Executive Summary

Created by the Housing and Economic Recovery Act of 2008 (HERA), the Federal Housing Finance Agency (FHFA or Agency) currently serves as the supervisor and conservator of Fannie Mae and Freddie Mac (together, the Enterprises). HERA also established (in 12 USC § 4567) two affordable housing funds – the Housing Trust Fund within the Department of Housing and Urban Development (HUD) and the Capital Magnet Fund within the Department of the Treasury (Treasury) (together, the Affordable Housing Funds) – both to be funded through annual set-asides by the Enterprises. (HERA also provided that a limited amount of the set-asides would go into a reserve fund (the HOPE Reserve Fund) managed by Treasury.) HERA requires the Enterprises to transmit the annual set-aside amounts to these Funds, unless the FHFA Director suspends the transmission, upon a finding that one or more of three statutory conditions have been met.

In November 2008, the then-FHFA Director suspended the Enterprises’ affordable housing set-asides and transmissions until further notice, upon his finding that at least one of the statutory conditions was met. In December 2014, the current FHFA Director lifted the suspension, effective January 2015. For 2015, 2016, and 2017, the Enterprises set aside and transmitted a total of $1.251 billion to the Housing Trust Fund ($0.678 billion), the Capital Magnet Fund ($0.364 billion), and the HOPE Reserve Fund ($0.209 billion, for 2015 and 2016 only).

We conducted this audit to understand the analyses, if any, performed by FHFA to determine whether the conditions that led to its 2008 temporary suspension of set-asides and transmissions had changed as of January 2015 and whether the explanation provided by FHFA to lift the temporary suspension in December 2014 continued in force through February 2018, when FHFA directed the Enterprises to transmit their 2017 set-asides. We also assessed the accuracy of the Enterprises’ set-aside computations for 2015 through 2017, as well as FHFA’s oversight of the Enterprises’ set-asides and transmissions to the Affordable Housing Funds.

We found that FHFA first considered whether to lift its temporary suspension of the transmissions to the Affordable Housing Funds in 2013. FHFA’s General Counsel, in a memorandum to the then-Acting FHFA Director in April 2013, analyzed whether one or more of the statutory conditions that led to the 2008 temporary suspension continued in force. The General Counsel cautioned that the Enterprises had only reported profitable quarters because “of the huge infusion of capital they received from the Treasury and which has not been repaid... [I]t must be remembered that the goal of the dividend sweep is to preserve the availability of Treasury support should further draws
be needed—a key element in market place willingness to deal with the Enterprises.” He concluded:

Continuing suspension of the [Affordable Housing Funds] contributions is justified while the Enterprises remain in conservatorship, especially since the Treasury Department has not recovered the amounts that it contributed... to cover Enterprise losses, currently over $180 billion.

In 2014, the General Counsel was asked by the current FHFA Director to analyze whether, under HERA, termination of the 2008 temporary suspension was warranted because the Enterprises were “making money” and to set forth the basis of the Director’s authority to lift this suspension. In a memorandum dated October 30, 2014, the General Counsel answered both questions. As to the first question, he reviewed the same statutory conditions that he analyzed in his 2013 memorandum but came to a different conclusion. In this memorandum, he reasoned:

The dollar amount of the set aside and allocation as a percentage of unpaid principal balance of new purchases is anticipated to be small compared to recent income and to dividend payments to the Treasury Department and would be viewed as an expense of the Enterprises—embedded in statute and suspended during a time of unusual stress in the determination of the prior Director and now initiated in line with changed circumstances.

Nowhere does this October 2014 memorandum state, or suggest, that General Counsel had previously concluded, in April 2013, that continuing suspension of contributions to the Affordable Housing Funds would be justified while the Enterprises remain in conservatorship, or attempt to reconcile the differences between the two analyses.

As to the second question, the October 2014 memorandum advised that “a decision to lift the suspension of Fund set asides and allocations is within the Director’s discretion.”

In December 2014, the FHFA Director notified each Enterprise, in writing, that he was exercising his discretion to terminate the temporary suspension of set-asides for and transmission to the Affordable Housing Funds and directed the Enterprises to begin transmitting their set-asides, beginning with the fiscal year 2015. Those written notifications also directed:

In the event that an Enterprise makes a draw during 2015 or any subsequent year or if transfer of the set-aside would cause the
Enterprise to make a draw in any year, that Enterprise will make no transfer of set-asides for that year to the Affordable Housing Funds, as supplemented or modified by specific guidance or directive from FHFA.

The Enterprises calculated their set-asides for 2015, which they transmitted to the Affordable Housing Funds. Our audit found that the Enterprises’ computations for the 2015 set-asides and subsequent transmittals were accurate.

Operating under this December 2014 notice, the Enterprises calculated their set-asides for 2016, which they transmitted to the Affordable Housing Funds. Our audit found that the Enterprises’ computations for the 2016 set-asides and subsequent transmittals were accurate.

Because of changes to the federal corporate tax law in December 2017, it became necessary for the Enterprises to re-measure the value of their deferred tax assets on their balance sheets. When these assets were re-measured, the Enterprises were put into a net worth deficit position as of December 31, 2017, as their net incomes from operations that quarter were insufficient to cover the amounts written-down for the decreased value of their deferred tax assets. During the first quarter of 2018, FHFA submitted a request to Treasury on behalf of the Enterprises to take additional draws to eliminate their net worth deficits.

While the December 2014 notifications directed that a draw by an Enterprise in any subsequent year would cause that Enterprise to suspend transmission of its set-asides for that year to the Affordable Housing Funds, the FHFA Director, by written notices to the Enterprises dated February 7, 2018, instructed each Enterprise to proceed with the transfer of 2017 set-asides to the Affordable Housing Funds. The FHFA Director explained that he did “not consider this one-time event to relate to any financial instability on the part of the Enterprise either now or in the future.” Our audit found that the Enterprises’ computations for the 2017 set-asides and subsequent transmittals were accurate.

Our audit also found that FHFA took steps to ensure the accuracy and the transmittal of the affordable housing allocations.

We recognize that 12 USC § 4567(b) vests the FHFA Director with authority to suspend the set-aside and transmission of the affordable housing allocations of one or both Enterprises, upon a finding that one or more of three statutory conditions have been met. One federal district court has held that the decision of the FHFA Director whether to impose a temporary suspension is committed
solely to his or her discretion and the Director, in both his December 2014 and February 2018 notices, invoked that authority and determined that transmittal of the set-asides did not contribute, and would not contribute to the financial instability of the Enterprises. For those reasons, we make no formal recommendations in this audit. Because FHFA is both the conservator for and supervisor of the Enterprises, in which U.S. taxpayers have invested more than $191 billion, prudence counsels that FHFA, in the future, acknowledge and explain the reasons for changes in its critical determinations.

We provided a draft of this report to FHFA and received oral and written technical comments, which we considered in finalizing this report. FHFA declined to provide a written management response.

This report was prepared by Tara Lewis, Audit Director; David Cho, Auditor-in-Charge; and with assistance from Bob Taylor, Assistant Inspector General for Audits. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov.

