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**FANNIE MAE'S**  
**2007 ANNUAL HOUSING ACTIVITIES REPORT**

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**SUBMITTED TO:**

**U.S. DEPARTMENT OF HOUSING  
AND  
URBAN DEVELOPMENT  
(HUD)**

**PURSUANT TO P.L. 102-550 AND**

**THE SECRETARY OF HUD'S REGULATION OF THE  
FEDERAL NATIONAL MORTGAGE ASSOCIATION  
(FANNIE MAE)  
AND  
THE FEDERAL HOME LOAN  
MORTGAGE CORPORATION  
(FREDDIE MAC)**

**24 C.F.R. § 81.63**

**MARCH 17, 2008**

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## INTRODUCTION

Fannie Mae is required under its Charter Act to submit an Annual Housing Activities Report (AHAR) to its oversight committees in the House of Representatives and the Senate and to the Secretary of the U.S. Department of Housing and Urban Development (HUD). In compliance with this requirement, Fannie Mae submits this AHAR for 2007.

HUD is required by law<sup>1</sup> to establish three housing goals for Fannie Mae and Freddie Mac: a low- and moderate-income housing goal, an underserved areas housing goal, and a special affordable housing goal. In 2004, HUD published housing goals regulations that govern the period from 2005 through 2008. In addition to setting the percent of business levels for each of HUD's three housing goals, the rule established three subgoals specifically related to home purchases.<sup>2</sup> The regulations also include a multifamily special affordable housing subgoal expressed as a dollar volume.

Fannie Mae views the regulatory goals and subgoals as an important part of its broader mission. This broader sense of our mission includes the purposes for which the company was chartered by the Congress – to bring liquidity, affordability and stability to the mortgage markets – but also includes the special efforts the company has made over the years to address other important industry needs and public policy objectives. These efforts have included initiatives over time, such as the company's role in expanding access to credit through support for low-downpayment lending and responsible lending for credit-impaired borrowers. It also encompasses efforts to increase minority homeownership, as well as the company's response to unforeseen, extraordinary circumstances that affect the nation's housing markets, such as efforts to ameliorate the impacts of Hurricane Katrina on housing along the Gulf Coast, and now, efforts to address the foreclosure crisis that is confronting the nation's housing markets.

Attached are tables specified by HUD that provide detailed, information about the company's performance in achieving each of the housing goals. The data relating to Fannie Mae's mortgage purchases of both single family and multifamily loans will be forwarded in electronic format under separate cover.

As described more fully in Section I, Fannie Mae believes that in 2007 it met each of its three base housing goals, the underserved areas home purchase subgoal, and the multifamily special affordable subgoal. However, due to challenging market conditions, Fannie Mae believes that it did not fully attain its low- and moderate-income and special affordable home purchase subgoals. Nevertheless, Fannie Mae has been – and will remain – focused on meeting the needs of low- and moderate-income and other underserved borrowers.

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<sup>1</sup> The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act), 12 U.S.C. § 4561-4564.

<sup>2</sup> The 1992 Act specifically provides that subgoals established with respect to the low- and moderate-income goal and the underserved areas goal are not enforceable. The 1992 Act is silent as to whether HUD has authority to establish enforceable subgoals under the special affordable goal. HUD, therefore, has taken the position that subgoals under the special affordable goal are enforceable.

## **Fannie Mae's Mission**

Fannie Mae's Charter and the 1992 Act describe the company's purposes. Those purposes can be summarized as follows: to provide stability to the secondary market for residential mortgages; to bring liquidity to all markets; and to focus, in particular, on affordable housing. In 2007, as market conditions changed dramatically, Fannie Mae continued to deliver on its core mission. The company helped to bring liquidity and stability to the segment of the market in which it operates at a time when the larger mortgage market experienced serious disruptions. Fannie Mae provided funds to mortgage lenders through its purchase of mortgage assets, and by issuing and guaranteeing mortgage-related securities that facilitate the flow of additional funds into the mortgage market. Fannie Mae's activities also demonstrated its focus on affordable housing. The company served 2.4 million low- and moderate-income households – an increase of about 340,000 families over 2006. The company provided record levels of support for multifamily housing with \$59.9 billion in acquisitions. And, the company had deliveries of more than \$26 billion in its flagship single family affordable housing product, MyCommunityMortgage<sup>®</sup>, up dramatically from \$9 billion in 2006.

In 2008, the company will continue to work closely with all of its business and community partners to increase access to credit and create opportunities for homeownership for low- and moderate-income borrowers and for borrowers living in underserved areas, while placing an even higher priority on keeping people in their homes as housing values decline and many borrowers struggle to make their mortgage payments. Fannie Mae's efforts to provide liquidity in the market have been limited by ongoing regulatory capital constraints.

## **Fannie Mae's HomeStay<sup>™</sup> Initiative and the HOPE NOW Alliance**

In April 2007, Fannie Mae announced its HomeStay initiative. This initiative has three main functions, and Fannie Mae continues to add strategic and tactical elements under the HomeStay umbrella. The three main areas of focus are as follows:

- The acquisition of refinance loans of borrowers who previously had subprime mortgages. Providing borrowers fixed-rate mortgages at market rates removes the risk of future payment shock, resulting in a more manageable monthly payment.
- Flexible servicing criteria and loss mitigation activities that focus on keeping borrowers in their homes. As a holder of risk, Fannie Mae's interest is aligned with that of the borrower. A foreclosure is undesirable for Fannie Mae as there is a substantial economic cost (loss) to the company, and it is undesirable for the borrower because it harms his or her credit and may remove him or her from the shelter of their home.
- Grant-making in support of foreclosure prevention counseling. (Please see The Office of Community and Charitable Giving in Section IV below for more information.)

In 2007, as a result of Fannie Mae's HomeStay initiative, approximately 110,000 homeowners were able to either refinance out of their subprime mortgage or remain in their homes when they fell behind on their mortgage payments. Of those 110,000 individuals, 43,000 homeowners were assisted through Fannie Mae's loss mitigation efforts, and 68,000 homeowners refinanced out of their subprime mortgages. In addition to assisting current borrowers, Fannie Mae also developed educational material about mortgage insurance, escrow and foreclosure avoidance. This information is made available to lenders so they may share it with borrowers, providing education on the inherent risks and responsibilities of home financing.

In October 2007, Treasury Secretary Henry Paulson and HUD Secretary Alphonso Jackson announced the formation of a new national alliance called HOPE NOW to assist homeowners struggling with their mortgages. This alliance between counselors, servicers, investors, Fannie Mae and others is creating a unified, coordinated plan to reach and help as many homeowners as possible. The HOPE NOW coalition aims to preserve homeownership while minimizing foreclosures, and to assist borrowers who have the willingness and wherewithal to remain in their homes but need assistance to do so. Some of the action items undertaken by the alliance include:

- Conducting a national direct mail campaign to contact at-risk borrowers, encouraging them to either call their lenders or a credit counselor.
- Adopting a standard process model to strengthen and speed work flow, productivity, and communications between servicers and counselors.
- Working to expand the capacity of an existing national network to receive, assess, counsel, refer, and connect borrowers to servicers.

Fannie Mae's HomeStay initiative is consistent with the goals of the HOPE NOW alliance.

### **Market and Economic Conditions**

Fannie Mae efforts to meet its regulatory housing goals and subgoals for the year were significantly challenged by extraordinary market and economic conditions that could not have been foreseen when HUD set the goal and subgoal levels in 2004. The market conditions that developed throughout 2007 had a negative impact on the opportunities to purchase mortgages that would have met the regulatory goal requirements.

During 2007, the mortgage industry experienced mounting credit losses as mortgage delinquencies increased and real estate values declined. The market experienced an unprecedented primary market credit crunch. The uncertainty in investor demand for mortgages, particularly those with lower credit scores and higher loan-to-value ratios, impacted lenders' willingness and ability to originate those loans. Moreover, many lenders originating these loans were forced to exit the origination business, and many lenders who remain tightened underwriting substantially and reduced originations. Additionally, lenders are pulling back from earlier underwriting expansions in response to falling housing prices and increasing credit losses. Fannie Mae believes that fewer

low- and very low-income borrowers are able to purchase homes as underwriting standards are tightened and the availability of nontraditional mortgage products contracts in the marketplace.

Beginning in 2005, the housing market experienced a significant drop in the origination of mortgages for low- and moderate-income homebuyers and homebuyers who qualify for the special affordable housing subgoal. This decrease in available loans was substantiated by 2006 Home Mortgage Disclosure Act (HMDA)<sup>3</sup> data. For example, HMDA data shows a decrease in the market for low- and moderate-income home purchase loans that qualify for the regulatory subgoal from 45.0 percent in 2004 to 37.4 percent in 2006. Projections of the 2007 market suggest low- and moderate-income lending levels were still well below the subgoal level of 47.0 percent for last year – even before taking into account the credit tightening that occurred in the market during the latter half of 2007. The market for special affordable home purchase loans showed similar declines over the same period of time and estimates for 2007 are well below the subgoal levels as well.

At the same time, while these market conditions have impacted Fannie Mae's ability to meet the standards for the affordable housing subgoals, Fannie Mae has played its fundamental role in continuing to provide liquidity, affordability and stability to the markets in which it operates, has met the three housing goals, and has initiated several targeted efforts to address the needs of families facing foreclosure.

