An Overview of

Fannie Mae's Multifamily Mortgage Business

As of May 1, 2012

EXECUTIVE SUMMARY

This Overview describes the core components of Fannie Mae's Multifamily Mortgage Business ("Multifamily"). It begins by providing a foundation for understanding the multifamily housing market, how multifamily housing is financed and Fannie Mae's role in that market. It then focuses on Multifamily's business model, how it operates and how it maintains its performance in the market.

Multifamily housing is any rental housing having five or more dwelling units, whether such units comprise the one-room efficiency apartment that is home to a graduate student, the suburban garden apartment shared by a large immigrant family, the apartment in a seniors housing facility that is home to an elderly couple or the apartment in an affluent metropolitan area that is affordable to a firefighter, a teacher, a nurse or a retail employee. The common feature is that the apartment, whatever its size and amenities, is a home. Fannie Mae's Multifamily Mortgage Business is focused on providing workforce housing — high-quality, affordable housing — to families with annual incomes at or below the median income of the areas where they live. For example, in the metropolitan statistical areas ("MSAs") with the highest number of Fannie Mae multifamily mortgage loans, the area median incomes ("AMIs") for families with four people are $78,300 in New York City, $68,200 in Los Angeles, $103,500 in Washington, DC, $93,400 in San Francisco and $68,300 in Dallas. Considering the generally accepted rule that monthly rent expense should equal no more than 30% of the tenant's monthly income, the challenge of housing working families is clear. Despite this challenge, more than 85% of the multifamily units financed by Fannie Mae from 2009 to 2011 were affordable to these very families.

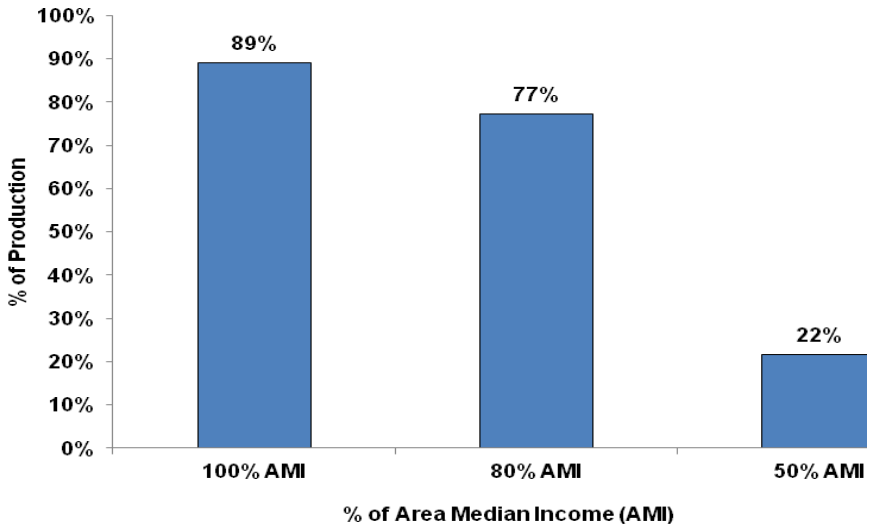
Fannie Mae's Multifamily Mortgage Business has successfully and consistently provided a secondary market for lenders financing multifamily housing for more than 25 years. During that time, Fannie Mae's business model of sharing risk with borrowers, loan originators and servicers has proven to be both sustainable and scalable across economic cycles. As a government-sponsored enterprise with the benefits of a congressional charter, Fannie Mae has remained competitive by offering speed of execution, certainty of transaction closure, flexibility, an attractive cost structure and demanding credit risk standards. Even today, in the most severe economic crisis since World War II, multifamily loans owned or guaranteed by Fannie Mae have a serious delinquency rate of less than 1%, while the multifamily loans originated by Fannie Mae's multifamily CMBS competitors have serious delinquency rates of nearly 12%.

History and Mission

Fannie Mae's involvement in the multifamily market began in 1938 as part of the New Deal when the federal government created its own mortgage association to facilitate the construction and financing of rental and for-sale housing by making direct loans insured by the Federal Housing Administration. Fannie Mae's authority was broadened over time to include the acquisition of multifamily loans that are not separately insured by the Federal Housing Administration. Fannie Mae created a business division dedicated to purchasing multifamily loans in 1984.

