FannieMae®

2003 Annual Housing Activities Report (AHAR)

FANNIE MAE'S

2003 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

MARCH 15, 2004

FannieMae

Franklin D. Raines

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March 11, 2004

The Honorable Alphonso Jackson
Acting Secretary
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington, D.C. 20410-0001

Dear Mr. Secretary:

Fannie Mae is pleased to report that for the tenth consecutive year, we have met all of our affordable housing goals. As required by statute, 12 U.S.C. § 1723 a (n), Fannie Mae also submits to you its *2003 Annual Housing Activities Report (AHAR)*, which describes how Fannie Mae worked with its partners to bring the American Dream of affordable housing to low-income and underserved families across the country.

As we indicated to the Department of Housing and Urban Development (HUD) during the course of the last year, market and economic conditions in 2003 made it particularly challenging to meet the housing goals. As originations and refinances in the single family market reached record levels, Fannie Mae stepped up its efforts and dedicated substantial resources to financing affordable mortgages to successfully meet the housing goals.

HUD's 2000 Final Rule established the low- and moderate-income goal at 50 percent, the underserved goal at 31 percent, and the special affordable housing goal at 20 percent. Additionally, the multifamily special affordable housing goal requires a minimum financing requirement of $2.85 billion. In 2003, Fannie Mae surpassed each goal. Of the units financed by Fannie Mae, 51.8 percent were for low- and moderate-income households, 32.0 percent of the units financed by Fannie Mae served those living in underserved areas, and 20.9 percent of the units financed targeted those from low- and very low-income households, which HUD defines as special affordable. Fannie Mae also invested $11.62 billion in special affordable multifamily housing.

In addition to consistently surpassing the housing goals, in 2000, Fannie Mae launched a ten-year, $2 trillion *American Dream Commitment* designed to shrink homeownership gaps and strengthen communities by serving 18 million American families. Then, in 2002, Fannie Mae pledged $700 billion in private capital and other broad initiatives to support President George W. Bush's initiative to expand company financed a record $246 billion in loans to more than 1.64 million minority families, an 81 percent increase over 2002.

Meeting the housing goals and meeting our corporate commitments requires Fannie Mae to be the low-cost provider of consumer-friendly financing and to make that financing available in underserved communities across the nation – something we cannot do alone. We work closely with our partners in communities all across the country. Lenders, brokers, realtors, homebuilders, housing advocates, non-profits, local governments, HUD and many others help Fannie Mae provide low down payment mortgages, cutting-edge mortgage technology, and mainstream mortgage financing to low-income families.

The AHAR includes several tables that provide specific information about each goal and how Fannie Mae performed under the goals. The tables include dollar volumes, unit numbers and the number of mortgages related to owner-occupied and rental properties purchased by Fannie Mae. As in the past, we are forwarding under separate cover data cartridges relating to our mortgage purchases on single-family and multifamily housing units pursuant to 12 U.S.C. § 1723a (n).

By the end of the decade, we project that there will be 30 million more Americans, including immigrants and native-born. These new Americans will drive the housing market, creating 13 to 15 million new households and challenging companies like Fannie Mae and other organizations dedicated to housing to work together to develop innovative housing solutions that will meet the county's diverse needs. We are committed to meeting the demands of a growing nation. The housing goals, combined with our own corporate commitments to expand homeownership, embody that commitment, which will guide Fannie Mae over the next decade and ensure that minority and lower-income Americans are at the core of Fannie Mae's mission-driven business.

Very truly yours,

FDR/cs

Enclosure

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INTRODUCTION

The U.S. Department of Housing and Urban Development (HUD) is required by law[1] to establish three affordable housing goals for Fannie Mae and Freddie Mac: a low- and moderate-income goal, an underserved areas goal, and a special affordable housing goal. Since 1995, HUD has expressed these goals as a percentage of the dwelling units financed by Fannie Mae's mortgage purchases and securitizations.[2] 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. That rule remains in effect until HUD institutes a new regulation.

Fannie Mae's Charter Act requires the company to submit an Annual Housing Activities Report (AHAR) to the HUD Secretary. The report's content, per the Charter, is listed in Section 309(n) of the Act.[3] This document constitutes Fannie Mae's AHAR, in compliance with these requirements.

Section I describes Fannie Mae's 2003 performance in meeting its affordable housing goals. Section II is an overview of the various activities Fannie Mae undertook in 2003 to meet the affordable housing goals. Section III describes Fannie Mae's fair lending review, underwriting, and business practices. Lastly, Section IV discusses housing market trends and the actions Fannie Mae plans to undertake in 2004 to continue meeting HUD's affordable housing goals.

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.

[1] The Federal Housing Enterprise Financial Safety and Soundness Act of 1992 (the 1992 Act), 12 U.S.C. § 4561.

[2] See 24 C.F.R. §§ 81.2, 81.11-81.22, 81.63 (2002).

[3] 12 U.S.C. § 1723 a(n).

I. 2003 AFFORDABLE HOUSING GOALS RESULTS

In 2003, market and economic conditions, specifically record low interest rates and high mortgage originations and refinances, created a challenging environment for Fannie Mae to meet its mandated goals. Low interest rates helped many people purchase their first home and spurred record refinances in the single family market. However, the share of affordable mortgages originated last year was not as high as the share in non-high refinance years. At the same time, the multifamily market, which provides high affordability, had a smaller impact on goals achievement due to its relatively slower loan origination growth rates. These three factors: record single family originations, high refinance activity, and slower multifamily market volume challenged Fannie Mae's ability to achieve each of HUD's affordable housing goals in 2003. However, by year-end, due to extraordinary efforts, Fannie Mae met its housing goals for the tenth consecutive year.

A. Low- and Moderate-Income Housing[4]

As defined by HUD's regulations, low- and moderate-income families are those with incomes equal to, or less than, the median income in the area. Of the dwelling units Fannie Mae financed with eligible mortgage purchases in 2003, 51.8 percent served low- and moderate-income families. In meeting this goal, in a year of record originations, Fannie Mae served 4.5 million low- and moderate-income borrowers compared to 2.9 million in 2002.

B. Underserved Areas[5]

Fannie Mae's mortgage finance activities in central cities, rural areas and other underserved areas accounted for 32.0 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 2.8 million households in underserved areas during 2003. This marked a significant increase from 2002, when Fannie Mae served 1.8 million families living in underserved areas.

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[4] HUD has established the low- and moderate-income housing goal at 50 percent of the total number of dwelling units financed by eligible mortgage purchases annually. "Low income" means: (1) in the case of owner-occupied units, income not in excess of 80 percent of area median income; and (2) in the case of rental units, income not in excess of 80 percent of area median income depending on family size as determined by the Secretary. "Moderate income" means: (1) in the case of owner-occupied units, income not in excess of 100 percent of area median income; and (2) in the case of rental units, income not in excess of 100 percent of area median income depending on family size as determined by the Secretary.

[5] HUD has established the underserved areas housing goal at 31 percent of the total number of dwelling units financed by eligible mortgage purchases annually. By regulation, HUD has defined an "underserved area" to mean for (A) "central city" and other "underserved area," certain areas having (i) a median income at or below 120 percent of the median income of the metropolitan area and a minority population of 30 percent or greater; (ii) or a median income at or below 90 percent of median income of the metropolitan area; (B) for a "rural area," certain areas having (i) a median income at or below 120 percent of the greater of the State non-metropolitan median income or the nationwide non-metropolitan median income and a minority population of 30 percent or greater; (ii) or a median income at or below 95 percent of the greater of the State non-metropolitan median income or the nationwide non-metropolitan median income; and (C) certain Indian reservation or tribal lands as designated by HUD.

C. Special Affordable Housing[6]

Fannie Mae also met its requirements to provide financing for very low-income families and low-income families in low-income areas. Fannie Mae's special affordable mortgage finance activities accounted for 20.9 percent of the housing units it financed by eligible mortgage purchases in 2003. In addition, Fannie Mae provided $11.62 billion in multifamily financing that qualified under the special affordable housing goal, compared to $7.22 billion in 2002. HUD's regulations require that Fannie Mae provide a minimum of $2.85 billion in multifamily special affordable housing financing.

The following chart summarizes Fannie Mae's performance in achieving the affordable housing goals in 2003.

AFFORDABLE HOUSING GOALS AND RESULTS FOR 2003

GOAL SUMMARY	2003 GOAL	2003 RESULT
Low- and Moderate-Income Housing	50% of Eligible Units	51.8%
Underserved Areas	31% of Eligible Units	32.0%
Special Affordable Housing	20% of Eligible Units	20.9%
Special Affordable Housing -Multifamily*	$2.85 Billion Minimum	$11.62 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).

Fannie Mae's commitment to affordable housing and community development is not only demonstrated through achievement of its housing goals, but also through increased corporate allocation of human and capital resources. For example, in the period between 1994 and 2003, staff dedicated to affordable housing and community development increased from 295 to 633, a 114.6 percent increase. During the same period, Fannie Mae increased its annual administrative budget for affordable housing activities by 323 percent from $26.6 million in 1994 to $112.5 million in 2003. In the past ten years, Fannie Mae has dedicated more than $671.5 million in administrative costs to the company's affordable lending and community development activities.

[6] HUD has established the special affordable housing goal at 20 percent of the total number of dwelling units financed by eligible mortgage purchases annually. "Very low income" means: in the case of owner-occupied units, income not in excess of 60 percent of area median income; and in the case of rental units, income not in excess of 60 percent of the area median income depending on family size as determined by the Secretary. See footnote four for a definition of low income.

II. FANNIE MAE'S 2003 HOUSING ACTIVITIES

"[F]amily dreams and financial futures, the jobs and livelihoods of roofers, bricklayers and backhoe operators, the revenue base of public schools, the health, safety and commerce of communities—so much of what makes America great is riding on housing."
--- Franklin D. Raines, Chairman and Chief Executive Officer

The 21st century has featured a stellar performance by the housing industry. In 2001, housing helped alleviate the pains of an economic downturn; in 2002 it helped boost an economic recovery; and in 2003, the best year yet, it fueled a stronger economy as families experienced growing wealth in the form of increased home equity. The value of homeownership is not only material wealth, it is also the richness of community, family and the virtues of the "ownership society" described by President George W. Bush. It is, in effect, the realization of the American Dream. These ideals are what drive Fannie Mae to work with partners across the country to increase homeownership and affordable rental housing opportunities, especially for minority families who have historically lagged in homeownership rates and been less able to achieve the American Dream.

Cognizant of the need to shrink the homeownership gap for minority families, Fannie Mae launched a $2 trillion ***American Dream Commitment®*** in 2000. Three years later, against the backdrop of record volume for the housing industry, the homeownership gap remains too wide. In the words of Chairman Raines, "…the boom times for housing can be tough times for many families. In this instance, the rising tide doesn't necessarily lift all boats. We need to support policies that bridge the gap between the housing 'haves' and 'have-nots'."

To that end, the *American Dream Commitment* advances the following six-point plan:

- **Mortgage Consumer Rights Agenda,** to increase and support public advocacy to protect mortgage consumer rights.

- **National Minority Homeownership Initiative,** to fight mortgage discrimination and lead the market in all categories of minority lending.

- **Opportunity for All Strategy,** to address the unique housing needs of women-headed families, young people, new immigrants, seniors, urban and rural dwellers and other underserved groups.

- **America's Living Communities Plan,** to strengthen communities in inner cities and older suburban areas through new capital investments and expanded Partnership Offices.

- **eHomeownership™,** to provide lenders and consumers with new technologies that will lower the costs of mortgage financing.

- **Affordable Rental Housing Leadership Initiative,** to increase the supply of affordable rental housing.

In 2002, Fannie Mae went one step further in honoring the spirit of the *American Dream Commitment* by joining other Blueprint Partners to support the Bush Administration's minority homeownership agenda. This unique and historic initiative was based on President George W. Bush's challenge to the housing industry—both public and private sector entities—to increase the number of minority homeowners by at least 5.5 million before the end of the decade. In response, Fannie Mae developed 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 2003, Fannie Mae invested $382.9 billion to provide financing to 2.6 million minority families.

