of approximately 6,000 second lien loans, all of which met the low- and moderate-income subgoal. The loans have low-balances, with an average original balance of approximately \$10,000 and an average seasoning of 24 months.

## Implications of Strategies to Meet Goals

- Market Distortion
  - Disincentive to purchase certain deals
    - Loans from Puerto Rico score low on income-based goals because of low Area Median Incomes
    - Pursuing Alt-A business risks driving up missing data above maximum levels
  - Lenders benefit by holding goals-rich loans and selling at a premium
  - Deferring acquisitions impacts liquidity mission
- Taking on Uncertain Risks
  - Credit Risks
  - Operational Risks – e.g. daily simple interest, deferred payments
- Cost of Strategies

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### 1. Implications of strategies:

- Market Distortion –
  - We do not buy many loans in Puerto Rico because the AMIs are so low and thus the loans rarely qualify for the housing goals.
  - Purchasing loans without income caused us to go over the proxy cap by 6000 loans in 2005 and 3000 in 2006.
  - Fannie Mae worked on a deferral strategy last year where certain lenders could wait to deliver dilutive loans until 2007. It may have affected the amount of liquidity to market.

### 2. Taking on uncertain risks

- Credit Risk –
  - We purchased loans further down the credit spectrum but which were more goals-rich. Result is higher risk of defaults.
- Operational risk –
  - We purchased loans that required us to make “fixes” quicker than we would have preferred. For example, we needed to track the CAL HFA loans manually because there are no payments made. In an ideal world, we would have been able to create a system to do that for us.
  - Includes purchasing loans with daily simple interest, lenders delivering mailing addresses rather than property addresses, tracking loans manually because there are no regular payments (e.g. Cal HFA deal),
  - new lenders were delivering loans.

### 3. Largest costs are opportunity cost of foregone revenue. In 2006, opportunity cost was about \$400 million, whereas the cash flow cost was about \$134 million. If opportunity cost was \$0, our shareholders would be indifferent to the deal. The cash flow cost is the implied out of pocket cost.



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## Response to Subprime Market Turmoil

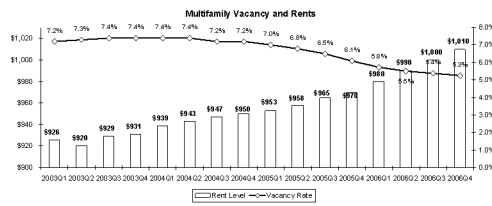
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- The vast majority of borrowers with 12 months of good payment history on current mortgage are eligible for a prime-based refinance of their principle residence
- DU Applications already increasing in response to crisis
- Plans to increase “Yes” for subprime borrowers
  - Expanded Approval (EA) to be a standard selling guide product
  - Adding 40-year option to EA
  - Tie-ins to counseling with nonprofit partners
  - Relaxing policy on borrowers with outstanding collections
- Responsible risk management
  - Limiting multi-layered risks
  - Cutting off the high-risk tail
  - Retaining \$500 minimum contribution and limiting subordinate financing for riskier EA loans

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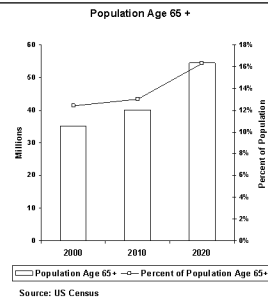
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# Overview of Multifamily Market

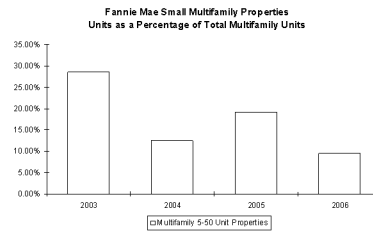


Source: Historical: PPR (vacancies), Realpoint (rents), 2005-present: Fannie Mae: HCD Market Research

- Healthy market expected, but higher rents may lower affordability
- Competition remains intense
- Increasingly complex transaction structures
- Fannie Mae priorities include expansion into markets for seniors' and small multifamily



Source: US Census



Source: Fannie Mae AHAR 2003-2006

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1. Higher rents may decrease overall number of affordable units.
2. Increased competition is pushing Fannie Mae into higher credit risk loans.
  - Competition from CMBS, insurance companies and depository institutions.
  - Fannie Mae began buying CMBS in 2006.
3. Borrowers are increasingly requesting more complex transaction structures e.g. bond credit enhancements and bond participations
  - We respectfully request the 2009 - 2012 HUD Regulations to broadly define these complex transactions.
4. Small multifamily and Senior housing loans are Fannie Mae's expansion markets.
  - Market expansion increases credit and operational risks.
  - Small multifamily and Senior housing loan rental data is difficult to attain. We ask for HUD's flexibility in the new Regulations around missing rental data.
5. Seniors' trends: The U.S. population age 65 and over is expected to double in size within the next 25 years. By 2030, almost 1-out-of-5 Americans — some 72 million people — will be 65 years or older. This will increase the importance of housing for seniors.

