FannieMae®

2004 Annual Housing Activities Report (AHAR)

March 16, 2005

FANNIE MAE'S

2004 ANNUAL HOUSING ACTIVITIES REPORT

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

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INTRODUCTION

Fannie Mae's Charter Act requires the company to submit an Annual Housing Activities Report (AHAR) to the Secretary of the U.S. Department of Housing and Urban Development (HUD). Section 309(n) of the Charter Act lists the matters required to be included in this AHAR.[1] This AHAR provides an overview and examples of Fannie Mae's 2004 efforts to serve its affordable housing mission.

HUD is required by law[2] to establish three affordable 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. Since 1995, HUD has expressed these goals as a percentage of the dwelling units and multifamily dollar volume,[3] financed by Fannie Mae's mortgage purchases and securitizations. By regulation dated October 31, 2000, HUD increased Fannie Mae's goals for all three categories to be effective from January 1, 2001 to December 31, 2003. The rule remained in effect through 2004. On November 2, 2004, HUD published a new housing goals rule that went into effect on January 1, 2005. The new rule governs the period from 2005 through 2008 and thus does not apply to the 2004 housing goals results reported in this AHAR.

Fannie Mae has undertaken numerous initiatives to meet the HUD housing goals and to further the company's mission of providing access to homeownership and affordable rental housing. In June 2002, Fannie Mae responded to President Bush's call to significantly increase the number of minority homeowners before the end of the decade, committing to a ten-point plan that includes a $700 billion commitment through 2009 to provide home financing to 4.6 million minority households. By year-end 2004, Fannie Mae invested $635.4 billion to provide financing to 4.5 million minority families under the President's White House Initiative. In 2004, Fannie Mae expanded its ***American Dream Commitment*** to focus on three broad objectives:

- Expanding access to homeownership for millions of first-time homebuyers;
- Making homeownership a success for millions of families who are at risk of losing their homes; and,
- Expanding the supply of housing where it is needed most.

As a private, shareholder-owned company, Fannie Mae operates in the secondary mortgage market and makes funds available for lenders to make loans more affordable for home buyers. These funds are made available through two processes. The first is through Fannie Mae's purchases of mortgage loans directly from lenders and other mortgage sellers. The second process is achieved by assembling pools of mortgages acquired from lenders and issuing Mortgage-Backed Securities (MBS), which lenders and sellers then hold or sell to investors. The company's Charter authorizes these

[1] 12 U.S.C. § 1723a(n).

[2] The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the 1992 Act), 12 U.S.C. § 4561-4564.

[3] 24 C.F.R. §§ 81.12(c), 81.13(c), 81.14(c) (2004).

activities. In 2004, Fannie Mae securitized $527.1 billion in mortgages and purchased $262.6 billion for its portfolio.

The multifamily market is a significant source of affordable housing for many American families and a key driver behind Fannie Mae's housing goals performance. Many metropolitan areas suffer from the lack of affordable rental housing, a challenge for local officials and national policymakers alike. Fannie Mae works with partners to develop technologies and mortgage solutions that ensure affordable rental opportunities. From 2000 to 2004, the company's multifamily portfolio grew from $61.1 billion to $119.9 billion.

Fannie Mae is also attaching the tables specified by HUD to provide detailed information about the company's performance in achieving each of the housing goals. The data cartridges relating to Fannie Mae's mortgage purchases of both single family and multifamily loans will be forwarded under separate cover. The narrative section of this AHAR describes, as required by the Charter Act, examples of Fannie Mae's activities in 2004 to achieve the affordable housing goals.

I. 2004 AFFORDABLE HOUSING GOALS PERFORMANCE[4]

A. Low- and Moderate-Income Housing[5]

HUD's regulations define low- and moderate-income families based on family income and area median income. Of the dwelling units Fannie Mae financed with eligible mortgage purchases in 2004, 53.4 percent served low- and moderate-income families. Fannie Mae financed $219.7 billion in mortgages that served 1.4 million low- and moderate-income homebuyers[6] on owner-occupied properties and 657,000 low- and moderate-income renters.

B. Underserved Areas[7]

Fannie Mae's mortgage finance activities in central cities, rural areas and other underserved areas accounted for 33.5 percent of the housing units it financed with eligible mortgage purchases, satisfying the 31 percent goal set by HUD. In meeting this goal, Fannie Mae assisted 1.36 million households in underserved areas during 2004.

C. Special Affordable Housing[8]

Fannie Mae also met HUD's requirement that 20 percent of the housing units financed be for very-low-income families and low-income families in low-income areas. The company's special affordable mortgage finance activities accounted for 23.6 percent of the housing units it financed by eligible mortgage purchases in 2004. In addition, Fannie Mae provided $7.3 billion in multifamily financing that qualified under the special affordable housing goal. HUD's regulations require that Fannie Mae provide a minimum of $2.85 billion in multifamily special affordable housing financing.

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[4] Information on the dollar volume and number of mortgages on owner-occupied and rental properties purchased under each annual housing goal can be found in Tables 1 and 1A. The following tables include additional information on: Table 1, the number of families served; Table 2, the income class; Table 7a, race of borrowers; and Table 10, gender of homebuyers served. The income class of tenants by affordability of rent can be found in Table 4. 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.

[5] HUD has established the low- and moderate-income housing goal for 2004 at 50 percent of the total number of dwelling units financed by eligible mortgage purchases annually. Id. § 81.12(c)(2). "Low-income" and "moderate-income" are defined in HUD's regulations at section 81.17.

[6] 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.

[7] HUD has established the underserved areas housing goal for 2004 at 31 percent of the total number of dwelling units financed by eligible mortgage purchases annually. Id. § 81.13(c)(2). "Underserved area" is defined in HUD's regulation at section 81.2.

[8] HUD has established the special affordable housing goal for 2004 at 20 percent of the total number of dwelling units financed by eligible mortgage purchases annually to address the needs of low-income families in low-income areas and very-low-income families. Id. § 81.14(c)(2). "Very-low-income" is defined in HUD's regulations at section 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.

The following chart summarizes Fannie Mae's performance against the affordable housing goals in 2004.

AFFORDABLE HOUSING GOALS AND RESULTS FOR 2004

GOAL SUMMARY	2004 GOAL	2004 RESULT
Low- and Moderate-Income Housing	50% of Eligible Units	53.4%
Underserved Areas	31% of Eligible Units	33.5%
Special Affordable Housing	20% of Eligible Units	23.6%
Special Affordable Housing -Multifamily*	$2.85 Billion Minimum	$7.3 Billion

* Under HUD's regulations, the Special Affordable Housing goal includes a minimum financing requirement "totaling not less than 1.0 percent of the average annual dollar volume of combined (single family and multifamily) mortgages purchased by [Fannie Mae] in 1997, 1998 and 1999…." 24 C.F.R. § 81.14(c)(1).

II. FANNIE MAE'S ACTIVITIES WITH FEDERAL SUBSIDY PROGRAMS

Fannie Mae's mission activities intersect with federal government policies and programs that support housing. In some cases this is through investments in government loans or guarantees or through underwriting flexibilities that allow for the purchase of a federally subsidized loan. In 2004, Fannie Mae's portfolio included government loans such as the Federal Housing Administration's (FHA) Title 1 Property Improvement Loans, the FHA's Home Equity Conversion Mortgage, loans insured by FHA and guaranteed by the U.S. Department of Veterans Affairs and the U.S. Department of Agriculture's (USDA) Rural Housing Services. Government loans purchased by Fannie Mae in 2004 totaled $15.1 billion.

Listed below are examples of Fannie Mae's 2004 single-family activities in conjunction with federal subsidy programs.

- 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 to receive cash. In 2004, Fannie Mae purchased 37,610 HECMs for a total value of $2.78 billion, and provided $689.2 million in advances on existing loans. The company is committed to providing financing for this product to ensure that the nation's elderly population has an affordable alternative when making quality-of-life decisions. As part of its ongoing reverse mortgage business, Fannie Mae annually convenes a Customer Advisory Group made up of sellers and servicers in the reverse mortgage industry to discuss key issues.

- The ***FHA TOTAL (Technology Open To All Lenders) Scorecard*** went into production in Fannie Mae's automated underwriting system, ***Desktop Underwriter®*** (***DU™***) in 2004. The Department of Housing and Urban Development (HUD) developed the *Scorecard* to process FHA single-family loans. The *Scorecard* works with *DU* to provide a recommended level of underwriting and documentation for FHA loans and to determine a loan's eligibility for insurance by FHA. In early 2004, HUD informed lenders that they must use the *FHA TOTAL Scorecard* for all FHA loans submitted through an automated underwriting system. By allowing lenders to convert to the *Scorecard* prior to HUD's mandatory May 1, 2004 conversion date, Fannie Mae helped more than 200 lender partners transition without any interruption to their business processes. On May 1, 2004, all remaining lenders were converted to the *FHA Total Scorecard*.

- *Dreamcatcher*, a lease-purchase initiative, was launched with the Three Affiliated Tribes (TAT) on the Fort Berthold Reservation in North Dakota. Under the initiative, Bank One originated loans through HUD's ***Section 184 Loan Guarantee Program***. Fannie Mae purchased the mortgages from the TAT totalling $4.1 million. The goal of the initiative is to have individual tribal members eventually assume the individual mortgages from the TAT.

- Fannie Mae worked with the USDA and Dacotah Bank to make affordable mortgage options on tribal lands available to the Sisseton-Wahpeton Oyate tribe in South Dakota. Dacotah Bank will originate the mortgages for the Sisseton-Wahpeton Oyate tribe and Fannie Mae will purchase the ***Rural Development Section 502 loans*** which require no down payment and are guaranteed under USDA's Rural Housing Native American Program.

- Since 2001, Fannie Mae has partnered with lenders, public housing authorities, community organizations and counseling agencies to help Section 8 recipients achieve homeownership by using their Section 8 voucher to help pay their mortgage. Since Fannie Mae started this initiative, 175 lenders have participated in Section 8 homeownership pilots across the country. Starting in 2004, Fannie Mae added Section 8 Housing Assistance Vouchers as an acceptable source of borrower income for Fannie Mae's ***MyCommunityMortgage***™ loans in *DU*.