Marla A. Freedman, Deputy Inspector General for Audits /s/
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<td>the Housing Trust Fund within HUD and the Capital Magnet Fund within Treasury</td>
</tr>
<tr>
<td>Enterprises</td>
<td>Fannie Mae and Freddie Mac</td>
</tr>
<tr>
<td>FHA</td>
<td>Federal Housing Administration</td>
</tr>
<tr>
<td>FHFA</td>
<td>Federal Housing Finance Agency</td>
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<tr>
<td>HERA</td>
<td>Housing and Economic Recovery Act of 2008</td>
</tr>
<tr>
<td>HUD</td>
<td>Department of Housing and Urban Development</td>
</tr>
<tr>
<td>President’s Budget</td>
<td>Budget of the United States Government</td>
</tr>
<tr>
<td>PSPA</td>
<td>Senior Preferred Stock Purchase Agreement</td>
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</table>
Created by HERA, FHFA currently serves as the supervisor and conservator of the Enterprises.

**Affordable Housing Funds and the HOPE Reserve Fund**

HERA established the Affordable Housing Funds—the Housing Trust Fund within HUD and the Capital Magnet Fund within Treasury—to be funded through set-asides by, and transmissions from, the Enterprises.\(^1\) As discussed more fully below, HERA requires the Enterprises to transmit the annual set-aside amounts to these funds, unless the FHFA Director suspends the transmission upon a finding that one or more statutory conditions have been met.

HERA defines the purpose of each fund. The purpose of the Housing Trust Fund is to provide grants to States “to increase and preserve the supply of rental housing for extremely low- and very low-income families, including homeless families and to increase homeownership for extremely low- and very low-income families.”\(^2\) The purpose of the Capital Magnet Fund is to fund a competitive grant program to attract private capital for, and increase investment in, “the development, preservation, rehabilitation, or purchase of affordable housing for primarily extremely low-, very low-, and low-income families” and “economic development activities or community service facilities such as day care centers, workforce development centers, and health care clinics, which in conjunction with affordable housing activities implement a concerted strategy to stabilize or revitalize a low-income area or underserved rural area.”\(^3\)

HERA directs FHFA to enforce the Enterprises’ compliance with the requirements for the set-asides, and transmission of these amounts to HUD (for the Housing Trust Fund) and Treasury (for the Capital Magnet Fund).\(^4\) While the Enterprises are the funding sources for the Housing

---

\(^1\) HERA also provides that both the Housing Trust Fund and the Capital Magnet Fund may be funded with other amounts that are or may be appropriated, transferred, or credited under other law. For example, the Consolidated Appropriations Act, 2010 (Public Law 111-117) provided an appropriation of $80 million to the Capital Magnet Fund.

\(^2\) 12 USC § 4568. Housing Trust Fund.

\(^3\) 12 USC § 4569. Capital Magnet Fund.

\(^4\) For purposes of this report, we use the term “transmitted” as a substitute for the statutory term “allocated” in HERA.
Trust Fund and the Capital Magnet Fund, FHFA is not responsible for administering either fund under HERA.\(^5\)

Additionally, HERA created the HOPE for Homeowners Program\(^6\) administered by the Federal Housing Administration (FHA),\(^7\) and the HOPE Reserve Fund, managed by Treasury, and funded through the Enterprises’ set-asides. The HOPE Reserve Fund provides a source of support for obligations of the HOPE for Homeowners Program.

**Set-Asides and Transmissions to the Affordable Housing Funds and the HOPE Reserve Fund**

HERA establishes the formulas to calculate the annual set-asides by the Enterprises and transmissions to the Affordable Housing Funds. HERA directs that the annual contribution from each Enterprise shall be an amount equal to 4.2 basis points for each dollar of the unpaid principal balance of its total new business purchases.\(^8\) HERA instructs that each Enterprise

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\(^5\) That FHFA has no role in administration of these two Funds was underscored by Director Watt in a January 2015 congressional hearing. In response to a Member’s question about the impact of the Funds on affordable housing, the Director stated in part that: “[W]e don’t have any control over at FHFA over the use of these funds. Those decisions are actually made at Treasury and HUD.” (Hearing before the Committee on Financial Services, U.S. House of Representatives, *Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency*, at 13 (Jan. 27, 2015) (Serial No. 114 1) (online at www.gpo.gov/fdsys/browse/collection.action?collectionCode=CHRG&browsePath=114%2FHOUSE%2FCommittee+on+Financial+Services&isCollapsed=false&leafLevelBrowse=false&isDocumentResults=true&ycord=164).

\(^6\) According to HERA, the purpose of the HOPE for Homeowners Program is: (1) to create an FHA program, participation in which is voluntary on the part of homeowners and existing loan holders, to insure refinanced loans for distressed borrowers to support long-term, sustainable homeownership; (2) to allow homeowners to avoid foreclosure by reducing the principal balance outstanding, and interest rate charged, on their mortgages; (3) to help stabilize and provide confidence in mortgage markets by bringing transparency to the value of assets based on mortgage assets; (4) to target mortgage assistance under this section to homeowners for their principal residence; (5) to enhance the administrative capacity of the FHA to carry out its expanded role under the HOPE for Homeowners Program; (6) to ensure the HOPE for Homeowners Program remains in effect only for as long as is necessary to provide stability to the housing market; and (7) to provide servicers of delinquent mortgages with additional methods and approaches to avoid foreclosure.

\(^7\) Part of HUD, FHA is a mortgage insurer and operates as a self-funded entity, typically obtaining capital to operate its programs from the mortgage insurance premiums it receives from lenders that participate in the programs.

\(^8\) For purposes of this statutory provision, FHFA determined and, through a supervisory communication dated March 19, 2015, informed the Enterprises that “new business purchases” includes acquisitions of single-family and multi-family mortgage loans that an Enterprise holds in portfolio or that support a guaranteed Enterprise trust, but does not include Long Term Standby Commitments or other commitments to buy mortgages at a later date or time, acquisitions of delinquent loans from guaranteed Enterprise trusts, post-mortgage loan purchase credit enhancements, or securitizations of previously purchased mortgages.
shall transmit 65% of its annual set-aside amount to HUD for the Housing Trust Fund and 35% of its annual set-aside amount to Treasury for the Capital Magnet Fund.

HERA also required the FHFA Director to issue a regulation prohibiting each Enterprise from passing on, to the originators of mortgages purchased or securitized by the Enterprise, the costs of any required allocation to the Affordable Housing Funds through increased charges or fees, or decreased premiums, or in any other manner. On December 16, 2014, FHFA issued an interim final rule and on March 26, 2015, a final rule implementing this requirement.

**Requirement to Transmit 25% of the Enterprises’ Set-Asides to the HOPE Reserve Fund**

HERA established the HOPE Reserve Fund to be managed by Treasury, with allocations to the HOPE Reserve Fund to come from a portion of the Affordable Housing Funds set-aside and allocations by the Enterprises. According to FHFA’s General Counsel, the Enterprises’ obligations to make deposits to the HOPE Reserve Fund is governed by the Appendix to the Budget of the United States Government (the President’s Budget) for a given fiscal year. For the years when this HERA provision was applicable, 25% of the aggregate amount set-aside and transmitted by the Enterprises for the Affordable Housing Funds was to be deposited into the HOPE Reserve Fund and the remaining amount was to be transmitted to the Housing Trust Fund (65%) and to the Capital Magnet Fund (35%). Since HERA was enacted, such assessments were included only in the President’s Budgets for fiscal years 2016 and 2017.