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 homebuyers. These funds are made available through two processes. The first is through Fannie Mae's purchases of mortgage loans directly from lenders. The second process is achieved by assembling pools of mortgages acquired from lenders and issuing Mortgage-Backed Securities (MBS), which lenders then hold or sell to investors. The company's charter authorizes these activities. The charter also requires that Fannie Mae meet three affordable housing goals set by HUD. In compliance with this mandate Fannie Mae financed 51.8 percent of dwelling units from eligible mortgage purchases to low- and moderate-income families, 20.9 percent of dwelling units from eligible mortgage purchases to very low-income families and low-income families in low-income areas, and 32.0 percent of dwelling units from eligible mortgage purchases in underserved areas. As mentioned above, Fannie Mae's leadership in meeting the needs of underserved families is also embodied in the *American Dream Commitment*.

And as these families search for the American Dream of homeownership, others—about one out of three American households or 34 million—seek affordable rental housing. Although some people rent because they cannot afford to have a home, 40 percent of renters simply prefer this option to homeownership. As the nation's largest source of financing for rental housing, Fannie Mae has demonstrated a deep commitment to the provision of rental housing opportunities. Over the past four years, while the multifamily market has grown by 42 percent, Fannie Mae's multifamily portfolio has grown by 100 percent. One of the largest areas of growth has been in small loan production, financing rental properties that house 5-50 families and providing a critical source of affordable rental housing. In 2003 alone, Fannie Mae financed $12.4 billion of small multifamily loans.

Through joint efforts with local and other partners, the use of cutting-edge technology, development of innovative products and financing, and strategic initiatives, Fannie Mae helps to ensure that the American Dream is delivered to families across the country.

A. Product Innovation and Development

Product development at Fannie Mae is focused on working with lenders to enhance current mortgage products through underwriting flexibilities to better meet their needs and the needs of the marketplace, improving processes for better execution, and working with lender partners on new initiatives that increase the availability of affordable housing mortgage credit. In that pursuit, Fannie Mae works to provide customization for individual lenders so that they have the tools to increase financing options for underserved families. During product development, Fannie Mae also consults industry partners, local nonprofits, consumer groups, mortgage insurance companies and advocacy groups. In 2003, Fannie Mae enhanced various product offerings and business processes to better meet the needs of first-time homebuyers, families with limited down payment funds, those with disabilities, people with blemished credit and families wanting to rehabilitate their homes.

Overcoming the Down Payment Barrier

According to research, the biggest obstacle to homeownership for most families is saving the necessary funds for a down payment and closing costs. In fact, many potential homeowners erroneously believe they need to save as much as 20 percent of the sales price for the down payment. To address this concern, Fannie Mae worked with lender partners and modified underwriting standards to create a suite of low down payment mortgages, such as the ***Flexible*** mortgage product line, that assists borrowers who have minimal funds for a down payment and closing costs. With these loans, the borrower is permitted to obtain funds for the down payment and closing costs from various sources. Flexible sources include gifts from a relative, domestic partner, fiancée or fiancé; grants from an employer, public agency, and nonprofit organization; and unsecured loans from a relative, domestic partner, fiancée or fiancé, employer, and nonprofit organization. (For information on more Fannie Mae low down payment products, see ***MyCommunityMortgage™*** on pages 8-9.)

- The ***Flexible*** mortgage product suite includes the ***Flexible 97® mortgage*** and the ***Flexible 100™ mortgage.*** With *Flexible 100* mortgages, borrowers have the option of either making a minimum contribution of 3 percent (of the lesser of the sales price or appraised value) from approved flexible sources or making a minimum contribution of $500 from their own funds. With *Flexible 97* mortgages, the three percent down payment may come from flexible sources of 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 monthly payments for the first 5, 7, or 10 years, after which the interest rate adjusts annually.) In 2003, Fannie Mae purchased $13.7 billion in *Flexible* loans that benefited 100,886 households.

- In 2003, Fannie Mae continued to provide lenders with mortgage solutions that helped more individuals become homeowners. With the implementation of ***Desktop Underwriter® (DU™) Version 5.3.1,*** Fannie Mae offered an enhancement to the

Flexible 100™ mortgage by allowing borrowers the option of contributing a minimum of $500 from their own funds to the transaction. The remaining funds to close the loan can come from the flexible sources identified earlier or from interested party contributions. Borrowers can now choose between the new $500 contribution or the previously offered three percent contribution (that is, three percent of the lesser of the sales price or appraised value) all of which can come from flexible sources. The *Flexible 100* mortgage, including the $500 contribution option is also available for loans that receive an ***Expanded Approval™*** recommendation. (For more details on *DU Version 5.3.1*, see Section B: Harnessing Technology.)

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 Payments Rewards*** ® (***EA/TPR™)*** initiative provides lower cost financing for borrowers with blemished credit histories.

- With *Expanded Approval*, borrowers may secure a mortgage rate that may be significantly lower than non-traditional financing. *Expanded Approval* can also be combined with the *Timely Payment Rewards* 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. The *EA/TPR* option can result in an overall savings to the borrower of as much as three percent. And with certain 5-, 7-, and 10-year ARM Plans that are available with *Expanded Approval*, the borrower can have lower payments for the first 5, 7, or 10 years after which time the interest rate adjusts annually. In 2003, Fannie Mae purchased $24.8 billion in *Expanded Approval* loans to help 182,949 homebuyers lower the cost of home financing. In the same period, Fannie Mae purchased $1.9 billion of loans using the *TPR* feature enabling 14,661 additional homebuyers to benefit from further interest savings. Total *EA/TPR* volume for Fannie Mae in 2003 closed at $26.7 billion.

Helping Lenders Increase Affordable Housing and Reach CRA Goals

Fannie Mae's products not only increase homeownership opportunities for underserved families, they also help lenders meet their obligations under the Community Reinvestment Act (CRA). As part of the *American Dream Commitment*, Fannie Mae has committed to investing $20 billion in CRA-targeted business, and funding $530 billion in CRA-eligible investments. A major business driver for Fannie Mae's CRA business is *Housing and Community Development Lender Partnerships*, which offer significant housing and community lending resources to help lenders reach their CRA and other affordable housing goals. (For a more detailed description of these partnerships, see Section C: Lender Partnerships Focus on Minority Markets.)

Fannie Mae provides a source of liquidity for CRA targeted loans in any interest rate environment to help lenders leverage more CRA lending. A cornerstone of Fannie Mae's CRA business strategy is the ***MyCommunityMortgage***™. Introduced in October 2000, *MyCommunityMortgage* offers a comprehensive menu of product options designed to break down barriers, lower costs, and increase access to homeownership for low- and moderate-income families, including minorities, immigrants, first-time homebuyers, and underserved borrowers living in rural areas. In 2003, Fannie Mae purchased or securitized more than $2.27 billion of *MyCommunityMortgage* products. This finance activity helped provide affordable housing solutions for 20,400 households.

In 2003, Fannie Mae enhanced the *MyCommunityMortgage* to help lenders further expand affordable financing to underserved families.

- To help serve the needs of America's increasingly diverse population, Fannie Mae introduced several new credit and income flexibilities for *MyCommunityMortgage* borrowers purchasing single family homes, including: (1) expanded income sources that allow the homebuyer to count rental payments from boarders as income, even if the boarders are not related to the buyer; (2) more flexible income guidelines that allow a co-borrower, even without an established credit history, to count a portion of his or her income to qualify for the loan, as long as the primary borrower meets the minimum requirements; and (3) more flexible credit guidelines for homebuyers with nontraditional credit histories.[7]

- ***Community HomeChoice***™ replaces Fannie Mae's HomeChoice product and offers more flexible requirements to meet the unique needs of people with disabilities including as little as a 3 percent down payment and an income of up to 115 percent of the average median income of a given area. In addition, borrowers using the *Community HomeChoice* product can use gifts or grants to assist with the down payment, with only $500 required to come from the borrower's own funds. 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 2003, Fannie Mae invested $16 million in the *Community HomeChoice* product which benefited 193 families.

- Through its efforts to make the purchase of 2-4 unit homes more affordable for first-time homebuyers, Fannie Mae purchased over $1.7 billion of higher LTV, 2-4 unit business in 2003. These efforts included offering more flexible underwriting and credit history parameters under regional experiments, as well as developing lender partnerships which resulted in a variety of underwriting pilots and experiments targeted at serving the needs of first-time homebuyers. Under one of these initiatives—the ***Community 2-4 Family***™ pilot—a borrower's down payment can be as little as 3 percent for two-family homes or 5 percent for three- to four-family homes. Borrowers are also allowed to add a higher percentage of rental income to total borrower income in order to qualify for a mortgage. In 2003, Fannie Mae purchased approximately $25 million in loans under this pilot, which was launched in several markets, including: Newark, New Jersey; Milwaukee, Wisconsin; and the states of Connecticut and Rhode Island.

[7] Credit evaluation has been streamlined, now requiring only three lines of nontraditional credit sources, instead of the four different sources previously required in most cases.

- Home improvement and housing preservation can be costly, especially for borrowers with limited finances. Yet, many first-time homebuyers and minority families purchase homes in need of repairs because they are more affordable. To help minimize renovation costs and keep these families in their homes, Fannie Mae announced the ***Community Renovation™ 1-4 Family Pilot***. The pilot allows borrowers to purchase a home and make moderate home renovations such as updating kitchens and bathrooms, in a single mortgage. For lenders and community leaders, the product also offers an effective community revitalization tool in areas with aging single family and 2-4 unit housing stock. In 2003, Fannie Mae purchased over $10 million in *Community Renovation* loans from lender partners.

- In 2003, *MyCommunityMortgage* was added to the list of Community Lending products underwritten by Fannie Mae's automated system, *DU*. By making this product available in *DU*, both borrowers and lenders can benefit from the advantages inherent with *DU*-processed loans. (For a more detailed description of the benefits of automated underwriting, see Section B: Harnessing Technology.)

Targeted Product Development

To be fully responsive to the needs of a diverse country, Fannie Mae develops products specifically geared toward populations with unique needs such as seniors, Native Americans and families living near public transit routes. This effort is in addition to underwriting flexibilities designed for national partnership organizations discussed later in this report.

Examples of targeted product development include the following:

- Fannie Mae is a major 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 2003, Fannie Mae purchased 27,644 HECMs for a total value of $1.87 billion. The company has historically committed to providing the 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, the company annually convenes a Customer Advisory Group made up of sellers and servicers in the reverse mortgage industry to discuss key issues. In addition, Fannie Mae belongs to the National Reverse Mortgage Lenders Association, serves on AARP's Reverse Mortgage Counseling Advisory Board, and serves on the National Council On Aging's Research Advisory group examining the use of reverse mortgages to fund long-term care.

- With Fannie Mae's ***PaymentPower™*** mortgage, borrowers with strong credit can skip their regularly scheduled monthly mortgage payment up to two times during a twelve-month period, and up to ten times during the life of the loan. *PaymentPower* provides a cash-flow management tool not widely available in the marketplace and helps meet the needs of seasonal workers such as teachers, contractors, resort area business owners and self-employed borrowers with inconsistent income streams. First-time homebuyers also benefit from this feature as a means of mitigating unanticipated costs associated with homeownership. Borrowers decide when and why to skip payments, without any concern of late fees or adverse impact on their credit rating. *PaymentPower* was launched as a pilot in July 2002 with 10 lenders. By year-end 2003, Fannie Mae purchased 963 *PaymentPower* mortgages that totaled $126 million.

- In partnership with the Navajo Nation and local housing providers, Fannie Mae joined in the ***Navajo Community Guaranty Initiative*** to provide $3 million in home financing that will help 60 families currently living on a reservation. The initiative, announced in 2003, features an innovative Fannie Mae product that allows Navajo families to contribute a minimum of $500 or 1 percent of the purchase price, whichever is lower. The product was developed through a Memorandum of Understanding (MOU) between the Navajo Nation and Fannie Mae that, among other provisions, specified customized mortgage financing documents designed by Fannie Mae and recognized the exclusive jurisdiction of the Courts of the Navajo Nation to address matters involving the MOU and the mortgages. The agreement, first signed in 1996, was the first of its kind in the nation and made flexible mortgage products featuring lower down payments and no income restrictions available to families living on the reservation. (For a broader description of Fannie Mae's Native American Partnerships, see Section C: Targeted Initiatives.)

- The ***Smart Commute***™ ***Initiative*** was first piloted in 2001 in the seven county Minneapolis-St. Paul metropolitan area and targeted to borrowers purchasing homes near a public transit route. Recognizing that a homebuyer will save on commuting expenses and therefore have more disposable income to pay housing expenses, this product gives borrowers more purchasing power. In 2002, the product was launched in Pittsburgh and Philadelphia, Pennsylvania; Salt Lake City, Utah; and Burlington, Vermont. In 2003 Fannie Mae purchased approximately $5 million in *Smart Commute* loans from these pilots and launched 11 additional pilots across the country.