Fannie Mae's primary mission in the multifamily housing market is to provide financing for workforce housing — safe, sanitary, quality housing affordable to families with annual incomes at or below the median income of the areas where they live. In 2011, Fannie Mae provided $24.4 billion in financing for nearly 423,000 multifamily rental housing units. Under Federal Housing Financing Agency guidelines, approximately 390,000 of these units could be counted towards the Agency's multifamily special affordable housing goals. Of those units, 89% were affordable to families that earned 100% of AMI or less. Fannie Mae met the "low-income goal" for families earning less than 80% of AMI by financing approximately 301,000 units (77%), as well as the " very low-income goal " for families earning less than 50% of AMI by financing approximately 84,000 units (22%). (More information about America's workforce housing and the role Fannie Mae plays in supporting this market may be found in *Fannie Mae and Workforce Rental Housing* at https://www.efanniemae.com/mf/refmaterials/pdf/wpworkhouse.pdf)

Figure 1: % Affordable Units to Goals-related Production in 2011



Multifamily has a sustainable, integrated business model that is premised on four key principles:

1. Workforce Housing. Fannie Mae focuses on providing affordable, quality housing for America's workforce. Over 85% of the multifamily units financed by Fannie Mae from 2009 to 2011 were affordable to families at or below the applicable area median income.
2. Skin in the Game. Fannie Mae requires borrowers to put cash equity into financed properties. Lenders that sell loans to Multifamily must share in any losses so that both parties have a stake in the economic outcome and their interests are aligned.
3. Cash is King. Fannie Mae requires lenders to underwrite multifamily loans for sale to Fannie Mae based upon actual rather than projected income.
4. Delegation. Fannie Mae delegates underwriting and servicing responsibility to risk sharing lenders, which aligns risk, provides certainty of execution and leverages the lenders' capabilities.

This business model, built on the foundation of the congressional charter that established Fannie Mae as a government-sponsored enterprise, is scalable and has proven resilient in good times and bad.

Multifamily's understanding of its mission as a government-sponsored enterprise, carried out through its unique business model, has meant that Fannie Mae is "always in the market." Unlike other financial institutions, which move in and out of the multifamily financing market depending on market conditions, Fannie Mae has always been present and ready to do business. In fact, Fannie Mae expanded its multifamily activity during the dislocation of the credit markets that started in late 2007. This is not the first time that Fannie Mae has proven its reliability in the marketplace. As stated in a January 2009 report by the Joint Center for Housing Studies of Harvard University, "Both in the wake of the currency crisis in 1998 and again after 9/11 and the 2001 recession, Fannie Mae and Freddie Mac stepped up portfolio purchases and guarantees of multifamily debt."

Multifamily's Unique Qualities

Although Fannie Mae's Multifamily and Single-Family Mortgage businesses both serve the secondary mortgage market, they are different in fundamental ways. To start, the multifamily market is considerably smaller than the single-family housing market. At year-end 2011, the multifamily debt outstanding across the industry totaled approximately $841 billion in contrast to the $10.3 trillion in outstanding single-family debt. Compared to Fannie Mae's Single-Family business, the Multifamily business features a smaller number of loans that are larger, more complex and more heterogeneous than Single-Family's loans. The complexity of multifamily loans arises from the fact that multifamily borrowers are operating businesses, and that multifamily

loans are collateralized by the income-producing properties owned by these businesses.

Multifamily loans differ from single-family loans in many ways. The average size of a multifamily loan acquired by Fannie Mae from 2009 through 2011 was $8 million, compared to the average of $200,000 for single-family loans acquired by Fannie Mae during the same period.[1] The lifecycle of a multifamily loan is much shorter than the standard 30-year single-family residential loan. Multifamily loans typically have terms of 5, 7 or 10 years with balloon payments due at maturity. In addition, there are different prepayment features for single-family and multifamily loans. Although Fannie Mae's Single-Family and Multifamily businesses both use mortgage-backed securities ("MBS") to finance loan purchases, MBS investors treat multifamily MBS as commercial investments requiring standard terms and conditions, including prepayment restrictions, and the imposition of prepayment premiums. In contrast, single-family borrowers are broadly allowed to prepay their loans at any time without penalty and, therefore, investors do not require or receive prepayment premiums on single-family MBS.

Multifamily loans require a more detailed underwriting process than single-family loans due to the complexity of the collateral, the borrowers and the underlying transactions. Multifamily loans are collateralized by a variety of property types — including garden and high-rise apartment complexes, seniors housing communities, cooperatives, dedicated student housing and manufactured housing communities — all of which are operated as businesses to generate income.