Regardless of whether the Enterprises set aside an amount for the HOPE Reserve Fund, the total amount of the set-aside to the Affordable Housing Funds remains the same (4.2 basis points of new business purchases).

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12 The HOPE Reserve Fund was established to pay, if necessary, the subsidy costs associated with the refinanced loans under the HOPE for Homeowners program. The HOPE for Homeowners program was available to qualified homeowners between October 1, 2008, and September 30, 2011. Based on our review of HUD budget documents, there was very little activity in the HOPE for Homeowners program; only about $125 million in loan guarantees were refinanced under this program, compared with the amount authorized in HERA of up to $300 billion.
From September 2008 Through December 2014, FHFA Suspended Enterprise Set-Asides and Transmissions to the Affordable Housing Funds

HERA directs that the FHFA Director “shall” temporarily suspend the transmission of the Enterprises’ annual set-asides upon a finding that one or more conditions have been met. These conditions in 12 USC § 4567(b) are:

(1) that the transmissions are contributing, or would contribute, to the financial instability of the Enterprise;

(2) that the transmissions are causing, or would cause, the Enterprise to be classified as undercapitalized; or

(3) that the transmissions are preventing, or would prevent, the Enterprise from successfully completing a capital restoration plan under section 4622 of this title.

HERA does not define the term “financial instability.”

Pursuant to that authority, the then-FHFA Director found that at least one of these conditions was met and in a letter to each Enterprise dated November 13, 2008, served notice that FHFA was suspending the Enterprises’ set-asides and transmissions until further notice. He explained in those letters that this temporary suspension was triggered by FHFA’s findings that the transmissions would (1) further contribute to the financial instability of each Enterprise and (2) cause the Enterprises, which were facing negative net worth, to increase the size of their draws from Treasury.

FHFA’s suspension of set-asides and allocations continued through 2014. In December 2014, the current FHFA Director lifted the suspension, effective January 2015.

The total amount of the Enterprises’ allocations to the Housing Trust Fund, Capital Magnet Fund, and HOPE Reserve Fund for set-asides made during 2015, 2016, and 2017 was $1.251 billion, consisting of $724 million allocated by Fannie Mae and $527 million allocated by Freddie Mac. See Figure 1 following:
**FIGURE 1. ENTERPRISES’ SET-ASIDES AND ALLOCATIONS TO THE AFFORDABLE HOUSING FUNDS AND HOPE RESERVE FUND 2015 THROUGH 2017 (DOLLARS IN MILLIONS)**

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Year</th>
<th>Affordable Housing Funds</th>
<th></th>
<th>HOPE Reserve</th>
<th></th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Housing Trust</td>
<td>Capital Magnet</td>
<td>Fund</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fannie Mae</td>
<td>2015</td>
<td>$106</td>
<td>$57</td>
<td>$54</td>
<td>$217</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>131</td>
<td>70</td>
<td>67</td>
<td>268</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2017</td>
<td>155</td>
<td>84</td>
<td>—*</td>
<td>239</td>
<td></td>
</tr>
<tr>
<td>Total – Fannie Mae</td>
<td></td>
<td>$392</td>
<td>$211</td>
<td>$121</td>
<td>$724</td>
<td></td>
</tr>
<tr>
<td>Freddie Mac</td>
<td>2015</td>
<td>$81</td>
<td>$43</td>
<td>$41</td>
<td>$165</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>91</td>
<td>49</td>
<td>47</td>
<td>187</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2017</td>
<td>114</td>
<td>61</td>
<td>—*</td>
<td>175</td>
<td></td>
</tr>
<tr>
<td>Total – Freddie Mac</td>
<td></td>
<td>$286</td>
<td>$153</td>
<td>$88</td>
<td>$527</td>
<td></td>
</tr>
<tr>
<td>Total Enterprises</td>
<td></td>
<td>$678</td>
<td>$364</td>
<td>$209</td>
<td>$1,251</td>
<td></td>
</tr>
</tbody>
</table>

*An assessment on the Enterprises for the HOPE Reserve Fund was not included in the President’s Budget for fiscal year 2018. FHFA confirmed with Treasury that no deposit to the HOPE Reserve Fund (from the 2017 set-asides) was required in 2018.

Source: Fannie Mae’s and Freddie Mac’s public financial reports.

**FACTS AND ANALYSIS**

**FHFA Performed an Analysis in 2013 and Determined that the Conditions Warranting the 2008 Temporary Suspension Remained in Effect**

We found that FHFA first considered whether to lift the temporary suspension of the transmissions to the Affordable Housing Funds in 2013. FHFA’s General Counsel, in a memorandum to the then-Acting FHFA Director in April 2013, analyzed whether the one or more of the statutory conditions that led to the 2008 temporary suspension continued in force.

As of the end of the first quarter 2013, both Enterprises reported a positive net worth. Fannie Mae projected a positive net worth of $62.4 billion at March 31, 2013, and anticipated that its aggregate dividend payments to Treasury by June 30, 2013, would be $95.0 billion, and Treasury’s investment in it remained at $117.1 billion at March 31, 2013 (as dividend payments do not offset prior Treasury draws). Freddie Mac projected a positive net worth of $10.0 billion at March 31, 2013, and anticipated that its aggregate dividend payment to Treasury by June 30, 2013, would be $29.6 billion and Treasury’s investment in it remained at $72.3 billion at March 31, 2013.
In his written analysis, the General Counsel reasoned:

*Statutory Requirement.* The plausible rationale for the mandate to make contributions to the [Affordable Housing Funds] is that Enterprise status as GSEs [government sponsored enterprises]… enabled them to generate profits for private investors and that it was fair to require the Enterprises to make contributions to affordable housing, contributions that would come out of those private investor profits.

*Conservatorship and Market Stability.* Both Enterprises continue to be deeply insolvent but for the Treasury’s capital infusions… Requiring the Enterprises to make contributions to the [Affordable Housing Funds], amounting to millions of dollars a year, would aggravate that insolvency. While the Enterprises are not currently unstable—in the sense that America’s housing finance markets are functioning, market participants continue to rely on the Enterprises to meet their obligations, and the economy is slowly recovering—all of this is only because of the continuing Treasury support of the Enterprise. The statute must be interpreted in light of the conditions in which it was enacted, when the Enterprises were free-standing companies not supported by taxpayer contributions. The Enterprises are not stable in the absence of that government support; withdrawing or weakening such support [would] immediately give rise to massive market instability.

*Treasury Support.* Any contributions in conservatorship would be paid by the Treasury, and hence by the taxpayers, either because they would be included in draws… or because they would reduce dividend payments to the Treasury, postponing Treasury’s recovery of the capital that has already been provided. That was not what these provisions intended. Indeed, it could be questioned whether these [Affordable Housing Funds] provisions have any applicability at all when the Enterprises are in conservatorship, similar to the agency having suspended the Enterprises’ capital classifications.

