FANNIE MAE'S ROLE IN THE SMALL MULTIFAMILY LOAN MARKET

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EXECUTIVE SUMMARY

State of the Small Multifamily Loan Market

In the wake of the U.S. housing crisis, multifamily rental housing – especially affordable rentals – is expected to play an increasingly important role in the market due to stronger residential mortgage lending standards, more modest consumer aspirations for homeownership, growth in households that tend to rent (e.g., Echo Boomers, retiring Baby Boomers, and New Americans), and other drivers. Within the rental housing market, loans to smaller rental properties – which Fannie Mae defines as loans of $3 million or less in most markets and $5 million or less in high-cost markets – play a unique role.

As of June 30, 2010, the company's $34 billion book of smaller rental properties tend to be more affordable, a key source of housing for working families, and concentrated in urban areas in close proximity to transportation and jobs – lowering the cost of living there.

Financing a ready supply of smaller multifamily rental properties poses unique challenges, however. The lending market is fragmented, with more than 2,600 lenders originating an average of six small loans each[1], which impedes standardization, efficiency, and the benefits of securitization (e.g., greater and lower-cost funding). Smaller property financing also tends to rely on a disparate range of borrowers, often individual investors, entrepreneurs, or smaller commercial businesses of varying credit profiles that invest in a limited number of properties and operate them on a thin margin with fixed costs but potentially higher income fluctuation risk. The disparate nature of small multifamily property borrowers also creates financial, underwriting, and credit issues for national investors in the loans, which limits the supply of low-cost liquidity for these loans.

In short, while smaller multifamily properties provide an important supply of affordable rental housing, the fragmentation and non-standardization of financing complicates a national solution to expanding this housing.

Fannie Mae is a leader in small loan financing, providing a key source of affordable rental housing for working families close to transportation and jobs.

Fannie Mae's Role in the Multifamily Market

Fannie Mae plays a critical role in the U.S. rental housing market. Our original charter in 1938 provided authority to facilitate the construction and financing of economically sound rental housing projects. In 1984, Fannie Mae created a business division dedicated to purchasing multifamily loans. Since that time, Fannie Mae has continued to provide a consistent supply of funding to the multifamily market through all market cycles.

Currently, amid a shortage of private investment capital and credit for housing finance, Fannie Mae provides more than 50 percent of all secondary market funds available for multifamily housing finance. As of June 30, 2010, the company's $185 billion book of roughly 42,000 multifamily loans is performing significantly better than the commercial mortgage-backed securities market.

Fannie Mae's Role in the *Small* Multifamily Market

Fannie Mae also has a history of providing liquidity for smaller rental property loans. Over the past ten years, the company has developed and refined a dedicated, small-loan platform to provide consistent liquidity to the small loan market and financed $60 billion of small loans during that time. In 2007, Fannie Mae expanded its small loan team to include dedicated

1 Source: 2009 Mortgage Bankers Association data.

credit and production staff focused solely on the origination, acquisition, and underwriting of small loans. We have continued funding the small multifamily loan market through the current challenging market cycle.

As of midyear 2010, Fannie Mae held a $34 billion book of 30,000 loans on properties with loans of $3 million or less or up to $5 million in high cost MSAs (18 percent of total multifamily book) or a $21 billion book of 23,500 loans on five- to 50-unit properties (12 percent of multifamily book). Roughly 86 percent of Fannie Mae's 2009 small loan book of business was affordable to families at or below 100% area median income and met the definition of affordable housing set forth by the U.S. Department of Housing and Urban Development (HUD).

Fannie Mae's 2010 small multifamily loan acquisitions of $2.4 billion were comparable with 2009 acquisitions of $2.2 billion.

The fragmented and disparate nature of the small multifamily rental housing financing market poses challenges to how the company can expand its support for this market segment in a significant way. However, Fannie Mae remains committed to supporting this critical housing segment.

FANNIE MAE & SMALL MULTIFAMILY LOANS

This paper describes the unique nature of the small multifamily market, the challenges of financing loans for these properties, and Fannie Mae's role and efforts to support this critical source of affordable housing.

What role has Fannie Mae played in the small loan market?

Fannie Mae aims to provide liquidity to the multifamily housing sector in every market, every day. As a result, Fannie Mae's experience, particularly in serving many of the most challenging segments of the multifamily market, can help inform the broader discussion about our country's housing finance needs.

Fannie Mae's involvement in the multifamily market began in 1938 as part of the New Deal when the federal government decided to create its own mortgage association. The purpose was to facilitate the construction and financing of economically sound rental and for-sale housing by making direct loans secured by first mortgages insured by the Federal Housing Administration (FHA).

Over time Fannie Mae's mission was redirected to a secondary market role that included the authority to purchase mortgages on multifamily rental housing and those with conventional financing. Fannie Mae created a business division dedicated to purchasing multifamily loans in 1984 and since that time, has provided liquidity to the multifamily market for loans of all amounts.

What is a small loan in the multifamily market?

In general, the market defines small loans in two ways:

1. **Unit Count** which is defined as loans to apartment buildings with five to 50 units
2. **Principal Balance** which is defined as apartment building loans with principal balances of $3 million or less in most markets, or up to $5 million in high cost MSAs.

Fannie Mae uses the principal balance definition, referring to small loans as loans of $3 million or less nationwide and $5 million or less in high cost markets like New York City and Los Angeles. Fannie Mae believes using the principal balance to define small loans is a more prudent way to address risk since it allows for easier benchmarking between small and non-small loan performance within its portfolio. Additionally, defining small loans based on principal balance allows for meaningful adjustments for high-cost urban areas where there are a significant concentration of small multifamily properties.

Note: A small loan is not always synonymous with a small property. Limiting the definition of small loans to properties with five to 50 units results in the exclusion of larger subsidized affordable multifamily properties. These larger, subsidized properties also generally benefit from the low income housing tax credit (LIHTC) which offers below market rents to qualified tenants and requires less debt as a result of the subsidies they receive.

How has Fannie Mae participated in the small loan lending market?

Fannie Mae has distinguished itself among the national financing sources and, as the Federal Housing Finance Agency (FHFA) recognized in its proposed 2010 Housing Goals Rule among the GSEs, for consistently providing dedicated resources and products to the small loan lending market. "Fannie Mae has a division dedicated to purchasing mortgages on smallmultifamily properties." (FHFA, Final 2010 Enterprise Housing Goals Report) Highlights of Fannie Mae's conventional and small loan lending activity include:

- **1938:** Fannie Mae is chartered with specific authority to facilitate the construction and financing of economically sound rental housing projects.
- **1985:** Fannie Mae begins purchasing pools of seasoned small multifamily loans.
- **1988:** Fannie Mae starts the Delegated Underwriting and Servicing (DUS®) model where a network of approved lenders originate, sell, and service individual loans (both small and large) to Fannie Mae; this is known as flow delivery. The DUS model relies on sharing the risk of loss with lenders to support the delegated underwriting and align the interests of Fannie Mae and lenders.
- **1998:** Fannie Mae begins to accept small loan flow deliveries from non-DUS lenders.
- **2000:** Fannie Mae adopts a "5-50" unit count flow execution that is available to all lenders. This execution

is adopted to align with the HUD housing goal requirement and is the first attempt to streamline the DUS underwriting guidelines for small loans.