It is against this backdrop that the company describes the activities it conducted in 2007 in accordance with the annual housing goals and statutory AHAR reporting requirements.

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Section 309(n) of the Charter Act lists the information that Congress requires the company to include in this AHAR.<sup>4</sup> The AHAR is organized by these Charter requirements and includes, where appropriate, examples of Fannie Mae's business activities that address these requirements. These are illustrative examples that do not define every activity that Fannie Mae engages in under each Charter requirement. The text in italics sets out the information that the Charter Act requires that Fannie Mae cover in the AHAR.

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<sup>3</sup> The Home Mortgage Disclosure Act (HMDA) requires lenders to collect and publicly disclose loan applicant and borrower characteristics. Data for 2006 is the most currently available HMDA data.

<sup>4</sup> 12 U.S.C. § 1723a(n).

**I. FANNIE MAE'S 2007 HOUSING GOALS PERFORMANCE**

In accordance with 12 U.S.C. § 1723a(n)(2)(A), Fannie Mae's AHAR is required to: *include, in aggregate form and by appropriate category, statements of the dollar volume and number of mortgages on owner occupied and rental properties purchased which relate to each of the annual housing goals established under each subpart.* Fannie Mae submits the information below addressing this report requirement.

**Affordable Housing Goals Results for 2007**

<b>Goal Summary</b>	<b>2007 Goal</b>	<b>2007<sup>5</sup> Result</b>
<b>Base Goals</b>		
Low- and Moderate-Income <sup>6</sup>	55%	55.3%
Underserved Areas <sup>7</sup>	38%	43.4%
Special Affordable <sup>8</sup>	25%	26.5%
<b>Home Purchase Subgoals<sup>9</sup></b>		
Low- and Moderate-Income	47%	42.1%
Underserved Areas	33%	33.4%
Special Affordable	18%	15.5%
<b>Multifamily Special Affordable Subgoal<sup>10</sup></b>	\$5.49 billion	\$19.85 billion

<sup>5</sup> Percents are rounded to the nearest tenth.

<sup>6</sup> HUD has established the low- and moderate-income housing goal for 2007 at 55 percent of the total number of dwelling units financed by eligible mortgage purchases in 2007. 24 C.F.R. § 81.12(c)(3). "Low-income" and "moderate-income" are defined in HUD's regulations at § 81.17.

<sup>7</sup> HUD has established the underserved areas housing goal for 2007 at 38 percent of the total number of dwelling units financed by eligible mortgage purchases in 2007. Id. § 81.13(c)(3). "Underserved area" is defined in HUD's regulation at § 81.2.

<sup>8</sup> HUD has established the special affordable housing goal for 2007 at 25 percent of the total number of dwelling units financed by eligible mortgage purchases in 2007 to address the needs of low-income families in low-income areas and very low-income families. Id. § 81.14(c)(3). "Very low-income" is defined in HUD's regulations at § 81.17(c). "Low-income area" means: a census tract or block numbering area in which the median income does not exceed 80 percent of the Area Median Income. Id. § 81.2.

<sup>9</sup> Home Purchase Mortgage is defined as a residential mortgage for the purchase of an owner-occupied single family property. Id. § 81.2. HUD's home purchase subgoals are based on the purchase of Home Purchase Mortgages in metropolitan areas that meet each goal.

<sup>10</sup> HUD has established the Multifamily Special Affordable Subgoal for 2007 at \$5.49 billion to finance special affordable multifamily housing. Id. § 81.14(c)(3).

As shown in the table above, in 2007, Fannie Mae believes it met each of its three base housing goals, the underserved areas home purchase subgoal, and the multifamily special affordable subgoal. However, Fannie Mae believes it missed the low- and moderate-income and special affordable home purchase subgoals.

In setting the subgoal levels in the 2004 regulation, HUD relied primarily on HMDA data and projections that originations of qualifying mortgages would continue to grow. HMDA data released for 2005 and 2006 shows that the percentages of the home purchase market represented by low- and moderate-income borrowers and borrowers who qualify for the special affordable subgoal fell significantly during the years following the publication of the current regulation. Affordability levels in the market dropped, serious delinquencies increased, and origination capacity left the market. Fannie Mae believes that fewer low-income borrowers were able to purchase homes in 2007 as underwriting standards tightened and the availability of nontraditional mortgage products declined. These circumstances exacerbated the decline in lending to households that would have qualified for goals and subgoals eligibility.

### **Housing Goal Performance by Property Type<sup>11</sup>**

In aggregate, Fannie Mae's single family housing goals performance for both owner-occupied and investor-owned properties for the low- and moderate-income, underserved areas and special affordable housing goals are 47.0 percent, 39.4 percent, and 20.0 percent, respectively.<sup>12</sup>

In 2007, Fannie Mae acquired nearly 1.3 million owner-occupied home purchase mortgages located in metropolitan statistical areas. The low- and moderate-income, underserved areas, and special affordable performance of these mortgages is 42.1 percent (\$76.4 billion in financing), 33.4 percent (\$80.7 billion in financing) and 15.5 percent (\$22.3 billion in financing) respectively.

In 2007, Fannie Mae acquired 11,741 multifamily mortgages with an unpaid principal balance of \$59.9 billion. In aggregate, these mortgages financed over 1.1 million units. Of these units, 88.0 percent, 59.2 percent, and 52.1 percent met the low- and moderate-income, underserved areas, and special affordable housing goals respectively. Of the aggregate volume of multifamily mortgages, \$19.85 billion met the special affordable multifamily subgoal, with a total of nearly 446,000 units.

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<sup>11</sup> Tables 1-4 and 7-14 (tables 5, 6, 15, and 16 are marked proprietary and are forwarded under separate cover) are attached to set forth, in aggregate form and by appropriate category, the dollar volume and number of mortgages on owner-occupied and rental properties, purchased during 2007, that contribute toward Fannie Mae's satisfaction of its housing goals and subgoals. In 2007, Fannie Mae acquired 3.48 million single family mortgages with an unpaid principal balance of \$675 billion. These mortgages account for the financing of 3.62 million units. A total of 3.14 million mortgages, with an unpaid principal balance of \$616 billion, financed owner-occupied 1-unit properties and 57,476 mortgages, with an unpaid principal balance of \$16.1 billion, financed owner-occupied 2-4 unit properties. The remaining 275,790 mortgages, with an unpaid principal balance of \$43 billion, financed investor-owned 1-4 unit properties.

<sup>12</sup> The housing goal percentages identified in this section were developed, in part, using proxies and other adjustments approved by HUD.

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In accordance with 12 U.S.C. § 1723a(n)(2)(B), Fannie Mae's AHAR is required to: *include, in aggregate form and by appropriate category, statements of the number of families served by the corporation<sup>13</sup>, the income class, race, and gender of homebuyers served, the income class of tenants of rental housing (to the extent such information is available), the characteristics of the census tracts, and the geographic distribution of the housing financed.* Fannie Mae submits the information below addressing this report requirement.

In 2007, Fannie Mae's purchases of mortgages that were eligible for housing goals scoring served 4.5 million families across the country. Under the low- and moderate-income goal, Fannie Mae served nearly 2.4 million families, while nearly 543,000 families were served through the low- and moderate-income home purchase subgoal. The company's purchases of mortgages on properties located in underserved areas helped provide mortgage financing for almost 1.9 million families. Fannie Mae served nearly 431,000 families through mortgage purchases meeting the underserved areas home purchase subgoal. In meeting the special affordable goal, Fannie Mae served over 1.1 million families. Under the special affordable home purchase subgoal, the company served 199,000 families. Finally, financing that qualified for the special affordable multifamily subgoal in 2007 assisted nearly 446,000 families. More detailed characteristics of the borrowers and renters that Fannie Mae served in 2007 including, but not limited to, income class, race, and gender, are provided in the tables attached to this AHAR.<sup>14</sup>

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<sup>13</sup> Where Fannie Mae refers to "families" or "households" served by its mortgage purchases throughout this document, the company is defining families and households based upon the number of units financed by mortgage purchases.

<sup>14</sup> The following tables provide specific borrower and renter information: for income class, see Table 2; for race, see Table 7a; for gender, see Table 10. Table 4 sets forth information on multifamily mortgages and units classified by affordability of rent. Tables 11, 12 and 13 illustrate the characteristics of the census tracts in which Fannie Mae purchased single family and multifamily mortgages under each affordable housing goal. The geographic distribution of Fannie Mae's single family and multifamily mortgages by state and territory can be found in Table 14.

## II. FANNIE MAE'S ACTIVITIES WITH FEDERAL SUBSIDY PROGRAMS

In accordance with 12 U.S.C. § 1723a(n)(2)(C), Fannie Mae's AHAR is required to: *include a statement of the extent to which the mortgages purchased by the corporation have been used in conjunction with public subsidy programs under Federal law.* Fannie Mae submits the information below addressing this report requirement.

