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Good morning, Chairman Shelby, Ranking Member Sarbanes, and distinguished members of the Committee. Thank you for the opportunity to testify today about the role of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) in promoting affordable housing and homeownership opportunities for low- and moderate-income Americans and the Administration's initiatives to ensure that these government-sponsored enterprises, or GSEs, refocus on this important mission.

Over the past few decades, America's homeownership rate has grown steadily. It now stands at a record 69.2 percent and is a testament to the steadfast commitment to housing by successive Congresses and Administrations over the past 70 years. The Bush Administration has demonstrated its commitment to housing and homeownership through the American Dream Downpayment Initiative, the homeownership voucher, and the President's Blueprint for the American Dream.

The minority homeownership rate is also at a record high at 51.4 percent, and the gap between white and minority households has been narrowing. However, there is still more work to be done. Despite the recent gains in homeownership among minorities, the Administration believes it is important to extend homeownership opportunities further. For this reason, President Bush has embraced the goal of creating 5.5 million new minority homeowners by the year 2010.

HUD and its predecessor agencies have played a key role in implementing Congress' and the Nation's long-standing housing policies, both through its Federal Housing Administration (FHA) and Government National Mortgage Association (Ginnie Mae) programs and as a regulator of Fannie Mae and Freddie Mac. This morning, I would like to focus my remarks on the Administration's recent affordable housing initiatives with respect to Fannie Mae and Freddie Mac. As these initiatives make clear, it is the Administration's purpose to ensure that these GSEs fulfill the public purposes that Congress intended when it authorized their creation.

I. Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac are the largest specialized financial institutions in the United States housing finance system. They are considered to be "government-sponsored" because Congress authorized their creation and established their public purposes. These statutory purposes are to:

1. Provide stability in the secondary market for residential mortgages;

2. Respond appropriately to the private capital market;

3. Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

4. Promote access to mortgage credit throughout the nation (including central cities, rural areas, and other underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

While Fannie Mae and Freddie Mac are Congressionally chartered, they are also private, shareholder-owned corporations. Both GSEs fund residential mortgages by purchasing loans/securities directly from lenders and either holding the loans/securities in portfolio as investments or issuing and guaranteeing mortgage-backed securities (MBS) that are sold to a wide variety of investors in the capital markets.

II. Statutory and Regulatory Background

When Congress assigned HUD regulatory authority over Fannie Mae in 1968, it authorized HUD to require that a “reasonable portion” of Fannie Mae's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families. In 1989, Congress granted the Department essentially identical authority over Freddie Mac pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

In 1992, Congress passed the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) which established the current regulatory structure for the GSEs. FHEFSSA established the Office of Federal Housing Enterprise Oversight (OFHEO) as the GSEs' safety and soundness regulator and affirmed, clarified and expanded the Secretary of Housing and Urban Development's GSE regulatory authority. Under FHEFSSA, Congress charged the Secretary of HUD with general regulatory authority over Fannie Mae and Freddie Mac in all areas other than the GSEs' financial safety and soundness.

Specifically, the Secretary's authority includes monitoring compliance with fair lending requirements, collecting loan-level data from the GSEs on their mortgage purchase activities, creating and making available to the public a database of non-proprietary GSE loan purchase data, and reviewing and approving new GSE programs with express authority to disapprove any program that the Secretary determines is not authorized under a GSE's charter act or that otherwise is not in the public interest. The Secretary also has general authority to ensure that the GSEs comply with their charters with respect to ongoing activities.

The legislative history also reflects Congress’ strong concern that the GSEs need to do more to benefit low-and moderate-income families and residents of underserved areas that lack access to credit. In recent years, the GSEs’ public mission has evolved further to focus new resources on families and communities that have been traditionally underserved by the mortgage markets. For that reason, the Secretary’s authority also includes setting the level of, monitoring, and enforcing, three affordable housing goals, as follows:

- Low- and Moderate-Income Housing Goal: Targets families with incomes at or below the area median income. ("Area median income" is defined as the median income of the metropolitan area, or for properties outside of metropolitan areas, the median income of the county or the statewide non-metropolitan area, whichever is greater.);

- Special Affordable Housing Goal: Targets very low-income families (at or below 60% of area median income), and low-income families in low-income areas (at or below 80% of area median income); and

- Underserved Areas Housing Goal: Targets families living in low-income census tracts or in low- or middle-income census tracts with high minority populations.