Most multifamily borrowers are for-profit corporations, limited liability companies, partnerships, real estate investment trusts and individuals who invest in real estate for cash flow and equity returns in exchange for their original investment in the asset. Although multifamily loans are generally non-recourse to the borrower, careful underwriting is required to confirm a borrower's creditworthiness and ability to successfully operate the apartment property that acts as collateral for the loan. This is evaluated through the review of a combination of quantitative and qualitative data including liquid assets, net worth, number of units owned, experience in a market and/or property type, multifamily portfolio performance, access to additional liquidity, debt maturities, asset/property management platform, senior management experience, reputation and lender exposure.

It is more challenging and costly to service a multifamily loan because of the increased complexity of the collateral, borrowers, loan structures and resulting securities. Servicing must include ongoing monitoring of operational and financial statements, property condition and compliance with complex commercial requirements, including property insurance needs. This requires the frequent collection, processing and monitoring of a large number of individualized data elements.

[1] Fannie Mae's ability to purchase multifamily mortgage loans is not limited by the maximum loan-to-value and loan amount limits its Charter places on its purchase of single family mortgage loans.

As a result of these many differences, Fannie Mae Multifamily conducts the majority if its business with 25 lenders — a very small number compared to the more than 2,000 lenders with which Single-Family engages. These select lenders must demonstrate financial strength, extensive multifamily underwriting and servicing experience and strong portfolio performance. They also must be willing to share in any risk of loss associated with the loans that they sell to Fannie Mae.

Multifamily Housing Basics

Multifamily housing provides homes for a wide range of families, from those in the workforce to senior citizens and students, including families with significant economic need, through deeply affordable and government-subsidized housing. Most multifamily housing — 14 million out of 15.2 million occupied housing units[2] – is considered to be affordable to people earning 100% or less of AMI for their location, meaning that rental payments consume no more than 30% of household income. Nearly 85% of all occupied multifamily rental units, approximately 13 million units, are affordable to households earning 80% or less of the area's median income. As these numbers suggest, the multifamily market segment serves a critical role in providing housing to a wide range of individuals and families. Despite the critical role of this market segment, the supply of affordable rental housing has been declining for at least a decade[3] and is in increasingly short supply, particularly in high-density metropolitan areas such as Washington, DC and New York City.

Almost all multifamily rental units are "inherently affordable" when you apply the traditional standard that defines affordable housing as any rental unit with rent that does not exceed 30% of area median income. However, the reality is that, for many renter households, this standard is aspirational. According to the National Low Income Housing Coalition, 71% of families making 30% of AMI spent more than half of their income on rent in 2008 and the data suggest that the challenge has only grown since then. Putting that in context for a family of four, in Washington, DC, area median income is $103,500, and fair market rent, by U.S. Department of Housing and Urban Development's ("HUD") calculations, is $1,494 a month for a two-bedroom apartment. A retail sales person making an average of $24,274 a year working full time would have to pay 71% of his income to rent a two-bedroom apartment in Washington, while a Licensed Practical Nurse with a typical salary of $43,472 would have to pay 41% percent of her income on rent, based on data developed by the Center for Housing Policy. Using the same data sets, AMI for the New York City MSA is significantly lower, at $78,300 for a family of four. HUD calculates fair market rent in New York at $1,359 a month, but supplies of available units at that rate are significantly constrained. For many of these working families, the solutions are federal subsidies, doubling up or living far from their jobs.

[2] 2009 American Housing Survey, U.S. Department of Housing and Urban Development.

[3] Harvard Joint Center for Housing Studies, 2010 State of the Nation's Housing.

Financing Multifamily Housing

Prior to the recent economic downturn, lenders financing multifamily housing projects included banks, life insurance companies, conduits and depository institutions. The commercial mortgage-backed securities product ("CMBS") was an important factor in the market. Most of these institutions, including those providing the CMBS execution, exited the market in 2008, leaving Fannie Mae, Freddie Mac and the Federal Housing Administration as the primary liquidity providers for the multifamily market. The market share held by Fannie Mae and Freddie Mac ("GSEs") expanded significantly from less than 40% historically to more than 70% in 2009. As the market has stabilized and private liquidity sources have returned, the GSEs' market share has begun to return to historical levels. In 2011, the GSEs had a 50% share of the multifamily market.

Fannie Mae's Multifamily business purchases multifamily mortgage loans originated by lenders for cash, guarantees multifamily loans in securities issuances and provides credit enhancement of bonds issued by state and local housing finance authorities that finance multifamily housing. Multifamily's flagship business is its Delegated Underwriting and Servicing™ program ("DUS™"). As noted above, this program aligns the interests of Fannie Mae with those of participating lenders by requiring the lenders to share in the risk of loss associated with the multifamily loans they sell to Fannie Mae.