Fannie Mae's multifamily activities intersect with federal programs such as **Low-Income Housing Tax Credits** (**LIHTC**) and the **Historic Tax Credits (HTC**). The company also participates in projects and community efforts that receive funds from HUD programs such as ***HOPE VI*, *Home Investment Partnerships* (*HOME*)** and ***Section 8***. Examples of some of these activites are described below.

- The federal LIHTC program directs private equity capital toward the creation of affordable rental housing. Investors receive the value of tax credits through leasing to qualified families at or below market rate rents. In 2004, Fannie Mae committed over $1.7 billion in LIHTC equity properties that resulted in 30,144 affordable rental housing units. Over the life of the LIHTC program, using both direct investments and investments in equity funds, Fannie Mae participated in the creation or preservation of over 345,500 units of affordable rental housing.

  In 2004, Fannie Mae partnered with Enterprise Mortgage Investments Inc. to help finance a $3.3 million rehabilitation on the Hanover Garden Apartments in Wilmington, North Carolina. Fannie Mae provided a $5.4 million LIHTC investment. This 104-unit property included 90 units covered by a Section 8 Housing Assistance Plan contract. Through a syndicator, Fannie Mae also invested $5.4 million in the property that qualifies for LIHTCs. Once the rehabilitation was completed, the project was renamed Tidewater Town Homes.

- The federal **Historic Tax Credit** (HTC) program directs private equity capital toward the rehabilitation of certified historic landmarks and other designated historically significant properties as determined by the National Park Service's Department of Historic Preservation. Investors receive the value of tax credits through successfully restoring and rehabilitating the historic property by maintaining the historic integrity of the improvements. In 2004, Fannie Mae committed over $45 million in HTC properties that were oriented toward affordable multifamily rental housing.

III. INCREASING HOMEOWNERSHIP OPPORTUNITIES FOR FIRST-TIME HOMEBUYERS

In January 2004, Fannie Mae pledged to create 6 million first-time homebuyers, including 1.8 million minority first-time homebuyers, by 2014 through the company's expanded *American Dream Commitment*. In 2004, 36.9 percent of Fannie Mae's conventional owner-occupied purchase mortgages were made to first-time homebuyers.[9] Under the goals of the White House Initiative, between June 2002 and December 2004, Fannie Mae with its lender partners, financed mortgages for 312,184 minority first-time homebuyers.

Although some of the tools and initiatives highlighted in this section are not exclusively for first-time homebuyers, by removing barriers to homeownership for underserved families, they increase the ability for borrowers to purchase their first home.

Low Down Payment Products

According to the 2002 Fannie Mae National Housing Survey, the biggest obstacle to homeownership for many low- to moderate-income families is saving the necessary funds for down payment and closing costs. In 2004, 21.6 percent of Fannie Mae's low- and moderate-income mortgage purchases for owner-occupied units had an LTV above 95 percent. This compares to the company's share of 19.3 percent in 2003. For the underserved goal, 21 percent of owner-occupied mortgage purchases had an LTV above 95 percent. This activity also demonstrates an increase from 2003 when Fannie Mae's percentage share totaled 18.9 percent. In the final special affordable housing goals category, loans above a 95 percent LTV made up 25.3 percent of Fannie Mae's mortgage purchases at the time of origination. This difference in mortgage purchases is a two-percentage point increase from 2003 activity.

To break down the down payment barrier, Fannie Mae worked closely with lender partners to develop a suite of low down payment mortgages, such as the ***Flexible*** mortgage product line, that may help first-time home buyers and others with limited funds. These loans permit the borrower to obtain funds for the down payment and closing costs from various approved flexible sources, including: 1) gifts from a relative, domestic partner, fiancée or fiancé; 2) grants from an employer, public agency, and nonprofit organization; 3) unsecured loans from a relative, domestic partner, fiancée or fiancé, employer, and nonprofit organization; and, 4) secured borrowed funds and ***Community Seconds***.™

- The ***Flexible*** mortgage product suite includes the ***Flexible 97***® mortgage and the ***Flexible 100***™ mortgage. With *Flexible 97* mortgages, borrowers must make a minimum contribution of three percent of the sales price, all of which may come from

[9] Fannie Mae's Selling and Servicing Guide 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 will also be considered a first-time homebuyer if her or she had no ownership interest in a principal residence (other than a joint ownership interest with a spouse) during the preceding three-year period."

approved flexible sources of funds identified above. With *Flexible 100* mortgages, borrowers have the option of making either a minimum contribution of three percent of the sales price which can come from approved flexible sources, or a minimum contribution of $500 from the borrower's own funds. To provide borrowers additional purchasing power, Fannie Mae made certain 5-, 7-, and 10-year adjustable-rate mortgages (ARMs) eligible as *Flexible* mortgages. These ARMs have lower interest rates than comparable fixed rate mortgages for an initial five, seven or ten year period, and therefore have lower monthly payments. After the initial fixed period, the mortgage note rate adjusts annually based on market interest rates and payments are adjusted accordingly. In 2004, Fannie Mae purchased $18.3 billion in *Flexible* loans made to 132,647 households. Of that total, 70,937 Flex mortgages were made to families that were first-time homebuyers.

Certain products, such as ***MyCommunityMortgage*™**, an affordable product with a wide range of flexibilities and options that are designed to break down barriers, lower costs, and increase access to homeownership, help increase the number of first-time homebuyers. In 2004, Fannie Mae purchased or securitized more than $2.1 billion of *MyCommunityMortgage* products, which served 15,745 first-time homebuyers. Overall, in 2004, this product helped provide affordable housing solutions for 20,022 households.

In 2004, Fannie Mae enhanced *MyCommunityMortgage* to help lenders further expand affordable financing to underserved families.

- Today, *MyCommunityMortgages* in *DU* are available to housing finance agencies (HFA) who can offer these mortgage products through their mortgage revenue bond programs. The HFA-related *MyCommunityMortgage* loans allow first-time homebuyers to finance up to 100 percent LTV with a borrower contribution of as little as $500. By statute, HFAs must use their mortgage revenue bond programs to help borrowers purchase their first home. In 2004, Fannie Mae purchased $32.4 million in HFA-related *MyCommunityMortgage* loans.

- The ***Community HomeChoice***™ option under *MyCommunityMortgage* provides extra flexibilities to serve people with disabilities with a new 100 percent LTV option for one-unit properties and as little as three percent down for two-unit properties. Only $500 is required to come from the borrower's own funds for a one-unit property. In meeting the product's income requirements, special consideration is given to non-wage sources of income, such as public or private disability benefits or Section 8 vouchers. In 2004, Fannie Mae invested $19.5 million in the *Community HomeChoice* loans, serving 216 families.

- Section 8 Housing Assistance Payment vouchers were added as an acceptable source of borrower income for *MyCommunityMortgage* loans in *DU*. Lenders work with local public housing agencies (PHAs) to serve borrowers who hold Section 8 homeownership vouchers issued by the PHA.

- To better serve Native American borrowers, properties located on tribal trust or restricted lands now qualify for *MyCommunityMortgage* in *DU*.

Fannie Mae worked with lender partners to pilot a 40-year fixed-rate mortgage in 2004 to help increase opportunities for first-time homebuyers.

- Fannie Mae, working with the National Association of Federal Credit Unions to increase affordable housing options for credit union members, piloted a ***40-Year Fixed-Rate Mortgage Pilot*** with a small group of credit unions in 2004. By extending the fixed-rate term from 30 years to 40 years, payments are lower and more affordable for borrowers. Credit union members are financially conservative and prefer fixed-rate mortgages over ARMs and/or interest-only (IO) products, despite the lower interest rates and payments in the first years of the ARMs and IOs. Some credit unions already had established a 40-year product, but had no place to sell it in the secondary market. Borrowers electing this mortgage option received pre-purchase counseling and post-purchase counseling from participating credit unions. The 40-year fixed-rate mortgage pilot follows certain standard 30-year fixed guidelines and mortgage insurance coverage requirements and other *DU* guidelines. In 2004, Fannie Mae purchased \$15.4 million of these mortgages under the 40-year pilot.

Navigating through the homebuying process can be a daunting experience, even for the most experienced borrower, but it presents even more challenges for first-time homebuyers. To help lenders and counseling agencies work with consumers, Fannie Mae offered the following tools in 2004:

- ***Home Counselor Online***™ is a Web-based tool that enables homeowner educators and other trusted advisors to help low- to moderate-income, minority, and credit-impaired borrowers purchase a home. In 2004, Fannie Mae added bilingual capability to *Home Counselor Online*. All consumer-facing tools, forms, calculators, and results, as well as support tools for counselors, are available in both English and Spanish. *Home Counselor Online* also enables counselors to compile a formatted nontraditional credit payment history report, including more than 25 payment types, to establish creditworthiness for potential homebuyers lacking traditional credit sources. To assist counseling agencies with community outreach, the latest *Home Counselor Online* enhancements enable counselors to produce letters and mailing labels directly from the system when planning marketing classes, workshops, and home-buying fairs. *Home Counselor Online* is currently being used by faith-based and other nonprofit counseling organizations, such as ACORN Housing Corporation, Salvation Army, National Council of La Raza, Catholic Charities, Mission of Peace, and NeighborWorks™ affiliates. As of year-end 2004, *Home Counselor Online* had 5,185 registered users representing 1,778 organizations.

- ***Online Spanish Loan Documents.*** In 2004, Fannie Mae translated a number of loan documents into Spanish to help serve Spanish-speaking borrowers. Over 100 security instruments, notes, riders, and special purpose documents are now available on a "test" basis to a limited number of Fannie Mae customers and industry partners on *eFannieMae.com*. Although these documents are for informational purposes and not executable, partners may find them useful when working with Spanish-speaking customers.