» **2001:** Fannie Mae changes the definition for its small loan platform to focus on loans with original principal balances of $3 million or less ($5 million in certain high-cost areas) rather than a unit count approach. The product is rebranded "3MaxExpress" and is a targeted attempt to address the needs of lenders and borrowers by further streamlining the underwriting guide for small loans with separate underwriting parameters.

» **2007:** Fannie Mae expands its support for small multifamily loans with a larger, dedicated production and credit team. Fannie Mae includes a separate credit underwriting chapter in the DUS selling and servicing guide and, for the first time, incorporates more simplified asset management and servicing functions for small loans.

FANNIE MAE HAS A DEDICATED SMALL LOAN TEAM. The company has historically maintained dedicated expertise and products for specialty lending areas like small loans and subsidized affordable housing. For more than 10 years, Fannie Mae has developed and refined a dedicated, small loan platform to consistently provide liquidity to the small loan market. Fannie Mae has financed $60 billion of small loans over the past 10 years, and continues to provide liquidity to the small loan market during this difficult market cycle. In 2007, Fannie Mae expanded its small loan team to include 10 dedicated credit and production staff focused solely on the origination, acquisition, and underwriting of small loans nationwide.

FANNIE MAE OFFERS DEDICATED PRODUCTS. The company consistently provides liquidity to the small loan market through two primary products:

1. **Flow Business:** Fannie Mae purchases individual loans originated by approved mortgage lenders who have delegated authority to sell loans to Fannie Mae which the lenders have underwritten and originated. These loans are underwritten and serviced by the lenders according to specific, published guidelines and the lenders retain a risk position in these loans through a loss sharing agreement with Fannie Mae. Delegated Underwriting and Servicing also known as DUS®, is the primary platform through which Fannie Mae provides liquidity to the multifamily market. Within the DUS program guide, there is a dedicated underwriting and servicing standard for small loans.
2. **Pool Financing:** Fannie Mae purchases pools of seasoned, multifamily loans from DUS and non-DUS financial institutions that originate and hold these loans on their books. By purchasing these loans in bulk, Fannie Mae provides a source of liquidity which enables these financial institutions to make new loans. The loans purchased by Fannie Mae in these seasoned pools have traditionally been composed mostly, but not exclusively, of small loans.

FANNIE MAE PROVIDES CONSISTENT PRODUCTION.

The company uses prudent underwriting standards and loss sharing with DUS lenders to acquire small loans. Additionally, Fannie Mae requires market acceptable structures that allow the loans to be securitized, in accordance with Fannie Mae's goal to maintain a liquid portfolio. This, in turn, enables Fannie Mae to continue providing liquidity to the small loan market.

Flow volume has consistently averaged approximately $2.5 billion per year over the last 10 years, providing reliable liquidity to the market. Pool financing, on the other hand, has historically fluctuated depending on the level of small loan activity among financial institutions. Fannie Mae has focused more heavily on seasoned pool activity in years where additional volume was needed to support the corporate housing goals needs as seen in 2003 and 2007. The following table shows that, regardless of the definition used (unit count or principal balance), Fannie Mae plays a significant role in the small loan market.

SUMMARY OF MULTIFAMILY ACQUISITIONS
5 - 50 UNITS DEFINITION VS. $3MM ($5MM HIGH COST) PRINCIPAL BALANCE DEFINITION

		5 - 50 Unit Definition				Principal Balance Definition				
YEAR	Data	DUS	Pools	Total	% Total	DUS	Pools	Total	% Total	Total AQSN
2000	Loan Count	186	53	239	17%	379	68	447	32%	1,435
	UPB ($M)	$231	$84	$315	3%	$676	$100	$776	7%	$11,200
2001	Loan Count	322	1,824	2,146	46%	703	2,186	2,889	62%	4,698
	UPB ($M)	$605	$718	$1,323	7%	$1,638	$1,577	$3,215	17%	$19,929
2002	Loan Count	227	5,397	5,624	73%	579	5,763	6,342	82%	7,692
	UPB ($M)	$413	$2,893	$3,306	17%	$1,354	$3,706	$5,061	26%	$19,386
2003	Loan Count	301	14,530	14,831	80%	632	15,875	16,507	89%	18,465
	UPB ($M)	$591	$10,485	$11,075	33%	$1,428	$13,201	$14,628	44%	$33,280
2004	Loan Count	335	2,128	2,463	56%	543	2,505	3,048	69%	4,435
	UPB ($M)	$1,660	$2,018	$3,678	20%	$1,148	$2,917	$4,065	22%	$18,793
2005	Loan Count	386	6,201	6,587	75%	657	6,524	7,181	82%	8,747
	UPB ($M)	$1,289	$3,806	$5,095	22%	$1,314	$4,546	$5,859	25%	$23,415
2006	Loan Count	558	3,101	3,659	64%	832	3,428	4,260	74%	5,754
	UPB ($M)	$1,207	$2,485	$3,692	17%	$1,583	$3,217	$4,801	22%	$22,302
2007	Loan Count	807	10,387	11,194	78%	1,059	11,349	12,408	86%	14,406
	UPB ($M)	$2,142	$7,169	$9,311	20%	$2,044	$9,201	$11,244	24%	$46,727
2008	Loan Count	737	2,939	3,676	54%	1,025	3,503	4,528	67%	6,778
	UPB ($M)	$2,684	$3,380	$6,063	17%	$2,157	$4,553	$6,710	19%	$34,678
2009	Loan Count	588	230	818	33%	886	335	1,221	49%	2,473
	UPB ($M)	$1,068	$327	$1,395	7%	$1,671	$581	$2,252	11%	$19,592
YTD 9/2010	Loan Count	458	87	545	36%	684	131	815	53%	1,534
	UPB ($M)	$856	$98	$953	9%	$1,413	$217	$1,630	16%	$10,325

SUMMARY OF MULTIFAMILY ACQUISITIONS
5 - 50 UNITS DEFINITION VS. $3MM ($5MM HIGH COST) PRINCIPAL BALANCE DEFINITION

		5 - 50 Unit Definition				Principal Balance Definition				
BOOK	Data	DUS	Pools	Total	% Total	DUS	Pools	Total	% Total	Total Book[1]
9/2010 Book	Loan Count	4,277	19,220	23,497	56%	7,301	22,519	29,820	70%	42,301
	UPB ($M)	$7,524	$13,931	$21,456	12%	$13,945	$19,738	$33,683	18%	$186,144

Note: Pools also include non-DUS negotiated contracts.