B. Harnessing Technology

Fannie Mae's *eHomeownership* strategy, a component of the *American Dream Commitment*, seeks to use state-of-the-art, e-commerce strategies to help lenders lower costs and break down the barriers to homeownership and affordable rental housing opportunities.

At the center of Fannie Mae's technology solutions are ***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 by helping lenders make an informed and unbiased decision about the relative credit risk of a mortgage. *DU* 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 to lenders on loans receiving certain *DU* recommendations. This waiver can remove repurchase risk for lenders in certain instances, thereby encouraging them to make mortgages to low- and moderate-income borrowers, and other borrowers that otherwise may not be served. *DO*, used in concert with *DU*, allows wholesale lenders to extend the benefits of *DU* to their sponsored mortgage brokers.

According to Fannie Mae's *2003 Mortgage Focus* study, an origination benchmarking study, the production cost per loan decreased significantly as lenders moved automated underwriting closer to the point of sale. For example, retail lenders using an integrated automated underwriting system at the point of sale have reported origination costs that are more than $1,000 less than those using manual underwriting. In 2003, 14.8 million loans were processed through *DO* and *DU*.

In February 2003, Fannie Mae introduced a number of enhancements to the visual design and functionality for *DO* and *DU*. These enhancements simplified the data entry and loan submission process in *DO* and *DU*. In addition, the wholesale lender view originally in *DO* was merged into *DU*. This consolidation makes it easier for wholesale lenders to manage their entire pipeline (retail and wholesale) through one application. Finally, the *Help Center* for *DO* and *DU* also debuted. Accessible from any page within *DO* or *DU*, the *Help Center*, a Web-based support tool, provides quick and easy access to a database of help information as well as the "Chat with an Expert" feature which instantly connects users to a Customer Service Representative online.

Additional enhancements in *DU* in 2003 are described below.

- ***Desktop Underwriter® 5.3*** outlined new eligibility requirements for mortgages secured by manufactured homes. It also expanded the ***InterestFirst*™** mortgage product line, thereby offering borrowers greater purchasing power by allowing lower initial monthly payments than those available with traditional loan products. For lenders, *DU 5.3* enhanced data integrity through a new functionality that assisted lenders in verifying the accuracy of Social Security numbers.

- ***Desktop Underwriter® 5.3.1*** enhanced the *Flexible 100* mortgage to allow borrowers to contribute as little as $500 of their own funds to the transaction. The remainder of the funds can come from flexible sources of funds[8] and interested party contributions subject to Fannie Mae's standard contribution limit. These contribution options are designed for borrowers who have minimal funds for a down payment and closing costs. *DU's* functionality was further enhanced to allow lenders the ability to underwrite *MyCommunityMortgage* loans with *DU*, thereby improving efficiency and affordability for this product. The online loan application was also revised to help lenders collect additional borrower-related information required by the Federal Reserve System's Regulation C - Home Mortgage Disclosure Act (HMDA) and

[8] Flexible sources include gifts from a relative, domestic partner, fiancée or fiancé; grants from an employer, public agency, and nonprofit organization; and unsecured loans from a relative, domestic partner, fiancée or fiancé, employers, and nonprofit organizations.

information required under the USA Patriot Act, in addition to the new data fields for *DU* enhancements.

Fannie Mae's technology solutions not only streamline the lender origination process and reduce originating costs as illustrated by *DU* and *DO*, they also expand markets and open new channels of distribution by allowing lenders (who otherwise may not have the infrastructure or ability) to reach into small, rural areas or diverse markets. The examples below demonstrate how, in partnership with mortgage originators, Fannie Mae delivers more consumer choices and affordable products to borrowers regardless of where they live.

- Fannie Mae has worked closely with HUD over the last several years to deploy FHA solutions. For example: the ***FHA TOTAL Scorecard*** was developed by HUD to evaluate the credit risk of FHA loans submitted to an automated underwriting system such as *DU*. 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 2003, Fannie Mae conducted a market test of the *Scorecard* with 18 FHA approved *DU* lenders. HUD published an Interim Rule on November 21, 2003, announcing their plans to deploy the *Scorecard* to all approved FHA lenders. Over 3,000 loans were submitted by *DU* to the *Total Scorecard* through *DU* during the market test period.

- In order to help community banks better meet the needs of their customers and gain access to tools to help them compete in today's marketplace, Fannie Mae introduced ***HomeTown Mortgage Suite*** to small to medium sized depositories. Through a partnership announced in 2003 with the **America's Community Bankers** (**ACB**) association, ACB members using the *HomeTown Mortgage Suite* now offer their borrowers an online presence. This allows smaller banks to compete in ways they have not been able to before.

- Working with **BET.com**, **Univision.com**, **Century 21 Mortgage** and **Countrywide Home Loans**, Fannie Mae is increasing homeownership opportunities for African Americans and Hispanics via the World Wide Web. The *Owning a Home* channel on BET.com, with lender partner Century 21 Mortgage, offers African Americans the information and tools they need to participate in the home buying process. Similarly, the *Casa* channel on Univision.com, sponsored with lender partner Countrywide Home Loans, is a resource for Hispanics who prefer to learn about the home buying process in Spanish. Each lender provides consumers with the ability to apply for a home loan online, through their call centers or by visiting a branch office. Fannie Mae provides the technology that helps power these sites. More than 2 million users visited *Owning a Home* and *Casa* in 2003.

In addition, Fannie Mae continues to offer other tools and applications such as the examples listed below.

- ***Home Counselor Online™*** (*HCO*), a free Web-based tool, is designed for homeowner educators and other trusted advisors who work with low- to moderate-income, minority and credit-impaired borrowers that are preparing for homeownership. In 2003, Fannie Mae enhanced *HCO* to provide special consumer features and data conversion utilities that allow for more efficient case processing for counselors and compatibility with HUD counseling agency reporting requirements. In 2003, 641 counselors representing over 2,000 organizations used *HCO*.

- The ***True Cost Calculator 2.0®*** is designed to help homebuyers make informed home purchase decisions by helping them compare loan products and prices. The goal of the *True Cost Calculator* is to ensure that a consumer is aware of all the costs associated with getting a mortgage, including interest rates and points, mortgage insurance and title insurance costs, appraisal fees and more. Over 60 Fannie Mae partners offer the *True Cost Calculator* through their web sites and a Spanish version is available on www.univision.com. The *True Cost Calculator* is available free of charge.

C. Forging National Partnerships, Faith-Based and Community Initiatives

National Partnerships

Fannie Mae believes that in order to have the broadest possible impact on addressing the nation's housing needs the company must establish partnerships with organizations that serve constituents nationwide. In so doing, Fannie Mae has established multi-year partnerships to increase affordable housing opportunities with organizations such as: **The Enterprise Foundation, The Neighborhood Reinvestment Corporation, the National Urban League, The National Council of La Raza, ACORN Housing Corporation, the National Training & Information Center, the National Association of Real Estate Brokers, The McAuley Institute, the Congressional Black Caucus Foundation**, and many others engaged in promoting affordable housing.

Through these partnerships, Fannie Mae supports efforts that target underserved families and minorities by providing access to Fannie Mae products such as *MyCommunity Mortgage* and *Expanded Approval*, and aligning partners with lenders, training, Fannie Mae technology such as *Home Counselor Online*, and other resources. In 2003, Fannie Mae financed $1.3 billion of mortgages with these national partners and participating lenders, which resulted in 9,597 loans. Below are examples of some of these partnerships in action.

- The **National Training and Information Center (NTIC)**, a nonprofit resource center for grassroots community organizations based in Chicago, and Fannie Mae continue to partner on an affordable housing initiative aimed at helping low- and moderate-income borrowers in six cities with NTIC community group affiliates in the Bronx, Chicago, Cincinnati, Des Moines, Pittsburgh, and Syracuse. One component of the partnership includes the development and implementation of an underwriting experiment, the ***Low Down Payment Home Mortgage***, that the partnership team enhanced to include maximum LTVs ranging from 97 to 100 percent; borrower contribution requirements from 1 percent to as little as $500; and credit flexibilities allowing 33/41 expense to income ratios. The experiment is available for borrowers purchasing single- and two-family homes, homes needing renovation, and homes with energy efficient mortgage features. Homebuyer education is an integral 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. In 2003, the *Low Down Payment Home Mortgage* was introduced to low- and moderate-income borrowers in Cleveland and Central Illinois. Since the partnership began in 1997, Fannie Mae has purchased or securitized more than $3 billion in loans from NTIC lender partners.

- The **National Urban League (NUL)** has 33 affiliates that are actively engaged in homeownership activities. In 2001, Fannie Mae committed to purchase $50 million in loans originated through this partnership over five years. Since November 2000, Fannie Mae has worked closely with the NUL and **JP Morgan Chase Bank** to increase homeownership among minorities. Approximately $6 million in loans were originated in 2003 through this initiative.

- To create one million new African American homeowners by 2005, Fannie Mae joined forces with the **Congressional Black Caucus Foundation** (**CBCF**), a consortium of lenders and nonprofit organizations. Together these partners launched the **WOW (With Ownership Wealth)** initiative which targets congressional districts with high minority populations. Participating lenders include **Chase Manhattan Mortgage**, **Cendant**, **CitiMortgage**, **Countrywide**, **Fleet Bank**, **Irwin Mortgage**, **Wells Fargo** and **Washington Mutual**. WOW also includes industry representation from groups such as realtors and mortgage insurance companies.

- Since February 1993, Fannie Mae and the **Association of Community Organizations for Reform Now (ACORN) Housing Corporation** have worked together to increase housing opportunities. ACORN is one of the largest community organizations in the country dedicated to the cause of low-income Americans. Fannie Mae's partnership with ACORN includes the development of customized products and anti-predatory lending experiments and the provision of tools for their use in homebuyer education and counseling, including technology such as *Home Counselor Online*. In July 2000, Fannie Mae committed to invest $50 million over three years to meet the goals of this partnership. In 2003, loans purchased through the ACORN initiative totaled approximately $51 million.

- Through a four-year agreement with the **Neighborhood Reinvestment Corporation (NRC)** signed in December 2000, Fannie Mae committed to purchase up to $250 million in mortgages originated with the assistance of NRC's 225 **NeighborWorks® Organizations** (**NWOs**), including 70 NeighborWorks HomeOwnership Centers throughout the United States. These organizations provide "one-stop" access to all of the services potential and current homeowners need to purchase, rehabilitate, or insure their homes. Fannie Mae will also invest up to $10 million in NRC's community development activities through other internal Fannie Mae investment vehicles, including Fannie Mae's ***American Communities Fund® (ACF)*** and ***Community Development Financial Institutions (CDFI)***.[9] Since launching the partnership, Fannie Mae has purchased $1.5 billion in loans originated with the assistance of NRC to serve 12,925 homeowners. In 2003, Fannie Mae purchased $784.7 million in mortgages through the NRC partnership.

- Fannie Mae announced a five-year commitment with the **Enterprise Foundation** in September 2002. The Enterprise Foundation works through a network of more than 1,200 community-based nonprofit organizations in over 400 locations across the country. As part of this commitment, Fannie Mae pledged to invest $1.5 billion in affordable housing projects nationwide. Fannie Mae is committed to providing up to $100 million in debt and equity financing for community development and revitalization projects through the Fannie Mae *ACF*. Fannie Mae is also committed to investing in up to $1 billion in Low-income Housing Tax Credits managed by the **Enterprise Social Investment Corporation (ESIC)**—a subsidiary of the Enterprise Foundation. Through 2003, Fannie Mae committed $154 million toward this initiative. Fannie Mae is also committed to investing $400 million or more in permanent financing through the **Enterprise Mortgage Investments (EMI)**—another Enterprise Foundation subsidiary to purchase mortgages on affordable multifamily housing projects.

- The **McAuley Institute** is a national, nonprofit housing organization founded by the Sisters of Mercy. The McAuley Institute provides state-of-the-art technical assistance and financial resources to grassroots organizations that work to expand housing and economic opportunities for low-income women and their families. Since 2001, McAuley has been the lead Fannie Mae partner in the **Women-Headed Household Initiative** that was launched in locations across the country: Washington, DC; Pittsburgh, Pennsylvania; Chicago, Illinois; Kansas City, Missouri and Kansas City, Kansas; Los Angeles California; Houston, Texas; and the States of Tennessee and New Jersey. In partnership with various lenders, as of 2003, over $1 million in mortgages have been originated through this initiative. Fannie Mae is committed to purchasing $50 million in mortgages through this initiative over five years.