Technology Strategy

Fannie Mae believes technology plays a vital role in the effort to expand access to homeownership for first-time homebuyers by lowering origination costs. Fannie Mae's technology capabilities are designed to cut costs, streamline processes, and open new markets in an effort to create a more cost-effective and transparent mortgage finance process. At the core of this strategy is Fannie Mae's automated underwriting systems: ***Desktop Underwriter*®** (***DU*™**) and ***Desktop Originator*®** (***DO*™**). *DU* is an automated underwriting system that greatly reduces the time, cost and subjectivity associated with the mortgage loan underwriting process. *DO*, used in concert with *DU*, allows wholesale lenders to extend the full range of benefits from *DU* to their sponsored mortgage brokers.

DU recommendations help lenders make decisions about the relative credit risk of a mortgage which enhances Fannie Mae's ability to create mortgage financing opportunities in the marketplace. An important benefit for Fannie Mae lender partners is the waiver of certain underwriting representations and warranties extended on loans receiving certain *DU* recommendations. This waiver can remove repurchase risk for lenders in certain instances, encouraging them to make mortgages to low- and moderate-income and other underserved borrowers.

Through DU, lenders are also able to offer a wide variety of affordable housing products—including *MyCommunityMortgage* and ***Expanded Approval*™ *with Timely Payment Rewards*.™** These products give lenders greater flexibility to serve America's increasingly diverse population.

Partnerships Focused on Increasing First-Time Homebuyers

Under the new goals of the *American Dream Commitment*, Fannie Mae is focused on building stronger partnerships with lenders and those in the community who serve first-time homebuyers. Examples include the following partnerships and initiatives:

- The **National Association of Hispanic Real Estate Professionals** (**NAHREP**) and Fannie Mae entered into a three-year partnership focused on increasing first-time homebuyers in underserved, minority, and immigrant communities. Through this alliance, Fannie Mae hopes to purchase up to 25,000 mortgages generated by NAHREP for first-time homebuyers through participating lenders in various underserved, minority and immigrant communities. Fannie Mae and its lender partners are working with NAHREP to build the capacity of NAHREP brokers and real estate professionals to increase loan origination in designated underserved communities, providing them with technical assistance, innovative mortgage products, technology and marketing research. Additionally, NAHREP members will have access to technology support, such as Fannie Mae's Mortgage Broker Center on *eFanniemae.com* and the company's new Spanish translations of mortgage loan documents.

- In 2004, Fannie Mae and the **National Association of Home Builders** (**NAHB**) launched a "workforce housing initiative" in the Atlanta metropolitan area that focuses on the needs of low- and moderate-income workers especially in high-cost markets. The initiative encompasses a variety of Fannie Mae products and services. NAHB and Fannie Mae are working with organizations such as the **Greater Atlanta Home Builders Association** and the **Atlanta Development Authority.** Other partners include individual home builders, lenders, mortgage insurers, real estate professionals, housing finance agencies, nonprofits, government agencies and other regional partners.

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

Underwriting Standards

Fannie Mae does not make underwriting decisions on single-family loan originations. Underwriting for origination is a function performed by Fannie Mae's lender partners, prior to purchase or guarantee by Fannie Mae. If a lender originates a loan that is intended to be purchased or guaranteed by Fannie Mae, the lender must underwrite the loan using guidelines that are acceptable to Fannie Mae. 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 ***Desktop Underwriter®*** (***DU™***) and manual underwriting. Both methods follow Fannie Mae's underwriting standards which are based on the company's understanding of default risk.

Underwriting standards are derived from continuous research and analysis of borrower profiles and loan performance and are detailed in Fannie Mae's ***Selling Guide***. Primary risk factors include equity investment and credit history. These two characteristics are the most significant factors in determining the default risk for any mortgage and establish the foundation of the comprehensive risk of a mortgage. Contributory risk factors are those factors that are not of sufficient weight by themselves to use as the basis for reaching an underwriting decision, however, when combined with primary risk factors, may materially influence the default risk of the mortgage. Contributory risk factors include liquid financial reserves, employment classification, mortgage term, product type, type of property, transaction type, presence of co-borrowers, total debt-to-income ratios, previous mortgage delinquency and prior bankruptcy or foreclosure. Each risk factor must be analyzed by the lender and, based on the attributes of the particular characteristic, categorized as either; satisfies basic risk tolerances, decreases risk, significantly decreases risk, increases risk or significantly increases risk.

Each underwriting method is designed to enable a lender to evaluate the overall credit risk of a mortgage application and to determine whether the mortgage is eligible for delivery to Fannie Mae.[10] Under appropriate terms and conditions, Fannie Mae purchases mortgages that represent varying levels of risk, including those that have relatively higher risks related to such factors as a blemished credit history, limited savings, or low down payments.

Fannie Mae generally relies on the selling lender's representations and warranties that the mortgage loans being purchased or guaranteed conform to the applicable Fannie Mae guidelines. At the company'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's National Underwriting Center (NUC) performs Fannie Mae's underwriting reviews and provides

[10] Fannie Mae also considers purchasing mortgages that are underwritten using a lender's guidelines.

loan quality information and analyses to Fannie Mae staff throughout the country. NUC focuses its resources on loans that represent a higher risk to the company but also randomly samples all loan deliveries for quality assurance reviews. This helps ensure that loan reviews are done in an objective and consistent manner. 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 NUC performs anti-predatory lending screening of a targeted segment of reviews. 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 or indemnification by the lender in lieu of immediate repurchase.

Fannie Mae's Automated Underwriting: *DU*

DU is designed to assist lenders in processing mortgage applications in a more efficient and accurate manner. *DU* promotes fair lending by evaluating applications consistently and objectively. *DU* applies the same criteria to every loan it processes. *DU* 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.

DU features fast and comprehensive risk assessments, reduced data entry requirements, reduced documentation, and comprehensive underwriting reports. *DU* complements, but does not replace, the considered judgment of experienced underwriters. Instead, *DU* provides recommendations to lenders based on Fannie Mae's purchasing and securitization guidelines. Lenders make the final decision. To help lenders better analyze the risk for those loans that do not receive an "Approve" recommendation, *DU* provides loan-specific messages that are designed to assist the lender in discussing the application with the borrower. To assist lenders in understanding *DU's* evaluation of an application, whenever an application receives a recommendation other than an "Approve" the *DU* underwriting report provides an analysis of the application's significant risk factors. This underwriting report, called a Findings Report, summarizes the overall underwriting recommendation and provides lenders with loan-level messages that will identify the risk factors that contributed to the recommendation.

Since 2000, Fannie Mae has made the mortgage process more transparent by disclosing the factors *DU* considers in its risk evaluation. These factors 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 and collection accounts; and credit inquiries. The non-credit risk factors include the borrower's equity and LTV ratio, liquid reserves, loan purpose, loan term, loan/amortization type, occupancy type, total expense ratio, property type, co-borrowers, and self-employment.

It should be noted that lenders may also deliver loans to Fannie Mae that have not received recommendations from *DU*. In those cases, lenders must follow Fannie Mae's standard underwriting guidelines, and then represent and warrant compliance to Fannie Mae. Subject to the company's review and approval, Fannie Mae also purchases or securitizes mortgages underwritten to a lender's own underwriting guidelines, including a lender's own automated underwriting system.

DU is Predictive of Default Risk

DU represents an empirically designed statistical assessment of mortgage default risk. *DU* makes evaluations and determines default risk based on past loan performance. *DU* evaluates a prospective borrower's specific credit and non-credit history risk factors based on data in the loan application and credit report. *DU* weighs all of this information based on the amount of risk and its overall significance to the underwriting recommendation. As a result, *DU* is highly predictive of mortgage default risk. Recent 2004 performance of loans delivered to Fannie Mae that received an "Approve" recommendation from *DU* exhibited a two-year serious delinquency performance (90-days delinquent within 24 months) four times better than loans that received a "Refer with Caution" recommendation. For lenders participating in the ***Expanded Approval with Timely Payment Rewards®*** (***EA/TPR™***) initiative, *DU* separates risk further by placing *EA* loans into four categories: levels *EA-I*, *EA-II*, *EA-III*, and *Refer with Caution/IV*. Levels I to III are eligible for delivery to Fannie Mae by approved sellers and servicers. Loan performance data on Fannie Mae's *EA* loans demonstrates the relative performance between categories: *EA-II* loans perform 1.7 times better than *EA-III*. Similarly, *EA-I* loans perform 1.6 times better than *EA-II* loans.

2004 Enhancements to *DU's* Risk Assessment Capabilities

Fannie Mae conducts quarterly reviews of loan performance to ensure the predictability of the model. Each new version of *DU* strives to increase homeownership opportunities for all borrowers, including low- and moderate-income borrowers, minority borrowers and other underserved borrowers. The Fair Lending Compliance team in the Legal Department of Fannie Mae reviews all changes to *DU* to ensure that they comply with fair lending laws.

Throughout the course of 2004, there were two major *DU*/*DO* software releases.

- ***DU Version 5.4*** was enhanced to process loan applications in which a co-borrower lacks a traditional credit history. In addition, this version reduced the amount of data required for loan submission, which improves loan productivity.

- ***DU Version 5.4.1*** reflected joint efforts with lender partners to combat the occurrence of and costs associated with fraud in the mortgage origination process by alerting the lender to potential red flags. In this version, *DU's* capabilities were enhanced to identify a number of potential red flags, such as inconsistent or contradictory data. The messages provided by *DU* help lenders ensure data integrity. *DU 5.4.1* also expanded the *MyCommunityMortgage* product to allow three- to four-unit principal residences and to include ***Community Renovation™*** loans on 1- to 4- family properties. In addition, the maximum LTV for *MyCommunityMortgage* loans that have financed MI increased from 95 percent to 100 percent. With these enhancements, Fannie Mae can streamline and more efficiently process these affordable housing products.