Fannie Mae coordinated its affordable housing finance initiatives with a variety of public subsidy programs<sup>15</sup> in 2007. Fannie Mae also partnered with organizations—including community-based nonprofits and state and local public entities—to help them leverage federal funds to increase their capacity to carry out their affordable housing and community development activities. In 2007, Fannie Mae's transactions included purchasing mortgages where the borrower received down payment assistance from the federal Community Development Block Grant program or the Section 8 Housing Assistance Vouchers program administered by the Department of Housing and Urban Development (HUD). Fannie Mae also provided forward commitments to purchase the first mortgage debt on projects funded by HUD's HOPE VI program. Other transactions included substantial equity investments in properties that have been allocated federal Low Income Housing Tax Credits (LIHTC) and the acquisition of multifamily financing secured by properties benefitting from LIHTC, Home Funds, Section 8 Housing Assistance Payments contracts, and Section 236 Interest Reduction Payments. Fannie Mae participates in risk sharing with the Federal Housing Administration (FHA) on qualifying multifamily mortgages originated for sale to Fannie Mae. Through its secondary market activities, Fannie Mae may also purchase federally guaranteed loans such as mortgages insured by the FHA or rural housing loans insured by the U.S. Department of Agriculture (USDA).

A sample of some of the housing finance products purchased by Fannie Mae that were used in conjunction with federal housing subsidy programs in 2007 is described below.

- Fannie Mae is a secondary market investor in HUD's reverse mortgage product, the Home Equity Conversion Mortgage (HECM). HECMs allow seniors to convert the equity in their homes into monthly streams of income and/or a line of credit, generally to be repaid when they no longer occupy the home. In 2007, the number of HECMs in the Fannie Mae portfolio grew by 33 percent, to just under 230,000 loans. The unpaid principal balance (UPB) of these loans was \$26.5 billion in 2007, a 44 percent increase from 2006. The growth of the HECM UPB book is reflective of new loan acquisitions, advances on existing loans, and accrued interest.

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<sup>15</sup> For the purposes of this AHAR, Fannie Mae is defining "public subsidy programs" to include federal government programs that provide direct subsidies to borrowers for down payment and closing costs or to reduce interest rates on first or second mortgages or to renters or rental housing developments to increase the affordability of these developments. The definition also includes direct loans, loans guaranteed or insured by the federal government, and tax expenditure programs such as mortgage revenue bonds and tax credits which, although not necessarily a direct subsidy to the borrower or renter, reduce the cost of financing through features such as reduced mortgage interest rates and the provision of below market rents.

- Fannie Mae has for many years actively sought to purchase HUD Section 184 mortgage loans (Section 184 is HUD's loan guarantee program designed specifically for American Indian and Alaska Native families, tribes, Alaska Villages or tribally designated housing entities). In 2007, Fannie Mae modified its pricing philosophy to offer lenders more favorable pricing to incent the delivery to the company of these loans.
- The Rural Housing Service (RHS) of the USDA has several loan programs designed to provide better access to adequate credit and decent housing for low- and moderate-income rural borrowers. Fannie Mae purchases RHS loans, and in 2007, the company's pricing structure was modified to enable smaller lenders to offer RHS loans in their local markets and sell them to Fannie Mae.
- In 2007, Fannie Mae committed over \$1.18 billion for LIHTC equity investments that resulted in the development or rehabilitation of 17,426 affordable rental housing units.
- In addition to equity investments in LIHTC properties, Fannie Mae purchased \$934 million in permanent mortgages on apartments that also benefited from 9 percent LIHTC investment funding and provided approximately \$1.32 billion in credit enhancement on bond financings with 4 percent LIHTC. This includes all newly-funded credit enhancement commitments plus the conversions of prior-year standby commitments that occurred throughout 2007.
- Fannie Mae provides equity, in the form of LIHTC equity investments, as a source of funds to help complete HOPE VI housing projects. In 2007, Fannie Mae helped finance 2 HOPE VI transactions by investing \$27 million in equity. Fannie Mae also purchased mortgage debt secured by HOPE VI projects to leverage federal HOME funds, which also provide low-cost financing in building or rehabilitating affordable housing units.

### III. INCREASING HOMEOWNERSHIP OPPORTUNITIES FOR FIRST-TIME HOMEBUYERS

In accordance with 12 U.S.C. § 1723a(n)(2)(D), Fannie Mae's AHAR is required to: *include statements of the proportion of mortgages on housing consisting of 1 to 4 dwelling units purchased by the corporation that have been made to first-time homebuyers, as soon as providing such data is practicable, and identifying any special programs (or revisions to conventional practices) facilitating homeownership opportunities for first-time homebuyers.* Fannie Mae submits the information below addressing this report requirement.

First-time homebuyers accounted for 44.7 percent of Fannie Mae's conventional owner-occupied purchase money mortgages in 2007.<sup>16</sup> Further information about Fannie Mae's purchases of first-time homebuyer loans is provided in Table 9.

Fannie Mae utilizes tools and initiatives that are not exclusively for first-time homebuyers but, because they remove barriers to homeownership for underserved families, such as no down payment or lack of affordability, they increase the ability of borrowers to purchase their first home. For example, Fannie Mae's Community Investment group focuses on affordable housing opportunities, including equity and mezzanine financing, to support the acquisition, development and construction of for-sale property developments that are projected to result in affordable housing. Participating exclusively in the form of a limited partner, Fannie Mae invests through both developers and fund managers. In 2007, for-sale investments totaled approximately \$44 million.

#### Partnerships Focused on Increasing First-Time Homebuyers

Partnerships with state and local HFAs provide HFAs access to Fannie Mae's single family and multifamily products, and access to tools to help finance, develop, and preserve affordable housing. Local HFAs can also offer MyCommunityMortgage<sup>®</sup> loans (discussed in detail in the following subsection) through their mortgage revenue bond programs that focus on serving first-time homebuyers. Additional information on Fannie Mae's partnerships with HFAs is set forth in Section VIII below.

#### Lack of Down Payment

The lack of borrower funds to close remains a prevalent issue for first-time homebuyers, particularly low- and moderate-income families. The company's flagship community lending product, MyCommunityMortgage<sup>®</sup> (MCM<sup>®</sup>), helps address this problem by

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<sup>16</sup> This percent excludes purchases of manufactured housing, for which first-time homebuyer data is not typically collected by lenders. Fannie Mae relied on information provided by its customers to identify units occupied by first-time homebuyers. Fannie Mae's Single Family Selling Guide, Part XIII, defines a first-time homebuyer as "an individual who: (1) is purchasing the security property; (2) will reside in the security property; and (3) had no ownership interest (sole or joint) in a residential property during the three-year period preceding the date of the purchase of the security property. In addition, an individual who is a displaced homemaker or single parent also will be considered a first-time homebuyer if he or she had no ownership interest in a principal residence (other than a joint ownership interest with a spouse) during the preceding three-year time period."

permitting higher loan-to-value (LTV) ratios and allowing flexible sources for closing costs. In recent years, Fannie Mae has taken a series of steps to enhance MCM with the goal of promoting sustainable homeownership. These enhancements resulted in significant growth in the total number of borrowers who are being served by MCM. In mid-2007, due to changing market conditions, it became necessary to implement pricing and eligibility changes that allow MCM to continue providing borrower funds while also remaining aligned with performance and underwriting criteria. The MCM product continues to help Fannie Mae's customers provide conventional financing opportunities to underserved homebuyers, including many first-time homebuyers, by offering a number of flexibilities, including, lower mortgage insurance (MI) coverage requirements than that required for other products, and features such as an amortization period of 40 years.

Pricing and eligibility changes in 2007 included:

- A 1.00 percent loan-level price adjustment on all MCM loans.
- Changes to underwriting guidelines that remove EA-II loans from eligibility for delivery as MCM loans.

Refinements made to MCM in 2007 included:

- Adding military personnel as a workforce category for the Community Solutions™ option within MCM.
- Updating the method for determining borrower income – now determined by the annual income relied on by the lender in evaluating the borrower's creditworthiness for the mortgage loan.
- Adjusting the income threshold – the Area Median Income (AMI) estimates used for determining MCM eligibility are based on the higher of the 2006 and 2007 AMI limits.

In 2007, the total MCM acquisition volume increased by over 180 percent compared to 2006.<sup>17</sup> Of MCM acquisition volume for 2007, 79.8 percent consisted of financing for first-time homebuyers.

Another product offered by Fannie Mae that helps address down payment-related challenges for borrowers is the Flexible mortgage product line (Flexible 97<sup>®</sup> and Flexible 100<sup>™</sup>). In 2007, Flexible mortgages offered the potential for borrowers, based on down payment amount, to obtain up to 100 percent LTV funding while allowing flexible sources for closing costs. Flex products served many borrowers with incomes below area medians and many first-time homebuyers as well. Specifically, Fannie Mae purchased \$37.5 billion in Flexible loans made to 207,819 households in 2007. Of that total, 96,738 Flexible mortgages were made to first-time homebuyers.