[1] Excludes Credit Enhancement Bonds Adjustments

WHAT IS UNIQUE ABOUT THE SMALL LOAN MARKET?

According to the Mortgage Bankers Association (MBA) 2009 Survey on Multifamily Lending, small loans comprised approximately 27% of the total multifamily market by dollar volume and 81% by number of loans. Based on Fannie Mae's $2.2 billion of small loan flow production and the MBA data, Fannie Mae's estimated market share for small loans in 2009 was 15%.

Fragmented Market: Due to their relative size, small loans constituted about a quarter of the total multifamily dollar volume in 2009, which equaled more than three quarters of the number of loans originated. According to the same MBA data, over 2,600 financial institutions financed 16,751 small loans. This means that the average financial institution originating small loans in 2009 originated roughly six small loans of approximately $847,000 each or an aggregate of $5.5 million in total small loan volume.

By contrast, loans over $3 million (non-small loans) were originated by only 122 financial institutions. Those institutions originated an average of 32 non-small loans with an average balance of $10 million each or an aggregate of $314 million in total non-small loan volume.

One conclusion from these statistics is that non-small loans appear to be a core business for the institutions originating them, while small loans appear to be a more fragmented, complementary business that may support other relationship businesses participated in by these institutions.

More recent data from the Federal Financial Institution Examination Council (FFIEC) supports this view. FFIEC's June 2010 data indicates that among FDIC-insured banks and thrifts, the top five institutions with multifamily loan balances accounted for 35% of total multifamily debt outstanding, while the remaining 65% of multifamily debt outstanding was spread among almost 6,000 FDIC-insured institutions.

The impact of such a fragmented small loan lender market is that small loans are more complicated and more expensive to originate and underwrite than conventional non-small

2009 SURVEY ON MULTIFAMILY LENDING

Average Firm Loan Size	# of Firms	# of Loans	Volume ($millions)	Average Loan Size ($millions)	Average Loans per Firm
$1 million or less	2,124	11,271	$5,820	$0.5	5
$1 million to $3 million	479	5,480	$8,373	$1.5	11
$3 million to $10 million	97	2,577	$16,121	$6.3	27
Greater than $10 million	25	1,350	$22,178	$16.4	54
Total	**2,725**	**20,678**	**$52,492**	**$2.5**	**$7.6**

Source: Mortgage Bankers Association

multifamily loans. The data indicates that a broad cross section of small loan originations are made by small local and regional financial institutions often doing only a handful of transactions annually in support of local lending relationships. This characteristic creates a unique challenge for Fannie Mae, which operates exclusively as a secondary market liquidity provider with relatively few dedicated origination partners (DUS lenders).

The targeted geographic focus of these local lending institutions make them uniquely qualified to underwrite and lend in these markets. As a result, expanding small loan originations beyond current DUS flow would likely require Fannie Mae to develop hundreds of specialty small loan relationships with local and regional institutions.

With a loan origination platform based on shared loss, Fannie Mae is limited in its ability to expand beyond its current origination relationships. While Fannie Mae's small loan team has focused on expanding its small loan relationships, local and regional financial institutions active in the business are traditional buy-and-hold banks and have historically been unwilling or unable to participate in a loss-sharing arrangement.

Fragmentation within the small loan origination network also contributes to a more challenging economic cost structure. In general, since the cost to originate, underwrite, and service a multifamily loan does not vary significantly with loan size, small loans offer little in the way of economies of scale to dedicated multifamily originators. As a result, originators are less likely to focus on small loans. In addition, as a secondary market mortgage participant, Fannie Mae does not provide non-housing loan products. Contrastingly, financial institutions that participate in the small loan market also have multiple product offerings that provide multiple opportunities to touch their small loan customer and earn fees. This allows them to use small loan lending in combination with the other products they offer, such as business lines, car loans, and residential mortgages.

Fannie Mae's Multifamily platform of loss sharing with lenders, benefits investors, owners, and tenants.

Risk Sharing and Financial Strength: The cornerstone of Fannie Mae's multifamily platform is the loss sharing relationship with the lenders who originate, sell, and service loans. By committing to share in potential loan losses, lenders are motivated to prudently underwrite and service loans delivered to Fannie Mae. This heightened responsibility and liability on the part of the DUS lenders ultimately benefits investors, owner/operators, and tenants by ensuring more sustainable multifamily housing. However, for Fannie Mae to accept shared loss with a DUS lender, that lender must demonstrate sufficient organizational and financial knowledge – in the form of infrastructure and capital reserves – to make good on those loss-sharing obligations.

Fannie Mae maintains strict financial and organizational requirements to qualify for and maintain DUS selling and servicing authority. In many cases, the minimum DUS capital and infrastructure requirements dissuade or disqualify local and regional lenders from participating in DUS. While Fannie Mae could choose to lower its counterparty credit standards or not require loss sharing at all to expand its origination platform, our experience has shown us that maintaining delegation and enforcing minimum capital standards is prudent and commercially reasonable.

To support the small loan lending market in the past, Fannie Mae had selectively entered into lending relationships with small loan lenders without loss sharing. Our experience with that showed us that the performance of these loans was generally worse and asset management by the servicer was weaker because the lender did not have "skin in the game." Based on these mixed results and the success of loss sharing over the last 20 years, Fannie Mae now requires all small loan lenders to participate in loss sharing with Fannie Mae. This limits the range of lenders who are willing and eligible to work with Fannie Mae, but supports sound and responsible lending.

Small Loan Borrowers: Having financed over $60 billion of small loans over the last 10 years, our experience has led us to the conclusion that the small loan borrower is fundamentally different than a conventional or non-small loan borrower – and our partners generally agree.

According to one of the largest multifamily real estate brokerage firms in New York City, "the small loan borrower is generally a small business owner, who has a small portfolio of multifamily real estate, typically a local or regional owner/operator that is not as financially savvy or as sophisticated in the commercial real estate market, and may not have the financial strength of a large traditional multifamily borrower. Many borrowers have additional jobs and sources of income and they or their relatives often live in the properties".

Based on past experience, and the experience of our partners, Fannie Mae has concluded that small loan borrowers have unique characteristics. First, small loan borrowers often do not employ professional property management, but choose to maintain and manage properties themselves because smaller properties may not support the cost of third party management. However, borrowers may take on this responsibility without any significant experience or expertise. Looking at Fannie Mae acquisitions through September 2010, only 57% of small loan borrowers employed professional property management compared to 85% for non-small loan borrowers.