In December 2004, Fannie Mae launched a pilot version of ***Desktop Underwriter® 6.0*** *(DU 6.0)* with a limited number of lenders. *DU 6.0* provides a more comprehensive view of risk. *DU 6.0* also offers expanded eligibility, thereby increasing access to conventional mortgages. Fannie Mae's Fair Lending Team worked closely with the Automated Underwriting Product Development Team to ensure that *DU 6.0* was subject to a rigorous fair lending review.

Underwriting Flexibilities

To support its efforts to increase the availability of affordable housing opportunities, Fannie Mae reviews and changes underwriting guidelines from time to time. For example, Fannie Mae introduces new underwriting criteria to make the mortgage finance system more accessible to minorities, low- and moderate-income families, underserved and rural residents, and people with special needs. The ***Home Front Mortgage*** and ***Buy for Family*** mortgages are two examples of this practice.

- Due to changes of duty station, many military families suffer temporary income loss when an active service member relocates and his/her spouse must seek new employment. As a result, military families may have higher debt-to-income ratios and find it difficult to save money for a down payment. With the *Home Front Mortgage*, which offers greater underwriting flexibilities, soldiers returning from Iraq do not need to make a down payment. The *Home Front Mortgage* pilot is being offered to active duty military personnel stationed at Fort Campbell and will help them purchase homes in Kentucky or Tennessee. All personnel at Fort Campbell are eligible for the pilot. The Fort Campbell Federal Credit Union is originating the loans and Affordable Housing Resources Inc., a nonprofit housing organization, is providing homeownership counseling.

- *Buy for Family*, a new mortgage designed by Guaranty Bank, allows a qualified borrower to finance the purchase of a residence for his or her parents or a sibling if they are unable to buy a home for themselves. This mortgage, which is available to anyone, can be particularly effective in helping minorities and immigrants, who lack traditional forms of credit or mainstream banking relationships, achieve homeownership. Fannie Mae's flexible underwriting guidelines allow borrowers to contribute as little as $500 down from their own funds, with the remainder coming from a gift from their family member, or grants from a church, employer, municipality, or nonprofit agency. In addition to the flexible down payment sources, additional funds may be obtained from cash on hand or money not traditionally placed in a financial institution. Guaranty Bank is offering the product in Chicago, Atlanta, Detroit and the state of Wisconsin.

In cooperation with local housing and lender partners, Fannie Mae also conducts various underwriting experiments aimed at addressing the obstacles faced by prospective homebuyers across the country. Each experiment is place-based and features Fannie Mae's standard product offerings with enhancements that accommodate the targeted needs of the local population and mitigate barriers facing local borrowers. In 2004, Fannie Mae approved $204.6 million through its Housing and Community Development regional delegation fund in place-based commitments for a total of 64 experiments. A 2004 underwriting experiment is highlighted below.

- In South Florida, Fannie Mae and two lenders, the **Home Financing Center** and the **Peninsula Mortgage Bankers Corporation** partnered to offer a flexible, affordable initiative that helps working families keep their aging parents at home with them. Under this *Seniors and Family Together* initiative, multigenerational families can finance a larger home through use of underwriting flexibilities involving borrower's income (up to 130 percent of the area median), non-traditional credit history, and a $500 minimum contribution from the borrower's own funds. Fannie Mae purchased $248,000 in mortgages under this experiment in 2004.

Another place-based initiative with flexible underwriting is featured below.

- Under the *Arizona Border Initiative*, Fannie Mae is working with local partners including **AEA Federal Credit Union** and **PMI Mortgage Insurance Co.**, to increase the supply of for-sale and rental housing, improve substandard housing conditions, and offer new mortgage financing pilots created to meet the unique needs of minority families, Native Americans, immigrants, migrant farm works and other underserved populations in the Arizona border region. The Arizona border is plagued by low incomes, high unemployment, high cost of land and language barriers. In 2004, Fannie Mae purchased $8 million in affordable mortgages under this initiative. Features under this initiative include, but are not limited to the following:

    - the ***Border Region MyCommunityMortgage pilot*** offers expanded credit flexibilities that address unique credit issues of low-income border populations that experience high rates of unpaid medical bills and lack credit histories;

    - the ***Border Region Sweat Equity pilot*** allows borrowers to contribute labor, or sweat equity, in lieu of a cash contribution to pay for as much as 25 percent of the as-completed value of the home; and,

    - the ***Border Region Renovation pilot*** was created to renovate and transform substandard housing by creating one loan for the mortgage and the costs of substantial renovation of the property.

Responsible Lending Products

Fannie Mae also develops strategies for lenders to offer products to borrowers who have past credit problems and who may otherwise be offered more costly alternative financing. Fannie Mae's ***Expanded Approval with Timely Payment Rewards®*** (***EA/TPR™)*** initiative may provide lower cost financing for borrowers with blemished credit histories.

- With *EA*, borrowers may secure a mortgage rate that may be significantly 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 after making timely mortgage payments for a specified period, without having to refinance. And with certain 5-, 7-, and 10-year ARM plans that are available with *EA*, the borrower can have lower payments for the first 5, 7, or 10 years after which time the interest rate adjusts annually. In 2004, Fannie Mae purchased $16.1 billion in *EA* loans to help 120,588 homebuyers lower the cost of home financing. In the same period, Fannie Mae purchased $1.2 billion of loans using the *TPR* feature enabling 9,449 additional homebuyers to benefit from further interest savings. Total *EA/TPR* volume for Fannie Mae in 2004 was $17.3 billion.

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

As illustrated in various sections of this report, Fannie Mae works with a variety of lenders across the country including banks, thrifts, and mortgage companies. To keep these lenders informed of policies and procedural requirements and keep them abreast of the company's efforts to promote responsible lending, Fannie Mae publishes a *Selling Guide*. The *Selling Guide* covers standard requirements for the origination, underwriting, and delivery of one- to four-family mortgages.

In 2004, Fannie Mae amended its *Selling and Servicing Guides* to further address the company's affordable housing mission and promote fair and responsible lending. Examples include amendments detailing: 1) the expansion of Fannie Mae eligibility guidelines for properties secured by manufactured homes; 2) further clarification of Fannie Mae's anti-predatory lending policies, such as prepayment premiums, arbitration agreements and escrow accounts; 3) the temporary purchase of Guaranteed Rural Housing mortgage loans from prior approved lenders, before the lender receives the original Loan Note Guarantee from Rural Housing Services; and 4) the elevation of new maximum mortgage amount limits effective for 2005 for all conventional mortgages.

The new guidance on Fannie Mae's anti-predatory lending policies included in the 2004 *Selling and Servicing Guides* are part of the company's efforts to help keep people in their homes and promote responsible lending practices. As discussed earlier, if it is determined that a loan fails to comply with Fannie Mae's policies, the company may pursue various options, including requiring repurchase of the loan or indemnification by the lender in lieu of immediate repurchase. Key points of the expanded responsible origination and servicing policies are described below, and are in addition to the policies set forth in 2000 in Lender Letter 03-00.

- **Mandatory Arbitration:** Fannie Mae issued a policy of not investing or accepting delivery of any mortgage that is subject to mandatory arbitration provisions.

- **Balloons:** Fannie Mae will not purchase balloon mortgages with terms less than seven years. Fannie Mae recommends lenders provide consumers disclosures regarding their obligations related to the balloon.

- **Servicing:** Fannie Mae's servicing policies are intended to promote practices that help preserve homeownership. Fannie Mae clarified and reaffirmed several policies:

  - Loss Mitigation/Customer Service: Fannie Mae reaffirmed support for effective customer complaint resolution efforts and the use of loss mitigation to help avoid foreclosure. Fannie Mae reiterated the expectation that servicers have sufficient and properly trained staff, adequate controls and effective processes to promptly address borrower inquiries and manage servicing transfers.
  - Fees and Charges: Fannie Mae reaffirmed that fees charged to borrowers must comply with applicable law and be consistent with the mortgage documents accompanying the loan. The company clarified that a borrower's failure to pay miscellaneous fees generally should not result in the acceleration of the debt and commencement of foreclosure proceedings. Fannie Mae also adopted a policy that if a payment included sufficient funds to pay the mortgage obligation, except for the late charge, the servicer should generally apply the payment received and defer the collection of late charges.
  - Posting of Payments: Fannie Mae reaffirmed servicers' responsibility to credit borrowers' payments in a timely manner to avoid inappropriate assessment of late charges and inaccurate reporting of delinquencies to credit bureaus.
  - Lender-placed Insurance: Fannie Mae requires servicers to have policies that protect consumers against inappropriate lender-placed insurance practices. Servicers should use lender-placed insurance only after they have made good faith attempts to contact the borrower and the borrower has been given sufficient time to obtain evidence of insurance.
  - Credit Reporting: Fannie Mae reaffirmed that servicers should advise seriously delinquent borrowers of the impact on the borrower's credit of such delinquency. Fannie Mae also reaffirmed servicers' obligation to comply with the Fair Credit Reporting Act, including addressing disputed or inaccurate information.

- **Prepayment Premium:** Fannie Mae expanded existing policies by limiting the purchase of loans with prepayment premiums. This provision applies to prepayment premiums with terms greater than three years from the date the note is executed. Lenders are also encouraged to waive part of the prepayment premium if the home is sold.

- **Single Premium Credit Protection:** Fannie Mae expanded its existing policy of not purchasing loans with single-premium credit life insurance to include any single-premium credit insurance and single-premium debt cancellation agreements.

- **Escrows:** Fannie Mae reaffirmed its policy encouraging that escrows not be waived for blemished credit borrowers. Lenders are encouraged to: (1) develop policies that consider more than just LTV ratios in making this decision, and (2) provide borrowers disclosure about the implications of a waiver. Fannie Mae clarified that a lender should not make it a business practice to rarely or never establish escrows for blemished credit borrowers with the intent of understating the true cost of financing and generating fees out of activities like lender-placed insurance.

Anti-Predatory Lending Initiatives

In more than 30 markets around the country, Fannie Mae has worked with local organizations to launch ***Anti-Predatory Lending Refinance Initiatives*** that help borrowers refinance out of abusive loans and into responsible ones. Each of these initiatives is designed to address the particular needs and conditions in the local communities. To date, Fannie Mae has committed to purchase $110 million in loans delivered through these initiatives, including $16 million in new commitments in 2004.