Fannie Mae's Community Seconds<sup>®</sup> option supports affordable housing partnerships created by government entities, nonprofit organizations, lenders, or employers working

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<sup>17</sup> Volume is calculated using unpaid principal balances.

with lenders in a particular community. Under the Community Seconds option, Fannie Mae purchases a first mortgage on a property that also secures a subordinate mortgage funded by a state, county, or local housing agency, a nonprofit organization, or an employer. Because the subordinate mortgage is often used to finance the down payment and/or closing costs, Fannie Mae's Community Seconds option assists in lowering a significant barrier to homeownership – the amount of upfront cash a borrower needs to purchase a home.<sup>18</sup> In 2007, Fannie Mae substantially enhanced Community Seconds in the following ways:

- Expanded eligibility to include Community Seconds loans where the first mortgage has an interest-only (IO) feature.
- Permitted Community Seconds to be used where the subordinate loan provides for a balloon payment that matures prior to maturity of the first mortgage.
- Enhanced risk assessment in Desktop Underwriter<sup>®</sup> (DU<sup>®</sup>) to assess the risk of a loan with a Community Seconds loan where repayment is deferred for 5 or more years based on the LTV, rather than the combined loan-to-value ratio (CLTV).

### **Financing Flexibility/Options**

Fannie Mae works with lenders to develop flexible loan terms and new guidelines that help facilitate financing for the benefit of first-time homebuyers. In 2007, Fannie Mae announced several enhancements to its IO offerings designed to further expand financing options. In addition, these changes were designed to increase efficiencies for lenders. Fannie Mae expanded the products and property types eligible for an IO feature, modified pooling and delivery guidelines for mortgage loans with an IO feature, and eliminated the need for lenders to have negotiated contracts to deliver loans with an IO feature. Fannie Mae also adjusted its underwriting standards and lender requirements for IO products in accordance with a directive by the company's regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), to comply with the principles of recent federal banking agency guidance on nontraditional and subprime mortgage products. A more detailed discussion of Fannie Mae's response to this directive is included in Section IV.

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In accordance with 12 U.S.C. § 1723a(n)(2)(E), Fannie Mae's AHAR is required to: *include, in aggregate form and by appropriate category, the data provided to the Secretary under subsection (m)(1)(B); (the loan-to-value ratios of purchased mortgages at the time of origination).* Fannie Mae submits the information below addressing this report requirement.

In 2007, 43.1 percent of Fannie Mae's purchases of owner-occupied one-unit home purchase loans meeting the low- and moderate-income goal had an LTV ratio greater

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<sup>18</sup> Fannie Mae does not purchase Community Seconds mortgages. However, for first mortgages delivered to Fannie Mae, the company provides the eligibility requirements for the subordinate Community Seconds mortgage.

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than 95 percent but less than or equal to 100 percent. For the underserved and special affordable goals, the percentages are 36.9 percent and 50.9 percent, respectively.

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In accordance with 12 U.S.C. § 1723a(n)(2)(F), Fannie Mae's AHAR is required to: *compare the level of securitization versus portfolio activity*. Fannie Mae submits the information below addressing this Charter requirement.

In 2007, Fannie Mae securitized \$629.6 billion in mortgages and purchased \$182.5 billion for its portfolio.

DRAFT

#### **IV. UNDERWRITING STANDARDS, BUSINESS PRACTICES AND EFFORTS TO PROMOTE FAIR AND RESPONSIBLE LENDING**

In accordance with 12 U.S.C. § 1723a(n)(2)(G), Fannie Mae's AHAR is required to: *assess underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures, that affect the purchase of mortgages for low- and moderate-income families, or that may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending.* Fannie Mae submits the information below addressing this report requirement.

Fannie Mae's lending policies comply with fair lending laws and promote fair and responsible lending. Fannie Mae has established lender selection criteria and conducts routine checks on the quality of loans the company purchases to ensure compliance with Fannie Mae's lending policies. The company's fair lending compliance team also works closely with business units on initiatives such as those highlighted throughout this report, which support lenders' efforts to reach low- and moderate-income families and underserved borrowers.

##### **Underwriting Standards Impacting the Purchase of Low- and Moderate-Income Mortgages**

Fannie Mae offers two underwriting methods a lender can use in making a decision about whether to approve or decline a mortgage application—automated underwriting through DU and manual underwriting. Both methods incorporate underwriting standards that are based on Fannie Mae's assessment of the risk of default. Each underwriting method enables a lender to evaluate the overall credit risk of a mortgage application and to determine the mortgage's eligibility for delivery to Fannie Mae. Under appropriate terms and conditions, Fannie Mae purchases mortgages that represent varying levels of risk, including those that have relatively higher risks attributed to such factors as a blemished credit history, limited savings, or low down payments. Fannie Mae's efforts to provide appropriate liquidity to lenders who serve higher risk borrowers are another way that the company serves low- and moderate-income borrowers.

##### **Automated Underwriting through DU**

DU is designed to assist lenders in processing mortgage applications in an efficient and accurate manner. DU evaluates applications consistently and objectively, thus promoting fair lending. DU applies the same criteria to every loan casefile submitted to it, and does not consider prohibited factors such as a borrower's age, race, color, religion, gender, national origin, disability, familial status, or marital status in making a recommendation. Factors that are included in the DU risk evaluation include both credit and non-credit risk factors. The credit factors include the borrower's credit history, delinquent accounts, mortgage accounts, revolving credit utilization, public records, foreclosures, collection accounts, and credit inquiries. The non-credit risk factors include the borrower's LTV

and CLTV ratio, liquid reserves, loan purpose, loan term, loan/amortization type, occupancy type, total expense ratio, property type, co-borrowers, and self-employment.

### **Manual Underwriting and Underwriting through Lenders' Automated Systems**

Lenders may also deliver loans to Fannie Mae that have not been underwritten with the assistance of DU. Subject to Fannie Mae's review and prior approval, Fannie Mae also purchases or securitizes mortgages underwritten to a lender's own underwriting guidelines, including loans that are underwritten with a lender's own proprietary automated underwriting system. Regardless of how a non-DU loan is underwritten, lenders must represent and warrant that the loan complies with the underwriting policies, guidelines, and eligibility criteria as described in the Fannie Mae Selling Guide, including compliance with all applicable laws.

### **Business Practices and Procedures Impacting the Purchase of Low- and Moderate-Income Mortgages**

Fannie Mae publishes a Single Family Selling Guide and a Single Family Servicing Guide to provide information to lenders about the company's policies and procedures. The guides explain Fannie Mae's standards and requirements for the origination, underwriting, and delivery to Fannie Mae of one- to four-family mortgages. Periodic updates to the guides also inform lenders about the company's efforts to promote fair and responsible lending.

In response to changes in housing market affordability and at the request of lender partners, Fannie Mae made several amendments to its guides in 2007. Some of these changes included amending requirements for the Community Seconds option, discussed above, and updating the method for determining borrower income by considering the annual income relied on to evaluate creditworthiness of the loan.

Fannie Mae issues periodic guidance on the company's anti-predatory lending policies and responsible servicing practices. Fannie Mae's policies and related guidelines are codified in the selling and servicing guides, which are amended from time to time through lender announcements and lender letters. If Fannie Mae determines that a loan fails to comply with these policies and guidelines, the company may pursue various options, including requiring repurchase of the loan and indemnification by the lender. In 2007, Fannie Mae implemented new guidance as outlined below.

### **Nontraditional Mortgage Products and Subprime Lending**

The increase in nontraditional products where either interest or principal is deferred, such as IO and negative amortization mortgage products, presents an important consumer protection issue. In October 2006, five federal financial regulatory agencies jointly issued the "Interagency Guidance on Nontraditional Mortgage Product Risks" to address risks posed by these mortgage products and the layering of risks that results from combining these product types with other features that may compound risk. In July 2007,

the same financial regulatory agencies issued the "Statement on Subprime Mortgage Lending," which addresses risks related to certain subprime mortgages.

The October 2006 and July 2007 interagency issuances direct regulated financial institutions that originate nontraditional and subprime mortgage loans to follow prudent lending practices, including safe and sound underwriting practices and providing borrowers with clear and balanced information about the relative benefits and risks of these products sufficiently early in the process to enable them to make informed decisions. In accordance with OFHEO requirements, Fannie Mae applied the risk management, underwriting and consumer protections principles of both the October 2006 and July 2007 interagency issuances to the mortgage loans and mortgage-related securities that the company acquires for its portfolio and for securitization. Fannie Mae made changes to its underwriting standards implementing the interagency issuances and requires its lenders to represent and warrant that loans delivered to the company comply in all respects with the interagency issuances, as applicable.

In addition to the changes made to implement the interagency issuances, the company tightened loan eligibility in many high-risk loan categories. The extreme volatility of the credit markets combined with deteriorating mortgage performance necessitated the need for Fannie Mae to curtail eligibility for such high-risk loans. In particular, loans with high LTVs, poor credit history and/or layered risk characteristics were subject to tightened eligibility. The company continues to actively manage its single family eligibility standards and pricing to account for rapidly changing market conditions.

In connection with Fannie Mae's Single Family Subprime business, Fannie Mae conducted pre-acquisition loan level due diligence on bulk transactions to validate compliance with (i) lender's underwriting guidelines within Fannie Mae's credit eligibility criteria, (ii) federal and state regulatory requirements, and (iii) Fannie Mae's anti-predatory lending policies and other responsible lending requirements. Loans that failed to meet any such requirements were not eligible for purchase.