In addition to providing liquidity to traditional apartment projects, Fannie Mae participates in specialized types of multifamily housing across the range of rental categories, including:

- seniors housing — financing for properties that include skilled nursing, independent living and assisted living facilities
- cooperative apartments – financing for cooperative corporations
- manufactured housing parks — financing of land-leased manufactured parks and related amenities
- student housing — financing for apartment complexes built exclusively for students, located near major colleges and universities
- affordable housing — financing for housing that is rent-restricted and subsidized by federal, state or local government

HOW MULTIFAMILY OPERATES IN THE MARKET

Fannie Mae provides liquidity to the multifamily market using three primary executions.

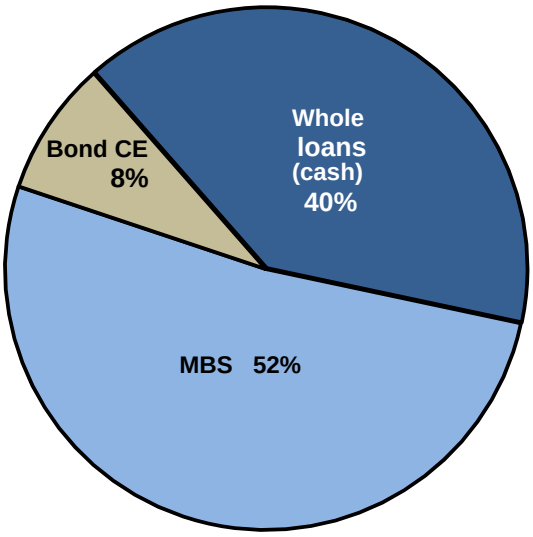
In a **whole loan execution,** Fannie Mae purchases a mortgage loan for cash from a lender and then holds the loan in Fannie Mae's portfolio. The size of the underlying loan typically ranges from $1 million to $50 million. Whole loan executions have accounted for a smaller portion of Multifamily's acquisitions each year since 2008. Multifamily mortgage loans purchased by Fannie Mae using a whole loan execution may be securitized by Fannie Mae at a later time.

In **MBS executions,** lenders deliver loans to Fannie Mae in exchange for an MBS that is backed by the mortgage loan. Fannie Mae guarantees to the MBS trust that it will supplement amounts received by the MBS trust as required to permit the timely payment of principal and interest on the MBS. Creating an MBS transforms the mortgage loan into a more liquid asset that is generally easier to sell than a whole loan because the investor receives both the cash flow and a guarantee of repayment. DUS MBS are typically backed by one mortgage loan bearing a fixed rate of interest. However, Fannie Mae's multifamily MBS may be backed by multiple loans or by loans with an adjustable interest rate. Fannie Mae also securitizes multifamily loans using real estate mortgage investment conduits ("REMICs") through its Capital Markets business.

Prior to 2004, MBS constituted more than 80% of the annual Multifamily acquisitions volume. From 2004 through 2008, Multifamily's acquisition strategy shifted toward whole loan executions to achieve greater flexibility for its portfolio and to offer greater flexibility to customers. The 2008 senior preferred stock purchase agreement between Fannie Mae and the U.S. Treasury Department restricts the amount of mortgage assets Fannie Mae may own. As a result, Multifamily renewed its focus on the MBS execution beginning in 2008. By year end 2011, 98% of Multifamily's acquisitions used the MBS execution. More information about Fannie Mae's multifamily MBS may be found on Fannie Mae's website. Please see *Basics of Multifamily MBS* at http://www.fanniemae.com/ resources/file/mbs/pdf/basics-mf-mbs.pdf.

Fannie Mae also provides **bond credit enhancement** for tax-exempt bonds that are issued by state and local Housing Finance Agencies to finance affordable rental housing. In the event of a default, Fannie Mae guarantees to the bond trust that it will supplement amounts received by the bond trust as required to permit the payment of the principal and interest on the bonds to the bondholder.