The General Counsel cautioned:

*Director Determination.* Enterprise reporting of profitable quarters does not alter this analysis. The Enterprises can report these profits only because of the huge infusion of capital they received from the Treasury and which has not been repaid. Further profitability may be questioned, and it must be remembered that the goal of the dividend sweep is to preserve the availability of Treasury support should further draws be needed—a key element in market place willingness to deal with the Enterprises. Therefore, any diversion of funds from the Enterprises threatens the availability of a key conservatorship support function… The Director of
FHFA should take the above considerations in mind in authorizing any expenditures or diversion of funds from conservatorship purposes and while considering the preservation of assets and the desired market presence of the Enterprises.

The General Counsel concluded:

Continuing suspension of the [Affordable Housing Funds] contributions is justified while the Enterprises remain in conservatorship, especially since the Treasury Department has not recovered the amounts that it contributed… to cover Enterprise losses, currently over $180 billion.

**FHFA Performed an Analysis in 2014 to Determine Whether to Lift the Temporary Suspension of the Enterprises’ Set-Asides; the FHFA Director Lifted the Temporary Suspension for 2015; and the Amounts of the Transmitted Set-Asides for 2015 Were Calculated Properly**

*Written Analysis Whether to Lift the Suspension for 2015 Contributions*

According to the General Counsel, the current FHFA Director asked him at some point in 2014 to analyze whether termination of the suspension of the Enterprises’ set-asides and transmissions to the Affordable Housing Funds was warranted in light of the fact that the Enterprises were “making money.” The General Counsel also recalled that the Director asked him to set forth the basis of the Director’s authority to lift this suspension. In a memorandum dated October 30, 2014, the General Counsel answered both questions.

As of the end of the third quarter 2014, both Enterprises reported a positive net worth. Fannie Mae projected a positive net worth of $6.4 billion at September 30, 2014, and anticipated that its aggregate dividend payments to Treasury by December 2014 would be $134.5 billion in comparison to the $117.1 billion in Treasury’s investment in it. Freddie Mac projected a positive net worth of $5.2 billion at September 30, 2014, and anticipated that its aggregate dividend payment to Treasury by December 2014 would be $88.2 billion and Treasury’s investment in it remained at $72.3 billion.

In an October 2014 memorandum, the General Counsel first explained that HERA required the Enterprises to set-aside and transmit monies to the Affordable Housing Funds, unless the FHFA Director imposed a suspension of those contributions upon a finding that one or more of three statutory conditions had been met. Next, he addressed whether the statutory conditions that gave rise to the 2008 suspension had changed. His memorandum explained:
- **Financial Instability.** The statute provides for temporary suspension of funding where the Director finds that the allocations ‘are contributing, or would contribute, to the financial instability of the enterprise…’

The Director has primary access to information concerning the financial state of the Enterprises. Not only their current income, but as well their market performance, asset mix, expenses and other information inform his decisions. The Director can look to market certainty surrounding the presence of the Enterprises, satisfaction of debt holders with Enterprise debt, stability of Enterprise contracting and dealing with counterparties, core market improvements and other market factors as well as internal management of assets and liabilities to determine that an Enterprise’s current and foreseeable future conditions warrant set asides. The Director may decide that allocations to the Funds would represent a small percentage of anticipated income and would not contribute to financial instability, either in fact or in any adverse market reactions.

The conservatorships themselves provide evidence of market stability by providing public assurance of strong government oversight and management of core Enterprise activities.

- **Capital.** The statute provides for suspension of contributions where allocations ‘are causing, or would cause, the enterprise to be classified as undercapitalized…’

The capital determination that a Director would make is not applicable in conservatorship. Capital classifications were suspended and, in effect, replaced with [Treasury’s investments] to maintain net worth to each Enterprise. The allocations to a Trust or Magnet Fund, therefore, would not affect the capital ‘position’ of an Enterprise as there is no such position set forth during the conservatorships. Thus, there is no ability for an allocation to move an Enterprise to an undercapitalized position. Until some action by Congress altering Enterprise status or some action such as moving to receivership with a capital classification imposed, it is not possible to make a finding regarding a movement in an Enterprises capital standard. Setting aside funds and making allocations would be an expense of the Enterprises, not an alteration of capital levels.

- **Capital Plans.** The statute provides for suspension of contributions where allocations ‘are preventing, or would prevent, the enterprise from successfully completing a capital restoration plan under section 4622 of this title.’

As there are no capital standards in the FHFA conservatorships, there is no ability to submit a capital restoration plan. Further, the [Enterprises are not permitted to build] capital… Until Congress acts or receiverships are determined to be necessary with
enunciated capital standards, the absence of capital levels and, therefore, that ability to have capital restoration plans prevents a finding that the Enterprises are not meeting capital restoration goals. Again, the set asides and allocations would be expenses of the Enterprises, not detracting from any restoration plans.

The General Counsel then explained that HERA vested the FHFA Director with discretion to impose a suspension of the set-asides and transmission of the payments and to lift any prior suspension. He wrote:

In current circumstances, it is within the Director’s authority to determine to rescind the finding that the statutory set asides and allocations would contribute to continued financial instability of an Enterprise and, thereby, to terminate the suspension. In exercising his authority, the Director of FHFA may take into account the considerations of Enterprise stability, capital position, size of the sets [sic] asides and the role of the Treasury Department support. The Director maintains discretion to revisit the issue and to make a new finding that subsequent contributions could contribute to financial instability and to suspend contributions if circumstances evolve in the future.

He elaborated on the change in circumstances that could lead the FHFA Director to terminate the temporary suspension:

The Director could reasonably exercise his discretion to find that set asides and allocations would not contribute to the financial instability of the Enterprises... based on circumstances that have changed since the time the suspension was initially put in place, such as changes in the Enterprises’ income statements and balance sheets, changes in markets for housing and housing finance, changes in the legal environment, and changes in the arrangement for Treasury support of the Enterprises. Further the Director could consider that neither Fannie Mae nor Freddie Mac has made a draw from the Treasury Department... since the [sic] 2012 during which time the Enterprises have paid multiple billions in ‘dividends’ to the Treasury Department and the Third Amendment to the [PSPA] helps preserve the stability of the funds available to the Enterprises and, thereby, their financial stability and market confidence. FHFA continues to monitor the financial condition of the Enterprises.

Finally, a formal and explicit reservation by FHFA of its authority to revise or reverse a decision on setting aside and allocating money to the Funds at any time... reinforces the prudential nature of a Director’s decision to take such actions in line with the statute.
In conclusion, the General Counsel wrote:

The Director has the ability to make a determination under 12 USC 4567 to revisit the findings underlying a suspension of contributions where circumstances have changed. Here a decision to lift the suspension of Fund set asides and allocations is within the Director’s discretion. The lifting of the suspension and institution of the program, with an embedded plan to suspend set asides, as outlined to the Office of General Counsel, meets legal sufficiency for a Director’s determination.