### **Disaster Preparedness and Response**

Created in an effort to help borrowers and provide housing solutions to communities affected by the hurricane disasters occurring in 2005, Fannie Mae's Disaster Preparedness and Response business unit remains focused on aiding the rebuilding efforts in the Gulf region. This business unit has also developed plans and protocols to help the company respond to other disaster events that damage the properties on which Fannie Mae is the mortgage investor. The plans and protocols are designed to help Fannie Mae assess its exposure in a timely fashion and support both lender partners and borrowers in recovery and rebuilding. Fannie Mae's standard guidelines provide significant flexibility for borrowers and lenders affected by natural disasters.

Fannie Mae developed a special initiative called the Limited Cash-Out Refinance Gap Option for homeowners who, even after receipt of property insurance and grant proceeds, still lack the necessary funds to rebuild their homes. The initiative is available through

current servicers to borrowers with existing Fannie Mae loans and allows 'gap funding' through a limited cash-out refinance transaction.

In addition, Fannie Mae, through its Office of Community and Charitable Giving (please see The Office of Community and Charitable Giving subsection below for more information), announced grants totaling \$186,000 to organizations including the Salvation Army and the American Red Cross for disasters in southern California and the Midwest. These chapters are providing emergency shelter, food, and assistance to thousands of individuals who have been displaced as a result of natural disasters.

### **Repurchase Requirements that May Impact the Purchase of Low- and Moderate-Income Mortgages**

Fannie Mae generally relies on the selling lenders' representations and warranties that the mortgage loans being purchased or guaranteed conform to the applicable Fannie Mae guidelines. At Fannie Mae's discretion, waivers or variances from these underwriting guidelines may be granted. After purchase, Fannie Mae performs quality control reviews of selected loans to monitor compliance with the guidelines. Fannie Mae may require repurchase of loans that do not conform to the guidelines.

Fannie Mae's National Underwriting Center (Center) performs Fannie Mae's underwriting reviews and provides loan quality information and analyses to Fannie Mae staff throughout the country. The Center focuses its resources on loans that represent a higher risk to the company but also randomly samples loan deliveries for quality assurance reviews. The goal of each review is to identify any significant underwriting deficiencies, possible misrepresentations, or eligibility issues associated with the loan. In addition to loan-level quality assurance, the Center performs anti-predatory lending policy screening on the random sample of loans. If it is determined that a loan should not have been delivered to Fannie Mae, the company may pursue various options, including requiring repurchase of the loan and indemnification by the lender.

### **Pricing and Fees Impacting the Purchase of Low- and Moderate-Income Mortgages**

Fannie Mae's pricing policies and strategies are based on competitive market factors, the company's experience, capital and other requirements, and other factors such as:

- Contribution to housing goals and other mission objectives
- Portfolio opportunities
- The liquidity of the security
- Seller/servicer performance
- Availability of credit enhancement or recourse
- Counterparty strength

There are a number of factors that are used to predict loan performance, including credit histories, mortgage loan and property characteristics, interest rate fluctuations, and housing prices. Fannie Mae continually updates its databases with current information.

Through various negotiated vehicles and lender agreements, Fannie Mae arrives at specific fees for accepting a certain amount of risk on mortgages purchased or guaranteed in mortgage-backed securities (MBS). A number of pricing structures are utilized based on lender needs, Fannie Mae's business and mission objectives, and competitive market factors. In making pricing decisions, Fannie Mae considers its ability to meet strategic business goals and its obligation to meet its regulatory housing goals.

### **Underwriting Revisions, Products and Other Activities to Promote Affordable Housing or Fair Lending**

Fannie Mae conducts quarterly reviews of loan performance data to assess the loan default risk predictability of the DU model. The fair lending compliance team in Fannie Mae's legal department reviews all changes to DU to ensure that DU complies with fair lending laws.

DU was updated throughout 2007 in response to changing market conditions, and in support of interagency issuances (please see Nontraditional Mortgage Products and Subprime Lending section above). The following updates were made to DU in 2007:

- **DU Version 5.6 Update**

- DU was updated, in support of the corporate HomeStay™ initiative, to enable homeowners facing potential payment shock to refinance their existing loans without first having to pay off outstanding collections – regardless of the amount.
- DU's risk assessment of loans with considerable risk layering – in particular those loans with a high CLTV where the borrowers have had significant credit problems in the past – was updated, resulting in certain high-risk loans that previously would have received an “approve” or other level of credit risk recommendation now potentially receiving a more conservative credit risk recommendation and potentially becoming ineligible for delivery to Fannie Mae. These changes were made to ensure the appropriate management of the company's overall credit risk in light of current economic and market conditions. These adjustments seek to ensure that lenders are able to provide reasonable, prudent, and sustainable options to their borrowers.
- In 2006, Fannie Mae enhanced DU to improve the underwriting recommendation on certain loans when the borrower's income was at or below Area Median Income and the loan met specific criteria based on the property type and purpose of the loan. This enhancement was retired in 2007 in light of current economic and market conditions.

- **DU Version 5.7**

This version of DU incorporated a number of enhancements to Fannie Mae products that directly supported the company's efforts to meet the 2007 housing goals. In this version of DU:

- Expanded Approval<sup>®</sup> became a standard feature in DU - making it more broadly available.
- Expanded Approval was enhanced to allow terms up to 40 years (excluding the Timely Payment Rewards<sup>®</sup> (TPR) feature).
- The maximum LTV for all loans - including Flexible mortgages - with financed single-premium mortgage insurance was increased to 100 percent.
- Flexible mortgage enhancements were implemented that allowed for the IO feature, financed mortgage insurance and gifts of equity.
- Community Seconds were permitted in conjunction with loans that have an IO feature.
- DU was updated with the 2007 AMI amounts, with MCM eligibility, based on the greater of the 2006 and 2007 amounts.
- The Gulf Coast hurricane-related mortgage underwriting flexibilities in DU were extended to June 30, 2008.
- DU was updated to generate a message on loan casefiles when it appears that the property is located in an area of declining home prices, or in an area in which it may be difficult to assess home values.
- Maximum LTV limits were implemented on loans that receive an EA-II or EA-III recommendation, and where no subordinate financing exists. EA-II mortgages are eligible up to and including an LTV ratio of 97 percent, and EA-III mortgages are eligible up to and including an LTV ratio of 95 percent.

In addition to the updates noted above, DU was also updated in 2007 to align with the Interagency Guidance on Nontraditional Mortgage Product Risks.

- **Expanded Approval with Timely Payment Rewards (EA/TPR<sup>™</sup>)**

Fannie Mae's EA/TPR initiative, offered through DU, continues to provide an alternative for borrowers with blemished credit histories. With EA, borrowers may secure a mortgage rate that may be lower than non-traditional financing. EA can also be combined with the TPR feature, which gives qualifying borrowers an interest rate reduction of up to one percentage point without having to refinance after making timely mortgage payments for a specified period. In 2007, Fannie Mae purchased \$20.5 billion in EA loans to help 131,213 homeowners potentially lower their costs of home financing. In the same period, Fannie Mae purchased \$949 million of loans using the TPR feature, enabling almost 6,417 additional homebuyers to benefit from further interest savings. Total EA/TPR volume for Fannie Mae in 2007 was \$21.5 billion.

- **Annual Fair Lending Conference**

Fannie Mae's eighth Annual Fair Lending Conference was held in Washington, D.C. in October 2007. The conference brought together consumer advocates, lenders, government-agency representatives, housing and civil rights organizations, and academia. The theme of this year's conference was "Preserving Homes, Preserving Communities," and during open forums and small group brainstorming sessions, speakers and

participants focused on solutions, strategies, and programs to help borrowers avoid foreclosures and preserve homeownership.

- **Initiatives to Combat Mortgage Fraud**

Fannie Mae investigates suspected mortgage fraud reported by both internal and external sources. In 2007, Fannie Mae assessed over 1,500 mortgage fraud tips and referrals which resulted in reports of mortgage fraud incidents to law enforcement as well as the pursuit of financial remediation. The company also partners with lender customers, law enforcement, government agencies and industry trade groups to promote anti-fraud best practices. In 2007, Fannie Mae contributed to 65 industry and public policy events, reaching over 8,700 industry participants such as lenders, mortgage brokers, real estate agents, appraisers, law enforcement officials, regulators and title agents. These events included the following:

- *Preserving Homeownership: Addressing the Foreclosure Issue* - Federal Reserve Bank of Dallas
- *Colorado Predatory Lending and Mortgage Fraud Prevention Seminar*
- *HOEPA Public Hearing* - Board of Governors, Federal Reserve
- *National Fraud Issues Conference* - Mortgage Bankers Association
- *Regulatory Compliance Conference* - American Bankers Association
- *Mortgage Fraud Podcast* - National Association of Realtors

- **The Office of Community and Charitable Giving**

In 2007, Fannie Mae supplemented its affordable housing activities with grant-making efforts through its new Office of Community and Charitable Giving. The company made over 650 grants totaling approximately \$43.5 million which were directed to the following:

- *Tackling America's Toughest Housing Problems™*. This initiative is focused on foreclosure prevention, urban/workforce affordable housing, rural affordable housing, affordable housing for Native Americans, and rebuilding the Gulf Coast.
- *Advancing Efforts to Prevent and End Homelessness*. This initiative is aimed at increasing public awareness, advancing public policy, and strengthening organizations working to develop supportive housing units.
- *Building Thriving Communities in Our Hometown (Washington, D.C.)*. This initiative directs support to three key areas: affordable housing, homelessness and strengthening public education.