## Suggestions for Revised Regulations

- Reach consensus on market size for the base goals
- Set single-family subgoals annually based on HMDA data
- Modify rules for missing data
- Provide protection for high refinance environments
- Increase flexibility for complex transactions
- Retain credit for reverse mortgages and possibly add other government loans

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1. It is early in the process, reserve the right to revise and extend. Here are some of the big points that we'd like to ask the Department to consider as we go into the rewrite. .
2. Our biggest concern in the upcoming rewrite process will, be the level of the goals and subgoals. Given the assumptions and data limitations in sizing the market as well as the potential distortions of the market if we get this wrong, we would really like to request that the Department consider a process where we get our economists and data people together with yours, to discuss data and assumptions and come up with reasonable approaches.
3. For the Home Purchase Subgoals we would ask that HUD consider setting the PMM subgoals annually based on the HMDA data. The legislation reported out of the House financial services committee would set the PMM subgoal based on a 3-year rolling average using HMDA data. This strikes us as appropriate so long as the market benchmark is adjusted for take into account the role of subprime that is not in our market.
4. Go off script a little bit to say that we might also consider market adjustments to the goals as well as the subgoals. One of the issues on our list to address is some effort to the risk that single-family refinance boom poses to the size of the market and therefore to our ability to meet the goals in any given year. We have proposed a cap on the number of reingnance that count in the past, but one might also consider adjustments to the goals levels based on new HMDA and market conditions. Going forward.
5. We will also ask the Deparment to conssider changes in the rules for income proxies. Fannie Mae asks HUD to consider excluding from housing goals scoring loans underwritten without income. Alternatively, we ask HUD increase the level of the proxy cap so that all missing data can be proxied. We recommend increasing the proxy cap for single-family rental loans to 25% for both current year and seasoned loans. We also request no proxy limits for seniors' housing.
6. Fannie Mae would like to work with HUD to make the rules less restrictive and to allow us to better respond to the market on certain transactions (e.g. participations, missing data, credit enhancements).
7. Fannie Mae believes that the current housing goals credit reverse mortgages should be maintained. We would also propose that the Department consider credit for other smaller niche federal programs like Section 538 rural guarantee programs. Just an additional incentive to participate in the important rural multifamily markets.