Figure 2: Multifamily Book of Business by Execution Type as of 12/31/11



Delegated Underwriting and Servicing ("DUS") – Multifamily's Flagship Business

Fannie Mae initiated the DUS program in 1988 to drive, enhance and maintain product standardization in the multifamily marketplace. More than 6 million multifamily housing units have been financed through the DUS program since 1991. This is a unique business model in the commercial mortgage industry (with the exception of a less frequently used FHA risk-sharing product). Standard industry practice is for a loan purchaser or guarantor to underwrite or re-underwrite each loan before making a decision to purchase or guaranty it. Under Multifamily's model, designated DUS lenders are authorized to commit Fannie Mae to acquire multifamily loans. The loans must be underwritten, originated and serviced according to standards established by Multifamily. In exchange for this authority, DUS lenders must share the risk of loss over the life of the loan, generally retaining one-third of the underlying credit risk on each loan sold to Fannie Mae. DUS lenders must post collateral to secure their risk sharing obligations.

The authority delegated to lenders under the DUS model allows them to respond quickly to customers. In addition, the DUS lenders' servicing fee includes compensation that recognizes their share in the credit risk for each loan. Multifamily believes this model aligns the interests of the borrower, lender and Fannie Mae. As a result, the 25-member DUS lender network, composed of large financial institutions and independent mortgage lenders, has become Fannie Mae's principal source of multifamily loan deliveries.

More information about the DUS model and the role of risk retention in multifamily finance may be found on our website. Please see *Twenty Years of Multifamily Mortgage Financing Through Fannie Mae's Delegated Underwriting and*

Servicing Program at http://www.fanniemae.com/resources/file/mbs/pdf/mbsenger0412.pdf and *The Role of Risk Retention in Multifamily Finance* at https://www.efanniemae.com/mf/refmaterials/pdf/wprskret.pdf.

Affordable and Small Loans

In addition to standard DUS deliveries, Fannie Mae buys and guarantees affordable loans from small community banks and non-profits on a prior-approval basis in order to meet the growing need for affordable property financing. Fannie Mae also is an active purchaser of small multifamily loans from both DUS and non-DUS lenders (although small balance non-DUS loan acquisitions have not been a significant portion of our total multifamily acquisitions since 2008). Fannie Mae defines "Small Loans" as loans of less than $3 million nationwide or less than $5 million in high-cost markets such as New York City and Los Angeles. As of December 31, 2011, Small Loans represented 69% of the multifamily book of business by loan count and 16% based on unpaid principal balance. More information about the importance of Small Loans and Multifamily's role in supporting this market may be found on Fannie Mae's website. Please see *Fannie Mae's Role in the Small Multifamily Loan Market* at https://www.efanniemae.com/mf/refmaterials/pdf/wpmfloanmkt.pdf.

HOW MULTIFAMILY MANAGES RISK

Historically, Fannie Mae's multifamily book has generally performed well. Despite the challenges of the recent credit crisis, Multifamily's credit performance has led the market.

Multifamily's credit performance is driven by three key factors:

- risk-sharing embedded in the DUS business model
- prudent underwriting requirements
- loan-sizing based upon actual cash flow, not projected cash flow

Risk-Sharing Aligns Fannie Mae and Lender Interests

Approximately 79% of the multifamily loans owned or guaranteed by Fannie Mae have the benefit of lender risk-sharing. Approximately 90% of the Small Loans owned or guaranteed by Fannie Mae have the benefit of lender risk-sharing.

Multifamily requires DUS lenders to meet identified capital standards to support their risk-sharing obligations.

Multifamily Maintains Strict Underwriting Standards

DUS lenders are required to underwrite potential loans in accordance with Fannie Mae's Multifamily Selling and Servicing Guide ("Guide"). Multifamily continually reviews its underwriting standards and adjusts them as necessary to address credit tolerances relative to current market and economic conditions. Core property-underwriting requirements include:

- 80% loan-to-value ratio
- 1.25 debt service coverage ratio in most markets
- 20% equity contribution from the borrower

Multifamily financing is similar in many respects to a loan on an operating business. Thorough underwriting must include an evaluation of many factors, including:

Property Quality. The property is the primary collateral for repayment of a multifamily loan. Lenders must confirm that the property is in good condition and provides safe and sanitary housing for the tenants occupying the units. The Guide also requires on-site property inspections and independent third-party reports that describe both current and future physical needs of the property.

Borrower Strength. The borrower's track record, property management experience, financial capacity and other real estate holdings are examined in detail. Although most multifamily loans are non-recourse, the borrower still must have the financial capacity to handle significant events during the life of the loan, such as casualty, condemnation and other unforeseen events. Because small-loan borrowers are primarily individuals, existing Small Loan credit standards require a review of the borrower's FICO scores and the proximity of the borrower's residence to the property. Additionally, Fannie Mae generally requires personal recourse for Small Loans.