In addition to local housing organizations and lenders, Fannie Mae works closely with real estate professionals to put them at the forefront of preventing unwarranted high-cost lending. In 2003, the **Texas Association of REALTORS**,® seven local Realtor associations and Fannie Mae launched a statewide education and outreach campaign to promote responsible lending and expand homeownership in Texas. The campaign, titled ***Borrow with Confidence***,™ continued through 2004 and provides real estate professionals with training on a host of flexible mortgage products that address the barriers that many of their clients face, such as lack of down payment funds, blemished credit and over-indebtedness. Real estate professionals are also provided with a list of lenders that offer competitive interest rates to potential homebuyers and local homebuying counseling agencies. Due to the success of the *Borrow with Confidence* campaign in Texas, Fannie Mae has expanded the campaign to include state and local REALTOR associations in Louisiana, Tennessee, Northern Virginia, New York and Colorado. In 2004, seven state REALTOR associations partnered with Fannie Mae to launch *Borrow with Confidence* in Indiana, Michigan, Alabama, Rhode Island, Georgia, Utah and Iowa.

Credit Pricing

Fannie Mae's pricing policies and strategies are based on competitive market factors, the company's experiences, capital requirements, and key determinants or indicators of loan performance. There are a number of factors that are used to predict loan performance. They include credit histories, mortgage loan and property characteristics, interest rate fluctuations, and housing prices. As an ongoing practice, Fannie Mae continually updates its databases with the most current loan origination information, payment status of all loans outstanding, and net losses associated with defaulted loans.

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 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 factors in its ability to meet strategic business goals and continue to fulfill its housing mission to provide affordable mortgage credit and tear down barriers to homeownership.

Fair Lending

Fannie Mae's fair lending efforts are focused on promoting responsible lending practices and ensuring that lenders have the tools to effectively reach underserved markets. To ensure compliance with Fannie Mae's policies, Fannie Mae maintains high standards, from the quality of information provided to partners who work with consumers to educate them about the homebuying process, to careful lender selection and routine checks on the quality of loans Fannie Mae purchases. At Fannie Mae, a Fair Lending Compliance Team that includes a Vice President and Deputy General Counsel for Fair Lending, five Associate General Counsel, one Senior Business Analyst and one Business Consultant play a key role in these efforts. The Fair Lending Compliance team also reviews some of Fannie Mae's new initiatives, such as those highlighted throughout this report, and reviews updates and new releases of *DU*. Lastly, the Fair Lending Compliance Team convened Fannie Mae's Fifth Annual Fair Lending Conference in 2004.

Fifth Annual Fair Lending Conference

In September 2004, Fannie Mae hosted its Fifth Annual Fair Lending Conference in Washington, D.C bringing together participants from the lending industry, government, housing and civil rights organizations, and academia. The conference was entitled "Building Partnerships -- Building Communities" and focused on the new goals of the *American Dream Commitment* and other current topics in fair lending. The conference included a panel on Non-Traditional Credit, including representatives from **Pay Rent**, **Build Credit, Inc.**, **Equifax Inc.**, and the **Fair Isaac Corporation**, that discussed various ways non-traditional credit may be included in automated underwriting in the future. The next panel discussed strategies for reaching underserved communities and included representatives from the **Choctaw Nation Housing Authority**, **First American Corporation**, and **Bank of America**. The final panel discussed new research on the causes of defaults and strategies for preserving homeownership and included representatives from **The Reinvestment Fund**, the **Ford Foundation**, and **HOME of Richmond**.

Delinquency and Default Rates for Low- and Moderate-Income Loans

Analysis of the performance of mortgage loans serving low- and moderate-income housing families (defined as a unit occupied by a household earning less than or equal to the median area income) shows a steady poor performance relative to loans on units serving households with incomes above the median level. *The analysis presented here does not control for other risk dimensions, such as LTV or credit history, only income relative to the area median.*

The attached table display serious delinquency performance and default performance over time. Fannie Mae defines early serious 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 anytime in the life of the loan.

The analysis demonstrates that loans to low- and moderate-income borrowers on average performed about 1.75 times worse than mortgages to higher income borrowers with respect to early serious delinquency for years 1996-2001. Since 2001, as eligibility for higher risk product has expanded, through such offerings as *My Community Mortgage* and *Expanded Approval*, performance on these loans has become worse. For 2003 acquisitions, loans to low- to moderate-income borrowers were delinquent 2.4 times more often than loans to higher income borrowers. The relative default rate performance is also consistently worse for low- to moderate-income borrowers than for higher income borrowers. 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.

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, forward amortizing, first liens, non GEMs/GPMs

Acquisition Year	Relative Serious Early Delinquency Performance	Relative Ever Default Performance
1996	1.8	1.7
1997	1.8	1.7
1998	1.8	1.8
1999	1.7	1.8
2000	1.7	1.9
2001	1.6	2.0
2002	2.0	2.4
2003	2.4	3.0

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 ever 90 or more days delinquent within 12 months of acquisition.
3.) Default is defined as a foreclosure, deed-in-lieu of foreclosure, or third party sale at any point in the loans life.
4.) Analysis on unseasoned loans by acquisition year to avoid commingling different aged loans for the purposes 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.

V. PROVIDING AFFORDABLE RENTAL HOUSING

Despite increasing homeownership rates, the need for affordable rental housing remains strong. Fannie Mae helps increase the supply of affordable rental housing through the purchase of debt investments, credit enhancement of multifamily housing bonds targeted at low- and moderate-income families, multifamily equity (including **Low-Income Housing Tax Credits**), equity in properties affordable to low- and moderate-income families, and multifamily mortgage revenue bonds. Fannie Mae's multifamily assets, comprised of multifamily mortgages purchased for cash, multifamily Mortgage-Backed Securities (MBS), credit enhancements of bonds, investments in LIHTC, and other assets, now total $119.9 billion.

In 2004, the domestic economy experienced decreasing interest rates and improving employment conditions. Low interest rates made homeownership more affordable and the continued increases in single-family homeownership rates between 2001 and 2004, led to increased vacancies in the rental market for that period. On the other hand, the country began to experience higher levels of employment in 2004. These increases in employment are expected to lead to a growing demand for multifamily units and lower vacancy rates from this point in the economic cycle and forward.

In the multifamily secondary market, competition continues to increase in capital markets for the provision of funds. GSEs, Commercial Mortgage-Backed Securities (CMBS) issuers, life companies, and other portfolio lenders are all currently active participants. CMBS volumes outstanding continue to increase. Several factors indicate that this participation might be more than warranted by market conditions: CMBS subordination levels and returns continue to decrease while CMBS multifamily delinquencies face an upward trend.

There are a number of factors impeding the standardization and securitization of mortgage products for multifamily housing. As discussed above, 2004 represented the continuation of historically low interest rates. With many economists predicting that rates will rise, a multifamily borrower's ability to manage interest rate risk is of the utmost importance to the mortgage market. Many of the product innovations discussed below, such as the ***Extended Rate Lock***, ***Extended Maturity***, ***MultiRate Mortgage***, and the ***DUS ARM*** provide borrowers with a greater ability to manage their exposure to interest rate risk. The influx of capital that is also discussed above has affected credit standards, especially by conduit and mezzanine lenders who sell off credit risk rather than hold it. Fannie Mae's efforts to create expanded delegated authority for the lenders to utilize an exit strategy—rather than standardized floors—allows lenders who hold credit risk, to better compete with other shorter term focused market players. Likewise the influx of capital has allowed borrowers to demand more customization of mortgage products. Work on innovations like actual/360 for interest only loans represent efforts to provide borrowers with customized products around prudent credit standards.

Multifamily Products and Activities
Fannie Mae's product innovations in 2004 focused on providing lenders and borrowers with more flexibility in arranging financing, creative new interest rate options, and easier processing and underwriting and include the following:

- an improved ***Extended Rate Lock*** (***ERL***) that combined previously existing products into one more flexible and less expensive option that enables borrowers to manage interest rate risk by locking the rate up to 12 months in advance of loan funding;
- expanded delegated authority for lenders to reduce the underwriting floors for 9- and 10-year loans subject to documented justification including exit strategy analyses supporting the refinance potential of the loans;
- the ***Extended Maturity Option*** (commonly called the "***9-1***") that provides flexibility in refinancing by allowing borrowers to repay the existing loan during the last year of its term;
- a new ***MultiRateMortgage*** product that offers the cost saving of a short-term variable rate for one or two years, a rate lock that provides the certainty of a fixed-rate execution for the remainder of the loan term, and the option to extend the term of the loan for up to one year beyond the end of initial maturity;
- improvements to the ***DUS ARM***, including new prepayment premium options and a new index, (12-Month Treasury Average), that increases more slowly than other existing indices in a rising rate environment; and,
- the ability to deliver actual/360 interest-only loans for cash purchase, providing an alternative to using a 30/360 accrual method.

In addition, Fannie Mae provided its first-ever credit enhancement for auction rate bonds, a significant milestone as it further diversifies the financing available for multifamily affordable housing.

Delegated Underwriting and Servicing (DUS™) remains Fannie Mae's principal product line for purchasing individual multifamily loans. Fannie Mae offers the *DUS* product line through approximately 26 lenders with expertise in financing multifamily properties. Under the DUS product line, underwriting is delegated to the DUS lenders enabling them to move quickly to arrange financing for borrowers. The vast majority of loans purchased through Fannie Mae's *DUS* lender network are secured by properties that are affordable to families earning at or below the median income in their area. For the year ending 2004, 90.5 percent of the *DUS* units acquired served low- and moderate-income families; 44.8 percent of *DUS* units were made in underserved markets; and 55.9 percent of *DUS* units addressed special affordable needs.