A major focus of the Office of Community and Charitable Giving in 2007 was grant-making to prevent foreclosure and in support of HomeStay, which is described in greater detail above. In 2007, the company provided over \$9 million in grants in support of these efforts. Specifically, the company granted \$5 million to the Homeownership Preservation Foundation and NeighborWorks America to support the national foreclosure prevention hotline and the expansion of staff operating capacity to help borrowers at risk of foreclosure. Moreover, approximately \$4 million in grants was made to national non-profit counseling agencies to help increase their capacity to assist borrowers at risk of foreclosure.

## V. PROVIDING AFFORDABLE RENTAL HOUSING

In accordance with 12 U.S.C. § 1723a(n)(2)(H), Fannie Mae's AHAR is required to: *describe trends in both the primary and secondary multifamily housing mortgage markets, including a description of the progress made, and any factors impeding progress toward standardization and securitization of mortgage products for multifamily housing.* Fannie Mae submits the information below addressing this report requirement.

Fannie Mae's business includes the issuance and purchase of multifamily MBS, purchase of mortgage loans, the credit enhancement of multifamily housing bonds, investment in mortgage revenue bonds, and equity investments in multifamily affordable rental housing. Fannie Mae's multifamily mortgage assets—comprised of multifamily MBS, multifamily mortgage loans, bond credit enhancements, mortgage revenue bonds, and other securities—now total \$184.5 billion. In 2007, the company also purchased investment grade commercial mortgage-backed securities (CMBS) backed solely by multifamily loans.

Unlike the overall U.S. economy which started out slowly, rebounded, and then slowed significantly by the end of the year, the multifamily property sector of the economy held fairly steady throughout most the year. Real estate fundamentals, including job growth and positive migration trends, remained healthy for the sector. Vacancies had remained stable at an estimated 5.75 percent from the second quarter through the third quarter of 2007, but then increased to an estimated 6.0 percent during the fourth quarter of 2007 for institutional-type multifamily properties (which are properties of significant size that typically are owned by large national or international investors).

Average asking rent growth in 2007 kept up a healthy pace of an estimated annualized rent growth of between 3.0 percent on a national basis. As a result, average asking rents are estimated to have been about \$1,025 during the third quarter and then again in the fourth quarter of 2007, compared to \$1,000 as of the third quarter of 2006.

The multifamily loan originations market in the late summer of 2007 abruptly declined in volume as a result of the subprime mortgage market fallout. Investor demand for CMBS declined quickly and dramatically. The ensuing credit crunch spread into the multifamily sector and in turn reduced multifamily property sales. Through October 2007, multifamily property sales totaled \$62 billion, down by about 8 percent year over year. With investors hesitant to buy CMBS, Fannie Mae became the largest source of debt to multifamily borrowers.

In an effort to enhance product standardization in the marketplace, Fannie Mae created the Delegated Underwriting and Servicing (DUS<sup>®</sup>) product line in 1988 for purchasing individual multifamily loans. DUS continued to evolve to become Fannie Mae's principal network for purchasing multifamily loans. In the DUS product line underwriting is delegated to the DUS lenders, enabling them to move quickly to arrange financing for borrowers. The majority of loans purchased through Fannie Mae's DUS

lender network are secured by properties with units that are largely affordable to families earning at or below the median income in their area.

### **Multifamily Products and Activities**

Fannie Mae's product innovations in 2007 focused on providing lenders and borrowers with more options in arranging financing. Highlights include the following:

- Community Investment Mezzanine-Moderate Rehabilitation Product (CI Mezz-Mod Rehab Product) targets multifamily borrowers seeking to finance multifamily properties that require moderate rehabilitation in the range of \$5,000 to \$20,000 per unit. This product is part of Fannie Mae's initiative to preserve affordable housing and is targeted at properties having not less than 60 percent of the dwelling units affordable to individuals/families earning not more than 100 percent of AMI as determined by Fannie Mae. Fannie Mae through its DUS partners, provides a one-stop financing solution that combines a DUS first-lien mortgage with a mezzanine loan provided by a Community Investment Mezzanine Fund (the "Fund") supported by HCD Community Investments. The product is structured so that the rehabilitation expenses are funded with the mezzanine loan, separate from the DUS Loan, which is supported by the property's current operations. Once the rehabilitation is completed it is anticipated that the mezzanine debt would be refinanced with a lower cost DUS Supplemental Loan that is provided by Fannie Mae through its DUS Lender partner.
- DUS Lender Affiliate Mezzanine (DUS Mezz) permits approved DUS Lender affiliates to originate mezzanine financing to provide additional borrower funding or to finance rehabilitation of less than \$5,000 per unit in connection with the origination of a DUS Loan.
- The Good Faith Deposit requirements for DUS Extended Rate Lock (ERL) commitments were reduced from 3 percent to 2 percent for commitment periods up to 6 months reducing the upfront-cost of ERL transactions. Fannie Mae also reduced its Good Faith Deposit requirements from 2 percent to 1 percent for transactions of \$3 million or less with commitment periods of 45 days or less.
- The MBS/DUS ERL enhancements expanded Fannie Mae's ability to provide a forward rate lock on an MBS execution by aligning many of the requirements of the MBS/DUS ERL execution with the requirements applicable to the DUS ERL product for whole loan purchases. The enhancements included: (i) extending the maximum commitment period from 90 to 180 days; (ii) reducing the minimum Good Faith Deposit from 3 percent to 2 percent; (iii) permitting acquisition transactions; and (iv) aligning the applicable underwriting requirements with the cash whole loan purchase execution.
- The T+50 Prepayment Premium option provides an alternative to the standard DUS yield maintenance prepayment premium calculation. By adding 50 basis points to the yield rate used to calculate the yield maintenance payment, the T+50 Prepayment

Premium option generally reduces the prepayment premium which would otherwise be due when a loan prepays during the yield maintenance period.

- The Structured Interest Rate Swap (Structured Swap) for variable-rate tax-exempt and taxable bond credit enhancement transactions provides borrowers with long-term interest rate protection. The hedging structure is designed to attract tax credit investors who typically require a fixed rate through the term of the tax credit compliance period. Transactions utilizing a Structured Swap are underwritten at an adjusted swap rate using existing fixed-rate bond credit enhancement underwriting criteria. The interest rate swap structure and the flexible underwriting terms associated with it provide lenders with a competitive product for originating high quality variable-rate bond credit enhancement transactions.

### **Community Investments**

Fannie Mae's Community Investments group focuses on equity investments in affordable housing. The group is divided into two separate business areas, bifurcating tax-advantaged from other investment opportunities. Fannie Mae invests exclusively as a passive limited partner with developers and operators, acting primarily through fund managers.

Tax-advantaged equity investments include investments in properties that have been allocated a federal low income housing tax credit, which encourages investment in and thereby supports the creation of affordable housing. Developers may obtain an allocation of tax credits to help finance the construction, rehabilitation and/or preservation of affordable housing, and may sell ownership interests in the affordable housing projects to investors who receive in exchange equity interests in the project and the right to receive related tax credits. Investors apply these credits against their tax liabilities for a specified period of time. These housing units are affordable to families earning 60 percent of AMI or less.

Equity and mezzanine investments are made in existing and to-be-built affordable rental housing. These rental properties typically serve families earning 60 percent to 100 percent of AMI.

In 2007, Fannie Mae committed over \$1.18 billion in equity investments that qualify for LIHTC. For more details on Fannie Mae's LIHTC investments, see Section II above.

### **Other Activities Related to Affordable Rental Housing**

In 2007, Fannie Mae explored other opportunities with HFAs to address multifamily rental housing issues. For example, the company purchased a participation certificate for the first time in two years. Defined as a fractional interest in the principal amount of a mortgage, HFA-issued participation certificates represent an interest in a permanent or construction-to-permanent mortgage secured by a multifamily property.

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Fannie Mae's Community Lending group increases the supply of affordable rental housing through mortgage purchases from community development financial institutions (CDFIs). For more details on Fannie Mae's Community Lending group activities in 2007, see Section VIII below.

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## VI. DELINQUENCY AND DEFAULT RATES FOR LOW- AND MODERATE-INCOME FAMILIES

In accordance with 12 U.S.C. § 1723a(n)(2)(I), Fannie Mae's AHAR is required to: *describe trends in the delinquency and default rates of mortgages secured by housing for low- and moderate-income families that have been purchased by the corporation, including a comparison of such trends with delinquency and default information for mortgage products serving households with incomes above the median level that have been purchased by the corporation, and evaluate the impact of such trends on the standards and levels of risk of mortgage products serving low- and moderate-income families.* Fannie Mae submits the information below addressing this report requirement.

### **Delinquency and Default Trends Based on 2006 Performance Data<sup>19</sup>**

An analysis of the performance of mortgage loans serving low- and moderate-income families (defined as a unit occupied by a household earning less than or equal to the AMI) shows that these loans consistently perform below the performance of loans on units serving households with incomes above the median level.