- In 2003, Fannie Mae partnered with the **AFL-CIO Housing Investment Trust** and **Countrywide Home Loans** to increase homeownership opportunities for 13 million union members in 35 cities across the country. Through the **HIT HOME** initiative, mortgages such as the ***Working Mortgage,™ Flexible 97,™*** and ***Community Solutions™*** are available to union members. In addition, for those union members who purchase homes, the initiative will cover the cost of appraisals and credit reports. Also, since 1997, Fannie Mae has supported another initiative of the AFL-CIO Housing Investment Fund—the **Homeownership Opportunity Initiative (HOI)**.

[9] The *American Communities Fund* (*ACF*) offers debt and equity investment financing. For a more detailed description of ACF, see page 25. Community Development Financial Institutions (CDFI) provide investment capital to help financial intermediaries finance the development of affordable housing in neighborhoods traditionally underserved by the housing finance industry. For a more detailed description of CDFIs, see page 24.

HomeStreet Bank offers this initiative in Hawaii; Portland, Oregon; and Seattle, Washington. HOI offers a customized 30-year 1/4-point interest rate buy-down for union members in these states. In 2003, over $132 million worth of mortgages were originated through this partnership.

- In partnership with the **National Bankers Association (NBA)**, the only minority bank trade association, Fannie Mae is providing secondary mortgage market products and services to support NBA members. Current activities include investing with NBA members through Fannie Mae's ***CDFI Initiative***, providing technology solutions and other technical assistance to increase lending capacity, thereby reducing the costs associated with providing mortgage credit. In 2003, Fannie Mae purchased 1,479 loans from NBA banks for a total investment of $188.6 million.

- Fannie Mae is working with the **National Association of Real Estate Brokers** (**NAREB**) in a lending experiment with **United International Mortgage**, targeting minority borrowers for homeownership opportunities. The NAREB/United model links NAREB members to affordable mortgage products and Fannie Mae's technology solutions. In 2003, Fannie Mae's investment in this partnership totaled $37.6 million and served 244 families.

Lender Partnerships Focus on Minority Markets

When Fannie Mae announced the *American Dream Commitment* in 2000, the company vowed to lead the market in lending to minority families as part of its National Minority Homeownership Initiative. In that pursuit, the company announced a $420 billion pledge to serve more than 3 million minority families. When President Bush called for a bold new minority homeownership strategy in 2002, Fannie Mae increased its capital commitment by 66 percent to $700 billion to serve 4.6 million families over the decade. As part of this strategy, Fannie Mae continues to hone its Housing and Community Development (HCD) lender partnerships to ensure a comprehensive business approach to increasing CRA, affordable and underserved housing lending, with a focus on increasing minority homeownership. In 2003, Fannie Mae executed 17 new HCD lender partnerships which seek to provide $394 billion in affordable housing lending to minority families. The following examples highlight 2003 partnerships.

- After completing a five-year $12 billion initiative—two years ahead of schedule, **Citigroup**, through its home mortgage lending business, **CitiMortgage**, and Fannie Mae, announced a new $100 billion affordable lending alliance. As many as one million low- and moderate-income households throughout the nation will benefit from this partnership, which will provide affordable mortgage financing through the end of the decade. This initiative targets families with incomes at or below the median level for their communities, including minorities, new immigrants, residents of central cities and other underserved areas, and people with disabilities and other special housing needs. Under the 2003 partnership, affordable homeownership lending products including ***MyCommunityMortgage***, and ***Expanded Approval/Timely Payment Rewards (EA/TPR)*** will be offered nationally through all

CitiMortgage affiliates and their business partners. Fannie Mae has pledged to purchase all of the eligible loans originated by CitiMortgage and its housing partners.

- In November 2003, Fannie Mae joined **PMI Mortgage Insurance Co.** to announce a landmark $50 billion community lending alliance through the end of 2006. The alliance, *Gateway to Homeownership in a New Century*, is the first of its kind between a mortgage insurance company and a secondary mortgage market company. The alliance focuses on three key strategies: (1) assisting 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) tackling the nation's toughest homeownership problems, including a strengthened commitment to PMI's Gateway Cities initiative to provide mortgage products to Native Americans and people with disabilities; and (3) building on PMI and Fannie Mae's joint affordable housing initiatives with community organizations and lenders.

The Faith-Based Initiative

Over the years faith-based organizations have taken on a larger role in helping build and sustain their communities. For example, according to a 1998 poll by the National Congress for Community Economic Development (NCCED), 14 percent of all community development corporations across the country identify themselves as "faith-based." Today, faith-based organizations are growing in numbers and in membership, and many of them are deeply involved in a wide range of activities such as social services delivery and community development. Given their focus on local communities, faith-based organizations are an effective partner for creating housing solutions, particularly for underserved and minority communities. Under the *American Dream Commitment*, Fannie Mae has committed to establishing 250 faith-based homeownership partnerships in communities across the country by the end of the current decade. Fannie Mae's work under the ***Faith-Based Initiative*** in 2003 resulted in $125 million in mortgage financing to underserved families across the country.

The objectives of Fannie Mae's *Faith-Based Initiative* are to build strong partnerships with national faith-based organizations in order to reach potential new homeowners, work with faith-based and nonprofit partners to help increase access to homeownership information and education, partner with lenders to increase access to mortgage financing, and provide faith-based organizations with the tools, training, and resources needed to advance their community development efforts. In working to advance this agenda in 2003, Fannie Mae achieved the following milestones.

- Fannie Mae supported the efforts of the **White House** and **HUD's Center for Faith-Based Initiatives** to expand faith-based organizations. Fannie Mae staff, along with HUD field representatives, attended over 12 *Faith-Based Symposiums* and provided training and other technical assistance to over 2,000 symposium attendees.

- Fannie Mae developed *Faith-Based Initiative* marketing kits and distributed over 32,000 pieces to faith-based organizations across the country. The kits are designed for faith-based leaders and provide fact sheets, answers to frequent questions, homeownership surveys and a step-by-step guide for creating a housing partnership.

The activities highlighted below illustrate how Fannie Mae partners with faith-based organizations across the country to offer the company's affordable mortgage products and Fannie Mae's housing counseling software tool, *Home Counselor Online*.

- In Flint, Michigan, the **Mission of Peace Housing Counseling Agency** (**MOP**), a certified HUD counselor, originated over $12 million in affordable mortgages in partnership with five Fannie Mae lender partners. The MOP initiative is a $20 million targeted faith-based initiative that aims to provide homeownership opportunities to Michigan families.

- In 2003, Fannie Mae expanded an existing partnership with the **Christian Methodist Episcopal (CME) Church Community Development Corporation** to serve more African American families over the next 5 years in collaboration with local lenders. The CME Church reaches over one million families through its membership in ten districts throughout the United States. As of December 2003, $4 million in mortgages have been approved benefiting 44 families. In addition, 12,000 families have received homeownership information through various outreach efforts and 200 families are enrolled in homeownership counseling classes.

- In Pittsburgh, Pennsylvania, Fannie Mae announced a three-year, $100 million faith-based initiative with **Builders United of Southwestern Pennsylvania (BUSP)** and **Countrywide Mortgage**. BUSP is a consortium of religious leaders representing 1,200 churches and over 300,000 congregants throughout southern Pennsylvania. The **Fannie Mae Pittsburgh Partnership Office** provided technical assistance to help BUSP establish a nonprofit organization. Fannie Mae will purchase the mortgages under this initiative and Countrywide will provide financial literacy sessions, affordable mortgage products and toll-free customer information on becoming a homeowner.

Targeted Initiatives

As discussed earlier in this report, Fannie Mae develops unique financing tools designed to meet the housing needs of particular populations including families receiving Section 8 vouchers, Native Americans, women-headed households and minority families.

In 1998, the federal *Section 8* program was amended to allow Section 8 Housing Choice voucher recipients to purchase a home. In support of this national housing policy, Fannie Mae announced a ***Section 8 Homeownership Initiative*** in 2001. In doing so, Fannie Mae became the first private, secondary mortgage market company to invest in Section 8 loans. Under the initiative, Section 8 recipients use their Section 8 voucher to help repay their mortgage. Fannie Mae partners include lenders, public housing authorities (PHAs) and community organizations and counseling agencies. Since Fannie Mae started this initiative, 112 lenders have incorporated Section 8 Terms and Conditions in their contracts. In 2003, Fannie Mae purchased 81 Section 8 loans and funded an additional 55 loans through a Community Development Financial Institution investment. (For more information on CDFIs, see Section D: Maintaining Fannie Mae's Presence in the Community.) Below are highlights of the *Section 8 Homeownership Initiative*.

- In March 2003, the Fannie Mae **Atlanta Partnership Office** partnered with the **Housing Authority of Fulton County (HAFC)** and the **New South Federal Bank**, to recognize one of the first families to benefit from the program in the Atlanta area. Under the arrangement, New South Federal will originate the loans under the Section 8 program managed by HAFC, and Fannie Mae will purchase the eligible loans.

- In March 2003 in New Orleans, Fannie Mae along with its partners, the **Housing Authority of New Orleans**, the **Neighborhood Housing Services of New Orleans**, **Dryades Savings Bank, FSB**, and **Standard Mortgage Corporation,** announced one of the first success stories of the use of Section 8 vouchers for homeownership in New Orleans. Dryades Savings Bank originates the mortgages, which are serviced by Standard Mortgage Company. Fannie Mae is committed to purchasing eligible mortgages.

Native Americans are one of the most underserved, minority populations in the country. Their homeownership rates are substantially lower than the national average, ranging between 41 percent and 55 percent. High levels of poverty and unemployment and the complexity of mortgage lending on Native American lands pose significant barriers to providing conventional credit to Native Americans. To overcome these obstacles, Fannie Mae established a ***Native American Homeownership Initiative***, as part of the company's *American Dream Commitment (ADC)*. Under the *ADC*, Fannie Mae committed to invest at least $350 million to support homeownership strategies for 4,600 Native American families and to work with 100 tribes.

Fannie Mae is also an investor in public programs targeting Native Americans. For example, Fannie Mae invested $50 million in the largest Title VI loan ever made to help more than 580 families receive a home, an effort publicly lauded by President George W. Bush at a *Minority Housing Conference* in 2002. In addition, Fannie Mae offers a comprehensive menu of mortgage loans for Native Americans living on trust or restricted lands, including Fannie Mae's ***Native American Conventional Lending Initiative***, the HUD Section 184 Loan Guarantee Program, the FHA Section 248 Mortgage Insurance Program, the Department of Agriculture Rural Housing Native American Pilot, and the FHA Section 247 Program for Native Hawaiians. Fannie Mae's accomplishments in Native American lending for 2003 include the following highlights.

- More than 2,495 families on reservations and trust lands achieved the American Dream of homeownership through Fannie Mae's investments in Native American lending which totaled $274 million.

- Fannie Mae sponsored information sessions on Fannie Mae Native American loan products for more than a dozen tribes. The company also trained thousands of tribal representatives, tribal members, lenders, and other interested affiliate parties, and Fannie Mae staff on the intricacies of providing conventional financing on tribal lands.

- Fannie Mae purchased 10 HUD Section 184 Guaranteed loans for a total amount of $1 million.

The goal of Fannie Mae's ***Minority- and Women-Owned Lenders (MWOL) Initiative*** is to reach underserved communities and to develop innovative solutions for increasing business opportunities for these lenders. Because MWOLs serve the needs of families who have traditionally been underserved by the conventional market—women-headed households and minorities—this initiative helps ensure that Fannie Mae's products and mortgage solutions reach families in need of affordable home financing. In addition to partnering with lenders on mortgage tools and financial solutions, Fannie Mae provides cutting-edge information through the *MWOL Advisory.* This quarterly publication provides news of the latest developments in mortgage financing, product advancements, industry partnerships, and training opportunities to MWOLs. Below are examples of successful MWOL partnerships.[10]

- In the summer of 2003, **North Milwaukee State Bank**, an MWOL, launched a $10 million faith-based homeownership initiative in conjunction with the **NHS of Milwaukee**, the **Fannie Mae Wisconsin Partnership Office**, and dozens of faith-based institutions from throughout the city of Milwaukee. North Milwaukee State Bank will work with NHS of Milwaukee to host homebuyer seminars for members of the faith community and provide affordable financing using Fannie Mae's *MyCommunityMortgage* products.