The federal **Low-Income Housing Tax Credits (LIHTC)** program is a means of directing private equity capital toward the creation of affordable rental housing. Investors receive the value of tax credits through leasing to qualified families at or below market rate rents. To date, Fannie Mae remains the largest LIHTC equity investor. Through the tax credit program, using both direct investments and investments in equity funds, Fannie Mae participated in the creation or preservation of 345,500 units of affordable rental housing over the life of the LIHTC program. In 2004, Fannie Mae committed over $1.7

billion in LIHTC equity to properties that resulted in 30,144 units of affordable rental housing. Below is a highlight of a multifamily property financed in 2004 with LIHTC.

- ***Little Pines II Apartments, Lac du Flambeau, Wisconsin.*** Little Pines II is a proposed 24-unit project that will consist of seven single-family homes, six duplexes, and one 5-plex building on approximately 17 acres within an established subdivision. The property has committed to rent 15 units to households earning less than 50 percent of the area median income and nine units to households earning less than 60 percent of median income. Based on this commitment, the property will target households earning less than or equal to $33,000. The proposed rental range is $469 to $571 per month. There is a significant need for affordable, quality housing in this area, demonstrated by the long waiting lists maintained by the Lac du Flambeau Band of Lake Superior Chippewa Indians.

Fannie Mae provides financing for small multifamily properties through a variety of sources including the ***MFlex® Loan Product***, the ***3MaxExpress™ Streamlined Mortgage Loan Product*** and other products. The *MFlex Loan Product* was established in 2000 to target lending partners that serve small property borrowers and significantly increase Fannie Mae's participation in the 5-50 unit property market. By 2004, Fannie Mae had seven *MFlex* lending partners. The *3MaxExpress Streamlined Mortgage Loan Product* was developed in 2001 to finance loans less than or equal to $3 million. This product offers flexible amortization, prepayment, and loan terms. In 2004, Fannie Mae provided $3.4 billion small loan financing, for 127,812 units. An example of a small multifamily loan project financed in 2004 is described below.

- ***Oakcrest Village Apartments, Casper, Wyoming.*** Oakcrest Village Apartments is a 26-unit independent living facility for the developmentally disabled. The community is managed by Northwest Community Action programs of Wyoming, which works to improve the lives of developmentally disabled and brain-injured clients in Casper. The total cost of the project was $1.2 million. Fannie Mae purchased the $768 thousand loan made by First Interstate Bank.

Fannie Mae also offers financing products for special-use properties such as senior's housing. This product helps property owners and operators refinance and acquire purpose built multifamily dwellings that include services for independent living, assisted living or assisted living with alzheimers care units. In 2004, Fannie Mae provided nearly $790 million to meet the financing needs of seniors seeking safe and affordable rental housing. A project highlight for 2004 is described below.

- **Bridgewood at Four Seasons, Vancouver, WA.** The Washington State Finance Housing Commission issued $9.8 million in variable rate tax-exempt bonds to support this housing complex for seniors. This financing was arranged by CW Capital and credit enhanced by Fannie Mae. This property consists of 124 total units, 52 independent living apartments and 72 affordable and market rate assisted living apartments. The Housing Commission demanded that the borrower set aside 35 percent of units for residents at 50 percent or below of the average median income. As a result, the borrower filled the affordable units with

Medicaid waiver residents. All of the waiver residents are assisted living residents.

VI. FANNIE MAE'S SELLER AND SERVICER NETWORK

Fannie Mae has selling and servicing contracts with over three thousand primary market lenders under which the company both purchases loans for its portfolio and issues MBS. Ten of those lender customers accounted for approximately 68 percent of the single-family loans purchased or exchanged for MBS in 2004.

Before approving a lender or other customer to become a seller or servicer, Fannie Mae requires that it meet certain standards, which includes satisfying to the company that the lender:

- has as one of its principal business purposes the origination, selling, and/or servicing of residential mortgages;
- has a proven ability to originate, sell, and/or service the type of mortgages for which the approval is being requested;
- employs a staff with adequate experience;
- is duly organized, validly existing, properly licensed (and in good standing), or otherwise authorized, to conduct its business in each of the jurisdictions in which it originates, sells, or services, residential mortgages;
- meets financial criteria and standards;
- has internal audit and management systems to evaluate and monitor the overall quality of its loan production and servicing activites; and
- is covered by a fidelity bond and errors and omissions insurance that meets Fannie Mae requirements.

Fannie Mae enters into a written mortgage selling and servicing contract with each approved seller and servicer. In this contract, the sellers and servicers agree to a number of obligations, including ongoing compliance with the provisions outlined above. Because Fannie Mae has no direct contact with consumers, lender partnerships are a key means of carrying out the company's business and mission objectives.

HCD Lender Alliances

To specifically increase affordable finance opportunities for low- and moderate- income families and support lender's CRA goals, Fannie Mae forges Housing and Community Development (HCD) lender alliances. In 2004, Fannie Mae executed 10 new HCD lender alliances, while continuing to manage 25 additional alliances. Lender commitments through these community lending alliances totaled $ 433 billion by year-end 2004 and is expected to be delivered by 2010. The HCD Lending Alliance tool menu offers lenders customized strategies that bring together products, technology, market outreach and analysis, bilingual marketing materials, diversity training and national partnerships that are appropriate for the lender's targeted markets. As a part of the alliance agreements, the lender and Fannie Mae also work together to identify opportunities to work with faith-based and other organizations that target immigrant communities, women-headed households, rural borrowers, and other underserved communities. HCD Lender alliances have grown since 1999 with 11 lenders renewing their alliance agreements with increased volume commitments.

In addition to large lenders, Fannie Mae's selling and servicing networks includes minority and women- owned lenders as well as smaller, community-oriented lenders. Fannie Mae sellers and servicers categorized as minority and women- owned are generally small banks that are either owned or controlled by individuals that are minorities or women. Community-oriented lenders include community development financial institutions (CDFIs), credit unions and small Fannie Mae sellers and servicers.[11] (For more information on this relationship see Section VII, page 32.) According to third quarter data, volume for 2004 from these lenders totaled $461.9 billion.[12] In 2004, Fannie Mae purchased a total of $4.9 billion in mortgages from minority and women-owned lenders. Of that total, $2.1 billion was purchased from sellers and servicers identified by Fannie Mae as women-owned lenders. Efforts to facilitate relationships with these lenders include forming national partnerships with housing advocacy groups, community-based groups and industry groups such as the National Bankers Association, a trade association for minority and women-owned banks. Fannie Mae also reaches out to these types of lenders through targeted efforts such as the *Faith-Based Initiative*. A sampling of the outreach Fannie Mae conducts to reach minority, women-owned and community-based lenders is provided below.

Community Development Financial Institutions (CDFI) Initiative

CDFIs are community-based financial institutions that support affordable housing development in underserved markets. The ***CDFI Initiative*** provides investment capital to help such institutions finance the development of affordable housing in neighborhoods traditionally underserved by the housing-finance industry, and aims to provide $150 million in capital to qualified local housing intermediaries by 2010. As part of this initiative, Fannie Mae invests in community banks, low-income designated credit unions, affordable housing lending consortia, and housing related nonprofits. In 2004, Fannie Mae invested $15.4 million in CDFIs, including 11 debt and equity equivalent loan transactions totaling $9.3 million, 32 deposit transactions totaling $4.65 million, and one Certificate of Deposit Account Registry Service (CDARS) deposit of $1.5 million. These 2004 new commitments are projected to generate over 2,400 units of affordable housing. As of the end of 2004, Fannie Mae had over $100 million in outstanding commitments to CDFIs. Examples of 2004 CDFI activity are provided below.

- In October of 2004, Fannie Mae provided a $3.5 million line of credit and a $500,000 equity equivalent loan to Boston Community Loan Fund (BCLF), a non-profit

[11] For the purposes of this AHAR, Fannie Mae is defining small lenders as a bank that has total assets of less than $250 million.

[12] Because final 2004 data was not available at the time of AHAR publication, Fannie Mae used third quarter data provided by lenders who reported assets less than or equal to $250 million for 2004.

organization with a mission to create affordable housing for low-income families in New England. BCLF is using the line of credit to make loans to developers for the predevelopment, acquisition, construction, and rehabilitation costs associated with affordable housing projects in low-income communities. The equity equivalent loan helped enhance BCLF's capital and liquidity position to enable the organization to raise additional lending capital from other funders.

- In October of 2004, Fannie Mae deposited $1.5 million in Bank2 (the Bank), a subsidiary of the Chickasaw Banc Holding Company that is 100 percent owned by the Chickasaw Nation. The Bank provides needed credit and financial services to the Native American market in the Oklahoma City metropolitan area and the 13 county jurisdictional area of the Chickasaw Nation in South Central Oklahoma City. The $1.5 million deposit, made as part of the Certificate of Deposit Account Registry System (CDARS), enables investors to provide larger deposits, while retaining FDIC insurance coverage, to community banks that are members of the CDARS network and helped the Bank expand its affordable housing lending efforts for low- and moderate-income and Native American individuals.

- In November 2004, Fannie Mae entered into a multi-faceted agreement with the **National Community Capital Association (NCCA)**. NCCA is a network of over 160 private sector CDFIs and provides financing, training, consulting, and advocacy to community development financial institutions. As part of the agreement with NCCA, Fannie Mae agreed to become a founding subscriber of NCCA's new CDFI Assessment and Rating System, which provides impact and financial performance scores on CDFIs.

The Faith-Based Initiative

Faith-based organizations play a pivotal role in local communities, especially minority communities. In some neighborhoods, faith-based organizations serve multiple roles, often providing the portal to a network of social services. In housing, faith-based organizations may function as developers or sellers of affordable housing, or in some cases, play both roles. American Finance House LARIBA (AFHL) is an example of a minority-owned lender participating in a Fannie Mae Faith-Based initiative. In 2004, the AFHL developed a mortgage product to comply with Islamic law and to serve consumers whose religious convictions prohibit the payment of interest to purchase a home. The program is offered in 29 states. As of December 2004, Fannie Mae purchased over $90 million in AFHL mortgages that served approximately 516 Muslim families.

