

**Testimony of Terri Y. Montague
President and Chief Operating Officer
The Enterprise Foundation**

**On
“The Secondary Mortgage Market Enterprises Regulatory Improvement Act
And the Administration’s proposals on GSE regulation”**

For the House Committee on Financial Services

September 25, 2003

Introduction

Thank you, Chairman Oxley, Ranking Member Frank and members of the Committee for this opportunity to share with you The Enterprise Foundation’s views on government regulation of Fannie Mae and Freddie Mac.

I am Terri Montague, president and chief operating officer of The Enterprise Foundation. Enterprise is a national nonprofit organization that provides private capital to support affordable housing and economic development in low-income communities. Enterprise and its wholly owned subsidiary companies have invested \$4.4 billion to finance 144,000 affordable homes for low-income families and individuals, including more than 12,000 in 2002. We are currently investing half-a-billion dollars a year to help connect low-income people and communities to the mainstream economy.

We have no more important partners in our work than Fannie Mae and Freddie Mac. The companies have been indispensable to Enterprise’s efforts to expand housing opportunities for low-income homebuyers and renters. In many cases, Fannie Mae and Freddie Mac alone were willing and able to help Enterprise meet the needs of the people and places we serve. Without them, much of our work simply would not be possible.

In the interest of full disclosure, the Committee should know that Enterprise regularly seeks support from many major financial institutions, including Fannie Mae and Freddie Mac. The companies and their corporate foundations, along with other financial institutions, have been major contributors to The Enterprise Foundation.

In addition, we have sought out senior executives from financial institutions to lend their talent, energy and personal contributions to our cause. Franklin Raines, Fannie Mae’s chairman and chief executive officer, and Barry Zigas, senior vice president and executive director of Fannie Mae’s National Community Lending Center, are Trustees of The Enterprise Foundation. Mr. Zigas has served since his days as executive director of the National Low Income Housing Coalition. Our Board also includes executives from other financial institutions who are committed to affordable housing.

First, Do No Harm

Congress is considering significant changes to the federal government's regulation of Fannie Mae and Freddie Mac. The administration and members of Congress have proposed a new regulator and expanded regulatory authority for Fannie Mae and Freddie Mac's financial safety and soundness, as well as their new activities. In addition, the administration has proposed to increase regulation of Fannie Mae and Freddie Mac's congressionally mandated affordable housing responsibilities.

We encourage Congress to deal with these issues as expeditiously as possible to avoid any uncertainty in the mortgage markets. In acting, Congress should follow the "Hippocratic housing oath:" first, do no harm. It is imperative that any congressional action affecting Fannie Mae and Freddie Mac does not limit the companies' ability and incentive to address the housing needs of low-income people and communities. Any changes to their federal regulation should, in fact, enhance the companies' capacity to innovate in furtherance of their vital public purpose mission. This is our sole priority in Congress' review of Fannie Mae and Freddie Mac's regulation.

Certainly, the safety and soundness of Fannie Mae and Freddie Mac is critical for taxpayers and the economy. Vigorous regulation is essential. There is no reason, however, that strong safety and soundness oversight should chill or constrain Fannie Mae and Freddie Mac's vitally important affordable housing activities—and it must not be encouraged or enabled to do so. In fact, the interests of affordable housing and safety and soundness are very compatible, if carried out the right way. We are encouraged that the administration has not indicated a need to change the new risk-based capital standards for Fannie Mae and Freddie Mac at this time. Enterprise has worked hard to ensure that implementation of those standards does not undermine the companies' affordable housing activities.

We also agree with the administration that there is no reason to change Fannie Mae and Freddie Mac's mission, charter or status. And we agree with the administration that the Department of Housing and Urban Development (HUD) should remain responsible for ensuring Fannie Mae and Freddie Mac's compliance with their affordable housing responsibilities.

Issues of Concern in Pending Proposals

The balance of our testimony addresses three critical issues regarding federal regulation of Fannie Mae and Freddie Mac that the administration and members of Congress have raised recently: 1) the location of the regulator responsible for approving new Fannie Mae and Freddie Mac initiatives; 2) the scope of that approval authority; and 3) the establishment and enforcement of Fannie Mae and Freddie Mac's affordable housing responsibilities.

Location of approval authority. Under current law, HUD is responsible for approving new Fannie Mae and Freddie Mac programs. The administration has proposed transferring this authority to a new agency that also would regulate Fannie Mae and Freddie Mac's financial safety and soundness. The administration has said it would support establishing such an agency as a bureau of the Treasury Department. The new agency would "consult" with HUD on new programs. Subcommittee Chairman Baker's (R-LA) legislation (H.R. 2575) would leave HUD in charge of "prior approval authority."

