6-15-1999

Fannie Memo re HUD Housing Goals Options

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June 15, 1999

MEMORANDUM FOR FRANK RAINES

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Subject: HUD Housing Goals Options

The following materials outline the options that Fannie Mae could pursue to engage HUD on the FY 2000 housing goals.

This memorandum is divided into three sections. The analysis in Section 1 focuses on the effects of accounting changes to reach the low- and moderate-income goal. The analysis suggests that even with very generous treatment by HUD on a variety of counting issues, reaching a 50 percent low- and moderate-income goal through this route alone would prove difficult for Fannie Mae. When applied to our business since 1993, the low-mod score calculated with the sum of the proposed – and quite ambitious – changes would only have exceeded 48 percent in one year –1997 – and would have fallen below 47 percent in three of the six years we studied.

The second section outlines the estimates for expansion into several lines of business with the potential for increasing our low- and moderate-income shares – specifically, manufactured housing, 5-49 unit multifamily housing, and Alt A/A- lending. This section also reflects stretch goals for MRBs and Low-Income Tax Credits as other sources of low- and moderate-income business. Provided we were able to use advantageous scoring rules – the combined incremental units for each of these products would still have left us short of a 50 percent goal in every year except 1998.

An attached table shows the incremental effects of each of the proposed score rule changes and each of the increases in low-mod business activity. It is helpful to keep in mind that in 1998, we would have needed to purchase an additional 205,275 units in order to have reached a 50 percent low-mod score. In 1997, we would have had to purchase an additional 77,990 low-mod units to reach a 50 percent low-mod score.

Finally, Section 3 presents other approaches to the goals that could achieve a 50 percent goals score, but would require more radical changes in the ways the goals are measured and/or represented. The three alternatives are: 1) Exclude single family refinancing business; 2) Measure the percentage of our business from units that serve one or more of the goals; or 3) Allocate bonus points for certain business that serves a public purpose.

Section 1: Changing the Accounting Rules

We are proposing 4 different changes to the scoring rules. The attached table shows the effects of each of these changes on our low-mod score.

a) Missing data. Currently, Fannie Mae must include units with missing data in the denominator when calculating goals performance. Excluding missing data from the denominator would have increased our single-family low-mod score in 1998 from 38.44 percent to 39.78 percent and our multifamily low-mod score from 93.07 percent to 94.37 percent. This change alone would have increased our overall score in 1998 from 44.09 percent to 45.5 percent.

b) Low-Income Housing Tax Credit. Current counting rules do not allow us to include the units assisted by the tax credits we purchase. We have estimated that counting tax credit investments could have added as much as 12,700 low- and moderate-income units in 1998 and just short of 12,000 units in 1997. Achieving this scoring change could have a considerable effect on our low-mod score going forward, given business plans to double our tax credit investments from $500 million in 1998 to $1 billion per year. Staff estimates that Fannie Mae could get credit for a total of 23,000 low-mod units per year going forward.

c) Mortgage Revenue Bonds. In 1998, Fannie Mae purchased $1.9 billion in MRBs, but only $.2 billion of these transactions counted toward our housing goals under the HUD rules. Two barriers affect our ability to count these units. The first barrier is a data collection issue: When Fannie Mae agrees to purchase a mortgage revenue bond, we cannot know the composition of the underlying mortgages (e.g. income of borrowers). Second, many of these transactions include other forms of credit enhancements – most notably GNMA – that do not count toward our goals. If HUD would allow us to count those units not otherwise credit-enhanced by GNMA or Freddie Mac, and allowed us to estimate the number of low-mod units financed in an MRB transaction, this approach would have achieved 11,000 additional low-mod units in 1998.

d) Government-Backed Loans. Current counting rules do not allow us to count government-backed loans toward our low- and moderate-income scores. We are able to count HECMs, Native American Loans, and Rural Guaranteed loans toward our Special Affordable housing score and we get 50 percent credit for Title I Home Improvement Loans. Adding back in HECMs, Native American Loans, and Rural Guaranteed loans would have increased our low-mod units by about 7,000 in 1997 and about 8,000 units in 1998.