The attached table displays serious early delinquency performance and default performance over time. Fannie Mae defines serious early delinquency as being 90 days or more delinquent within 12 months of acquisition. Default is defined as foreclosure sale, deed-in-lieu of foreclosure, pre-foreclosure sale, or third party sale, at any time during the life of the loan.

The analysis demonstrates that loans to low- and moderate-income borrowers on average have a 70% greater chance of being seriously delinquent in the first year compared to loans for higher income borrowers for acquisition years 1996-2001. For acquisitions from 2002 to 2005, as eligibility for higher risk products has expanded through such offerings as MCM and EA, performance on these loans to low- and moderate-income borrowers has declined. For 2005 acquisitions, loans to low- and moderate-income borrowers were delinquent 2.4 times more often than loans to higher income borrowers. The serious early delinquency performance of the 2006 acquisitions for low- and moderate-income borrowers has dropped significantly. For 2006, loans to low- and moderate-income borrowers were delinquent 1.9 times more often than loans to higher income borrowers. The relative default rate performance is also consistently greater for low- and moderate-income borrowers than for higher income borrowers but has improved considerably for 2006 acquisitions. Fannie Mae continues to use this performance information to define prudent underwriting and eligibility standards that expand access to the housing market through a broad range of affordable product options, while maximizing the possibility of sustained homeownership for borrowers.

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<sup>19</sup> Serious delinquency performance information is based on acquisitions through September 2006. Default performance is based on acquisitions through December 2006. Performance is observed through September 2007. This analysis is based on income relative to Area Median Income and does not control for other risk dimensions, such as LTV or credit history.

**Relative Serious Early Delinquency and Ever Default Rates Between Single Family Loans Serving Low- and Moderate-Income Families and Loans Serving Households with Incomes Above the Median Level by Year**

Sample: Unseasoned, conforming, conventional, first liens, non reverse mortgages, non GEMs/GPMs, non subprime loans, no loans affected by Hurricane Katrina.

<b>Acquisition Year</b>	<b>Relative Serious Early Delinquency Performance</b>	<b>Relative Ever Default Performance</b>
<b>1996</b>	1.8	1.7
<b>1997</b>	1.7	1.8
<b>1998</b>	1.8	1.9
<b>1999</b>	1.7	1.9
<b>2000</b>	1.7	2.1
<b>2001</b>	1.6	2.1
<b>2002</b>	2.0	2.6
<b>2003</b>	2.4	3.1
<b>2004</b>	2.5	3.2
<b>2005</b>	2.4	2.8
<b>2006</b>	1.9	1.8

Notes:

- 1) Relative Performance equals the delinquency (default) rate for loans serving low- and moderate-income families divided by the delinquency (default) rate of loans serving households with incomes above the median level.
- 2) Serious Early Delinquency is defined as being 90 or more days delinquent within 12 months of acquisition.
- 3) Default is defined as foreclosure sale, deed-in-lieu of foreclosure, pre-foreclosure sale, or third party sale, at any time during the life of the loan.
- 4) The analysis presented here was performed on unseasoned loans by acquisition year to avoid commingling different aged loans for the purpose of displaying a trend over time.
- 5) The analysis presented here does not control for other risk dimensions, such as LTV or credit history, only income relative to the area median.

## VII. FANNIE MAE'S SELLER AND SERVICER NETWORK

In accordance with 12 U.S.C. § 1723a(n)(2)(J), Fannie Mae's AHAR is required to: *describe in the aggregate the seller and servicer network of the corporation, including the volume of mortgages purchased from minority-owned, women-owned, and community-oriented lenders, and any efforts to facilitate relationships with such lenders.* Fannie Mae submits the information below addressing this report requirement.

Fannie Mae has selling and servicing relationships with over 2,700 single family and multifamily primary market lenders under which the company both purchases loans for its portfolio and issues MBS.

### **Selling and Servicing Network**

Fannie Mae's selling and servicing network includes small, medium and large lenders; minority and women-owned lenders; and smaller, community-oriented lenders. Community-oriented lenders with assets less than \$1 billion include banks, thrifts, mortgage bankers, credit unions, and HFAs.<sup>20</sup> Fannie Mae purchased \$25.8 billion mortgages from these institutions in 2007. In 2007, Fannie Mae also purchased a total of \$2.6 billion in mortgages from lenders who reported that they are minority- and women-owned lenders. Of that total, \$717 million was purchased from sellers and servicers identified as women-owned lenders.<sup>21</sup>

Efforts to facilitate relationships with these lenders include formal business alliances or affinity agreements in which lenders receive benefits designed to reduce the cost of doing business with Fannie Mae.<sup>22</sup> To reach community banks in 2007, Fannie Mae either renewed or had in place Affinity Agreements with the major banking trade associations, including American Bankers Association, and the Independent Community Bankers of America. Under the agreements, members who participate and are Fannie Mae seller/servicers have access to Fannie Mae's business and technology solutions. By year-end 2007, 410 institutions were participating in one of these two alliances.

In 2006, Fannie Mae also forged an alliance with the National Association of Federal Credit Unions. By year-end 2007, 131 institutions were participating in this alliance. Fannie Mae supported the initial development of a mortgage point-of-sale solution with Prime Alliance Solutions, Inc., the largest credit union service organization, serving approximately 1,600 credit unions nationwide. Fannie Mae continues to support further enhancements to this technology platform through the integration of Fannie Mae technology applications.

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<sup>20</sup> For the purposes of this AHAR, a "community-oriented lender" is defined as a financial institution with total assets of less than \$1 billion. This definition is consistent with the definition of "small bank" in the Community Reinvestment Act implementing regulations at 12 C.F.R. § 228.12.

<sup>21</sup> Some of these women-owned lenders also identified as another minority group such as African-American, Hispanic, Asian-Pacific or Indian-Alaskan.

<sup>22</sup> These agreements do not preclude members from doing business through other secondary market channels.

As discussed in other parts of this report, Fannie Mae has partnered with lenders and state and local HFAs. For more details on Fannie Mae's partnerships with HFAs, see Section VIII below.

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## VIII. ACTIVITIES WITH PARTNERS TO INCREASE AFFORDABLE HOUSING OPPORTUNITIES

In accordance with 12 U.S.C. § 1723a(n)(2)(K), Fannie Mae's AHAR is required to: *describe the activities undertaken by the corporation with nonprofit and for-profit organizations and with State and local governments and housing finance agencies, including how the corporation's activities support the objectives of comprehensive housing affordability strategies under section 105 of the Cranston-Gonzalez National Affordable Housing Act*<sup>23</sup>. Fannie Mae submits the information below addressing this report requirement.

In 2007, Fannie Mae partnered with a variety of nonprofit and for-profit organizations (including commercial banks and community development financial institutions), state and local governments, PHAs and HFAs to increase affordable housing opportunities.

Some of the national and local organizations that the company partnered with in 2007 included Neighborhood Housing Services (NHS) of New York City; Mission of Peace CDC in Michigan; National Council of La Raza; NeighborWorks America (formerly known as the Neighborhood Reinvestment Corporation); National Alliance to End Homelessness and Corporation for Supportive Housing; Tri-Churches, Inc. in Maryland; and the YWCA of Delaware. The following pages illustrate some of the activities Fannie Mae undertook in 2007 with various types of partners. In most cases, the company's affordable housing activities in local communities with these partners—financing for affordable housing, rental opportunities, rehabilitation, and the development of strategies to address homelessness—will be aligned with a locality's housing affordability strategy as defined in the Cranston-Gonzalez National Affordable Housing Act (the Cranston-Gonzalez Act).<sup>24</sup>

- Until August of 2007 Fannie Mae continued to provide technical and business consulting assistance to NHS of New York City, an affiliate of NeighborWorks America, to support their interest in developing a nonprofit mortgage broker pilot. Fannie Mae provided guidance on infrastructure development, workflows, and processes associated with the nonprofit counseling agency implementing mortgage broker operations. NHS of New York City began operating as a mortgage broker in June 2007.

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<sup>23</sup> Under section 105, comprehensive housing affordability strategies include, among other things, efforts to address homelessness and meet the needs of homeless persons; the provision of housing for different categories of residents, such as very low-income, low-income, and moderate-income families, the elderly, single persons, large families, residents of non-metropolitan areas, families who are participating in an organized program to achieve economic independence and self-sufficiency, and other categories of persons; combined efforts with private industry, nonprofit organizations and public institutions to deliver safe and adequate housing; encouraging public housing residents to become homeowners; and efforts to provide affordable housing through the production of new units, rehabilitation, or acquisition of existing units.

<sup>24</sup> 42 USC 12705.