We agree with Chairman Baker that HUD should retain this responsibility. We are not aware of any evidence that HUD has not exercised prior approval authority appropriately. HUD is the only federal agency with expertise in affordable housing and a mission to advance it. Only HUD has the benefit of more than a decade of experience working with Fannie Mae and Freddie Mac to evaluate new programs. Getting a new agency up a new learning curve for no apparent gain seems an ill-advised use of limited resources.

Scope of approval authority. Current law requires Fannie Mae and Freddie Mac to obtain HUD's approval for any "new program" before implementing the program. The law generally requires HUD to approve any new program unless HUD finds that the new program does not comply with the appropriate company's charter or is not in the public interest. H.R. 2575 would require Fannie Mae and Freddie Mac to obtain HUD approval before commencing any "new activity," including changes to existing (approved) "programs, activities, business processes and investments" or expansion of (approved) programs.

Again, we wonder what problem this provision purports to fix. As noted above, HUD has exercised its prior approval authority appropriately. In addition, HUD has the authority under current law, which it has exercised, to itself initiate a request for information from Fannie Mae and Freddie Mac regarding what it considers possible new programs.

Requiring Fannie Mae and Freddie Mac to seek federal government sign-off on changes to such a wide range of activities could curtail the companies' ability to respond effectively to changes in the mortgage markets, such as rising interest rates. The expanded approval authority in H.R. 2575 also almost certainly would inhibit the companies' incentive to innovate. Low-income consumers and communities, which often benefit most from Fannie Mae and Freddie Mac's innovative initiatives, could lose out.

We recall that a primary purpose of prior approval authority when it was enacted in 1992 was to encourage and enhance Fannie Mae and Freddie Mac innovation in support of their affordable housing mission. We worry that the prior approval provision in H.R. 2575 would have the opposite effect. We wonder, for example, whether Fannie Mae would have had the same ability and incentive to pioneer with Enterprise the Low Income Housing Tax Credit (LIHTC) if the company had been subject to the approval requirements H.R. 2575 would impose.

Hardly any corporations were willing to commit capital to support affordable housing for low-income people through the LIHTC when the program was new. Virtually no federal officials understood the program. Even many housing groups that had advocated for the credit were not sure how well it would work. Fannie Mae stepped up when others would not to commit \$25 million in investment through Enterprise and worked with us convince other corporations to invest. Together, we helped create the corporate market in LIHTC investments. Freddie Mac joined Fannie Mae several years later in helping to expand the market of LIHTC investors by making matching pledges for state and local LIHTC investment.

Fannie Mae and Freddie Mac's commitment to this fledgling federal incentive sent a strong signal to the marketplace that the Credit was a sound investment. Their participation solidified the program at a critical juncture, when its future hung in the balance. The LIHTC is now the most important federal incentive for the development of rental housing for low-income people, accounting for more than 115,000 affordable apartments for working families, seniors, homeless individuals and people with special needs every year. It is impossible to imagine such success without Fannie Mae and Freddie Mac's early and sustained participation.

Establishment and enforcement of affordable housing responsibilities. As the Committee is aware, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires Fannie Mae and Freddie Mac to dedicate substantial portions of their business to serving low-income people and underserved communities. They must meet annual goals, established by HUD, and expressed as a percentage of all the housing units for which the institutions provide financing, in the following categories: loans to low- and moderate-income borrowers (minimum 50 percent of all units financed by each company for 2003); loans in central cities, rural communities and other underserved areas (31 percent); and "special affordable" loans to very low-income borrowers and low-income borrowers living in low-income areas (20 percent).

The administration has proposed expanding HUD's ability to establish, maintain and enforce Fannie Mae and Freddie Mac's "affordable housing goals." While we have not seen details of the administration's proposal, the proposal would appear to require significant statutory changes. We see no reason to change the statutory framework for the affordable housing goals at this time. Let us be very clear: Enterprise has long encouraged Fannie Mae and Freddie Mac to increase their affordable housing activities. The companies could and should do more to help meet pressing housing needs. But changing the statute is the wrong approach.

HUD has the authority already to increase the percentage-of-business targets in each statutory goal category. HUD also has the authority under current law to incentivize Fannie Mae and Freddie Mac to achieve more specific affordable housing objectives, such as through bonus points, and, on a more limited basis, through "subgoals" of the "special affordable" housing goal.

HUD has utilized both types of authority effectively in the past, resulting in substantial increases in Fannie Mae and Freddie Mac's affordable housing financing.