- **Liberty Bank and Trust** has taken full advantage of partnering with Fannie Mae to increase access to affordable mortgage credit for its customers. Liberty Bank and Trust sells Fannie Mae its loans, performs MBS swaps, uses *DU*, and received a Fannie Mae CDFI investment.

Employer-Assisted Housing (EAH) Initiative

The ***EAH Initiative*** is designed to assist employers in developing a company benefit that helps employees meet their housing needs. An EAH benefit can help employers reduce turnover, which leads to lower training and hiring costs. In addition, it strengthens links to local communities, provides neighborhood stability, and helps to foster community development, by sometimes encouraging employees to live near where they work or in areas undergoing revitalization. Lenders also benefit when they partner with employers as lenders of choice. Employers offering EAH benefits report that employee's morale and loyalty increases, while positively impacting their "bottom line." In September 2003, Fannie Mae received the **U.S. Department of Commerce's** prestigious **Ron Brown**

[10] Both MWOLs are also members of the **National Bankers Association** (NBA) and have access to the resources that Fannie Mae provides under the NBA-Fannie Mae Partnership.

Leadership Award, which recognizes companies for outstanding achievement in employee and community relations. The award is given annually through a competitive process. Examples of Fannie Mae's EAH activities are provided below.

- In Naples, South Florida, the **Naples Community Hospital** initiated an EAH program that provides eligible employees with homeownership seminars and other financial incentives to help employees along the path to homeownership. Fannie Mae is committed to purchasing eligible mortgages originated through this EAH partnership and is offering the *Community Solutions* mortgage product for program participants. Naples Community Hospital has committed $60,000 for the first year to provide $1,000 per employee for down payment and/or closing cost assistance.

- Fannie Mae assisted the **City of Seattle** and **HomeStreet Bank** in the creation of the *Hometown Home Loan Program* to help police and fire fighters afford homes closer to where they work and increase homeownership opportunities in Seattle. The program has been highly successful and is offered by more than 20 Seattle area employers. It offers a 50 percent reduction in the loan fee, a variety of closing cost discounts, free homeownership education, innovative loan programs, and access to a variety of down payment assistance programs.

Initiative to Reduce Barriers to Affordable Housing

Regulatory barriers that needlessly drive up the cost of housing or create obstacles to housing construction and finance often hamper the production and availability of affordable housing in metropolitan areas. For example, homes sit abandoned due to titles that cannot be cleared, new construction approval processes take months longer than necessary due to cumbersome regulations, and vacant industrial sites await redevelopment. Under Fannie Mae's ***Initiative to Reduce Barriers to Affordable Housing***, the company established local partnerships in seven new states and localities in 2003. In addition, eliminating regulatory barriers is a top priority of the Bush Administration. In 2003, Fannie Mae worked with HUD staff to support the Administration's efforts by sharing research and best practices. Below are examples of some of the work Fannie Mae engaged in under this initiative in 2003.

- In Birmingham and Utah, Fannie Mae sponsored studies on how building codes and permit processes impact housing development. In Mississippi, Fannie Mae began working with a new statewide coalition to develop a comprehensive housing strategy for the state. Some of the key issues that the strategy will address are the creation of a single statewide housing code, discouraging exclusionary zoning by municipalities, and reforming the eminent domain processes and tax lien requirements for abandoned properties. In Rhode Island and Wisconsin, Fannie Mae was the major sponsor of workshops to educate the development community on how to take advantage of new state laws to maximize affordable housing and redevelopment.

Underwriting Experiments

In cooperation with local housing and lender partners, Fannie Mae conducts various underwriting experiments aimed at eliminating 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. This flexibility is necessary to mitigate barriers facing borrowers that may include all or some of the following: minimal down payment funds, affordability measures and ratios, underwriting requirements, property valuation challenges, and language barriers. In 2003, Fannie Mae approved $222 million worth of Housing and Community Development place-based commitments for a total of 55 experiments. Two examples of underwriting experiments are described below.

- The ***MassHousing Municipal Workers Initiative*** provides financing to Massachusetts's state housing finance agency, MassHousing, to accommodate its *Municipal Workers Program*. Under the program, police officers, firefighters, schoolteachers and other municipal employees are eligible to use the Fannie Mae *MyCommunity Mortgage* products to purchase a one-, two- or three-unit home in the city or town where they work. Possible products include *Community 100 Plus*, *Community 2-Family* and *Community 3-4 Family*. In 2003, Fannie Mae purchased $2.25 million in loans from MassHousing under this initiative.

- Over the past few years, minority communities throughout Essex and Union counties in New Jersey have been victimized by alleged predatory lending practices. To help these borrowers restructure their existing indebtedness, Fannie Mae, in partnership with HUD and New Jersey Citizens Action, launched a $10 million ***New Jersey Remediation Initiative*** in 2002. In 2003, the experiment was expanded to include a renovation component and to increase the LTV requirements. Eligible borrowers must be identified by New Jersey Citizens Action as having been victimized by predatory lenders and must have received a Credit Repair Letter from HUD.

D. Maintaining Fannie Mae's Presence in the Community

Housing is a major force in American life that impacts the economy and financial markets but also profoundly transforms communities and families. Fannie Mae realizes the immediate effect housing has at the community level and is committed to seeking out respected partners in local cities, towns and states that will work alongside the company to bring housing opportunities to families in rural areas, large metropolitan cities, small towns in the mid-west, and along the east and west coast.

Local Partnerships in Action to Fulfill Fannie Mae's Mission

Fannie Mae operates 55 Partnership Offices throughout the country, including the West Virginia Partnership Office, which opened in 2003. Customized service based on geographic need is the cornerstone of Fannie Mae's Partnership Offices. This goal is achieved through collaboration with local governments, lenders, public officials, housing organizations, community nonprofits, real estate professionals, and other local stakeholders. Partnership Offices also serve as a catalyst for local community development efforts by encouraging and leveraging the investment of private and public funds. Launched in 1994, this local effort has resulted in comprehensive investment plans totaling more than $818 billion in commitments in neighborhoods and communities around the country. In 2003, Fannie Mae Partnership Offices launched a number of activities that brought Fannie Mae's affordable housing solutions to local communities.

- In February 2003, **Fannie Mae's New Jersey Partnership Office** in partnership with the **Housing and Neighborhood Development Services, Inc. (HANDS)** and the **Bank of New York** completed the rehabilitation of 22 formerly dilapidated and abandoned homes, through construction-to-permanent mortgages. This product allows developers or nonprofit organizations such as HANDS to obtain one mortgage to construct or rehabilitate a home, and have the future homebuyer assume the same loan once it is made permanent. This streamlines the process and reduces the cost for a potential homeowner. Fannie Mae agreed to purchase the eligible construction-to-permanent loans from the Bank of New York.

- In June 2003, the **Fannie Mae Wisconsin Partnership Office** teamed up with **Stone House Development**, **the Wisconsin Housing and Economic Development Authority (WHEDA)**, **First Business Bank**, and **Oakbrook Corporation** to develop Prairie Park Apartments—a $10 million complex to provide affordable housing for seniors. Through a syndicate partner, Fannie Mae invested $5.4 million in Prairie Park, which qualifies for Low-income Housing Tax Credits (LIHTC) issued by WHEDA. This investment allowed the property owner to lower development costs, thereby lowering the rents for seniors.

- When "Aspen" wildfires in the summer of 2003 ravaged southeast Arizona, the **Fannie Mae Arizona Partnership Office** announced a mortgage relief provision for homeowners facing hardships as a result of the widespread damage caused by the fires. The provisions allowed lenders more discretion to help homeowners that were victimized by the fires including alternatives such as temporary suspension or reduction of mortgage payments, and in some cases, modification of the terms of the existing mortgage. Through Fannie Mae's guidelines, lenders were permitted to determine appropriate relief steps by considering uninsured losses, extended unemployment periods, and extraordinary expenses related to the wildfires that affected mortgage payments.

- In an effort to address the shortage of affordable housing for military families, in May 2003, the **Tennessee Partnership Office**, in partnership with the **Fort Campbell Federal Credit Union**, local realtors, and the **Affordable Housing Resources**, launched the *Home Front Mortgage*. The $5 million pilot is designed to help active duty military personnel stationed at the Fort Campbell Base purchase homes in Tennessee and Kentucky. Due to duty station changes, many military families suffer income loss when an active duty service member relocates and his/her non-military spouse must find a new job. This sometimes leads to a higher debt-to-income ratio and difficulties making initial down payments. The *Home Front Mortgage* requires no down payment and allows families to borrow additional funds to assist with closing costs.

- In partnership with **Montgomery County, Maryland**; **BB&T Bank** and **Eastern Village Cohousing LLC**; the **Fannie Mae Washington, DC Partnership Office** announced plans to convert Eastern Village Cohousing Condominiums into a mixed-used residential and commercial development. The 93,000 square foot building will feature 55 condominium units, and 12,000 square feet of commercial space. The property will support the ongoing revitalization of Downtown Silver Spring, Maryland and will feature "smart growth" principles that encourage development near public transportation facilities. The development is located in a State Enterprise Zone and Arts District. Financing for the project derives from a $1.1 million construction loan from BB&T, along with a mezzanine debt investment from Fannie Mae.

Community Development Financial Institutions (CDFI) Initiative

CDFIs are financial institutions whose primary mission is community development. The ***CDFI Initiative*** provides investment capital to help financial intermediaries finance the development of affordable housing in neighborhoods traditionally underserved by the housing-finance industry, and aims to lead the market in affordable lending by providing $150 million in capital to qualified local housing partners 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 2003, Fannie Mae invested $15 million in CDFIs, which is projected to generate up to 2,600 units of affordable housing. More than $97 million has been invested in CDFIs since the company first began the initiative. Examples of Fannie Mae's commitment to investing in CDFIs are listed below.

- The **Fannie Mae Rhode Island Partnership Office**, housing partners, and Rhode Island elected officials, announced a $3 million CDFI investment in the **Corporation for Supportive Housing's (CSH)** first Rhode Island office in Providence. The investment will provide important predevelopment and acquisition funds for CSH and allow it to work with local nonprofits to facilitate the development of 300 single-room-occupancy units of housing for the homeless.

- In Maine, the **Northern New England Partnership Office** and other Maine housing partners announced a $3 million CDFI debt investment that enables **Coastal Enterprises, Inc. (CEI)** to build, acquire, and rehabilitate rural properties in the Lewiston/Auburn area.

- The **Fannie Mae Nevada Partnership Office** and other partners announced Fannie Mae's $500,000 CDFI deposit investment in **Nevada State Bank**. The proceeds from the deposit will support a line of credit that allows **Community Services Agency**

Development Corporation to purchase and rehabilitate homes for resale to first-time homebuyers.

The American Communities Fund

The ***American Communities Fund***^{SM} (***ACF®***) is a catalyst for positive change in many communities throughout the country. At a time when many communities are faced with abandoned buildings, dilapidation, neglect, and the lack of decent and affordable housing, Fannie Mae's ACF offers an effective solution to these challenges. To help increase the availability of affordable housing, and assist communities with housing and community development needs, ACF offers debt and equity investment financing. As part of Fannie Mae's commitment to community development, ACF plans to invest $10 billion over the next six years. In 2003, ACF investments totaled $550 million in equity and debt investments across the country. The following are examples of ACF's activities.

- In partnership with the **Lee Group Developers, Century Housing, Countrywide Home Loans, Essex Mortgage Company,** and **Los Angeles County**, Fannie Mae's *ACF* provided $683,000 in equity financing toward the development of **Willowbrook**, a $6.4 million project in central Los Angeles. The development offers three- and four-bedroom affordable homes ranging from $185,000 to $205,000, with nineteen homes reserved for families earning up to 80 percent of the area median income, or $45,100 for a family of four. In addition, residents of Willowbrook qualify for down payment assistance funds from the county, while Essex Mortgage and Countrywide originate mortgage loans for the development. Fannie Mae has committed to purchasing these mortgages. To keep the properties affordable, the county sold the land at an affordable price to the Lee Group, and Century Housing financed the construction.