Second, small loan borrowers are more like single family borrowers than traditional multifamily borrowers. Unlike larger multifamily loans that are driven almost exclusively by cash flow, Fannie Mae has observed, through analysis of its own small loan delinquencies, that a small loan borrower's ability to repay is driven by the strength of the property cash flow, as well as the borrower's own financial strength and repayment history – much like a single family loan. In fact, Fannie Mae has observed that a majority of small loan delinquencies are correlated to poor borrower financial strength and experience rather than poorly performing properties or slumping markets.

This dynamic makes sense when one considers the cash flow margin for error in a small multifamily property. If a 10-unit subdivided brownstone property has one vacancy for more than 30 days, cash flow could drop to the point where there is not sufficient income to pay the mortgage. In this case, a small loan borrower's personal worth or self-liquidity becomes a critical source for debt repayment. By contrast, one or two vacancies for more than 30 days in a 100-unit low rise apartment would not significantly impair cash flow to the point that debt repayment is at risk. In support of this assertion, a recent examination of Fannie Mae's small loan portfolio indicated that 64% of all small loan delinquencies were directly related to borrower credit issues.

Underwrite the Borrower and the Property: Given the importance of underwriting both the borrower and the property in a small loan transaction, Fannie Mae requires supplemental information regarding the borrower that it may not typically require for a non-small DUS loan, including credit score (FICO) and unique requirements around net worth and liquidity. Regional and community banks often have broad banking relationships with their small multifamily borrowers, and as such, make multifamily property loans on the security of the broader banking relationship, not just the rental property.

In essence, these institutions are relationship lenders, operating much closer to their borrowers and often having broader experience with them that allows for a lighter touch. In a recent survey of several active regional and local small loan lenders, Fannie Mae found that looking solely at the terms for an individual multifamily property loan, its credit standards and due diligence requirements were more conservative across the board. This narrower range of lending products and tighter credit approach has limited Fannie Mae's small loan market opportunities. However, we believe this is a prudent approach to credit, especially in light of the delegated nature of the program.

Given the inherent risks with the typical small loan borrower, Fannie Mae has substantially enhanced the small loan underwriting criteria to address these risks in a streamlined manner. All Fannie Mae lenders comply with the same requirements. This allows this product to take a commoditized approach and has made Fannie Mae more successful with this market.

Small Loan Products and the Secondary Market: Many small loan lenders take a buy-and-hold approach to the business – holding small multifamily loans on their balance sheets in lieu of selling them into the secondary market. In the 1980s, savings and loans and thrifts aggressively penetrated the small multifamily market. Credit losses that these institutions experienced in the commercial real estate crisis of the late 1980s drove many of these small institutions out of the market. However, several of the larger depositories survived and continued to consolidate and grow their presence in small multifamily lending throughout the 1990s and 2000s. These institutions included Independence Community Bank (Sovereign Bank) and New York Community Bank in New York, Washington Mutual and World Savings on the West Coast, and LaSalle Bank in Chicago.

With the recent mortgage market meltdown, many of these banks were acquired or consolidated into other institutions and their small multifamily lending platforms were reconsidered. However, several remain and are extremely active in this space. Both Banco Santander, with the acquisition of Sovereign Bank, and JP Morgan Chase, with the acquisition of Washington Mutual, continue to originate and add small multifamily loans to their balance sheets. These banks like the reliable returns and steady credit performance of multifamily real estate assets compared to other commercial lending products. By contrast, while these banks' balance sheet capacity allows them to pursue a buy-and-hold strategy, Fannie Mae has very limited balance sheet capacity to hold loans and, in fact, has been mandated to reduce its existing portfolio. This creates a significant competitive advantage for the largest banks that Fannie Mae competes with for small loan assets.

So how does Fannie Mae participate in the market?

Given current constraints, Fannie Mae is only able to participate in lending activities that allow for the securitization of the loans into Fannie Mae guaranteed mortgage-backed securities (MBS) and the sale of those MBS to investors. For Fannie Mae to securitize loans, they must be in a standardized or "plain vanilla" form that is broadly acceptable to MBS investors – typically a straightforward, 10-year, fixed-rate loan with standard prepayment term. Without that homogeneity, loans are difficult to securitize and unlikely to attract investors willing to purchase the security. While this is not an issue for conventional or non-small loans, it does present challenges for the small loan market where commercial banks and small loan borrowers favor shorter term loan products with non-traditional MBS terms.

Most financial institutions like to match their asset and liability profile and, therefore, shorter duration loans align with their short-term deposit profile. Many community banks and larger portfolio lenders offer short-term products with flexible loan terms to small loan borrowers. Flexibility around loan terms, amortization periods, prepayment options, and periods of fixed-rate or variable-rate payments are attractive to small loan borrowers. The prepayment structure may be yield maintenance, step-down, or based solely on a certain number of days of interest. The loan term could be 3, 5, 7, or 10 years. And, there could be additional flexibility built into the product, such as extensions at the borrower's option, the option to remain in a fixed-rate period, or to convert to a variable rate of interest. These are terms, however, that Fannie Mae cannot readily offer because of securitization rules and the lack of investor demand for most of the flexible loan terms.

The variability of terms and condition for small loans is supported by a Fannie Mae market survey completed in September 2010 and summarized in the following table.

SMALL MULTIFAMILY LENDERS COMPARABLE TERMS AND PRODUCTS

Lender	Min / Max Loan Amount	Products	Fixed Terms	Prepayment
Union Bank of California Date: 8/18/2010	$400K - $5MM	Hybrid ARMs	3 5 7 10 15	2,1 3,2,1 4,3,2,1 5,4,3,2,1 5,4,3,2,1,1,1,1
JPM Chase Date: 9/13/10	> $1MM	Hybrid ARMs	3 5 7 10	3,2,1 5,4,3,2,1 5,5,4,4,3,2,1 or YM YM
Capital One Date: 9/3/10	> $500K	5 + 5 7 + 5	5 7	5,4,3,2,1 5,5,5,4,3,2,1
NY Community Bank Date: 9/3/10	> $500K	5 + 5 7 + 5 10	5 7 10	5,4,3,2,1 5,5,5,4,3, 2,1 5,5,4,4,3,3,2,2,1,1
Dime of Williamsburgh Date: 9/3/10	> $500K	5 + 5 7 + 5	5 7	5,4,3,2,1 5,5,5,4,3,2,1
Signature Bank Date: 9/3/10	> $500 K	5 + 5 7 + 5	5 7	5,4,3,2,1 5,5,4,4,3,2,1
Investors Savings Bank Date: 9/3/10	> $500 K	5 + 5 7 + 5 10	5 7 10	5,4,3,2,1 5,5,5,4,3,2,1 5,5,4,4,3,3,2,2,1,1
Sovereign Portfolio Date: 9/3/10	> $500 K	5-year / no option 5 + 5 5-year / no option 7-year / no option 10-year / no option	5 5 5 7 10	4.5 YM 4.5 YM 5,4,3,2,1 6.5 YM 9.5 YM

Source: Market Rate Sheets (as of 9/20/10)

Among those surveyed, Union Bank of California is a west coast bank and JPM Chase lends nationwide with a concentration on the west coast and New York. The other banks are based in New York. In general, these lenders consistently offer hybrid interest rate terms, loan terms less than 10 years, options to extend loan term, and declining prepayment schedules. All these features offer borrowers added flexibility, but largely eliminate these loans from consideration for securitization.