HUD's most recent regulatory revision of the affordable housing goals, in 2000, resulted in Fannie Mae and Freddie Mac increasing their mortgage financing for low-income and underserved people and communities by nearly half-a-billion dollars between 2001 and 2011. That increase will enable the companies to serve 7 million families beyond the 21 million they already had committed to assist during that period. HUD also established bonus points in 2000 to increase Fannie Mae and Freddie Mac financing for small multifamily properties and owner-occupied two-to-four unit properties that also contain rental units.

More can be done under the current regulatory authority. In fact, the current affordable housing goals are up for a regulatory revision this year. We are not aware whether HUD plans to update the goals. We are not aware of any effort by the Department to seek the advice and assistance of housing organizations in any goal revision. If HUD intends to review the goals, we urge it to work with a wide range of housing organizations, including Fannie Mae and Freddie Mac, as it always has in the past, before moving forward.

We would support strengthening aspects of the affordable housing goal regulations to require, encourage and enable Fannie Mae and Freddie Mac to serve lower income borrowers and underserved areas. For example, we would support tightening the definition of "low-income" for the purposes of the "underserved areas" goal. The current regulation generally defines "underserved areas" as census tracts having a median income at or below 120 percent of metro median income and a minority population of 30 percent or greater, or a median income at or below 90 percent of metro median income. In rural areas, 95 percent substitutes for 90 percent (among other differences). The 90 percent and 95 percent targets should be changed to 80 percent, to align the definition of "low income" with the other parts of the goals regulation and other HUD programs and to get more resources where they are more needed.

In addition, we would support providing additional incentives to encourage greater Fannie Mae and Freddie Mac activity in other underserved segments of the market. These areas could include manufactured housing loans; single family loans to underserved minorities; single and multifamily rehabilitation loans; single and multifamily loans in Native America areas; single and multifamily loans in Empowerment Zones and Renewal Communities; loans to low-income rural borrowers; and loans to properties with expiring Section 8 contracts.

We also would strongly support measures to enhance Fannie Mae and Freddie's Mac's ability to pioneer innovative programs and initiatives such as financial guarantees, risk-sharing and targeted loan programs with mission-oriented partners, such as state housing finance agencies and community development financial institutions.

Enterprise's experience with Fannie Mae is illustrative. For example, Fannie Mae and Enterprise created a lending program, Enterprise Mortgage Investments (EMI), that provides low-cost capital and credit enhancement for rental housing for low-income working families. EMI's portfolio today includes nearly \$300 million in financing,

totaling more than 10,000 affordable apartments. Enterprise and Fannie Mae also launched a venture in the early 1990s, Cornerstone Housing Corporation, which acquired government-owned foreclosed properties from the Resolution Trust Corporation and preserved their affordability. Cornerstone helped save more than 5,000 apartments for low-income people in mixed-income communities.

Fannie Mae and Freddie Mac have developed similar initiatives with many other organizations that broke new ground in affordable housing. These innovations have often pointed the way for the mainstream market to follow—benefiting those institutions’ bottom lines and millions of low-income people. The ability to “test market” new private-public partnerships at scale is a unique value only Fannie Mae and Freddie Mac can provide in affordable housing.

Interestingly, Fannie Mae and Freddie Mac receive no affordable housing goals credit for their investment and direct lending activities, which are often the ways in which they have supplied the most innovative and important forms of capital to a variety of partners that reach extremely low-income people. Certainly, there should be an effort to encourage Fannie and Freddie Mac to make more of this capital available and to reward them for doing so in a financially prudent way.

Finally, we would support constructive efforts to enable Fannie Mae and Freddie Mac to play a more active role in the subprime mortgage market. The companies’ resources, capacity and clout could position them to increase alternatives to predatory lenders, which are still stripping wealth and assets from too many low-income families. We commend HUD for imposing tough standards to help ensure Fannie Mae and Freddie Mac do not receive affordable housing goal credit for purchasing certain high cost loans. And we commend the companies for the strong steps they have taken on their own to help fight the predators. Working with HUD, mortgage lenders and housing advocates, we believe the companies could find additional ways to serve subprime borrowers and create a strong, fair secondary market for subprime loans.

The last time Congress revised Fannie Mae and Freddie Mac’s statutory framework, it expressly provided the companies the freedom and flexibility to respond to fast moving market conditions and help meet our nation’s affordable housing needs. The companies have consistently met their affordable housing responsibilities, even as HUD steadily and substantially increased them over the past decade. It is our experience that Fannie Mae and Freddie Mac’s current statutory and regulatory framework has enhanced their ability and willingness to forge partnerships with organizations like Enterprise to deliver housing resources to people and places that cannot take full advantage of our nation’s generally well functioning housing system. Millions of low-income people have a decent, affordable home as a result. Any changes to federal regulation of the companies should not jeopardize or limit that progress.