As previously explained, one purpose of this audit is to understand the April 2013 and October 2014 analyses, not to assess their adequacy. We note that both memoranda review the same statutory conditions set forth in 12 USC 4567, but analyze those conditions differently, and the October 2014 memorandum makes no reference to the prior April 2013 analysis or attempts to reconcile differences between the two. Two examples are illustrative:

- Whether continued suspension of the Enterprises’ set-asides and transmissions is warranted during conservatorship:
  - April 2013: “Continuing suspension of the [Affordable Housing Funds] contributions is justified while the Enterprises remain in conservatorship, especially since the Treasury Department has not recovered the amounts that it contributed under the PSPAs to cover Enterprise losses, currently over $180 billion.... Indeed, it could be questioned whether these [Affordable Housing Funds] provisions have any applicability at all when the Enterprises are in conservatorship, similar to the agency having suspended the Enterprises’ capital classifications.”
  - October 2014: “Further the Director could consider that neither Fannie Mae nor Freddie Mac has made a draw from the Treasury Department under the [PSPA] since the [sic] 2012 during which time the Enterprises have paid multiple billions in ‘dividends’ to the Treasury Department and the Third Amendment to the [PSPA] helps preserve the stability of the funds available to the Enterprise and, thereby, their financial stability and market confidence.”

- Whether lifting the suspension during the conservatorship would effectively cause the Treasury to pay the contributions:
  - April 2013: “Any contributions in conservatorship would be paid by the Treasury, and hence by the taxpayers, either because they would be included in draws under the PSPAs or because they would reduce dividend payments to the Treasury, postponing Treasury’s recovery of the capital that has already been provided. That was not what these provisions intended.”
October 2014: While acknowledging “[c]ontributions to the Funds would... reduce any payments to the Treasury Department,” the “dollar amount of the set aside and allocation... is anticipated to be small compared to recent income and to dividend payments to the Treasury Department” and “would be viewed as an expense of the Enterprises—embedded in statute and suspended during a time of unusual stress in the determination of the prior Director and now initiated in line with changed circumstances.”

The General Counsel reported to us that, in addition to this memorandum, he provided the FHFA Director with supplemental information in response to his question about earnings, potential set-aside amounts, and FHFA guidance on implementation issues. The supplemental information included Enterprise public statements on profitability and continued profitability; estimates of the potential set-aside and allocation amounts based on the Enterprises’ new business purchases data for 2013 and 2014 (year-to-date at the time of the analysis); information from the annual and quarterly reports showing that the Enterprises’ total dividend payments to Treasury have exceeded the total draws from Treasury; and anticipated FHFA guidance on several related matters, including the scope of total new business purchases, methods for calculating and reporting set-asides, and procedures for transferring the funds.

**Written Notification by the FHFA Director to Terminate the Temporary Suspension**

Subsequently, the FHFA Director notified each Enterprise, on December 11, 2014, that he was exercising his discretion to terminate the temporary suspension of set-asides for and transmission to the Affordable Housing Funds and directed the Enterprises to begin transmitting their set-asides to the Affordable Housing Funds, beginning with fiscal year 2015. The notice explained that “circumstances have changed and the temporary suspension is no longer justified” because the “financial operations” of each Enterprise have “stabilized to a sufficient level,” which is evidenced by the fact that neither Enterprise had required a draw since 2012 and that both Enterprises had paid a total of $163.4 billion in dividends to Treasury. The notice further explained that the other two conditions set forth in HERA were not applicable because FHFA had suspended capital classifications for the Enterprises and neither was attempting to complete a capital restoration plan. Finally, the notice acknowledged that while the profit levels since 2012 were not expected to be sustainable, reasonable projections indicated that both Enterprises would remain profitable for the foreseeable future.

The notice directed each Enterprise to set aside and transmit funds to the Affordable Housing Funds, pursuant to 12 USC 4567(a), for 2015 and in subsequent years, in accordance with specific terms and conditions, which could be supplemented or modified by FHFA:
• During each fiscal year, commencing with 2015 and thereafter, each Enterprise will set aside an amount equal to 4.2 basis points of each dollar of unpaid principal balance of its total new business purchases during such year;

• Within 60 days after the end of 2015 and each year thereafter, each Enterprise will transmit its set-aside in accordance with 12 USC 4567(a)(2)(B), unless the Enterprise has made a draw from Treasury during that year or the transmission of the set-aside would cause the Enterprise to have to make a draw from the Treasury; and

• In the event that an Enterprise makes a draw during 2015 or any subsequent year or if transfer of the set-aside would cause the Enterprise to make a draw in any year, that Enterprise will make no transfer of set-asides for that year to the Affordable Housing Funds, as supplemented or modified by specific guidance or directive from FHFA.

That notice advised that FHFA would monitor the financial condition of the Enterprises and, pursuant to HERA, retained the authority to revise or reverse its decision to terminate the temporary suspension.

During a January 2015 hearing by the House Financial Services Committee, the FHFA Director was questioned about the basis for his December 2014 decision to lift the temporary suspension of the Enterprises’ set-asides. He explained that he:

[S]imply followed the statute. The statute tells us the exact circumstances for the criteria to be applied on the suspension of the contributions to the Housing Trust Fund. And it tells us the criteria to be applied under normal circumstances for funding. And that is whether the contributions to these funds would contribute or are contributing to the financial instability of the Enterprises, whether they are causing or would cause the enterprises to be classified as undercapitalized, or whether they are preventing or would prevent the Enterprises from successfully completing a capital restoration plan.

When pressed by a Committee Member to explain why he suspended guarantee fees and moved away from risk-based pricing but lifted the suspension on contributions to the Housing Trust Fund, Director Watt explained:

[A]II I am doing is following the statutes that were written by Congress and passed by Congress. And we are trying to do it as judiciously and prudently as we can. I am not even trying to connect those two things. The Housing Trust Fund funding was an independent decision that was based on the statute. The g-fee decision was a prudence decision just to give us an opportunity to study the issue thoroughly. And we are doing that. And we don’t know where we are going to get
to on that. So I think judging where that might go at this point would be premature.

If the statutory standards are met, the contributions to the trust fund can be suspended. They were suspended in 2008 by the acting Director at that time. And we applied the same principles under changed circumstances to reinstate them. That is all we did. But the Housing Trust Fund was not created by FHFA. The Housing Trust Fund was created by Congress. And the decision to fund it or not fund it is based on statutory criteria.