- In 2007, Fannie Mae closed on an \$8,000,000 line of credit with the Corporation for Supportive Housing (CSH), which will be used to capitalize a \$30 million fund to provide predevelopment and acquisition financing to developers of supportive housing for homeless people in the City of Los Angeles. Fannie Mae's investment leveraged commitments of \$5,000,000 and \$8,000,000 from the City of Los Angeles and the California Housing Finance Agency respectively as well as several banks. The fund will provide early stage capital financing critical to creating at least 1,500 supportive housing units over 5 years.
- In 2007, Fannie Mae transitioned its key relationships in the Faith-Based Initiative to a model where counseling organizations receive funding for the counseling services they provide. The transition allowed these nonprofit organizations, which provide bona fide housing and credit counseling services, to enhance their ability to provide these services to their constituents. Fannie Mae has confirmed that more than 500 new mortgage loans made by its lender partners resulted from the efforts of the organizations using this model. Many other faith-based organizations continue to receive support through the company's Home Counselor Online™ (HCO®) technology team. These counseling agencies, as well as many other homebuyer counselors, utilized Fannie Mae's HCO technology. HCO is a dynamic, free, and efficient Web-based technology tool for assisting counselors and other housing professionals in preparing borrowers for homeownership—as well as providing the post-purchase support necessary for the borrowers to remain successful homeowners. HCO is intended to improve the quality and capacity of the counseling experience, increasing the number of “ready borrowers” in underserved areas, and to increase integrated solutions, preventing “not quite ready” borrowers from falling out of the homeownership process.
- Fannie Mae purchases participations in AD&C loans that finance affordable rental and for-sale housing. By purchasing a participation interest, Fannie Mae helps local, regional and large commercial banks and community development financial institutions (CDFIs) provide construction financing for affordable housing and redevelopment of declining communities in their market areas. In 2007, Fannie Mae participated in more than \$290 million of AD&C loans, including a \$40 million participation in a construction and development loan for the redevelopment of an abandoned family courthouse in Jamaica, Queens to 345 residential units. The developer, Dermot Company, purchased the site from the New York City Economic Development Corporation, which is leading the effort to redevelop the greater Queens area.
- Intermediaries and CDFIs re-lend Fannie Mae's loan proceeds to developers for various aspects of affordable single family and multifamily housing development. In 2007, Fannie Mae financed more than \$227 million of Intermediary/CDFI debt, including a \$5.5 million, 5-year revolving line of credit to Enterprise Community for its Loan Fund. Enterprise is re-lending the funds for predevelopment, acquisition, rehabilitation, construction, and bridge financing of development projects that target

individuals and families earning less than 80 percent of AMI with a focus on the Gulf Coast recovery effort.

- Through the use of Modernization Express™, Public Housing Authorities can leverage their future federal capital finance funds in order to accelerate the rehabilitation or redevelopment of their public housing stock. In 2007, Fannie Mae provided almost \$40 million in Modernization Express loans to 13 PHAs, which facilitated the modernization of 4,098 units of public housing. For example, a \$1.6 million Modernization Express loan was provided to the Big Rapids, Michigan Housing Commission to replace the boilers, water heaters, and windows at all three of its public housing developments. The Authority had experienced a dramatic rise in utility expenses over the past few years. The goal of this project was to reduce and contain utility expenses at all three developments in order to reduce the cost burden on its day-to-day operations.
- In 2007 Fannie Mae created a new partnership with the Louisiana Housing Finance Agency and the company's lender partners to help finance the debt on affordable multifamily properties. This program makes available financing to LIHTC properties and bond financed properties where the total debt is less than \$3 million. In the past, few if any lenders would underwrite and approve these types of loans in Louisiana. In 2007, over \$10 million in forward commitments were approved.
- In 2007, Fannie Mae continued its Gulf region relief efforts by working with its lender partners serving that region. Working with the Finance Authority of New Orleans on their "Welcome Back Home Loan Program," Fannie Mae modified its Community Renovation loan product to offer a longer rebuilding term and an unlimited renovation percentage—two flexibilities critical in meeting the unique rebuilding needs of the Gulf Coast.
- In 2006, Fannie Mae formed an alliance with the National Council of State Housing Agencies (NCSHA) to help participating HFA members meet the affordable housing needs of the communities they serve. The company continued this alliance in 2007 by expanding participation to an additional thirteen agencies for a total of twenty-five states. Through this partnership, the HFA members gain access to distinct mortgage lending options that are designed to help them attain their goal of expanding homeownership to low- and moderate-income borrowers and first-time homebuyers in their states. The alliance provides cost savings to NCSHA member HFAs and provides other benefits to members related to origination, training and sales.
- Fannie Mae has approved variances for refinance products for three state HFAs: Massachusetts (MassHousing), New York (State of New York Mortgage Agency) and Ohio (Ohio Housing Finance Agency). These refinance products are intended to help low- and moderate-income borrowers who are facing an increased payment due to a reset in mortgage rate, or those who have already faced an increased mortgage rate. Numerous variances were granted based on structures specifically geared to

issues in the individual states. Total loan amounts projected under these products are \$450 million.

- In 2007, Fannie Mae purchased 34,419 loans from 77 state and local HFAs totaling over \$4.2 billion, an increase of \$1.68 billion from 2006 HFA mortgage purchases. Approximately 92 percent (31,775) of these borrowers were first-time homebuyers. In 2007, Fannie Mae significantly increased its commitment to HFAs and offered a single family alliance package to state HFAs through the National Council of State Housing Agencies. The alliance offers MCM product variances requested by the HFAs as well as other benefits.

As discussed in Section III above, Fannie Mae reaches first-time homebuyers through partnerships with state and local HFAs. By providing HFAs access to Fannie Mae's single family and multifamily products, Fannie Mae provides them with access to more tools to help finance, develop, and preserve affordable housing.

### **Local Partnerships Working to Support Affordability Strategies under the Cranston-Gonzalez Act**

One of the purposes of the Cranston-Gonzalez National Affordable Housing Act is to extend and strengthen partnerships among all levels of government and the private sector in the production and operation of housing that is affordable to low-income and moderate-income families.

Fannie Mae seeks partners in cities, towns, and states willing to work with the company to provide affordable housing opportunities throughout the country. Below are some examples that illustrate how these efforts with state and local governments support localities' affordable housing objectives under Section 105 of the Cranston-Gonzalez Act.

- Efforts to address homelessness by meeting the supportive and affordable housing needs of homeless and at-risk individuals and families. In 2007, Fannie Mae continued its multi-year initiatives aimed at increasing the supply of permanent supportive housing for the chronically homeless and advancing the national goal of ending chronic homelessness. In addition to working with state and local governments through Fannie Mae's Community Business Centers (CBCs), Fannie Mae partnered with the CSH, and the National Alliance to End Homelessness (NAEH), as well as dozens of state and local government agencies and nonprofits across the country.
  - Through private-label LIHTC funds, Fannie Mae invested \$85.5 million in equity in 8 projects, including 688 units serving the homeless and low-income at-risk households. For additional information on Fannie Mae's LIHTC investments, see Section II above.
  - The company committed \$8.0 million in predevelopment and acquisition financing for homeless and supportive housing projects through CSH. Fannie

- Mae investments in CSH's loan fund have assisted 87 projects including 3,528 units.
- Fannie Mae provided \$2 million in grants to CSH and NAEH (the fourth year of a five-year commitment). With this grant support:
    - CSH added 2,302 units to their development pipeline in the first three quarters of 2007. CSH's pipeline since 2004 is a total of 10,636 units. In the first three quarters of 2007, CSH provided technical assistance to 69 nonprofit supportive housing project sponsors.
    - In the first three quarters of 2007, NAEH provided technical assistance to 11 communities developing plans to end homelessness. NAEH's Homelessness Research Institute issued briefs highlighting local progress in ending homelessness and several key reports including "Vital Mission: Ending Homelessness Among Veterans."
  - Fannie Mae provided expertise and an additional \$2.2 million in grant funding to national, state and local partners to increase homeless housing production and implement comprehensive solutions. Highlights of this work are provided below:
    - Fannie Mae's Dallas/Forth Worth and Houston CBCs expanded their support for efforts to end homelessness in Texas in 2007. Fannie Mae helped to develop the concept for Houston's Catalyst Loan Fund and provided a \$100,000 seed grant. The fund will support creation of supportive housing for the chronically homeless in Houston/Harris County. Fannie Mae is working with the City of Fort Worth, Downtown Fort Worth Inc. and the Tarrant County Homeless Coalition to develop a new business plan for the coalition. Fannie Mae also provided a \$100,000 grant for the first year of operations of the new entity. The CBCs partnered with CSH to implement Texas' first Supportive Housing Development Institute, which provided technical assistance to 10 nonprofit partnerships developing projects in 4 cities across the state.
    - Los Angeles County has one of the nation's most serious homelessness problems. Fannie Mae provided \$325,000 in grant support to the Los Angeles Homelessness Services Authority and four other nonprofits to develop supportive housing and to implement Project 50, a joint city/county initiative to move the hardest to serve chronically homeless individuals from the street to stable permanent housing.
    - Fannie Mae provided technical assistance and \$150,000 in grant support to the Rural Homelessness Initiative of South Central Ohio. This 17 county effort is a partnership between the National Alliance to End Homelessness and a local healthcare foundation to develop the first-ever comprehensive strategy to address rural homelessness.

## **CONCLUSION**

In accordance with section (n)(1) of the Federal National Mortgage Association Charter Act, this AHAR was distributed to the House Committee on Financial Services and the Senate Banking, Housing and Urban Affairs Committee. Additionally, the report will be available to the public at the company's headquarters located in Washington, D.C., and at the five Fannie Mae offices in Philadelphia, Pennsylvania; Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; and Pasadena, California.

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