HUD has published three regulations pursuant to its authority under FHEFSSA to establish, monitor, and enforce the housing goals. Each regulation set new levels for the housing goals and was dated as follows: December 1, 1995 (establishing housing goals for the years 1996-2000); October 31, 2000 (establishing housing goals for the years 2001-2004); and November 2, 2004 (establishing housing goals for the years 2005-2008).

III. HUD's 2004 Final Rule – New Affordable Housing Goals

HUD's most recent final rule reflects the Administration's belief that the GSEs can and should do more to promote access to mortgage credit for those traditionally underserved by the mortgage markets. As demonstrated earlier, this belief is fully consistent with Congress' historical support for affordable housing and homeownership opportunities as well as HUD's long-standing commitment to furthering these objectives.

HUD's final rule implemented three main changes to the housing goals:

(1) Goal levels are significantly higher than HUD's goals for 2001-2004;

(2) The final goal levels rise in nearly equal stages from year-to-year. This staging will allow the GSEs time to adjust their business models to meet the required levels; and

(3) The final rule establishes Home Purchase Subgoals under each housing goal.

(A) HUD Sets Higher Housing Goals in 2005 – 2008

The following table summarizes the housing goal levels for the years 2005-2008, and compares the new housing goal levels to those in effect for 2001-2004:

Housing Goal	Goal Levels in: 2005	2006	2007	2008	Goal Levels 2001-2004
Low- and Moderate Income	52%	53%	55%	56%	50%
Special Affordable	22%	23%	25%	27%	20%
Underserved Areas	37%	38%	38%	39%	31% (1990 Census Data) 36% (2000 Census Data)

These goals have been set with the objective of ensuring that the GSEs fulfill their mandate to provide leadership to the mortgage market. By 2008, the goals will require that the GSEs at least "meet the market," meaning that the GSEs' purchases of mortgages in each goals category will be proportional to the share of all mortgages in the conventional conforming market that fall within that category. They will match HUD's calculation of market share averages for 1999-2003 and will be at the high end of HUD's estimated market share range for 2005-2008.

HUD has raised the Underserved Areas housing goal from 31 percent to 37 percent to reflect changes in our population, including a growing number of minority families, as shown by the 2000 census. The 31 percent Underserved Area housing goal for 2001-2004 was based on the 1990 census data. However, this same housing goal would equal 36 percent if it had been based on the 2000 census data, which show a large increase in the number of census tracts qualifying as underserved. HUD used the 2000 census data to create the housing goals for 2005-2008.

The new goals for 2005 and thereafter represent increases from the GSEs' average performance in 1999-2003 (adjusted to be consistent with the counting rules that take effect in 2005), which was as follows:

Housing Goal	Fannie Mae	Freddie Mac
Low-and Moderate-Income	49%	47%
Special Affordable	20%	19%
Underserved Areas *	35%	32%

(*The Underserved Area percentage is based on the 2000 census data, which show a large increase in the number of census tracts qualifying as underserved.)

HUD's purpose in setting higher housing goals is to encourage the GSEs to facilitate greater financing and homeownership opportunities for families and neighborhoods targeted by the housing goals. To enable the GSEs to achieve this leadership, the Department established staged increases in housing goal levels for 2005, which will increase further, year-by-year through 2008, to achieve the ultimate objective for the GSEs to at least meet the market under a range of foreseeable economic circumstances by 2008.

However, meeting the goals does not necessarily result in the GSEs' meeting the market. HUD defines the "market" as all conventional conforming loans, including A-minus and manufactured housing loans, that meet HUD's housing goal eligibility criteria and which could be sold to a GSE by a primary market lender. HUD's definition excludes all government insured and guaranteed loans, such as FHA and VA loans, as well as jumbo loans and B/C-quality loans. In analyzing the GSEs' past performance under HUD's previous regulations, even though the GSEs had typically met the housing goals in each year, the goals had not been set at the upper ranges of HUD's market share estimates for those years. Therefore, even though the GSEs had achieved each of the housing goals under the previous regulations, the GSEs, in fact, continued to serve less of the affordable housing market than was served by conventional conforming primary market lenders during those years.

The GSEs' state-of-the-art technology, staff resources, share of the total conventional conforming market, and financial clout strongly suggest that they have the ability to lead the industry in making home purchase credit available for underserved families and communities. They are also well positioned to lead the industry with innovative products that effectively remove traditional barriers to homeownership, especially for minorities and first-time homebuyers.