Director Watt testified that, pursuant to HERA, the FHFA Director shall temporarily suspend the Enterprises’ set-asides and transmissions to the Affordable Housing Funds upon a finding that they “are contributing or would contribute to the financial instability of the Enterprises.” According to Director Watt, “the primary factor you are looking at is whether [the Enterprises] are making money or not.” In response to a question from a Committee member to explain the basis for the decision to suspend payments if the Enterprises have to make a draw from the Treasury, when HERA is silent on the issue, Director Watt responded that he was “following the conservatorship statute there.” Another Committee Member asked how FHFA could reach the conclusion that the Enterprises were financially stable when they were in conservatorship and undercapitalized. Director Watt responded: “We put in place prudential stops if circumstances go back in the other direction. If we ever have a draw on the Treasury, that would automatically stop the funding of the Housing Trust Fund.” He explained that the other two statutory conditions were not applicable to the Enterprises because they were in conservatorship.13

In a letter to the Enterprises dated March 19, 2015, regarding implementation of the FHFA Director’s December 10, 2014, direction, FHFA’s General Counsel underscored the same terms and conditions. His guidance instructed:

[I]f an Enterprise makes a draw from the Treasury Department under the terms of the Senior Preferred Stock Purchase Agreement, as amended, based on a net worth deficit for any quarter of the fiscal year or if a quarterly ‘set aside’ amount would cause the Enterprise to make a draw for any quarter of such fiscal year, the Enterprise will make no allocation or transfer for that year, and any liabilities

13 See Hearing before the Committee on Financial Services, U.S. House of Representatives, Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency, at 9, 14, 25, 26, 34 (Jan. 27, 2015) (Serial No. 114-1) (online at www.gpo.gov/fdsys/browse/collection.action?collectionCode=CHRG&browsePath=114%2FHOUSE%2FCommittee%40on%40Financial%40Services%40%40Collapsed%3Dfalse%40leafLevelBrowse%3Dfalse%40isDocumentResults%3Dtrue%40ycord%3D164).
accrued for such allocation or transfer will be appropriately reversed in the Enterprise’s financial statements.

**Directions to Transmit the 2015 Set-Asides; the Amounts of the Transmitted Set-Asides for 2015 Were Calculated Properly**

On February 17, 2016, the FHFA Director instructed the Enterprises to transmit funds set aside during 2015 for the affordable housing programs, in accordance with remittance instructions provided by Treasury. The amounts set aside by the Enterprises during 2015 and subsequently transmitted totaled $382 million ($217 million in total transmitted by Fannie Mae and $165 million in total transmitted by Freddie Mac).

Applying HERA’s instructions for the amount of the annual set-asides, and FHFA’s definition of new business purchases, we determined that the Enterprises’ computations for the 2015 set-asides for the affordable housing allocations and the HOPE Reserve Fund and their subsequent transmittals in 2016 were accurate.

**FHFA Performed a Written Analysis in 2017 to Determine Whether to Direct the Enterprises to Transmit the 2016 Set-Asides to the Affordable Housing Funds and the HOPE Reserve Fund; the Amounts of the Transmitted 2016 Set-Asides Were Calculated Properly**

**Written Analysis Whether to Instruct the Enterprises to Transmit the 2016 Set-Asides**

The Enterprises continued to make set-asides for the Affordable Housing Funds during 2016. A memorandum to the FHFA Director dated February 16, 2017, “Affordable Housing Funds,” from FHFA’s General Counsel, reviewed whether any change had occurred in the first condition that might warrant imposition of a temporary suspension. The General Counsel reported:

- “During 2016 neither Enterprise made a draw on the Treasury Department under the PSPAs and FHFA has confirmed by review of each Enterprise’s 2016 year-end financials that transfer of funds set aside and allocated in 2016 would not cause either Enterprise to make a draw in this quarter.”

- “Each Enterprise’s 2016 financial reports contains information on the total amount of new business purchases for the quarter and then for the year as the basis for calculating the set aside amounts.... In the case of Fannie Mae, that amount totals $268 million; in the case of Freddie Mac, it is $187 million.”

- “[E]ach Enterprise, for fiscal year 2016, has now provided FHFA with a certification by an officer of the Enterprise with knowledge of the statutory requirements and the
Enterprise’s business practices that, based on information known to that officer, the Enterprise has not raised its guarantee fees or imposed other charges or fees on originators for the purpose of covering the costs of any allocation required... Additionally, each Enterprise provided FHFA information about its process in support of its certification.”

- “FHFA has reviewed the financial statements and disclosures of the Enterprises. FHFA has reviewed other available data, including information about ongoing guarantee fees as well as “up-front fees”... through, among other sources, monthly guarantee-fee data submissions and quarterly reporting submissions by the Enterprises... Thus, in light of the process undertaken by the Enterprise and FHFA review of materials as part of its oversight process, that certification has been found sufficient.”

The General Counsel concluded:

In sum, each Enterprise has met applicable statutory, regulatory and supervisory conditions for transferring funds set aside and allocated to the affordable housing programs and may be directed to make those transfers, in accordance with remittance instructions provided to it by the Department of the Treasury.

**Directions to Transmit the 2016 Set-Aside; Amounts of the Transmitted Set-Asides for 2016 Were Calculated Properly**

On February 17, 2017, the FHFA Director instructed the Enterprises to transmit funds set aside during 2016 for the affordable housing allocations, in accordance with remittance instructions provided by Treasury. The amounts set aside by the Enterprises during 2016 and subsequently transmitted totaled $455 million ($268 million in total allocated by Fannie Mae and $187 million in total allocated by Freddie Mac).

Applying HERA’s instructions for the amount of the annual set-asides and FHFA’s definition of total new business purchases, we determined that the Enterprises’ computations for the 2016 set-asides for the affordable housing allocations and their subsequent transmittals in 2017 were accurate.
FHFA’s General Counsel Did Not Prepare a Written Analysis in 2018 to Determine Whether the Enterprises’ Draws from Treasury Triggered the Financial Instability Condition in HERA and Provided Grounds for a Temporary Suspension of the 2017 Set-Asides; the Amounts of the Transmitted Set-Asides for 2017 Were Calculated Properly

The Enterprises continued to make set-asides for the affordable housing allocations during 2017.

In an October 2017 hearing before the House Financial Services Committee on Sustainable Housing Finance, the FHFA Director was asked whether he continued to hold the position that, in the event that an Enterprise was required to take a draw from the Treasury, that Enterprise would not transmit its set-side for that year to the Affordable Housing Funds. The Director provided a more qualified response that “one would presume” in the event that an Enterprise was required to take a draw from Treasury, that “we would – we may not be meeting the statutory standards” to contribute or suspend annual payments, if FHFA determined that payments of set-asides was going to increase that Enterprise’s financial instability.14

Because of the changes in the corporate tax law in December 2017, it became necessary for the Enterprises to re-measure the value of their deferred tax assets on their balance sheets. Specifically, on December 22, 2017, the Tax Cuts and Jobs Act15 was enacted into law and mostly took effect on January 1, 2018. One of its provisions cut the federal corporate income tax rate from 35% to 21%. The Act’s overall lowering of the corporate tax rate impacted those companies that recorded deferred tax assets on their balance sheets that could be used to reduce future tax liabilities or defer them. When the federal corporate tax rate was lowered by this Act, the deferred tax assets of such companies decreased in value. Generally accepted accounting principles require companies to re-measure their deferred tax assets at the reduced rate in the period in which the legislation is enacted. As a result, companies with large deferred tax assets were required to write down the value of those assets for the fourth quarter of 2017 to account for the drop in corporate tax rates.16

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14 Hearing before the Committee on Financial Services, U.S. House of Representatives, Sustainable Housing Finance: An Update for the Director of the Federal Housing Finance Agency (Oct. 3, 2017). The official transcript for this hearing was not available on the Government Publishing Office website as of September 17, 2018. The hearing webcast with the Director’s response is available on the Committee’s website at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402338, at 1:51 (1 hour, 51 minutes).