- In Richmond, Virginia, Fannie Mae's *ACF* provided a $500,000 revolving line of credit to fund the new construction of 15 affordable single family homes in the Carver neighborhood, a historical section of Richmond in need of renovation. The new homes were designated for first-time homebuyers, allowing for low- and moderate-income families to live in or near the downtown area of Richmond. The homes will start at $120,000 and will feature several attractive amenities. Other partners in this effort included **Sun Trust Bank**, the **City of Richmond**, the **Better Housing Coalition** and the **Carver Civic Improvement League**.

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 2003, the Fannie Mae Foundation invested $47 million in grants and other support to housing partners, national intermediaries, and housing advocates working to produce and preserve affordable housing and educate homebuyers. In 2003, Fannie Mae made a contribution of $75 million to the Fannie Mae Foundation to support its ongoing efforts.

E. Providing Safe and Affordable Rental Housing

Despite the increase in homeownership rates, the need for affordable rental housing remains strong. Fannie Mae's multifamily financing increases 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, the purchase of multifamily equity (including ***Low-Income Housing Tax Credits***) and equity in properties affordable to low- and moderate-income families and the purchase of multifamily mortgage revenue bonds.

In the face of high vacancies and weak multifamily markets, Fannie Mae was in every market every day. During 2003, multifamily business activity at Fannie Mae topped $33 billion which financed over 795,000 multifamily units. Of this total, over 87 percent were affordable to families at or below the median income of their communities.

During 2003, over 72 percent of all multifamily loans originated were sold into the secondary market. Liquidity in the secondary multifamily market continues to increase. While new participants are being brought in and many participants are consolidating, in 2003, the multifamily market was focused on preserving the performance of existing properties in the face of higher homeownership, higher vacancies and declining fundamentals. Fannie Mae recognizes that reaching all market segments is necessary to improve the distribution of liquidity. In this effort, the company continued to enhance its network of lenders to improve information collection about small multifamily properties and facilitate financing for these loans. Historically, this market segment has been less able to secure financing in the secondary market. Fannie Mae also enhanced multifamily products and added features to provide lenders solutions that better meet their borrowers' changing needs.

Multifamily Products and Activities

Product innovations in 2003 focused on increasing flexibility, lowering prepayment costs, and giving lenders and borrowers greater certainty of execution. Highlights include the following examples.

- Fannie Mae introduced the ***Extended Maturity*** product that enables borrowers to obtain a fixed-rate loan from lenders that provides an optional 1-year extension period. During the extension period the loan accrues interest at the 1-Month LIBOR rate plus a margin of 2.4 percent and can be prepaid at par at any time providing maximum refinance flexibility.

- The company announced additional ***Lifetime Cap*** options of 5 percent, 5.5 percent and 6 percent for ***DUS Cash Adjustable Rate Mortgage*** (***ARM***) executions. The higher *Lifetime Cap* options lower the investor spread on the *ARM* providing additional options to enable borrowers to structure their loan with the pay rate and interest rate limitation that best addresses their financing needs.

- Fannie Mae launched the ***Graduated Prepayment Premium*** option for fixed-rate loans under the *3MaxExpress* and *DUS* executions. Fixed-rate loans may be obtained from lenders under both the *DUS* and ***3MaxExpress*** product lines with a fixed prepayment fee that generally declines based on the year that the loan is prepaid. *Graduated Prepayment Premium* options are available for 5-, 7- or 10-year cash loans.

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 26 lenders with expertise in financing multifamily properties. For these loans, Fannie Mae delegates the origination, underwriting and closing responsibilities to its *DUS* lenders, to enable them to move quickly to arrange financing for borrowers. Fannie Mae currently has more than $71 billion of *DUS* multifamily financing in its portfolio. 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 2003, 91 percent of the *DUS* units acquired served low- and moderate-income families; 42 percent of *DUS* units were made in underserved markets; and 52 percent of *DUS* units addressed special affordable needs. The following are examples of properties financed in 2003 through the *DUS* network.

- ***Museum Place South, Portland, Oregon.*** Fannie Mae recently approved a $29.9 million transaction in downtown Portland, Oregon, to finance the new construction of a transit-oriented, mixed-use, mixed-income development, located on a full-city block in a key section of the city. *Museum Place South* is part of the three-block Museum Place Project, resulting from a collaborative effort of public and private partners including the **City of Portland, Sockeye Development,** and **Green Park Financial**, a Fannie Mae *DUS* Lender, to revitalize the center of the downtown's West End. Fannie Mae will provide credit enhancement for 30 years on a $29.9 million bond financed by the City of Portland. Twenty percent of the units will be restricted to individuals earning 50 percent or less than the area median income.

- ***Constitution Square Apartments, Colorado Springs, Colorado.*** Fannie Mae celebrated the grand opening of *Constitution Square Apartments*, a new 180-unit development located in Colorado Springs, Colorado. *Constitution Square Heights* is the first affordable apartment complex in eastern El Paso County. Forty-five percent of the 180-units will be reserved for residents earning at or below 60 percent of the area median income, which is $32,160. The $13.2 million complex was financed through the issuance of tax exempt and taxable bonds. Fannie Mae purchased $11.2 million in tax-exempt bonds.

Fannie Mae recognizes that small multifamily properties are a vital part of the country's affordable housing stock and has focused efforts on providing financing for these projects through the development of the ***MFlex Loan Product***, the ***3MaxExpress™ Streamlined Mortgage Loan Product*** and the ***Affordable Alliances Loan Product.*** 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 2003, Fannie Mae had seven *MFlex* lending partners and purchased $1.6 billion of loans securitized by 5-50 properties of which 81 percent were affordable to families earning at or below the median income in their area. 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 2003, Fannie Mae provided $1 billion in financing, which assisted over 34,000 families living in small multifamily properties. The *Affordable Alliances Loan Product* is responsible for debt investments in rental housing targeted to persons of low- and moderate-income and to rental markets that are underserved. During 2003, these financing initiatives for the creation and preservation of the nation's affordable housing stock provided affordable housing for 3,850 families. Examples of small multifamily loan projects financed in 2003 are described below.

- ***441 Brooklyn Avenue, Brooklyn, New York.*** Fannie Mae's *MFlex* product is offered by *Mflex* Lenders in a few small loan markets nationwide. Working through *MFlex* partner, **Independence Community Bank,** Fannie Mae provided long term fixed-rate financing of $2.4 million for a small property in the Flatbush North area of Brooklyn, New York. The property was constructed in 1930 and features 63 units that are rent stabilized, thus providing affordable housing opportunities for local residents.

- ***Timberidge Apartments, Eagle River, Alaska.*** Fannie Mae's *3MaxExpress* product is offered by both *DUS* and *MFlex* Lenders nationwide. Working through *DUS* partner, **Lend Lease Mortgage Capital**, Fannie Mae provided long-term debt financing of $1.3 million for a small multifamily property in Eagle River, Alaska. The property was constructed in 1985 and provides moderate-income housing for 28 families, 50 percent of whom are military tenants.

- ***Beaumont Avenue Apartments and Cranford Apartments, Bronx, New York.*** Fannie Mae and the **Community Development Trust** (**CDT**) announced a $100 million multifamily housing initiative to finance small, highly affordable properties in major markets around the country. The $100 million flexible cash purchase facility will allow CDT to provide competitive pricing and liquidity to affordable housing lenders. The average size of the loans is $2 million. Several loans already have been approved for properties in New York, Los Angeles, and Kansas City through the initiative. Two of the properties, the ***Beaumont Avenue Apartments*** and the ***Cranford Apartments***, are located in the Bronx. The properties were built in 1998 with 56 units each, primarily one-bedroom apartments. All apartments are affordable to tenants earning up to 60 percent of area median income, and are restricted to seniors 55 years of age and older. Through this agreement with CDT, Fannie Mae purchased the senior participation of small loans made on properties that qualify for federal Low-Income Housing Tax Credtis (LIHTC). CDT will retain the junior participations.

- The **Community Preservation Corporation** (**CPC**), a nationally recognized nonprofit leader in financing low- to moderate-income housing, and Fannie Mae completed a $24 million transaction which provided for the secondary market purchase of mortgages on small rental properties located throughout New York State and Northern New Jersey. Nearly 2,000 units of housing in 38 properties were financed through this transaction. The financing structure established under this transaction will provide additional capital to finance properties with 5-50 units.

The federal **Low-Income Housing Tax Credits (LIHTC)** program is a means of directing private equity capital toward the creation of affordable rental housing. The value conveyed to investors by the tax credits allows units to be leased to qualified families at or below market rate rents. To date, Fannie Mae remains the largest LIHTC equity investor. Through the tax credit, using both direct investments and investments in equity funds, Fannie Mae has participated in the creation or preservation of more than 300,000 units of affordable rental housing over the life of the LIHTC program. In 2003, Fannie Mae committed over $1.6 billion in LIHTC equity properties to help make affordable rental housing possible for over 30,000 families. Below are highlights of multifamily properties financed with LIHTCs in 2003.

- ***Bigby Villa Apartments, Fresno, California.*** Fannie Mae committed to a $6.2 million equity investment through **Alliant Capital** in this LIHTC-qualified renovation project, which also included a financing structure that preserved affordability through the use of residents' Section 8 allocations. Under the terms of financing, tenants pay only 30 percent of their income, while the remaining rent is covered by Section 8 subsidies. **Washington Mutual** also provided financing and ensured affordability through the use of $1.2 million in Interest Reduction Payments from **HUD**. *Bigby Villa* is an affordable 180-unit property that includes a playground, community center, a newly constructed computer room for residents and kitchen facilities. Apartments are reserved for families earning up to 60 percent of the area median income, or $27,240 for a family of four.

- ***Gold Dust Apartments, Missoula, Montana.*** The *Gold Dust Apartments* were built using recycled and energy-efficient materials and incorporate historic architectural features to blend in with other downtown buildings. These apartments consist of 18 affordable units within walking distance of public transit and downtown attractions. Fannie Mae provided a $1.8 million equity investment in exchange for LIHTCs through the **Enterprise Social Investment Corporation**. Other partners and financial contributors include the **Montana Board of Housing**, grants for energy upgrades from **NorthWestern Energy**, a Special Purpose grant from **HUD** and a HOME grant from the **Montana Department of Commerce**.

- ***Valle Verde Apartments, Orange Cove, California.*** In an effort to provide new, high-quality apartment homes to working families in Orange Cove, Fannie Mae partnered with developer **Simpson Housing Solutions, LLC** to make a $10.4 million equity investment in *Valle Verde Apartments*, a 73-unit affordable rental property.

The development was designed to meet the housing needs of the area's growing population of farm workers and other working families and is centrally located relative to public transportation, retail and commercial services, grocery stores, social service centers, day care and parks.

Fannie Mae is committed to the preservation and rehabilitation of the nation's affordable housing stock. In that pursuit, Fannie Mae invests equity in multifamily properties that need substantial rehabilitation and are affordable to families earning up to the area median income. Through 2003, Fannie Mae invested $248 million in these projects and kept 13,000 units affordable to low- and moderate-income families. Fannie Mae promotes preservation and rehabilitation through equity investments, purchases of mortgage revenue bonds, and debt financing. Highlights of such projects are listed below.

- ***Bella Vista Apartments, Dayton, Ohio***. Fannie Mae and *DUS* partner, **Lend Lease** provided a forward commitment for the preservation and rehabilitation of *Bella Vista Apartments* in Dayton, Ohio. Fannie Mae invested $9.7 million in bond credit enhancements.

- ***Sherwood Crossing Apartments, Elkridge, Maryland***. Fannie Mae provided an equity commitment in partnership with **Bozzuto and Associates,** to preserve affordable housing through a $4.6 million renovation and extending expiring 80/20 income restrictions by an additional 15 years. *DUS* partner **Capri Capital** provided a $27.2 million *DUS* loan on this 684 unit apartment complex. Fannie Mae also provided a $19.4 million equity investment, a credit enhancement on $23.6 million bonds and a portfolio loan of $5 million.

Fannie Mae also offers financing products for special-use properties such as Seniors Housing. This product solution helps property owners and operators refinance and acquire purpose-built multifamily dwellings that include age restrictions and/or services for congregate care or assisted living units. In 2003, Fannie Mae provided $873 million to meet the financing needs of seniors seeking safe and affordable rental housing. A project highlight for 2003 is described below.