Failure to meet the market has an especially deleterious effect on first-time homebuyers. For example, as the table below demonstrates, first-time homebuyers accounted for 25.9 percent of the GSEs' combined total purchases of home loans during the 2001-2003 time period compared to 39.1 percent of home loans originated in the conventional conforming market. Loans for African-American and Hispanic first-time homebuyers accounted for only 4.2 percent of the GSEs' purchases of home loans, compared to 9.0 percent of all first-time homebuyer loans originated in the conventional conforming market during the same time period. (HUD's first-time homebuyer definition for the market analysis is homebuyers who have never owned a home. The definition for the GSEs is purchasers who have not owned a home within the past three years.)

GSE LOANS TO FIRST-TIME MINORITY HOMEBUYERS: 2001-2003 AVERAGES

	Fannie Mae	Freddie Mac	Both GSEs	Market *
All Race/Ethnicity Groups	25.7%	26.1%	25.9%	39.1%
Minority	7.5%	6.1%	6.9%	12.3%
African-American and Hispanic	4.7%	3.5%	4.2%	9.0%

(* "Market" means conventional, conforming home purchase loans. This analysis is limited to loans on properties in metropolitan areas.)

Troublesome gaps in homeownership remain for minorities even after record growth in affordable lending and homeownership during the nineties. Studies indicate that, over the next few years, minorities will account for a growing share of the families seeking to buy their first home. HUD's analyses indicate, however, that Fannie Mae and Freddie Mac account for a disproportionately small share of the minority first-time homebuyer market. The GSEs have a responsibility to promote equal access to capital for minorities and others who are seeking their first homes, and to demonstrate the benefits of such lending to industry and borrowers alike. The GSEs also have an integral role in eliminating predatory mortgage lending practices.

(B) HUD Establishes Home Purchase Subgoals to Promote Homeownership

HUD's final rule establishes Home Purchase Subgoals, which the Department believes are necessary and warranted. Increasing homeownership is a national priority. However, the past average performance of the GSEs in the home purchase market has been below market levels. The GSEs must apply greater efforts to increasing homeownership for low- and moderate-income families, families living in underserved areas, and very-low income families and low-income families living in low-income areas. The addition of Home Purchase Subgoals to the regulatory structure will serve to better focus the GSEs' efforts in a clear and transparent manner. The Home Purchase Subgoals will better allow the government and public alike to monitor the GSEs' efforts in meeting the Nation's homeownership needs.

The final rule implements new Home Purchase Subgoals under each housing goal, as follows:

Housing Goal Categories	Home Purchase Subgoal Levels			
	2005	2006	2007	2008
Low-and Moderate Income	45%	46%	47%	47%
Special Affordable	17%	17%	18%	18%
Underserved Areas	32%	33%	33%	34%

Because there has been some confusion about these subgoals, I would like to clarify exactly what they mean. Under the Home Purchase Subgoals, there is no requirement for the GSEs to buy any particular number of home purchase loans. The goals are set in percentage terms. Whatever number of home purchase loans in metropolitan areas the GSEs buy, a certain percentage would need to be in each goal category. For example:

- If a GSE buys 1 million home purchase loans in 2005, then 450,000 would need to be for low- and moderate-income families.
- If a GSE buys 100,000 home purchase loans in 2005, then 45,000 would need to be for low- and moderate-income families.
- Indeed, if a GSE buys only 100 home purchase loans in 2005, then 45 would need to be for low- and moderate-income families.

The purpose of the Home Purchase Subgoals is to ensure that the GSEs focus on financing home purchases for homeowners targeted by the housing goals. HUD believes the new subgoals will place the GSEs in a leadership position in the housing goals categories while facilitating homeownership. The subgoals are also likely to help address racial and income disparities in homeownership that exist today. For example, although minority homeownership has grown, the homeownership rate for African-American and Hispanic families is still approximately 25 percentage points below that for non-Hispanic white families.

In setting the level of the Home Purchase Subgoals, HUD considered the GSEs' past performance in purchasing subgoal-qualifying home purchase loans. Their average goal qualifying percentages for home purchase mortgages under each housing goal in 1999-2003 was as follows:

Housing Goal	Fannie Mae	Freddie Mac
Low-and Moderate-Income	43%	42%
Special Affordable	15%	15%
Underserved Areas*	30%	28%

(* Percentages for the Underserved Areas goal include effects of the 2000 census.)