Fannie Mae's most competitive product is the 10-year fixed-rate balloon with 30-year amortization and 9.5 years of yield maintenance (which means that the borrower cannot prepay the loan before 9.5 years without making the investor whole). Because of the refinance or "balloon" risk of short-term products, Fannie Mae has underwriting guidelines such as interest rate floors and stressed interest rate exit tests to minimize this risk; as well as pricing and credit structures that favor longer duration products. There is also a strong MBS market demand for longer-term products and Fannie Mae is able to quickly and efficiently securitize these loans.

Securities law restrictions, such as the inability to provide payment relief for a borrower by modifying loan terms, except under clearly defined conditions, or the inability to transfer a recourse loan, can be burdensome to a borrower looking for flexibility. Portfolio lenders are able to meet the small loan borrower's desire for flexibility.

Additionally, products offering borrower options, such as ability to extend a loan term or customize prepayment premiums, may be ineligible for securitization or may be expensive or illiquid in the capital markets.

During the Commercial Mortgage-Backed Securities (CMBS) boom of the mid-2000s there were several small loan securitization programs including LaSalle Bank, Washington Mutual, and Sovereign Bank. The loans that were securitized in these programs were long-term products without prepayment flexibility and were not priced as attractively for borrowers as the lenders' portfolio programs. In short, the standard small multifamily loan product originated by banks is not easily securitizable. However, Fannie Mae has identified a segment of the market where borrowers will accept long-term fixed rate loans that can be placed into mortgage-backed securities.

Unique Small Loan Market Limits Fannie Mae's Role: Based on Fannie Mae's small loan flow volume of $2.2 billion in 2009, Fannie Mae estimates that our small loan market share is 15%. Although this is lower than the conventional multifamily loan market share of 40% in 2009, it is still a relevant volume and provides much needed liquidity to the market.

Overall, lenders, borrowers, and products are unique in the multifamily small loan market versus the larger, conventional multifamily loan market. Fannie Mae has embraced these differences, created a dedicated team, and partnered with the top small loan lenders to offer an effective, fixed-rate product that many borrowers demand. Fannie Mae's participation in small multifamily loans is valuable but the liquidity we can provide is limited by the nature of the market.

WHY IS THE SMALL MULTIFAMILY MARKET IMPORTANT TO FANNIE MAE?

It is important because small loans support affordable housing. Fannie Mae has chosen a business model that focuses on supporting the breadth of the rental housing market, with a particular focus on rental housing for working families. Unlike other market participants that have moved in and out of the small loan multifamily space, Fannie Mae has always considered small multifamily lending an important strategic business because a preponderance of lower income and working families live in small multifamily rental properties. Small multifamily rentals are concentrated in urban areas, particularly in the northeastern United States and Southern California, and as such provide affordable housing in close proximity to transportation and jobs. Small multifamily rentals also tend to be older properties, with more than half over 30 years old.

The importance of small loans and the affordability they provide is demonstrated by Fannie Mae's small loan book, 86% of which is affordable to families earning at or below 100% area median income (AMI).

HOW IS "AFFORDABLE" DEFINED?

Housing is considered affordable if a household spends no more than 30% of gross income for rent. However, the following chart shows a different scenario that households must routinely spend well over one-third of gross income to be able to live in a two-bedroom apartment, especially in high-cost areas.

For example, in Los Angeles, a household earning 50% of AMI, $34,100, must spend over 57% of income to be able to afford the typical market rate rent for a two-bedroom apartment of $1,627. A household earning $34,100 can afford to spend no more than $853 per month. Only households earning 80% to 100% of AMI can comfortably live in the typical market rate apartment.

What is striking in the following comparison is not the difference in asking rents, but the difference in the estimated household income needed to afford the corresponding rental rates. Based on this difference, it seems likely that many households in these high-cost metro areas are not actually earning the income needed to afford the two-bedroom market rate rent apartment, but rather are spending more than one-third of gross income to pay the rent.

Fannie Mae and Affordable Workforce Housing: These three metro areas may have higher costs of living on average, but there are still rental units affordable across the spectrum of AMI. As seen in the following chart, even a city as expensive as San Francisco has nearly 30,000 units renting at between 80% and 100% of AMI that were financed by Fannie Mae. More importantly, over 67,000 units are rented at between 60% and 100% of AMI, which is a perfect example ofworkforce rental housing.

Housing Policy Encourages Development of Mixed Income Housing: Over the last two decades, affordable housing policies have shifted from supporting large-scale, urban renewal projects in the 1950s and 1960s to supporting smaller, mixed-income projects supported by federal programs such as LIHTC initiated in 1986 and HOPE VI initiated in 1990. These types of housing development programs have guidelines that indicate what percentage of a new project's units must be affordable at various percentages of AMI and what percentage of units can be offered at market rates.

For example, under the LIHTC program initiated in 1986 to stimulate the production of new affordable housing, 20% of the units in a new development under construction must be affordable to households earning no more than 50% of AMI or 40% of units must be affordable to families earning no more than 60% of AMI. The remainder of the units may be offered at the market rate. Small loans are important to Fannie Mae as they directly support affordable and workforce housing in the high-cost metro areas in which they are located.