- ***Eden Estates, Weddington Park, and The Discovery Program at Statesville Place, North Carolina***. In 2003, Fannie Mae purchased $10.1 million of permanent financing from **RED Mortgage Capital** for three mixed-income properties located in North Carolina. All three properties are small, one-story structures that are designed specifically for seniors who need to receive assisted living or Alzheimer's-related services. In addition to individual living units, these residences provide common amenities such as a library, game room, dining room, beauty shop, and an interior landscaped courtyard. Utilities, meals, social activities, and community transportation are also provided. All three properties participate in a state-sponsored Medicaid waiver program under which low-income seniors have the opportunity to receive personal care services at a reduced rate in an attractive, market-rate environment.

III. FAIR LENDING REVIEW AND BUSINESS PRACTICES

" Our goal is to make sure that wherever there is a family that wants to own a home, there will be a trustworthy Fannie Mae lender there in the community with our full array of flexible, low-cost mortgage options and a way to say yes. And that, by the way, is the best antidote to predatory lending of all—using good money to drive out and replace the bad."

--- Franklin D. Raines

A. Fair Lending

Fair lending compliance at Fannie Mae continues to exemplify the belief that "our mission is our business." It is Fannie Mae's mission to expand homeownership opportunities for all Americans, including minorities, new immigrants, and other traditionally underserved families. The expected growth in these groups and the significant minority homeownership gap demonstrate that the traditionally underserved also represent the best market opportunities for lenders in the coming years. Fannie Mae's fair lending efforts are focused on ensuring that lenders have the tools to effectively reach these new markets and that, more importantly, loans delivered to Fannie Mae comply with all state and federal fair lending and anti-predatory lending requirements, as well as with Fannie Mae policies on abusive lending. To provide guidance on fair lending compliance to lenders, Fannie Mae, in April 2000, released its policy on abusive lending through **Lender Letter 03-00**. Key points of the letter are summarized below.

- ***Expanded Approval Mortgage Options***. Through *DU*, Fannie Mae offers more financing options designed to assist lenders in meeting the needs of individuals and families with blemished credit problems.

- ***Product Steering***. Fannie Mae is against the practice of lenders who steer applicants toward higher cost mortgage products when the borrower qualifies for lower cost mortgage products.

- ***Borrower's Ability to Make Mortgage Payments.*** Fannie Mae believes that a borrower should have the ability to make monthly mortgage payments. This ability to pay needs to be well established during the underwriting process, and through established and sound underwriting standards. Fannie Mae is willing to purchase responsibly underwritten mortgages made to borrowers with less than perfect credit, notwithstanding the higher credit risk.

- ***Excessive Fees***. Fannie Mae believes that loans generally should not contain points and fees charged to consumers in excess of 5 percent, except when this limitation would result in an unprofitable origination to the lender. In addition, Fannie Mae will not purchase "high cost" mortgages as defined by the Homeownership and Equity Protection Act.

- ***Prepaid Single Premium Credit Life Insurance Policies.*** Fannie Mae will not purchase or securitize a mortgage for which a prepaid single premium credit life insurance policy was sold to the borrower in connection with the loan origination.

- ***Prepayment Penalties.*** Fannie Mae will only consider purchasing loans with prepayment penalties under the terms of a negotiated contract. In addition, the mortgage lender must adhere to the following criteria: if a mortgage does carry a prepayment penalty, the borrower should obtain some benefit (i.e., a rate or fee reduction for accepting the prepayment premium); the borrower should be offered the choice of another loan that does not require the prepayment premium; loan terms requiring a prepayment penalty should be adequately disclosed to the borrower; and prepayment penalties should not be charged in the event that the borrower defaults on the mortgage.

- ***Full File Credit Reporting.*** Fannie Mae believes that a borrower's entire payment history should be reported to credit repositories. This provides the borrower with accurate payment records that could facilitate the opportunity to obtain new financing with better mortgage terms. Fannie Mae requires that lenders provide credit repositories a monthly report on the status of any Fannie Mae loan that they service.

- ***Servicing Practices (Escrow Deposit Accounts).*** Fannie Mae recommends that its mortgage loan servicers maintain escrow deposit accounts for depositing funds to cover mortgage insurance, taxes, ground rents, etc.

To ensure compliance with these guidelines, Fannie Mae maintains high standards at every level in the company, 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 and one Business Analyst lead these efforts. In 2003, in addition to ensuring compliance with our anti-predatory lending standards on a record volume of business and providing fair lending review and guidance on many of the initiatives described in Section II, the Fair Lending Compliance Team convened Fannie Mae's Fourth Annual Fair Lending Conference.

Fourth Annual Fair Lending Conference

In September 2003, Fannie Mae hosted the Fourth Annual Fair Lending Conference in Washington, D.C. Reflecting the range of important fair lending issues, the conference considered *Hot Topics in Fair Lending: From Origination to Servicing.* The conference began with a discussion between advocates and lenders, including representatives from **AARP**, **Self-Help**, **Ameriquest Capital Corporation**, and the **Mortgage Bankers Association**, on the potential risks and benefits of federal versus state anti-predatory lending legislation and the prospect of federal pre-emption of state legislation. Conference participants also heard a discussion of the potential effects of new state anti-predatory lending legislation on the secondary market. Offering opinions on whether the legislation is striking the right balance between promoting liquidity and protecting consumers were representatives of **Standard & Poor's**, the **Bond Market Association**, the **National Association of Consumer Advocates**, and the **New Jersey Institute for Social Justice**. The conference also explored emerging issues in servicing, as panelists from **Fitch Ratings**, the **Bureau of Consumer Protection of the Federal Trade Commission**, and the **National Community Reinvestment Coalition** discussed predatory lending concerns and servicing best practices. Finally, the conference closed with an overview of the anti-predatory lending refinance initiatives that have been launched across the country and a discussion by representatives of **Family Housing Advisory Services, BNY Mortgage Company**, and **JP Morgan Chase** of what it takes to make these initiatives successful. The conference was attended by approximately 120 representatives of government, housing and civil rights advocacy organizations, educational institutions, and members of the mortgage lending business community. It continues to be an important vehicle for bringing a wide spectrum of the housing community together to discuss the most significant and timely fair lending issues.

Expanding Responsible Lending

Fannie Mae's responsible lending strategy focuses on lowering costs and increasing opportunities for homebuying consumers, while ensuring that the company continues to be a force for positive change in the marketplace. These efforts have the following eight components:

- establish business guidelines that ensure Fannie Mae provides liquidity for responsible lending only;

- expand the application of conventional conforming mortgage practices to more borrowers;

- advance the Mortgage Consumer Bill of Rights Agenda;

- offer a broad range of alternative responsible products;

- leverage technology and the Internet to expand markets and reduce costs for consumers;

- work with partners to keep borrowers in their homes;

- support the homebuyer education industry to empower counselors to reach more consumers; and

- support the Fannie Mae Foundation as a national leader in consumer education and outreach.

Anti-Predatory Lending Initiatives

In more than 25 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 unique in addressing the particular needs and conditions in the local communities. To date, Fannie Mae has committed to purchase more than $ 85 million in loans delivered through these initiatives, including $10 million in new commitments in 2003. An *Anti-Predatory Lending Refinance Initiative* is highlighted below.

- In June 2003, Fannie Mae and local partners launched ***HomeSAFE***, an anti-predatory lending initiative in Nashville, Tennessee. A number of area counseling agencies, including **Nashville Housing Fund**, **Affordable Housing Resources**, **Woodbine Community Center**, **Residential Resources**, and **Citizens for Affordable Housing**, help screen and refer borrowers to the *HomeSAFE* Nashville Program. Under the initiative, Fannie Mae has committed to purchase $2 million in eligible loans originated by **First Tennessee**, **Union Planters**, **National Bank of Commerce**, and **USBank**.

Fannie Mae also takes a leadership role in supporting these initiatives by providing training and sharing best practices. In September 2003, the company hosted a two-day *Housing and Community Development University* training session for local partners. These sessions helped those with an existing program improve their borrower intake and referral processes and underwriting and servicing. These sessions also instructed new Fannie Mae partners on the necessary ingredients for success and how to leverage community support.

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 2002, the **Texas Association of REALTORS®**, seven local Realtor associations and Fannie Mae committed to create a statewide education and outreach campaign to promote responsible lending and expand homeownership in Texas. The campaign officially launched in January 2003 and over 1,000 REALTORS were trained under this campaign. The ***Borrow With Confidence™*** campaign 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. This training also provides real estate professionals with a list of conventional lenders who are committed to offering competitive interest rates to all potential homebuyer and local counseling agencies that can help borrowers prepare themselves for the home buying process. Due to the success of the *Borrow with Confidence* campaign in Texas, Fannie Mae expanded the campaign to include four more state REALTOR associations in Tennessee, New York, Colorado, and Rhode Island.

B. Ensuring Sound Underwriting

Desktop Underwriter (***DU***) is an automated underwriting system developed by Fannie Mae to help mortgage lenders make informed credit decisions on conventional mortgages. *DU* features fast and objective risk assessments, reduced data entry requirements, reduced documentation, and comprehensive underwriting reports. *DU* complements, not replaces, the considered judgment of experienced underwriters. Instead, *DU* provides recommendations to lenders, and 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 his/her discussion with the borrower about each significant risk factor and credit characteristic identified in the Fannie Mae Underwriting Findings report. In addition, *DU* may provide one or more "suggestion" messages that identify areas of the borrower's application that upon modification may result in a more favorable 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 factors. The credit report factors include the borrower's credit history, delinquent accounts, credit card accounts, public records, foreclosures and collection accounts, and credit inquiries. The non-credit report factors include equity and LTV ratio, liquid reserves, total debt-to-income ratio, loan purpose and type, loan term, property type, number of borrowers, self-employed borrowers, and occupancy type.

DU applies the same criteria to every loan it processes. This consistency and objectivity results in a fair and unbiased underwriting recommendation. *DU* does not consider factors such as a borrower's age, race, religion, gender, national origin, marital status, or sexual orientation in making a recommendation. To increase the transparency of *DU*, Fannie Mae provides easy-to-read information about *DU's* credit risk analysis. The information, available on-line and in booklet form, *Taking the Mystery Out of Your Mortgage,* was updated and reissued in 2003 and outlines what a lender considers in evaluating a mortgage application and how a lender often uses automated underwriting systems such as *DU*, to help evaluate the credit risk of a potential borrower's mortgage application. The booklet is also available on Fannie Mae's web site, www.fanniemae.com.

Desktop Underwriter 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 the past performance of two million loans. *DU* evaluates a prospective borrower's specific credit and non-credit factors (identified earlier) based on information supplied by the lender in the online mortgage loan application. *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 2003 performance of loans delivered to Fannie Mae that received an "Approve" recommendation from *DU* exhibited a two-year serious delinquency performance almost five times better than loans that received a

"Refer with Caution" recommendation. For lenders participating in the *EA/TPR* initiative, *DU* separates risk further by placing *EA* loans into four categories: levels I, II, III, and IV. Levels I to III are eligible for delivery to Fannie Mae by approved seller/servicers. Loan performance data on Fannie Mae's *EA* loans suggest that each category performs as predicted: *EA* loans in level II perform 1.5 times better than *EA* level III. Similarly, *EA* level I loans perform 1.5 times better than *EA* level II loans.

A proven effective tool in predicting mortgage default, *DU* is designed to ensure that it evaluates the information in each mortgage application the same way each time—consistently, objectively, and accurately. Fannie Mae conducts quarterly reviews of loan performance to ensure the predictability of the model. Each new version of *DU* incorporates the most recent research on credit performance and examines alternative ways to increase homeownership opportunities for all classes of borrowers, including low- and moderate-income borrowers and minority borrowers. Fannie Mae ensures that all changes comply with the Fair Housing Act.

Desktop Underwriter Expands a Lender's Market and Reduces Costs

As stated elsewhere in this report, *DU* provides fast and objective risk assessments, reduced data entry requirements, reduced documentation, and comprehensive underwriting reports. This reduces mortgage origination costs because less paperwork and processing time are required for lenders to make their underwriting decisions, thus allowing lenders to process a greater number of loans than they could with manual underwriting. Fannie Mae's *2003 Mortgage Focus* study, concluded that the production cost per loan decreased significantly as lenders moved automated underwriting closer to the point of sale. In the study, retail lenders using an integrated automated underwriting system at the point of sale reported origination savings of more than $1,000 over manual underwriting.