(C) HUD Increased the Special Affordable Multifamily Subgoal

In its 1995 final rule, HUD established a dollar-based multifamily subgoal under the Special Affordable Housing Goal. The multifamily subgoal sets a minimum dollar volume of qualifying multifamily mortgage purchases that each GSE must meet annually. In the 2004 final rule, HUD retained this subgoal but raised the minimum requirement for the years 2005-2008 as follows:

Special Affordable Multifamily Subgoal	New Subgoal Levels 2005-2008	Previous Subgoal Levels 2001-2004
Fannie Mae	$5.49 billion	$2.85 billion
Freddie Mac	$3.92 billion	$2.11 billion

(D) Impact of the Goals and Subgoals

The GSEs have been increasing their purchases of loans for low-income families and in underserved areas. Under the new goals and subgoals, the GSEs' performance will continue to improve. HUD expects that the GSEs will develop new products and make prudent adjustments to their underwriting standards to reach out to more low-income and minority first-time homebuyers, which will help them achieve the new goal and subgoal levels. This is particularly significant given the anticipated growth over the next few years in immigrant and minority households. In general, loans that qualify for the housing goals are more likely to be for first-time homebuyers, minorities, and borrowers requiring low down payments. These are areas where the GSEs have lagged the conventional, conforming primary market in funding mortgages for borrowers on the margin of homeownership.

The new goals and subgoals will particularly benefit first-time homebuyers. The GSEs will fund more loans for these prospective homeowners, which will result in many low-income and minority first-time homebuyers benefiting—for the first time—from low, prime market interest rates. HUD projects that to attain the new housing goals, the GSEs together will purchase an additional 400,000 goal-qualifying home loans during the four-year period 2005-2008 above the level they would purchase without the increases.

(E) HUD Considers New Counting Treatment Options for Refinance Mortgages

In setting the housing goals, HUD based the levels of the housing goals on market estimates that assumed a higher level of home purchase mortgages than refinance mortgages. However, the level of refinance activity in the primary market is variable, mostly depending upon interest rate fluctuations. HUD believes that refinance mortgages should count towards the goals because they help to sustain homeownership by providing opportunities for families to finance their homes on a more affordable basis. Refinance mortgages also provide subprime borrowers with an opportunity to lower their financing costs.

Even though FHEFSSA and HUD's regulations include a provision for determining the feasibility of a housing goal in any year, HUD has decided to consider – through separate rulemaking – a new provision for addressing the GSEs' ability to meet the housing goals in a high refinance environment. On November 2, 2004, HUD published an advance notice of proposed rulemaking (ANPR) soliciting comments on how it might add a regulatory provision that accommodates a high refinance environment under the housing goals. HUD received 23 comments representing 29 organizations, including trade associations, housing advocacy organizations, and the GSEs. HUD is currently reviewing the public comments and considering the suggestions and proposals of the commenters on how HUD may structure a regulatory provision for the treatment of refinance mortgages under the housing goals in a high refinance environment.

(F) Regulatory Issues Other Than the Housing Goals

(a) <u>Transactions with Seller Dissolution Options.</u>

In 2004, some public concern was raised about large year-end transactions entered into by the GSEs with lenders involving the GSEs' purchase of seasoned mortgages, and whether these transactions should count toward the housing goals. Of particular concern were transactions that occurred in 2003 between Freddie Mac and Washington Mutual (WaMu) and Citibank, and Fannie Mae and WaMu. HUD's review of these transactions revealed that they contained dissolution options exercisable by the seller.

Such transactions with seller dissolution options – when a seller can exercise its option to reverse or unwind a transaction and take back the mortgages within a short time period – raise questions as to whether these transactions provide liquidity because the transaction may be temporary and the resulting liquidity may also appear transitory. On the other hand, HUD recognizes that transactions with seller dissolution options play a legitimate role in serving the short-term liquidity needs of lenders as well as other business needs associated with management of risks, profitability, and capital.

In its 2004 final rule, HUD determined that placing no constraints on goals eligibility for transactions with dissolution options would have the effect of encouraging transactions that are so short-term as to be dissolvable almost immediately after they have been counted towards the housing goals. Clearly such an outcome would be at odds with FHEFSSA.

To forestall this possibility, HUD amended its counting rules to provide that, in order for housing units acquired in transactions with seller dissolution options to count toward the housing goals, two criteria must be met:

1) The terms of the seller dissolution agreement must provide for a minimum one-year lockout period before the transaction can be dissolved; and

2) The transaction cannot be dissolved during the one-year lockout period. The Secretary can grant an exception to the one-year limitation if the Secretary determines that the transaction furthers the GSE's charter purposes and the purposes of FHEFSSA.

The Department believes that the one-year lockout period will prevent potential misuse of these transactions. The Department's limit on dissolution options applies to all transactions, regardless of size, because it is the potential for misuse, rather than the size of the transaction, that could conflict with FHEFSSA.