15 Public Law 115-97.

At the time the law was enacted, each Enterprise held billions of dollars of deferred tax assets on its balance sheet. When these assets were re-measured, the Enterprises were put into a net worth deficit position as of December 31, 2017, as their net incomes from operations that quarter were insufficient to cover the amounts written-down for the decreased value of their deferred tax assets. As FHFA explained in its 2017 Report to Congress:

[E]ach Enterprise had to re-measure its [deferred tax assets] due to the [Tax Cuts and Jobs Act’s] reduction in the statutory corporate tax rate and record a one-time federal income tax provision expense in the fourth quarter of 2017. As a result of the income tax provision expense, each Enterprise had a net worth deficit as of December 31, 2017. Consequently, in the first quarter of 2018, FHFA submitted a request to the Treasury Department on behalf of Fannie Mae for $3.7 billion and on behalf of Freddie Mac for $0.3 billion to eliminate their net worth deficits.

No General Counsel Written Analysis as to Whether the Enterprises’ Draws from Treasury Triggered the Financial Instability Condition in HERA and Provided Grounds for a Temporary Suspension of the 2017 Set-Asides

Unlike the practice for the transmission of the 2015 and 2016 set-asides, the General Counsel did not prepare a written analysis with respect to the 2017 set-asides. In an interview, the General Counsel explained to us that he was advised by the FHFA Director that the Director exercised his discretion and determined that the Enterprises should transmit their 2017 set-asides to the Affordable Housing Funds. After the Director made that decision, he notified the Enterprises of his decision, on February 4, 2018, and directed them to transmit their 2017 set-asides.

According to the General Counsel, the Director made his determination before the Office of General Counsel began its analysis, and his determination mooted the need for any such analysis. The General Counsel reported to us that he undertook a very high-level review of the new tax law, which he did not reduce to writing, and understood from that review that the Enterprises’ February 2018 draw from the Treasury was a unique occurrence, caused by the need to re-measure their deferred tax assets as a result of the Tax Cuts and Jobs Act of 2017, which he thought would be off-set by the tax savings in 2018. In response to our request for specifics of his high-level review, the General Counsel provided this explanation in writing:

My review centered on the issue that the tax law would have an impact on firms with deferred tax assets (DTA) and that, as to those assets, it would be a one-time event. News stories immediately after the passage of the law and a few before indicated that companies would see a benefit from the overall lowering of the corporate tax rate, but certain companies with deferred tax assets would face a one-time hit to their balance sheets.... This was not unique to the Enterprises,
according to the news stories, and would be a one-time event. This was important to my understanding of what would occur at the Enterprises; the outcome was predicted, thus these news stories gave some comfort on the outcomes.

The General Counsel also provided us with illustrative articles he reviewed. He further advised us that he discussed the results of his high-level review with the Director.

**FHFA Director’s Instructions to Transmit the 2017 Set-Asides and His Basis for the Determination to Proceed with the Transmissions; the Amounts of the Transmitted Set-Asides for 2017 Were Calculated Properly**

The FHFA Director notified the Enterprises on February 7, 2018, to proceed with the transfer of 2017 set-asides to the Affordable Housing Funds. In his written notification to Fannie Mae, the Director explained:

This letter supplements my letter to you of December 11, 2014 about the [set-asides and transmission] of funds to the Housing Trust Fund and Capital Magnet Fund.

As I stated in my December 11, 2014 letter, my decision to exercise discretion regarding the reinstatement of contributions to the affordable housing funds related solely to whether ‘contributions to these Funds would cause financial instability and is not a finding for any other purpose.’ While the enactment of the Tax Cuts and Jobs Act of 2017, PL 115-97 (2017), requires Fannie Mae to re-measure its net deferred tax asset using the new law’s lower corporate tax rate which will trigger a one-time charge through the provision for federal income taxes and will require a draw… I do not consider this one-time event to relate to any financial instability on the part of the Enterprise either now or in the future. Indeed, between my December 11, 2014 letter and the enactment of the new tax law Fannie Mae has consistently generated profits that enable the Enterprise to declare dividends totaling $31.9 billion under the terms of the PSPA, and the reduction in the corporate tax rate under the new tax law is expected to increase the Enterprise’s net income in the future after the one-time charge is taken.17

In response to our inquiry as to analyses conducted by the Director or other FHFA personnel on whether transmission of the 2017 set-asides to the Affordable Housing Funds should be made, we were advised that the FHFA Director made such an analysis. He explained in writing that he reached his determination based on the following considerations:

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17 The last sentence in the FHFA Director’s letter to Freddie Mac used a different dividend total of $21.4 billion.
Regular consultations and meetings with the Enterprise CEOs at which the financial strength, and current and projected financial performance were discussed;

Routine meetings with FHFA staff; and

Quarterly meetings with FHFA financial staff at which the [Securities and Exchange Commission] SEC filings and quarterly financial reports were discussed in substantial detail in preparation for FHFA approval and Enterprise filing and public disclosure of these reports.

According to the FHFA Director, these meetings, consultations, and staff presentations confirmed that the DTA was a one-time accounting event that did not adversely affect the financial condition of the Enterprises on an ongoing basis and that the reduction in the corporate tax rate was expected to increase the Enterprises’ net income and financial strength going forward, and would not adversely impact the financial stability they had demonstrated since 2014.

As previously explained, one purpose of this audit is to understand whether the explanation provided by FHFA to lift the temporary suspension in December 2014 continued in force through February 2018, when FHFA directed the Enterprises to transmit their 2017 set-asides. We recognize that 12 USC § 4567(b) vests the FHFA Director with authority to suspend the set-aside and transmission of the affordable housing allocations of one or both Enterprises, upon a finding that one or more of three statutory conditions have been met. One federal district court has held that the decision of the FHFA Director whether to impose a temporary suspension is committed solely to his or her discretion. The FHFA Director, in both his December 2014 and February 2018 notices, invoked that authority and determined that transmittal of the set-asides would not contribute “to the financial instability of the Enterprises.”

That said, the FHFA Director’s February 2018 letter to each Enterprise, and his response to our inquiry makes no effort to explain the reasons for his change in position from his December 11, 2014, notifications and January 2015 testimony. Previously, the FHFA Director stated that any draw by an Enterprise would cause the suspension of funding by that Enterprise to the Affordable Housing Funds for that year. In his February 2018 notification, the FHFA Director determined that a draw by each Enterprise in 2018, caused by the re-measurement of the deferred tax assets in 2017, would not suspend the Enterprises’ contributions to the Affordable Housing Funds for 2017.

18 Order Granting Defendant’s Motion to Dismiss the First Amended Complaint, Samuels v. FHFA et al., No. 1:13-cv-22399-MGC (S.D. Fla.) at 12 (online at www.nlihc.org/sites/default/files/Samuels_v_FHFA_9-29-14.pdf).
The amounts set aside by the Enterprises during 2017 and subsequently transmitted totaled $414 million ($239 million in total allocated by Fannie Mae and $175 million in total allocated by Freddie Mac).

Applying HERA’s instructions for the amount of the annual set-asides and FHFA’s definition of total new business purchases, we determined that the Enterprises’ computations for the 2017 set-asides for the Affordable Housing Funds and the subsequent transmittals in 2018 were accurate.