Flexible Underwriting Standards

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, 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 the spring of 2002, the Selling Guide was updated to incorporate a comprehensive risk assessment approach to underwriting for manually processed mortgages. This approach to underwriting brings the manual underwriting process more in line with *DU's* risk assessment. It requires a lender to assess the level of risk associated with each risk factor in a mortgage application and to make its underwriting decision by focusing on the degrees to which the interaction of all of the risk factors influence the potential for default. A lender can offset weaknesses in one area with strengths in other areas. This approach provides more flexibility in underwriting. For instance, a given credit history (traditional or non-traditional) and LTV ratio assessed in combination with other risk factors in a mortgage application determine the appropriate level of reserves or debt-to-income ratio.

In 2003, Fannie Mae amended the ***Selling and Servicing Guides*** to further address the company's affordable housing mission. Examples include amendments detailing: 1) the expansion of Fannie Mae Underwriting Guidelines for people with disabilities; 2) borrower income limit increases for Community Lending Mortgages; 3) mortgage eligibility and servicing procedures for mortgages secured by manufactured homes; and 4) the elevation of new maximum mortgage amount limits effective for 2004 for all conventional mortgages.

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 this 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.

Underwriting Reviews

Fannie Mae's National Underwriting Center (NUC) performs Fannie Mae's underwriting reviews and provides loan quality information and analyses to Fannie Mae staff throughout the country. NUC uses *DU* and other risk assessment models to select loans for review, focusing its resources on loans that represent a higher risk to the company as well as selecting a random sample of loans for review. This ensures that loan reviews are done in an objective and consistent manner. The goal of each review is to identify any significant underwriting deficiencies, misrepresentations, or eligibility issues associated with the loan and then take the appropriate steps to minimize exposure to risk. 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.

C. Pricing

Fannie Mae's pricing policies and strategies are based on competitive market factors, Fannie Mae's ongoing assessment of risks, the company's experiences, and other key determinants or indicators of the likelihood of mortgage default and other trends. As an ongoing practice, Fannie Mae continually updates its databases with the most current loan origination information and the payment status of all loans outstanding. There are a number of factors that are used to predict loan performance or the likelihood of default. They include credit histories, mortgage loan and property characteristics, interest rate fluctuations, economic and/or market developments, and housing prices. From a credit risk management perspective, pricing is based on various internal analyses of the performance of Fannie Mae's existing book of business—including mortgages securitized and mortgages purchased. Key determinants for the severity of loss on defaulted loans include the current LTV, type of property, and the level of mortgage insurance or other types of credit enhancements.

Pricing strategies also require that Fannie Mae balance the needs of its lender customers with its own business objectives. Through various negotiated vehicles, lender alliances and 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 and Fannie Mae's business and mission objectives. In making pricing decisions, Fannie Mae factors in the ability of the company to meet its strategic business goals and continue to fulfill its housing mission to provide affordable mortgage credit and tear down barriers to homeownership.

D. Servicing and Credit Loss Management

Fannie Mae continues to effectively manage risks posed by the possibility that borrowers may default on mortgage payments. The company has one of the best loss mitigation programs in the industry. When there is a problem, Fannie Mae first seeks to resolve the issue through one of its loan workout options. Loan workout options include repayment plans, loan modifications, pre-foreclosure sales, and deeds-in-lieu. The repayment plan option allows borrowers to make up the delinquent payments over several months. In 2003, Fannie Mae's servicers closed 7,077 repayment plans. The loan modification allows the term of the mortgage to be adjusted, typically by extending the loan term or capitalizing the outstanding interest owed. Fannie Mae worked with servicers to modify 17,326 loans in 2003. In the case of a pre-foreclosure sale, which involves a delinquent borrower who cannot afford to remain in the home, Fannie Mae works with the servicer to sell the home and avoid foreclosure. In 2003, Fannie Mae and its servicers worked with borrowers to avoid foreclosure with the sale of 2,052 homes. The deed-in-lieu workout allows a borrower who cannot afford to remain in the home avoid foreclosure by giving the deed to Fannie Mae in lieu of the loan balance outstanding. In 2003, Fannie Mae and its servicers worked with 320 borrowers to avoid foreclosure by using the deed-in-lieu workout option.

Fannie Mae attempts to proactively engage borrowers before it becomes too late to intervene. The goal is always to try to prevent a homeowner from being foreclosed upon. In 2003, Fannie Mae and its servicers completed 26,775 workouts as compared to 26,788 foreclosed property acquisitions resulting in a workout ratio of 50 percent. Of the 26,775 borrowers who received loan workouts, over 90 percent were able to keep their homes.

Fannie Mae has implemented the following servicing and credit loss management strategies.

- ***Servicing Consultants.*** Fannie Mae has over 40 employees across the country that work as Servicing Consultants. Through this network of consultants, the company provides guidance and offers advice to servicers on policies and processes in implementing servicing and loss mitigation strategies.

- ***Asset Management Network and Home Saver Solutions.™*** A very important aspect of Fannie Mae's Asset Management Network is the creation of an avenue through which servicers, vendors, mortgage insurance companies, and attorneys can manage delinquent loan servicing and liquidation activities. Included in this Asset Management Network are the following: REO Property Information Application; Form 571; Cash Disbursement Request Application; and the Foreclosure, Eviction and Bankruptcy Tracking System. Fannie Mae's newest addition to this family of asset management tools is the ***Home Saver Solutions Network***. Originally launched as an option in February 2002, the *Home Saver Solutions Network* allows servicers to submit loss mitigation workout cases to Fannie Mae over the Internet. Once a lender provides the facts for any given delinquency and other borrower information, the application will automatically provide information about which workout options are most appropriate for the given circumstance. Through *Home Saver Solutions*, a lender with delegated loan modification approval authority can also use the Network to request reclassifications for MBS pool mortgages that are scheduled for modification.

- ***Assessing Risk.*** Being able to assess risk and the likelihood that an individual borrower will default is another important aspect of credit risk management. Since 1997, Fannie Mae has offered *Risk Profiler,*™ an automated risk assessment tool, to help servicers identify troubled loans that are in danger of default. *Risk Profiler* also enables Fannie Mae and lenders to keep people facing financial difficulty in their homes through loss mitigation. In 2003, over 80 percent of Fannie Mae's loans were scored using *Risk Profiler*.

IV. LOOKING AHEAD TO 2004

A. Housing Market Forecast

The housing market continued to surge in 2003, with home sales climbing to record levels for the third consecutive year. Mortgage rates, which fell to 45-year lows last spring, remained low for the entire year and helped drive the U.S. housing market—as did continued strong underlying demographics. Moreover, the generational lows in mortgage rates created an unprecedented refinance boom as many American homeowners took advantage of low mortgage interest rates. Many who refinanced also took advantage of continued strong house price appreciation (and thus rising wealth in their homes) and removed some of that equity while refinancing—helping to support consumer spending in a period when the rest of the U.S. economy was relatively weak.

In 2004, Fannie Mae expects the pickup in economic activity that began in the second half of 2003 to continue, with real GDP growth of around 4.5 percent, the fastest pace since 1999. Continued expansionary fiscal and monetary policy, combined with higher business and consumer confidence, should keep growth strong. It is anticipated that interest rates will be increased modestly at some point in 2004, as stronger borrowing demands pull rates up and the Federal Reserve begins to gradually tighten monetary policy as deflation concerns ebb. The Fed is unlikely to tighten in the first half of the year, however, as there are still worries that inflation could fall further and the pickup in growth could stall. Not only should this keep rates low well into 2004, expectations of continued low inflation, driven by strong productivity growth, should keep the expected rise in rates fairly modest.

Mortgage purchase originations are projected to rise to new record levels in 2004. While home sales should be little changed (modestly higher mortgage rates will be a small negative, but stronger job and income growth should roughly offset this), home prices are expected to rise by 4.5-5.0 percent. Purchase originations rose to an estimated record level of $1.18 trillion last year, and it is expected that they will rise to a new record of nearly $1.25 trillion in 2004. Driven by the low level of mortgage rates, refinance originations soared to a record $2.53 trillion in 2003 (about 68 percent of the market), but the modestly higher rates expected for this year should bring refinance activity down to only about $667 billion (about 35 percent of the market). Total mortgage originations (the sum of purchase and refinance volumes) also rose to a record $3.71 trillion last year – originations are expected to fall to $1.91 trillion in 2004, still the fourth strongest year ever. Mortgage debt growth also should slow in 2004 as refinance activity falls (and home price appreciation edges down), from a rapid 12.9 percent increase in 2003 to a still-strong 9.4 percent this year.

B. Fannie Mae Planned Activities: Expansion of the *American Dream Commitment*

In 2003, Fannie Mae exceeded the $2 trillion, 18 million household goal set under the *American Dream Commitment* and announced, in January 2004, the next stage of the company's efforts to tackle America's toughest housing problems. This new commitment is designed around three principal goals:

- expand access to homeownership for million of first-time homebuyers;
- make homeownership and rental housing a success for millions of families at risk of losing their homes; and
- expand the supply of housing where needed most.

Under the three-phase *American Dream Commitment* expansion plan, over this decade and the next ten years, Fannie Mae will pledge significant new resources through several dozen new and enhanced mortgage initiatives to achieve, among other things, the following:

- increasing the minority homeownership rate to at least 55 percent, with the ultimate goal of closing the gap between the minority and non-minority homeownership rates;
- financing 6 million first-time homebuyers and 1.8 million first-time minority homebuyers; and
- contributing to significant revitalization in 1,000 communities.

The company's broad based plan under the expansion of the *American Dram Commitment* will support change in communities, as illustrated below.

Expand Homeownership Opportunities for First-Time Homebuyers

To achieve this goal, Fannie Mae will focus on using technology to increase access to affordable housing products and reduce the cost of mortgage originations. The company will also build stronger partnerships with lenders and trusted advisors to first-time homebuyers; adapt products and processes that build upon public sector assistance to potential homebuyers and working families seeking affordable housing; and, work to transform manufactured housing lending.

Make Homeownership a Success for Millions of Families at Risk of Losing their Homes

Fannie Mae will continue to make its pre-purchase counseling technology, *Home Counselor Online*, available to lenders, housing organizations, community groups and others as well as developing strategies to combat predatory lending. Other actions the company plans to take to help families stay in their homes include creating new policies to expand responsible lending, and working with lender partners and counseling organizations to develop consumer-friendly product features and pre- and post-purchase counseling strategies. The company will also continue to support the preservation of affordable rental housing throughout the country.

Increasing the Supply of Affordable Housing Where Needed Most

A corporate focus will also include financing community development activities in at least 1,000 neighborhoods through the *American Communities Fund*, *Low-Income*

Housing Tax Credit, multifamily housing and other targeted investments over the course of the current decade. Areas of focus include, permanent supportive housing, rural communities, Tribal Lands, acquisition, development and construction mortgage participations, workforce housing and fair growth.

CONCLUSION

The 2003 AHAR illustrates the *who*, *what, how* and *why* behind Fannie Mae's efforts to increase access to mortgage credit for underserved families. The *who* includes lenders, nonprofits, government entities, housing advocates, trade associations and other partner organizations. The *what* are Fannie Mae's targeted initiatives, national and local partnerships. The *how* is the use of technology, product innovations and the development of process enhancements. And last, the *why* is Fannie Mae's commitment to its mission.

Fannie Mae believes that every American family has the right to affordable housing and in 2003, it supported this conviction by meeting HUD's housing goals requirements as follows:

- **51.8** percent of the units financed by Fannie Mae's eligible mortgage purchases served low- and moderate-income families;
- **32.0** percent of the units financed by Fannie Mae's eligible mortgage purchases were located in underserved communities;
- **20.9** 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
- **$11.62** billion in Fannie Mae multifamily financing qualified under HUD's special affordable housing goal.

In addition to these statutory requirements, the company continued to work on increasing homeownership rates among underserved populations through its own *American Dream Commitment*, and on fulfilling it's corporate pledge to meet President Bush's challenge to increase minority homeownership.

Building an "ownership society" in America never ends because America is a country with growing housing needs. Over the next 20 years, the Hispanic population is expected to grow by 75 percent, the African-American population by 28 percent, and Asian Americans by 80 percent. Over the next 20 years, the Harvard Joint Center for Housing Studies projects that the number of renter households is expected to grow by about two million families, in large part because of the expected growth in the immigrant population. These families will drive the housing market and drive Fannie Mae to continue looking for innovative partnerships, technologies and processes that ensure underserved Americans have their opportunity to achieve the American Dream.