(b) Double-Counting Seasoned Loans

HUD, in the course of reviewing Freddie Mac's 2002 mortgage purchases, discovered that Freddie Mac had counted some units towards its Low- and Moderate-Income and Underserved Areas housing goals in 2002 even though it had previously counted these same units under these goals in earlier years. HUD's regulations prohibit "double counting" of seasoned mortgages by the GSEs – i.e., counting a seasoned mortgage towards the goals if the mortgage was counted in a previous year. The housing units that Freddie Mac counted in 2002 were not eligible for goals credit and, as a result, Freddie Mac overstated its goals performance under these two goals in 2002.

HUD determined that in 2002 Freddie Mac had counted 31,951 housing units towards the Low-and Moderate-Income housing goal and 25,671 housing units towards the Underserved Areas goal even though it had previously counted these same mortgages (and housing units) towards goal performance in earlier years. Adjusting Freddie Mac's 2002 performance for the improperly credited units resulted in Freddie Mac's failing to achieve the Underserved Area housing goal of 31 percent in 2002. Freddie Mac's adjusted performance in 2002 is 30.97 percent, or 0.03 percent short of the required goal. This represents a shortfall of 1,222 housing units. Freddie Mac's performance under the Low-and Moderate-Income housing goal was also adjusted downward from 50.5 percent, but still exceeded the goal of 50 percent.

In its 2004 final rule, HUD made a change to its regulations clarifying the prohibition on the double counting of seasoned mortgages. HUD has also implemented new review procedures that will improve its monitoring in this area.

(G) HUD Implements New Data Integrity Provisions

The double-counting errors noted above highlight the need for strong regulatory mechanisms to ensure the accuracy and completeness of the housing goal data provided to HUD by the GSEs. HUD's 2004 final GSE housing goals rule includes new provisions that HUD believes will provide it with better tools to evaluate the accuracy, completeness, and integrity of GSE data and to limit and remedy errors in that data.

One new regulatory provision that would have been useful to the Department with regard to the discovery of the Freddie Mac's 2002 double-counting errors is a procedure to correct for prior year reporting errors, omissions and discrepancies in GSE data. (It should be noted that the discovery of Freddie Mac's shortfall in 2002 occurred prior to the effective date of HUD's final rule and the new provision.) The Department promulgated this new regulatory provision as part of its efforts to ensure the integrity of GSE data.

The new provision requires a GSE to compensate for errors, omissions, or discrepancies that occurred in a prior reporting year when any such error resulted in a GSE achieving a goal or Special Affordable subgoal that it otherwise would have failed. To remedy the prior year error, the Secretary may direct the GSE to compensate for an overstatement in its housing goal performance by purchasing additional mortgages that finance the lesser of either: (1) the number of units that HUD has determined were overstated in the prior year, or (2) the percentage of the overstatement as applied to the most current year-end performance.

Housing units or mortgages purchased to compensate for a prior-year overstatement must qualify under the same housing goal or Special Affordable subgoal that was overstated in the prior year. Purchases must occur by the end of the calendar year immediately following the year in which the Secretary notifies the GSE of the overstatement. The Secretary may extend this date. In addition,

- The additional units or mortgages purchased to compensate for the overstatement will not count towards the housing goals in any year, including the current year or the year in which the overstatement occurred.

- If a GSE does not compensate for the prior-year overstatement, the Department may issue a notice regarding the housing goal or subgoal failure; seek additional enforcement remedies; and/or pursue any other civil or administrative remedies available to it.

To promote greater corporate accountability, HUD also implemented a requirement that the GSEs must certify to the accuracy of their Annual Housing Activity Reports, including data tables and mortgage data. HUD may also require that the GSEs certify to the accuracy of such other data, information and reports as determined by the Secretary.

CONCLUSION

In conclusion, HUD's recent final rule, which will promote new homeownership opportunities for those who have traditionally been underserved by the mortgage markets, continues a long tradition of support for the Nation's housing markets. It is designed to leverage the strengths that both Fannie Mae and Freddie Mac have developed and perfected as government-sponsored enterprises and will ensure that both GSEs focus their considerable resources on meeting the growing housing demands of America's changing population.

This concludes my statement, Mr. Chairman. I thank the Committee for the opportunity to meet with you today to discuss Fannie Mae's and Freddie Mac's role in promoting affordable housing and homeownership opportunities for low- and moderate-income Americans and the Administration's initiatives to ensure that these GSEs renew their focus on this important mission.