Fannie Mae's outreach to minority-owned lenders is also conducted through partnerships as evidenced in the following examples:

- In 2004, Fannie Mae continued working with the **National Association of Real Estate Brokers** (NAREB) in a lending initiative with United International Mortgage, targeting minority borrowers for homeownership opportunities. Under this partnership, Fannie Mae purchased $31.4 million in loans that served 157 families throughout 2004. Since launching this initiative in 2003, Fannie Mae has made a total investment of $69 million, which created homeownership opportunities for 359 households. The NAREB and United International Mortgage lending initiative links NAREB members to affordable mortgage products and Fannie Mae's mortgage technology resources.

- In partnership with the **National Bankers Association (NBA)**, a trade association for minority and women-owned banks, Fannie Mae ensures access to secondary mortgage market products and services to support the expansion of business opportunities for NBA-member banks in order to increase homeownership opportunities for minority and underserved households. The volume of business from NBA members to Fannie Mae has increased each year since the partnership was launched in 2002. In 2004, Fannie Mae's investment in this partnership since 2002, totaled more than $1.5 billion and served more than 8,000 families nationwide. In addition to mortgage purchases, Fannie Mae has also invested in NBA members through the *CDFI Initiative*, as well as providing eBusiness solutions and other technical assistance to increase the lending capacity of NBA members, thereby reducing the costs associated with providing mortgage credit in neighborhoods which often have little or no access to financial services.

VII. FANNIE MAE WORKS WITH PARTNERS TO INCREASE AFFORDABLE HOUSING OPPORTUNITIES

Under the new goals of the *American Dream Commitment*, Fannie Mae has committed to building strong partnerships with lender customers and trusted advisors in the community to ensure the availability of responsible, affordable lending alternatives. In 2004, the company partnered with organizations such as, but not limited to: **AARP, The Enterprise Foundation, The Neighborhood Reinvestment Corporation, the National Urban League, The National Council of La Raza, ACORN Housing Corporation,** and the **American Federation of Labor-Congress of Industrial Organizations.** In 2004, Fannie Mae financed $2 billion of mortgages with these national partners, which resulted in 15,874 loans.

Fannie Mae also works with state, local, tribal and other units of governments. In some of these cases, the company's housing activities—the provision of affordable housing, rental opportunities and rehabilitation and the development of homeless strategies—align with a locality's housing affordability strategy as defined in the Cranston-Gonzalez National Affordable Housing Act.

As these organizations interface with borrowers, Fannie Mae's role as a housing partner is to provide affordable finance solutions, training opportunities and technology solutions such as *Home Counselor Online*.

Examples of some of these activities are highlighted in the following pages of this section.

- In February 2004, as part of the second phase of the company's *American Dream Commitment*, Fannie Mae announced a collaborative partnership with **AARP** to work on the toughest housing problems facing mid-life and older Americans. Over the course of five years, Fannie Mae, AARP, and other participating organizations will focus on making homeownership and rental housing a success for millions of families at risk of losing their homes. Through this collaboration, Fannie Mae and AARP agreed to work on policy and consumer information issues, rental housing production and preservation enhancements, livable communities strategies, and launching affordable mortgage solutions. As a first step in starting this policy discussion, in 2004, Fannie Mae published a policy paper that examined the link between housing and the health status for individuals aged 50 and older.

- In 2003, Fannie Mae formed its first affordable housing focused-alliance with a mortgage insurer, committing to purchase $50 billion in loans originated by participating lender partners. This three-year alliance with **PMI Mortgage Insurance Co.** known as the *Gateway to Homeownership in a New Century* includes goals that will: 1) assist lender partners in meeting the credit needs of their communities by enabling them to offer low down payment options with flexible credit guidelines for low- and moderate-income borrowers who have limited cash resources; 2) tackle the nation's toughest homeownership problems, including strengthening the commitment to PMI's *Gateway Cities* initiative; and 3) build on PMI's and Fannie Mae's joint affordable housing initiatives with community organizations such as **Habitat for Humanity**, the **Native American Indian Housing Council**, **National Council of La Raza** and others. Twenty months after the alliance began, deliveries have totaled nearly $36 billion. A 2004 highlight of Fannie Mae's activities under this partnership is described below:

  - PMI's *Gateway Cities* initiative is a $1 million initiative that provides revolving funds to underserved communities located in ten "gateway" cities and other locations across the United States. These initiatives are undertaken in partnership with nonprofit community development corporations to stabilize neighborhoods through the rehabilitation and/or new construction of homes for low- and moderate-income homebuyers. Since Fannie Mae began partnering with PMI Mortgage Insurance Co. in this effort, Gateway funds have been designated for the Pine Ridge Reservation, in South Dakota; to The Unity Council, in Oakland, California; to the Mission of Peace Counseling Agency, in Flint, Michigan, to the Acoma Pueblo tribe, in Sky City, New Mexico; to the Avenue CDC, in Houston, Texas; and to Hopeful Housing, in Wheeling, West Virginia. Since Fannie Mae began working with PMI on its *Gateway Cities* initiative, contributions have totaled $250,000.

- Through a four-year agreement with the **Neighborhood Reinvestment Corporation (NRC)** that was launched in 2000, Fannie Mae purchased in 2004, approximately $405.2 million in mortgages originated through their **NeighborWorks® Organizations** (**NWOs**). These 235 NWOs make up the NRC nation-wide network of affordable housing providers, and include over 80 NeighborWorks *"Home Ownership Centers"* throughout the United States. In addition, Fannie Mae developed a $2 million down payment assistant pilot with **Neighborhood Housing Services of America**, Neighborhood Reinvestment's secondary market outlet. The pilot is being launched in Santa Barbara and Ventura Counties. Through the four years of this initiative, Fannie Mae has purchased or securitized $1.87 billion in mortgages, made to 16,096 households.

- In 2004, $131 million was invested in affordable housing projects nationwide with the **Enterprise Foundation.** Fannie Mae's Low Income Tax Credit Investments through the **Enterprise Social Investment Corporation (ESIC)** totaled $135 million in 2004. Fannie Mae also closed 9 loans through Enterprise Mortgage Investments **(EMI),** a subsidiary of **ESIC**, for a total of $17.8 million. In 2004, Fannie Mae also issued forward commitments for 19 loans to **EMI** that totaled $54.5 million. Additionally, Fannie Mae approved a $20 million investment in the ESIC's Green Fund in 2004.

- The **National Training and Information Center (NTIC)** is a nonprofit resource center for grassroots community organizations based in Chicago. In partnership with Fannie Mae, NTIC is implementing an affordable housing initiative aimed at helping low- and moderate-income borrowers in eight areas with NTIC community group affiliates: the Bronx, Central Illinois, Chicago, Cincinnati, Cleveland, Des Moines, Pittsburgh, and Syracuse. One component of the partnership includes the development and implementation of the ***Low Down Payment Home Mortgage***, enhanced to include maximum LTVs ranging from 97 to 100 percent; borrower contribution requirements of only $500; and expanded credit flexibilities allowing a single ratio of 41 percent. The product is available through NTIC lender partners for borrowers purchasing single- and two-family homes, homes needing renovation, and homes with energy efficient mortgage features. Homebuyer education is a key component of the *Low Down Payment Home Mortgage*, and is provided by the NTIC community group affiliate or approved homebuyer education group acting on its behalf. Since the partnership began in 1997, Fannie Mae has purchased or securitized nearly $3.7 billion in loans from NTIC lender partners.

- For well over a decade, Fannie Mae and the **Association of Community Organizations for Reform Now (ACORN) Housing Corporation** have worked together to increase housing opportunities. Fannie Mae's partnership with ACORN includes the development of customized mortgage products and anti-predatory lending experiments. In addition, Fannie Mae invests in technology tools including *Home Counselor Online* that ACORN uses in its homebuyer education and counseling programs. In 2004, 905 loans were purchased through the ACORN initiative, for approximately $147.9 million.

- Fannie Mae's partnership with the **National Urban League (the League)** dates back to November 2000, when the two organizations announced a 5-year partnership agreement in which Fannie Mae committed to purchase at least $50 million in mortgages. The initiative, known as the *"Homeownership Demonstration Project"* has thus far resulted in more than $40 million in loans originated by lenders through League affiliates in Houston, Stamford, Rochester, Dallas, Seattle, and Atlanta. The League has 33 affiliates engaged in homeownership activities. Fannie Mae has provided grant funding to League affiliates to develop program implementation plans, provide program administration services, conduct marketing and outreach of the initiative, provide homebuyer education and financial counseling, and undertake capacity building and product training. Recent training efforts have focused on providing access for League affiliates to Fannie Mae's homeownership counseling software, *Home Counselor Online*. In 2004, Fannie Mae purchased $11.2 million in loans that were originated under this partnership.

- Fannie Mae has partnered with the **American Federation of Labor-Congress of Industrial Organizations (**AFL-CIO) through its Housing Investment Trust ("HIT") since 2001. Together, Fannie Mae and the AFL-CIO created two single-family housing initiatives that help union members purchase or refinance their homes. The *"HIT HOME"* initiative is the result of a national partnership with **Countrywide Home Loans** and **HomeStreet Bank** is the participating lender for the *"Homeownership Opportunity"* initiative (*HOI*) which is geographically targeted to union members in the states of Hawaii, Oregon and Washington. Many of the borrowers participating in both of these initiatives are historically underserved and include minorities and single parent households. To help union members bridge the gap to homeownership, Countrywide provides borrowers with the added benefits of a $500 coupon to be used toward closing costs and free home buyer education provided by bilingual loan experts. In 2004, Fannie Mae purchased $232 million worth of mortgages originated by Countrywide and HomeStreet, and since partnering with the AFL-CIO, Fannie Mae has invested $394.2 million in support of affordable housing mortgages for union members.