	San Francisco	Los Angeles - Long Beach	New York
Housing Costs			
Two bedroom at HUD determined Fair Market Rent (FMR)[1]	$1,760	$1,420	$1,359
Income needed to afford 2 BR FMR[2]	$70,400	$56,800	$54,360
Two bedroom Market Rate Rent[3]	$2,281	$1,627	$3,610
Income needed to afford 2 BR Market Rate Rent	$91,240	$65,080	$144,400
Area Median Income (AMI) / Monthly Rent Affordable[4,2]			
Annual AMI / Monthly Rent Affordable	$93,400 / $2,335	$68,200 / $1,705	$78,300 / $1,958
80% of annual AMI / Monthly Rent Affordable	$74,720 / $1,868	$54,560 / $1,364	$62,640 / $1,566
50% of annual AMI / Monthly Rent Affordable	$46,700 / $1,168	$34,100 / $853	$39,150 / 979
30% of annual AMI / Monthly Rent Affordable	$28,020 / $701	$20,460 / $512	$23,490 / $587

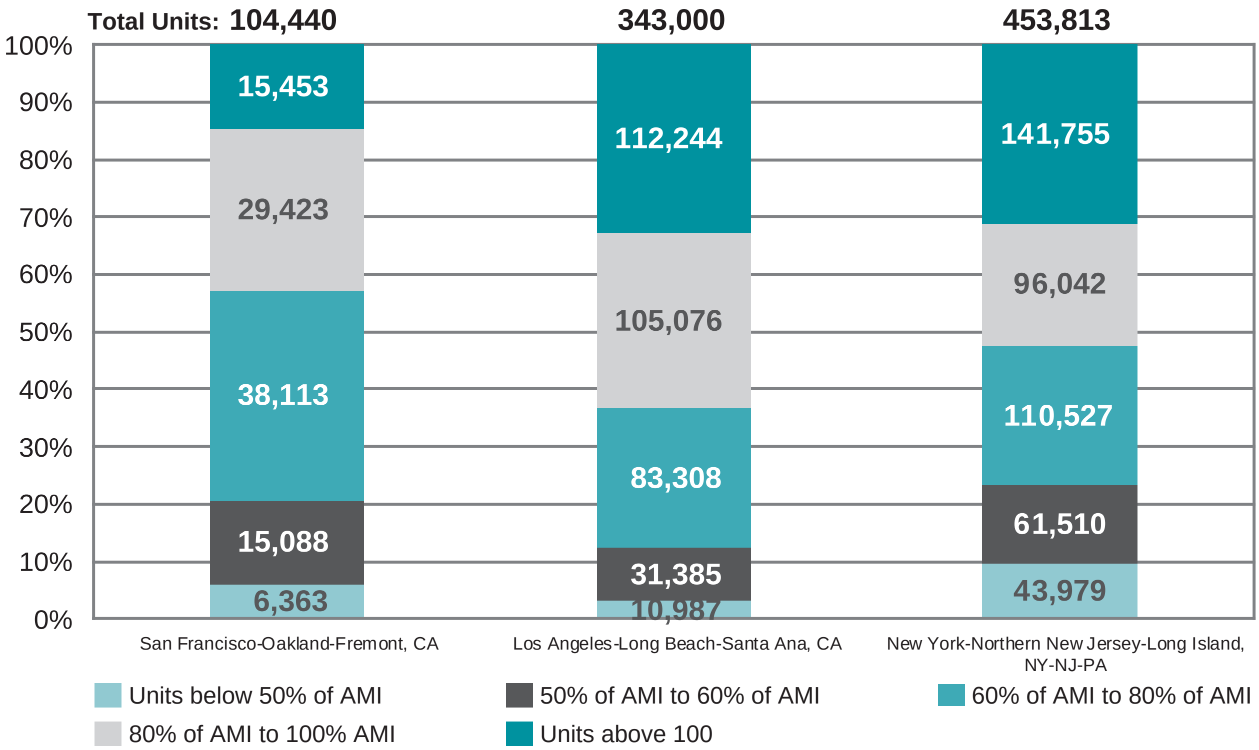
[1] *"Fiscal Year 2010 Fair Market Rent provided in Out of Reach 2010" – June Update, National Low Income Housing Coalition*

[2] *"Affordable" rents represent the generally accepted standard within housing policy circles of spending not more than 30% of gross income on housing.*

[3] *Market Rate Rents based on REIS 2nd quarter 2010 data for geography based on Metropolitan Statistical Area (MSA)*

[4] *AMI = Fiscal Year 2010 Area Median Income (HUD, 2010) as provided by Federal Housing Finance Agency (FHFA) to Fannie Mae.*

FANNIE MAE'S BOOK OF BUSINESS UNITS IN SPECIFIED MARKETS
SEGMENTED BY AFFORDABILITY TO AREA MEDIAN INCOME (AMI)



Source: Fannie Mae, December 2009 Book of Business

WHAT IS THE CREDIT PERFORMANCE OF SMALL LOANS?

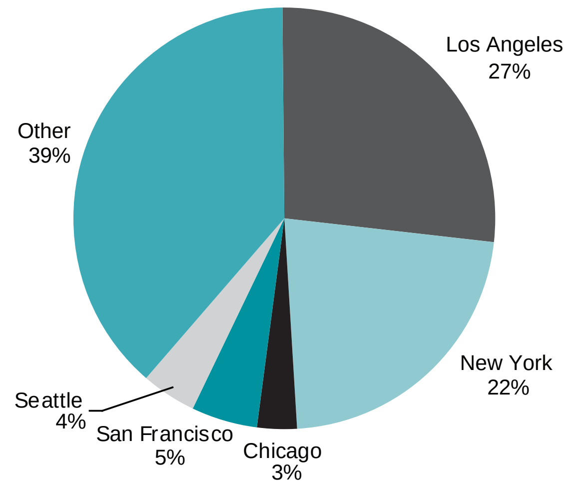
Fannie Mae Small Loan Book of Business: Fannie Mae has a long history of providing liquidity to the multifamily small loan market as demonstrated by the size of its current book of business. As of June 30, 2010, Fannie Mae's total multifamily book of business was approximately $185 billion comprised of over 42,000 apartment loans. The small loan book of business for that same period totaled approximately $34 billion (18% of total book) comprised of approximately 30,000 individual small loans (71% of total loan count).

Small Loan Geography: Small multifamily loans tend to be concentrated in large metropolitan areas, which traditionally have low home ownership rates and high demand for affordable rental housing. According to PPR (Property and Portfolio Research) data, New York City has the largest concentration of small multifamily buildings in the US. Within the metropolitan statistical area (MSA) there are an estimated 2,000,000 small multifamily units. This is not surprising for a city with a home ownership rate of approximately 30%.

Among other large cities, the Los Angeles MSA has approximately 1,080,000 small multifamily units and the Chicago MSA has approximately 632,400. From a loan production point of view, Los Angeles recorded the highest dollar volume of small multifamily loans financed in 2008, with New York and Chicago close behind.

Following geographic market trends detailed to the right, Fannie Mae's multifamily small loan book of business is also highly concentrated in the Los Angeles and New York MSAs. While this type of geographic concentration would typically create concern over diversity risk in the portfolio, multifamily small loan real estate has historically performed well in these MSAs. The chart shows the top five MSAs where the small loan book of business is distributed.