**FHFA’s Oversight of the Enterprises’ Compliance with FHFA’s Guidance for the 2015, 2016, and 2017 Set-Asides and Transmissions**

Subsequent to FHFA’s decision to lift the temporary suspension of the set asides for the affordable housing allocations and written notice to the Enterprises in December 2014, FHFA provided written supplemental guidance on the calculations of the amount of the set-asides and required the Enterprises to take certain actions to ensure the accuracy of their calculations and verify that transmittal of the set-asides had occurred.

*FHFA Required the Enterprises to Certify that Charges and Fees to Originators of Mortgages Were Not Increased to Cover the Allocations to the Affordable Housing Funds; an FHFA Economist Performed Annual Reviews of Each Enterprise’s Financial Information to Validate the Enterprises’ Certifications*

FHFA’s General Counsel, in a letter to the Enterprises dated March 19, 2015, underscored the prohibition against redirecting the costs of any affordable housing allocations funds through increased charges or fees to the originators of mortgages purchased or securitized by an Enterprise. To ensure that this prohibition was followed, FHFA required each Enterprise to certify in writing, for each calendar year, that the Enterprise had not raised its guarantee fees or imposed other charges or fees on originators for the purpose of covering the costs of any transmitted affordable housing allocations. Additionally, FHFA instructed each Enterprise to provide information about its process in support of its certification that fees were not raised or passed along to originators to cover the costs of the allocation to the funds. As directed, the Enterprises provided FHFA with the certifications and information for the 2015, 2016, and 2017 set-asides and allocations.

As an additional measure to ensure the Enterprises’ compliance with the prohibition, a supervisory economist in FHFA’s Division of Housing Mission and Goals reviewed various Enterprise reports containing information about fees and charges for each of the three years (2015, 2016, and 2017) and prepared a memorandum for each year documenting the results of his review. In each memorandum, he stated “I have reviewed the various data sources that I
have available to me and, taken as a whole, the data are inconsistent with the premise that the Enterprises are engaging in the prohibited pass-through of costs.”

**FHFA’s Measures to Ensure the Accuracy and Transmittal of the Affordable Housing Allocations**

For the 2015 through 2017 set-asides, FHFA provided guidance to the Enterprises for transmitting the affordable housing allocations, in accordance with wiring instructions separately provided by Treasury. This guidance was sent once FHFA was satisfied with the Enterprises’ calculations of the set-asides, disclosures, and certifications (that the cost of the allocations was not passed on to originators). Once the allocations were transmitted, the Enterprises confirmed to FHFA’s Office of General Counsel that the payments for the affordable housing allocations were made.

**CONCLUSION**

In November 2008, the then-FHFA Director suspended the Enterprises’ affordable housing set-asides and transmissions until further notice. In April 2013, the General Counsel advised the Acting FHFA Director that the conditions that led to the temporary suspension of set-asides had not changed. In October 2014, the General Counsel reviewed the same statutory conditions but analyzed them differently, and advised the FHFA Director in writing that he could exercise his discretion and lift the suspension. His October 2014 memorandum made no reference to his prior April 2013 analysis or attempted to reconcile differences between the two. In December 2014, the FHFA Director notified the Enterprises that he was exercising his discretion to terminate the temporary suspension of set-asides for and transmission to the Affordable Housing Funds and directed the Enterprises to begin transmitting their set-asides, beginning with fiscal year 2015. Those written notifications also instructed that, in the event an Enterprise were to make a draw in 2015 or subsequently, that Enterprise would make no transfer of set-asides for that year to the Affordable Housing Funds.

The Enterprises calculated their set-asides for 2015, which they transmitted to the Affordable Housing Funds. Our audit found that the Enterprises’ computations for the 2015 set-asides and subsequent transmittals were accurate. Operating under this December 2014 notice, the Enterprises calculated their set-asides for 2016, which they transmitted to the Affordable Housing Funds. Our audit found that the Enterprises’ computations for the 2016 set-asides and subsequent transmittals were accurate.

Because of changes to the federal corporate tax law in December 2017, it became necessary for the Enterprises to re-measure the value of their deferred tax assets on their balance sheets. When these assets were re-measured, the Enterprises were put into a net worth deficit position
as of December 31, 2017, as their net incomes from operations that quarter were insufficient to cover the amounts written-down for the decreased value of their deferred tax assets. During the first quarter of 2018, FHFA submitted a request to Treasury on behalf of the Enterprises to take additional draws to eliminate their net worth deficits.

While the December 2014 notifications directed each Enterprise that a draw in any subsequent year would cause that Enterprise to suspend transmission of its set-asides for that year to the Affordable Housing Funds, the FHFA Director, by written notices to the Enterprises dated February 7, 2018, instructed each Enterprise to proceed with the transfer of 2017 set-asides to the Affordable Housing Funds. The FHFA Director explained that he did “not consider this one-time event to relate to any financial instability on the part of the Enterprise either now or in the future.” Our audit found that the Enterprises’ computations for the 2017 set-asides and subsequent transmittals were accurate.

Our audit also found that FHFA took steps to ensure the accuracy and the transmittal of the affordable housing allocations.

We recognize that 12 USC § 4567(b) vests the FHFA Director with authority to suspend the set-aside and transmission of the affordable housing allocations of one or both Enterprises, upon a finding that one or more of three statutory conditions have been met. One federal district court has held that the decision of the FHFA Director whether to impose a temporary suspension is committed solely to his or her discretion, and the Director, in both his December 2014 and February 2018 notices, invoked that authority and determined that transmittal of the set-asides did not contribute, and would not contribute, to the financial instability of the Enterprises. For those reasons, we make no formal recommendations in this audit. Because FHFA is both the conservator for and supervisor of the Enterprises, in which U.S. taxpayers have invested more than $191 billion, prudence counsels that FHFA, in the future, acknowledge and explain the reasons for changes in its critical determinations.
OBJECTIVE, SCOPE, AND METHODOLOGY ...........................................

The objectives of our audit were to (1) understand the analyses, if any, performed by FHFA to determine whether the conditions that led to its 2008 temporary suspension of set-asides and transmissions had changed as of January 2015, and whether the explanation provided by FHFA to lift the temporary suspension in December 2014 continued in force through February 2018, when FHFA directed the Enterprises to transmit their 2017 set-asides; (2) assess the accuracy of the Enterprises’ set-aside computations for 2015 through 2017; and (3) assess FHFA’s oversight of the Enterprises’ set-asides and transmissions to the Affordable Housing Funds.

To address our objectives, we:

- Researched and identified applicable laws, regulations, and other guidance related to FHFA’s oversight of affordable housing allocations;
- Obtained and reviewed FHFA and the Enterprises’ documentation and correspondence related to FHFA’s oversight of the affordable housing allocations;
- Obtained and reviewed documentation regarding FHFA’s analyses and determination to lift the suspension of allocations beginning in 2015; and
- Interviewed FHFA officials to gain an understanding of the background related to lifting the suspension of allocations and the circumstances behind the Director’s determination to direct the Enterprises to allocate the 2017 set-asides.

We conducted this performance audit between May 2018 and September 2018 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.
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