The Faith-Based Initiative

Faith-based organizations play a pivotal role in local communities, especially minority communities. The position of trusted advisor makes faith-based organizations effective housing partners for reaching underserved families. The *American Dream Commitment* includes a pledge to establish 250 Faith-Based Initiatives by 2009. To meet this goal, Fannie Mae partners with faith-based groups that operate as both developers and sellers of affordable housing and provides them with the tools, training, and resources needed to advance their community development efforts. Partner efforts also focus on increasing access to homeownership information and education. Since launching the initiative in 2002, Fannie Mae has established 134 faith-based partnerships and purchased over $190 million in mortgages originated by lender partners. In addition, 24,000 persons have received housing counseling and homebuyer's assistance from participating counseling agencies since the initiative began.

Section 8 for Homeownership Initiative

Fannie Mae supports national housing policy that encourages recipients of Section 8 rental housing assistance to apply their benefit toward achieving homeownership. Fannie Mae has had a ***Section 8 Homeownership Initiative*** since 2001 and Fannie Mae partners include lenders, Public Housing Authorities (PHAs) and community organizations and counseling agencies. Under the initiative, Section 8 recipients use their Section 8 voucher to help pay their mortgage. Since Fannie Mae started this initiative, 175 lenders are participating in Section 8 housing pilots. In 2004, Section 8 Housing Assistance Vouchers were added as an acceptable source of borrower income for *MyCommunityMortgage* loans in *DU*.

Native Americans Initiative

As part of the new goals under the *American Dream Commitment*, Fannie Mae has increased its investment to support tribal housing initiatives during this decade to at least $1.25 billion and will create ten new Tribal Strategic Initiatives to provide these communities with an array of financing tools. The company supports lending on fee-simple, federally restricted trust lands, and tribally restricted fee-simple lands, and works with conventional loans, as well as government-backed loan products of the U.S. Department of Housing and Urban Development and the U.S. Department of Agriculture's Rural Housing Service, to better serve the housing needs of Native Americans. In 2004, Fannie Mae invested $218.2 million in Native American lending.

Increasing the Supply of Permanent Supportive Housing for the Chronically Homeless

In 2004, Fannie Mae announced a number of new 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. These initiatives include: 1) the creation, in partnership with **Enterprise Social Investment Corporation** (**ESIC**) and the **National Equity Fund** (**NEF**), of two new Low-Income Housing Tax Credit funds to support projects for extremely low- income households, including supportive housing projects; 2) the funding of at least $25 million in new low-cost acquisition and predevelopment financing for supportive housing projects; 3) the funding of two $5 million corporate challenge grants, one to the National Alliance to End Homelessness to support research and development of public policies that will increase production of supportive housing and one to the Corporation for Supportive Housing to increase the capacity of nonprofit providers to develop supportive housing; and 4) support for local planning and implementation efforts.

Highlights of 2004 activities under this initiative are described below.

- Fannie Mae worked with ESIC and NEF to create two new $100 million LIHTC funds to help increase the supply of permanent supportive housing. One example of the impact of these funds is ***The Plaza Apartments***. In partnership with ESIC, **The Enterprise Foundation**, and the **San Francisco Redevelopment Agency**, this 106-unit Single Room Occupancy property will be constructed in San Francisco, California and will feature fully furnished units with kitchenettes and private bathrooms.

- In November 2004, Fannie Mae joined with national foundations and corporations to announce the creation of the *Partnership to End Long-Term Homelessness*. Participating organizations have committed more than $37 million to the **Corporation for Supportive Housing**, the **National Alliance to End Homelessness**, and other organizations working to end long-term homelessness.

- Fannie Mae supported state and local efforts to prevent and end homelessness in twelve communities last year. For example, in Atlanta, Georgia, Fannie Mae is working with a local homeless task force to meet the supportive housing needs of the Atlanta homeless community. In New York City, Fannie Mae funded a study to explore new housing models for homeless families and new financing mechanisms that would encourage the development of permanent supportive housing for homeless families who are transitioning from the New York City shelter system.

Local Partnerships

Fannie Mae seeks partners in cities, towns and states that will provide guidance and work with the company to bring housing opportunities to families across the country. Below are some examples of how these place-based efforts helped the company reach its affordable housing goals.

- In Chicago, Fannie Mae and the City of Chicago, the **Chicago Housing Authority,** the **Chicago Department of Housing,** the **Illinois Housing Development Authority,** and the developer **Draper and Kramer** are working together to produce mixed-income housing at **Lake Park Crescent**, a new development located in the North Kenwood-Oakland neighborhood at the former site of the Chicago Housing Authority's Lakefront Properties public housing development. The City of Chicago Department of Housing issued HOME funds and the Illinois Housing Development Authority issued Low Income Housing Tax Credits (LIHTCs). Fannie Mae through, **SunAmerica Affordable Housing**, a tax credit syndicator, committed $4.6 million in the property. Lake Park Crescent will have a total of 148 rental units.

- In January 2004, **Fannie Mae,** the **Tennessee Housing Development Agency (THDA), Lawler-Wood Group**, a developer, and the **City of Kingsport** completed renovations at **Maple Oak Apartments**, a rental community designed to provide safe, affordable housing for Kingsport seniors. Maple Oak is a 27-year-old, 175-unit development that received a $4.1 million renovation while maintaining affordability for low-income senior residents. The renovations were financed through the issuance of $4.1 million in tax-exempt bonds authorized by THDA and issued by the **Health, Educational and Housing Facilities Board of Sullivan County**. Fannie Mae purchased the $4.1 million in tax-exempt bonds. ARCS Commercial Mortgage provided permanent financing for Maple Oak. Through a *Section 8 Housing Assistance Plan* (HAP) contract with **HUD**, the units are reserved for people age 55 and older. One hundred forty units are reserved for residents earning at or below 60 percent of the area median income, and 35 units are reserved for residents earning at or below 50 percent of median income. Residents pay only 30 percent of their adjusted monthly income toward rent. The monthly rents will range from $360 to $400.

The American Communities Fund

The American Communities Fund® (ACF®) increases the supply of affordable rental and for-sale housing through short-term debt and equity investments and public finance bond purchases. By partnering with lenders, developers and public entities, ACF helps to revitalize communities, increase and preserve the supply of affordable housing, and provide housing for underserved markets. In 2004, ACF's investments and bond purchases totaled more than $7 billion. The following are examples of *ACF* activities.

- **Acquisition, Development, and Construction.** Working with lenders, Fannie Mae purchases participations in acquisition, development, and construction loans, mini-perm loans, and letters of credit for residential housing. In 2004, Fannie Mae partnered with lenders to develop affordable housing projects such as the one highlighted below.

    - In an effort to create more workforce housing—homes priced for and located where wage-earning families need them—Fannie Mae partnered with Fountain Homes and Whitney Community Development Corporation (CDC), a wholly owned subsidiary of the Whitney Holding Corporation to build 12 new single-family homes near jobs in the retail, commercial, and casino growth area of Gulfport, Mississippi. The Fountain Homes development is part of an $8 million participation agreement created between Fannie Mae and the Whitney CDC to expand the construction of affordable homes across the state.

- **Public Finance & Preservation.** To help further the development and preservation of affordable housing, Fannie Mae partners with public entities including state and local housing finance agencies. Some of the company's financing tools for these projects include term loans, revolving and non-revolving lines of credit, bridge loans and mortgage revenue and community development bonds. A 2004 example of a project developed through these partnerships is highlighted below.

    - The **Oregon Housing and Community Services Department (OHCSD)** has an $8 million revolving line of credit provided by Fannie Mae to fund affordable housing projects in the state of Oregon. The line of credit was originally funded in 2001, when OHCSD partnered with Fannie Mae to finance rental and homeownership units throughout the state. Over the last three years of this partnership, the OHCSD has drawn over $10 million from its line of credit to fund predevelopment loans. These projects have created affordable housing opportunities for low-income families, seniors, farm workers, people with disabilities, and victims recovering from domestic violence. Examples include **Roselyn Village**, a four-unit apartment building for families with a member in recovery and/or living with HIV/AIDS and **Pearl Block 14**, a 200-unit family development targeting those with incomes at or below 60 percent AMI.

- **Equity Investment.** Working with residential builders and developers, ACF provides direct equity or a single source of capital for single-family for-sale and multifamily developments.

    - In Miami's Historic Riverside District, which was once an economically depressed area with deteriorating, abandoned properties, Fannie Mae made an $11.5 million equity investment in Neo Vertika. This 443-unit affordable condominium complex, developed by Urban Renaissance Partners, a minority development company, is located in an empowerment and homeownership zone. The development of Neo Vertika is part of a larger initiative for the reawakening of the Little Havana and Riverside neighborhood. The average sales price of the units was $239,000, making them affordable to many first-time and minority homebuyers.

Continued Support for the Fannie Mae Foundation

Fannie Mae created the Fannie Mae Foundation in 1979 and provides all of its funding. The Foundation creates affordable homeownership and housing opportunities for low- and moderate-income families across the United States with a special commitment to improve the quality of life in its hometown of Washington, D.C. In 2004, the Fannie

Mae Foundation invested $33.8 million in grants and other support to housing partners, national intermediaries, and housing advocates working to produce and preserve affordable housing and homebuyer education. In 2004, Fannie Mae made no monetary contribution to the Fannie Mae Foundation.

CONCLUSION

The activities and initiatives described in this AHAR demonstrate how Fannie Mae met HUD's housing goals requirements in 2004:

- **53.4** percent of the units financed by Fannie Mae's eligible mortgage purchases served low- and moderate-income families;
- **33.5** percent of the units financed by Fannie Mae's eligible mortgage purchases were located in underserved communities;
- **23.6** percent of the units financed by Fannie Mae's eligible mortgage purchases served very low-income families and low-income families in low-income areas; and
- **$7.3** billion in Fannie Mae multifamily financing qualified under HUD's special affordable housing goal.

In 2005, the company will work harder to be a leader in the provision of affordable housing and rental housing opportunities by not only meeting mandated housing goals, but also by listening to and working alongside partners in the expanded *American Dream Commitment* and meeting President Bush's challenge to increase minority homeownership.