If we convinced HUD to adopt all four of these options, Fannie Mae's score in 1997 for low-mod purchases would have been 48.02 percent and for 1998 our score would have been 45.86 percent. The gap – the number of additional low-mod units we would have had to produce even after including these generous scoring rules would have been 140,000 units in 1998 and 32,917 units in 1997.

Section 2: Business Opportunities to Reach New Goals

In order to reach higher stretch goals, there are several areas where Fannie Mae might expand to purchase goals-rich business. These areas are manufactured housing, 5-49 unit multifamily housing, sub-prime lending, and tax credits.

1) **Manufactured Housing**. Fannie Mae has historically captured 24 percent of this market overall, including both whole loans and REMIC purchases. The manufactured housing business unit is assuming purchases of 144,160 units in 1999 with 70 percent of these scoring toward the low-mod goal. This volume represents an increase of 30,000 low-mod units above 1998 levels. The attached analysis looks at our goals performance assuming that Fannie Mae would continue manufactured housing purchases at this higher level going forward.

2) **5-49 Unit Multifamily Housing**. The data suggests that in 1998, Fannie Mae purchased multifamily loans in the 5-49 unit property category covering just under 75,000 total housing units. We do not yet have enough data on this market to assess its true potential. Assuming $300 million in new, additional purchases of these loans, this would work out to approximately 9,231 additional units of multifamily housing with a low-mod share of 90 percent.

3) **Alt A/A- Market**. Efforts to expand into the Alt A and A- markets should also yield incremental business that will have a salutary effect on our low- and moderate income score. Single family business is estimating that the potential for this business in the first 12 months is $ _______ billion and XX,XXX units. They estimate that the low-mod shares of these units will be _______. [Frank Demarais to provide these numbers].

4) **Increasing Tax Credit Investments**. Current plans are to increase our tax credit business substantially. Estimates suggest that we will finance 35,000 tax credit units per year – an increase of 22,307 units above the amount assumed in the 1998 baseline.

Section 3: Other Alternatives for Reaching the Goals

1) **Single Family Purchase Money Mortgages Only**. Under this approach, HUD would calculate the annual goals using only units supported by purchase money mortgages for single family and all multifamily units. If this approach were adopted in 1998, Fannie Mae would have achieved a 52.7 percent share for the low-mod goal, a 31.0 percent share for the underserved goal, and a 21.3 percent share for the special affordable housing goal. In the two prior years, Fannie Mae's would have had a low-mod performance just below 50 percent in both years, an underserved areas performance of 28.4 percent in 1996 and 29.6 percent in 1997, and special affordable performance of 20.1 percent and 22.3 percent in 1996 and 1997 respectively.

   The advantages to this approach are that the scoring would remove the effects of single family refinancings, which are arguably a function more of interest rates than a function of our efforts to meet the goals. Freddie Mac suggested this approach and might have a higher comfort level with proceeding this way. The disadvantage of this approach is that it would de-emphasize refinancings for goals-qualified households. One could argue that you would want to provide an incentive for Fannie Mae to refinance mortgages to low- and moderate-income households, as these are families that would benefit from achieving lower interest rates.

2) **An All-In Goal**. Given the difficulties in reaching higher goals through counting rule changes, another option for reaching a 50 percent goal would be to calculate a the percentage of units meeting one or more goal as a percentage of our total HUD-eligible units. In 1998, 53.01 percent of our business met one or more of the HUD goals; in 1997, 55.86 percent of our units met one or more of the HUD goals.

3) **Create a Bonus System**. Finally, HUD could adopt a system for calculating the goals that provides extra credit for categories of lending that meet a public purpose goal. This type of approach would provide an incentive to the secondary market to go after this type of business. For example, HUD could allow us to count loans to households below 60 percent of area median income, minority households, or first-time homebuyer households twice. Under an approach that gave Fannie Mae double credit for first-time homebuyers, we would have achieved a total low-mod score of 47.81 percent in 1998 and 51.85 percent in 1997.