FANNIE MAE SMALL MULTIFAMILY BOB MARKET GEOGRAPHY AS OF JUNE 30, 2010



Source: Fannie Mae

Small Loan Credit Statistics and Performance: Despite relatively lower loan leverage in the small loan book, debt service coverage (DSCR) – a relative measure of the amount of cash flow needed to support debt service payments – for the small loan book slightly lags the total multifamily book. This relative under performance is attributable to the unique cash flow challenges smaller properties face, like the more dramatic effect on cash flow that vacancies have on small loan performance.

Fannie Mae's small loan serious delinquencies (SDQ) – loans that are 60 days past due – rose to 1.01% in the second quarter of 2010. However, if you disaggregate the seasoned pool business from the DUS small loan business – the two business segments that make up Fannie Mae small loan lending – the seasoned pool book of business experienced an SDQ rate of 1.44% compared to a more favorable 0.73% SDQ rate for the DUS flow small loan portfolio. These compare relatively favorably to an SDQ rate for the total multifamily book of 0.80% in the same period.

	Small Loans	Non-Small Loans	Total Multifamily
WAVG Loan to Value (LTV) at Origination	58%	68%	67%
WAVG Debt Service Coverage (DSCR) at Origination	1.54	1.37	1.40

Data as of June 30, 2010

FDIC INSURED FINANCIAL INSTITUTIONS
LARGEST HOLDERS OF MULTIFAMILY DEBT ($000S)

	Name	Total Assets	Loans Secured by 5 or more family units	SDQ Rate (Past 90 days)
1	JPMorgan Chase Bank, National Association	$ 1,568,093,000	$ 33,236,000	3.82%
2	New York Community Bank	$ 39,788,713	$ 16,496,224	2.30%
3	Wells Fargo Bank, National Association	$ 1,073,280,000	$ 10,061,000	4.03%
4	Bank of America, National Association	$ 1,518,957,843	$ 8,252,307	2.84%
5	Citibank, National Association	$ 1,157,877,000	$ 7,251,000	5.97%
6	Sovereign Bank	$ 72,580,147	$ 5,497,587	5.04%
7	Capital One, National Association	$ 123,523,320	$ 5,036,669	0.69%
8	Regions Bank	$ 131,010,846	$ 4,169,070	7.42%
9	U.S. Bank National Association	$ 278,464,643	$ 3,756,228	5.07%
10	PNC Bank, National Association	$ 251,075,292	$ 2,728,760	13.47%
11	OneWest Bank, FSB	$ 27,898,129	$ 2,476,562	2.26%
12	The Dime Svgs. Bank of Williamsburgh	$ 4,134,786	$ 2,473,551	0.47%
13	M&I Marshall and Ilsley Bank	$ 47,530,839	$ 2,442,381	1.93%
14	Astoria Federal Savings and Loan Association	$ 19,639,969	$ 2,409,258	2.34%
15	Union Bank, National Association	$ 83,842,126	$ 2,335,408	6.27%

Source: Federal Financial Institution Examination Council as of June 30, 2010

Despite slightly less favorable credit performance in the Fannie Mae small loan book compared to the total multifamily book, Fannie Mae's small loans demonstrate better performance than the overall multifamily performance of loans held by other lenders active in the small loan space. For example, SDQ rates for bank portfolios through the second quarter of 2010 were approximately 3.88%. Since these rates are based on a 90-day past due standard compared to Fannie Mae's 60-day past due standard, they can be considered conservative. Fannie Mae multifamily also outperformed the CMBS market, which registered 13.18% delinquency through Q2 2010.

Fannie Mae attributes this strong performance compared to its bank and CMBS competition to be attributable directly to standardized underwriting and credit guidelines for small multifamily loans and the strength of credit delegation and shared loss provided by the DUS lenders.

Property Condition and Small Multifamily Loans: In addition to the increased borrower risks, property condition is a significant factor that affects small loan performance. More than half of small rental buildings in the US are over 30 years old and much of the inventory is in need of substantial repair. Approximately 57% of the Fannie Mae small loan book was built before 1970 and faces many of the same property condition challenges as the rest of the market.

Many individual small rental owners do not have the resources to preserve and improve small rental properties. However, without sufficient capital to maintain their buildings the properties deteriorate, tenants are exposed to challenging living conditions, and vacancies increase leading to curtailed cash flow and a higher incidence of delinquency. The property condition of the Fannie Mae small loan book is slightly worse than the non-small loan book. A property condition rating of "1" is the strongest, a rating of "5" is the weakest, so the lower the rating the worse the condition. The weighted average property condition for small loans is 1.86 versus 1.70 for non-small.

Due to the challenges related to property condition for small loans, Fannie Mae monitors this portfolio closely to assure sustainable and safe housing for tenants. Fannie Mae also has strict guidelines related to property condition at origination to assure that as small loans are delivered, they adhere to this quality for tenants and to limit deferred maintenance issues.

Consistent with Fannie Mae's portfolio performance, according to data from University Neighborhood Program, UNHP, a NYC nonprofit that tracks property code violations in the five boroughs, smaller properties (≤ 50 units) have higher incidences of property code violations than larger properties with more than 50 units. A Building Indicator Project Score (BIP) of 800 or higher is considered to be a significant code violation issue. And, as the table shows, properties with less than 50 units have higher average of violations per unit, 1.42 vs. 0.32 for larger properties.

Based on these concerns, Fannie Mae believes it is prudent to apply a strict approach to property condition for small loans. Fannie Mae's approach is more conservative than other portfolio lenders. Using the UNHP data, 5.7% of all properties in the NYC market have BIP scores > 800 while only 3.17% of Fannie Mae's Book of Business has a BIP score > 800. This shows that Fannie Mae takes a more prudent underwriting approach to property condition which helps to ensure the safety of tenants.

Fannie Mae has also found that the credit performance of our small loan book, while not as strong as the larger loan book, is still good relative to the market. The fact that Fannie Mae has a dedicated credit team focused on this unique product has served the company well. Although Fannie Mae's credit guidelines are often stricter than portfolio lenders, Fannie Mae believes this is a prudent approach and is consistently

NYC Market Building Size	Total Buildings	Units	800+ BIP Score	800+ BIP %	Average Total Violations per Unit
<= 50 Units	49,010	736,136	2,904	5.90%	1.42
> 50 Units	8,847	1,212,411	396	4.50%	0.32
Totals	57,857	1,948,547	3,300	5.70%	0.73

Source: University Neighborhood Program Code Violation Data for Properties in the NYC Market calibrating issues relating to markets, property condition, and borrowers in the small loan space.