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# Appendix

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# Detail on Recommendations

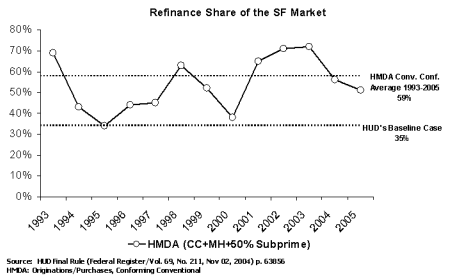
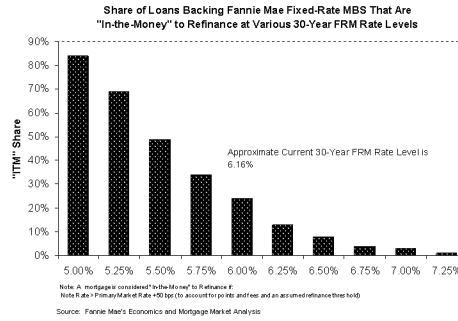
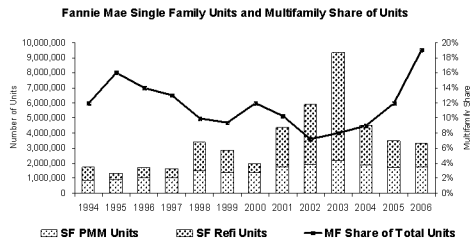
Issue	Description	Recommendation / Request
Reach Consensus on Market Sizing	Sizing the market, especially for multifamily, is a difficult process. Consensus on the market size and Fannie Mae's target market has been challenging in the past.	Fannie Mae would like to work with HUD and Freddie Mac on the size of the market and discuss the most difficult data issues.
Tie Subgoal Levels to HMDA	Goals set in previous years were not reflective of the market. In 2007, our low- and moderate-income subgoal is set at 47% and the current HMDA market is estimated to be 40%.	Each year after new HMDA data is released, Fannie Mae suggests setting subgoals for the next year using a 3-year rolling HMDA average. This is consistent with current legislative proposals.
Modify Rules for Single-Family Missing Data	HUD allows Fannie Mae to estimate incomes or rents for loans with missing data up to certain maximum levels. However, single-family loans underwritten without income have increased in recent years. Low documentation loans have increased as a share of prime conventional conforming mortgages from 14.6% in 2003 to 27.1% in 2006. Fannie Mae has exceeded the proxy caps for home purchase mortgages in 2005 and 2006.	Fannie Mae asks HUD to consider excluding from housing goals scoring loans underwritten without income. Alternatively, we ask HUD to increase the level of the proxy cap so that all missing data can be proxied.
Modify Rules for Missing Rental Data	Single-family rental loans often don't require rents for underwriting. In 2006, 25% of these loans were missing rent data, whereas the proxy cap for current year originations is only 5%. In addition, affordability for seniors' housing loans has to be estimated because rents include services. In 2007, we anticipate we will exceed our multifamily proxy cap due to an increased focus on seniors' loans.	We recommend increasing the proxy cap for single-family rental loans to 25% for both current year and seasoned loans. We also request no proxy limits for seniors' housing.
Provide Protections for Refi Booms	High levels of single-family refinances create a potential conflict between meeting the goals and serving the liquidity needs of the market. In 2004, HUD recognized the need to protect against high refinance environments but did not adopt changes.	Fannie Mae suggests either the removal of refinances from the goals calculation or implementation of a refinance cap. We urge HUD to make changes in this process.
Create More Flexible Rules	Customers increasingly are asking Fannie Mae to participate in complex transactions that are not anticipated in the housing goals regulations.	Fannie Mae would like to work with HUD to develop less restrictive counting conventions on certain transactions like REMICs, credit enhancements, bond participations and seniors' housing.
Retain Credit for HECMs	Fannie Mae is a major holder of HUD's reverse mortgage product, Home Equity Conversion Mortgages. We believe we have brought value and stability to the market.	Fannie Mae believes that the current housing goals credit for reverse mortgages should be maintained.

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These are just a few of our ideas. Fannie Mae welcomes the opportunity to discuss with HUD staff other thoughts we have.

# Potential for Refinance Volatility Remains



- High levels of single-family refinances drive down multifamily share and reduce housing goals performance
- Refinance volumes have moderated since the 2003 refinance boom
- A small decline in rates could have a big impact on refinance volumes, making base goals very difficult to meet

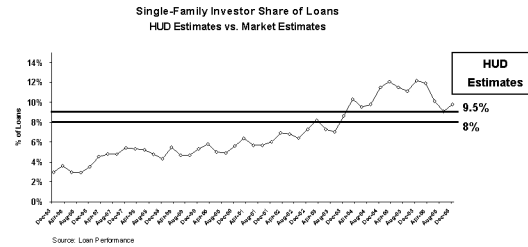
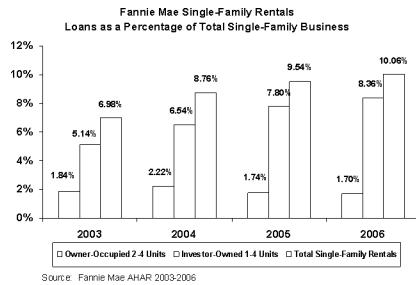
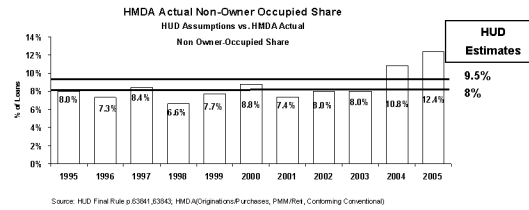
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1. Current refi shares hover between 40-50%.
2. Refis resulting from ARM rate re-sets combined with a drop in home purchase activity are keeping refi shares high.
3. Even with low levels of current rates a boom would be possible. If rates drop to 5.5% most mortgages originations since 2003 would be "in the money."
4. Overall, refinance shares have been much higher than expected at the time the housing goals were set.

# SF Investor Share has Fluctuated

- The high investor share of the 2004-2006 market has recently retreated to a more moderate level.
- The temporary high investor share contributed substantially to our housing goals performance.



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1. Investor share market fluctuations can greatly impact our ability to meet the housing goals. The higher the investor share, the better our performance is towards the base goals.
2. YTD SF Rentals are running about 10% of SF business.
3. This is also higher than the level expected when HUD set the goals.
4. However, we believe that the higher investor share was a temporary change in the market due to the real estate boom, and recent data show a drop back to more moderate levels.