Market and Submarket Factors. The overall market and submarket location of the property are reviewed for factors such as vacancy, unemployment, supply and demand and the availability of services for the tenants.

Analysis for Exit at Maturity. Because most multifamily loans result in a balloon payment at the end of the loan, an exit analysis is performed on each loan to provide reasonable assurance that the loan can be repaid at maturity.

Risk Rating. Each multifamily loan is assigned a risk rating at underwriting in order to establish an initial benchmark that can be used to evaluate the loan over its term.

Pre-Review of Certain Loans and Loan Types. Multifamily pre-reviews certain categories of loans deemed to present increased risk. These may include:

- loans collateralized by property located in a market with weak economic conditions
- individual loans larger than $25 million
- transactions with multiple loans and a single borrowing entity that aggregate to a amount greater than $50 million
- loans collateralized by certain asset types, including seniors housing, manufactured housing communities and student housing

Multifamily Loan Servicers Must Adhere to Guide Servicing Standards

DUS lenders typically service the loans they sell to Multifamily and must adhere to servicing standards set out in the Guide. The Multifamily servicing standards are continuously reviewed and updated to reflect market and economic conditions. The risk sharing obligations of the DUS lenders provide additional incentive for these lenders to maintain high quality servicing standards, including the performance of basic asset management and data gathering functions.

Robust Monitoring and Management of Loan and Property Performance

The risks associated with a multifamily loan must be monitored and managed throughout the life of the loan. Key Multifamily efforts include:

Monitoring Property Performance. As noted above, the property is the primary collateral for repayment of a multifamily loan. Loan repayments are typically made from income generated by the property. As a result, Multifamily and its lender servicing partners conduct significant oversight of the properties securing multifamily loans owned or guaranteed by Fannie Mae. Actions include review of financial and other property-level reports on a quarterly basis, performance of site inspections and management of complex commercial property insurance requirements.

Resources Focused on Early Delinquencies. Multifamily's servicers must report on early delinquencies. This data is analyzed by Multifamily to identify trends, key drivers and root causes of delinquencies.

Increased Monitoring of Large Credits. Multifamily undertakes special effort to monitor its largest credit exposures. Large loans that exhibit deteriorating performance and/or a potential likelihood of default may be restructured or subject to other intervention to reduce the risk of loss.

Secondary Surveillance through Continued Risk Rating. An automated "rating engine" is used to identify loans with heightened risk and to provide some differentiation of risk levels. Identified loans may then receive additional scrutiny to determine whether actions are necessary to minimize credit risk to Fannie Mae.

Loss Mitigation Efforts and Resources. Multifamily Loss Mitigation manages deteriorating and defaulted loans owned or guaranteed by Multifamily, as well as all “Real Estate Owned” assets in the Multifamily portfolio. The Special Asset Management (“SAM”) team serves as special servicer for a majority of the defaulted multifamily loans owned or guaranteed by Fannie Mae. The SAM team simultaneously pursues both legal foreclosure and borrower negotiations in order to maximize recovery and expedite resolution of the asset.

Management of Debt Maturities. Multifamily’s Maturity Management Group manages upcoming maturities by identifying loans that may be at risk of maturity default based on an analysis of prospective refinancing terms at maturity. The group then assists lenders and borrowers in identifying refinancing options to avoid defaults and foreclosures related to near-term maturities. Such options may include Fannie Mae refinancing to borrowers that adequately maintain their properties and who are willing to make a significant debt reduction payment.

Robust Monitoring and Management of Lender Partners

Multifamily also limits risk by monitoring the performance and stability of its lender partners. Key Multifamily efforts include:

- conducting post-purchase reviews of lender performance
- assessment of lenders’ financial strength
- review of servicer quality

CONCLUSION

Fannie Mae, as a government-sponsored enterprise with the benefits of a congressional charter, has a scalable multifamily business that can expand and contract readily to meet market conditions through reliance on lender delegation and risk sharing. The business is sustainable for three reasons:

- it aligns the interests of borrowers, lenders and Fannie Mae through risk-sharing
- it targets a large and permanent market segment of workforce housing that rarely attracts opportunistic capital

- it utilizes an integrated business team with commercial real estate expertise

Fannie Mae conducts its multifamily business in a disciplined way, underwriting multifamily loans based on actual income today, not projected income to be achieved in the future. As a result, Fannie Mae Multifamily has successfully served America's workforce for decades.