SMALL LOAN PROFITABILITY

A significant challenge associated with managing the small multifamily loan business is the high fixed costs at origination and sustained costs after closing for servicing, asset management, and special asset management for both Fannie Mae and the lenders. Both the lender and Fannie Mae work to streamline these costs and create economies of scale in order to sustain a profitable ongoing business.

Fannie Mae has streamlined the upfront underwriting requirements to make these loans less expensive for lenders to originate. While the asset management and servicing costs are less for a $2 million loan than for a larger loan, fixed costs associated with managing these small loans cause the profitability to be greater for the larger loans. Additionally, loss severity for small loans is higher than for larger loans; it takes a comparable level of effort and expense to "work out" a $2 million dollar loan in foreclosure as it does a $20 million dollar loan, thus driving up the percentage amount lost on each small loan.

Through our current small loan strategy and pricing, Fannie Mae has established a model where both the lenders and Fannie Mae are targeting profitable small loan business. We are constantly monitoring this profitability to assure that we are structured and priced effectively.

Lender Small Loan Profitability: Thin margins and limited profitability for the lenders prove challenging in the small loan market. Lender income is based on a percentage of the loan amount via origination fees, trade premiums, and servicing fees. The smaller the loan size, the harder it is to be profitable. Many lenders have created economies of scale that allow them to enter into this business. Based upon an informal survey of Fannie Mae's small loan lenders we have summarized the origination and servicing cost and profitability to illustrate some of the challenges associated with managing this business.

Origination Costs: The cost to originate and service a small loan is high in relation to the loan amount and generated revenue. As shown in the sample profit and loss statement ("P&L"), the expense ratio for a $1 million loan is roughly

Sample P&L			
Assumed Deal Terms			
Deal Terms			
Loan Amount	1,000,000	3,000,000	10,000,000
Origination Fee	1.0%	1.0%	1.0%
Loan Term	10	10	10
Purchase Price	103.50	102.00	102.00
Income Analysis *			
Premium (net)	35,000	60,000	200,000
Origination Fee	10,000	30,000	100,000
Ancillary Income (0.35%)	3,500	10,500	35,000
Borrower Reimbursed DD Expenses	N/A	N/A	27,400
Application Fee	5,000	5,000	12,500
TOTAL REVENUE	**$53,500**	**$105,500**	**$374,900**
Due Diligence Expenses **	9,000	9,000	39,900
Salaries and Incentives	32,700	32,700	125,000
Origination Fee	10,000	30,000	100,000
Capital Reserve	1,160	3,480	11,600
Operating Expenses	22,250	22,250	70,000
TOTAL EXPENSES	**75,110**	**97,430**	**346,500**
NOI	**(21,610)**	**8,070**	**28,400**

** Average income and expense data above provided by a DUS lender currently active in small balance lending for Fannie Mae.*

*** See the following chart for details*

7.5% vs. 3.2% for a $3 million loan and 3.5% for a $10 million loan. As shown in the P&L chart, Fannie Mae has streamlined the origination costs to make small loans less expensive to originate and therefore profitable for lenders.

The chart to the right is a sample of typical application fees and due diligence costs associated with underwriting a $1 million small loan and a $10 million loan.

Servicing Costs: On average, the cost to asset manage and service a small loan is lower than that of a larger loan. According to a DUS lender experienced in small balance lending, the average cost to service a $1 million loan is roughly $2,200 while the cost to service a $10 million loan is approximately $3,600. However, the loss severity for small loans is higher than for larger loans. It takes the same level of effort and expense to work out a $1 million dollar loan in foreclosure as it does a $10 million dollar loan, thus driving loss severities up for the small loans.

Assuming the same loan amount terms, the Sample Asset Managment/Servicing chart highlights the net present value breakeven cost of servicing fee income for the expenses of servicing a loan. The breakeven servicing fee to service a $1 million loan is 25 basis points annually versus 8 bps and 4 bps for $3 million and $10 million loans, respectively. Therefore, sustaining profitability for servicing smaller loans is much more challenging.

	Small Loan $1MM	DUS Loan $10MM
DUE DILIGENCE COSTS:		
Appraisal:	$2,500	$5,500
PNA:	$1,200	$2,000
Phase 1:	$0	$2,000
Seismic	$0	
Legal & Docs:*	$4,250	$29,350
Title Insurance**	$0	$0
Other (credit score):	$50	$50
Processing:	$1,000	$1,000
TOTAL:	**$9,000**	**$39,900**

** Legal for DUS loans includes lender legal fees, UCC Searches of $850, Survey of $4,000 to $10,000 and borrower legal fees of $10,000, which includes opinion letter.*
*** Title insurance costs for small loans range from $4,000 to $11,000 and are paid by the borrower. This includes UCC Searches which are also paid by the borrower. For large loans the average cost of title is $17,500.*

SAMPLE ASSET MANAGEMENT / SERVICING

Assumed Deal Terms			
Deal Terms			
Loan Amount	1,000,000	3,000,000	10,000,000
S-Fee to lender (per pricing memo)	0.60 bps	0.55 bps	0.55 bps
Estimated per loan cost to service	$2,200	$2,200	$3,600
Loan Term / Amortization	10 / 30	10 / 30	10 / 30
Net Present Value (NPV) Servicing Fee Income / Expenses			
Minimum servicing fee required to break even	0.25 bps	0.08 bps	0.04 bps
NPV servicing income based on break even s-fee	$19,786	$18,966	$31,610
NPV Servicing Expenses	$19,274	$19,274	$31,540
Profit / (Loss)	$512	($308)	$70

FANNIE MAE HAS A RELEVANT, FOCUSED ROLE IN SMALL LOANS

Fannie Mae's 2010 small multifamily loan acquisitions are expected to be comparable with 2009 acquisitions of $2.2 billion. The company estimates this will be consistent with our 2009 small loan market share of 15%. This makes Fannie Mae one of the largest providers of financing for small multifamily loans in the country and one of the only secondary market participants buying small loans. While several of the large bank portfolio lenders, such as JP Morgan Chase and Sovereign Bank, have entered and exited the small multifamily market in the past few years, Fannie Mae has been a consistent source of liquidity with a $34 billion book of 30,000 loans on small multifamily properties as of midyear 2010.

Fannie Mae continues to have a dedicated team of people committed to providing liquidity for strong, small loan properties and focused on borrowers who want long-term, fixed-rate financing. With over 25 years of history in small multifamily lending, Fannie Mae plans to maintain this leadership role by supporting our DUS lenders and non-DUS small loan lenders.

CONTACTS

For more information about Fannie Mae small multifamily loans, please visit eFannieMae.com. For a list of our small loan lenders, https://www.eFannieMae.com/mf/refmaterials/lenderinfo/smloanlenders.jsp.