The Economic Club of Washington

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The Washington, DC, region has a gross regional product that now totals more than $280 billion, bigger than Austria's and slightly smaller than Sweden's. As housing demand outpaces supply, however, home prices will continue to drive workers further from their jobs and create more housing hardship, house-poor families, and homeless families. Public policies could discourage sprawl, encourage close-in development, and promote tighter communities. Affordable housing could become a regional priority. Fannie Mae, the region's largest single provider of housing finance, is joining with local banks, developers, and other partners to build affordable housing and transform communities with venture capital investments. Fannie Mae has invested almost $5 billion in the District of Columbia alone.

Vernon Jordan, President, The Economic Club of Washington

Good evening, ladies and gentlemen. It is a pleasure to welcome you to the first event of this our 19th season.

Frank Raines was named Chairman and CEO of Fannie Mae on January 1, 1999. For the previous 2 years, he was Director of the Office of Management and Budget (OMB) and a member of President Clinton's Cabinet. Mr. Raines serves on the boards of Pfizer, PepsiCo, the Enterprise Foundation, and the National Urban League, and he is an Overseer for TIAA-CREF. He also chairs the Fannie Mae Foundation.

It is a great personal pleasure to welcome back to The Economic Club of Washington, Frank Raines.

Franklin D. Raines

Thank you very much for that introduction. I often said that when it comes time for my eulogy, I hope that Mr. Jordan will be around. The great thing about being introduced by him is that you get to hear your eulogy while you are still around. In a voice that is currently wasted in being an investment banker and a lawyer, when he really could have been a Baptist Minister where he would have some real influence. He has been a real mentor for me for a long time.

Washington, DC, and the region have a terrific economic story to tell. The gross regional product here now totals over $280 billion, which makes our economy bigger than Austria's and slightly smaller than Sweden's. We have grown faster than the national economy every year since 1998. Washington area added over 250,000jobs over the past 5 years. More than the total combined jobs added in Phoenix, Houston, and Philadelphia, the next three highest areas. Last year, the unemployment rate was 3.5%, among the lowest in the country. Area wages were 24% above the national average. From 2000 to 2003, the region added more than 90,000 new residents every year. Adding even more strength to the economy. If we have done this well without baseball in Washington, just wait until the team shows up next spring. All signs point to an even brighter future for DC and the region. But, one issue that is close to my heart and that of my colleagues is the issue of housing. Certainly, the boom in home building, home sales, and home improvement has been a boom to the economy as well. But, as this region continues to grow and prosper, we're struggling with where everyone is going to live. That affects our quality of life. It affects the productivity of our workforce. And it even affects our future prospects for growth.

I would like to offer a little bit of a survey of our regional housing issues, then talk about how Fannie Mae and how housing partners are helping to address these housing challenges as a simple illustration of how we can help the region's business leaders contribute to the solution of the region's problems.

First, let me introduce or reintroduce Fannie Mae. Fannie Mae began in 1938, during the New Deal, as a government-owned corporation providing public sector solutions to a public need for affordable housing. In 1968, at the tail end of the Johnson Great Society, in an effort to help balance the budget the last time it had been balanced prior to the most recent one. Fannie Mae became a private company when the federal government sold its ownership interest to private shareholders. Today, Fannie Mae raises private capital to carry out our public mission to expand access to home ownership and affordable rental housing for all Americans. I mention this history because greater Washington itself is undergoing a similar transformation from public to private. We all know about Washington's humble origins. Before 1800, Washington was called "the capital of miserable huts." Cows grazed on what is now The Mall, hogs rooted through the trash, and homes were infested with snakes. One observer called Washington, "a city so many are willing to come to and so anxious to leave."

As America grew so did our federal government and our Federal City. World War I, World War II, The New Deal, Cold War, The Great Society, all brought waves of people to the area making Washington a government town dominated in almost every respect by the public sector. In the 1990s, this began to change. Our region's economic power started to come more from the private sector, from the growth of the high-tech corridor on the Dulles corridor to the biotech corridor along I-270. Government contracting aided some of this growth. But, in an important sense you could say that Washington began the process of being privatized. Today, even with the slowdown of the tech sector and the rise in defense in homeland securities since the terrorist attacks of September 11th, we still have a much more balanced privately based economic foundation than we did just 15 years ago.

Consequently, our business community can have a greater impact than ever before on the quality of life in the area by applying its private sector resources and know how to public needs. Applying private sectors solutions to public needs is a reason for Fannie Mae's existence. I believe solving this region's future housing challenges and extending this region's economic success will require us to draw on all of our resources, talents, energies—public and private—all working together.

Lets look at our housing challenges. Every year, the Fannie Mae Foundation, led by Stacy Stuart and the Urban Institute, publishes a study of housing in the Nation's capital that analyzes current data on housing conditions and trends across the region. This year's report will come out in December. I have seen a draft. The report notes the region's economy is strong and the rising economic tide is lifting more and more boats across the region and across income groups, but our growing economy has created some growing pains. The pain is felt most by the growing demand for housing. This growing housing demand has been great for the housing trades and for the people who already own homes. Homeowners have seen dramatic gains in equity. Many have tapped into their growing equity to finance home makeovers, investments in business, and other things that have helped to pour more money into the region's economy. People all over the area are spending their weekends wandering around Home Depot or trying to track down that contractor that has seven other jobs in order to see if they can get their work done.

But this demand-driven growth in home values is also driving many working families out of the housing market or farther away from their jobs. A first-time homebuyer, who wants to buy a medium-priced home, needs an income that exceeds the area median income. If current trends continue, by 2008, area homebuyers will need 150% of the median income to afford a medium-priced home. This is making it virtually impossible for many public servants and other working families to live in the communities they serve. The average area police officer or fire fighter, for example, earns about half of what is required to buy the average-priced home. Rents have also spiked, making a one-bedroom apartment beyond the reach of families supported by someone who works as a receptionist or in a restaurant. Low- and very low-income households are taking an even harder hit from high rents and spiraling prices.

The Foundation's report goes on to explain how unbalanced patterns of growth within the region are exacerbating the housing challenge. The region's western suburbs, for example, have been very successful in attracting high-wage jobs. But, we have growing geographic mismatch between homes and jobs. Affordable housing is most scarce where the well-paying jobs are most abundant. This mismatch is causing families to look farther and farther afield in search of homes they can afford. The result, of course, is sprawl. They say in 1789 it took George Washington 8 days to travel the 200 miles from Mount Vernon to his inauguration as President in New York City. What is amazing is that journey would have taken exactly the same amount of time 3.000 years earlier. No real progress had been made in transportations since biblical times. Moses could have traveled it just as fast.

Today, transportation is getting faster and faster unless, of course, you use the Beltway. The problem with sprawl is closely related to problems of housing affordability. The places where housing production has lagged behind population growth most severely are in the suburbs. This results from growth restrictions that constrain productions and tighten the supply of homes. As the Foundation report states, when efforts to manage growth are limited to policies that restrict growth, housing market pressures and regional imbalances are likely to intensify. This summer, *The Washington Post* reported that the master plans for new mixed-use complexes or even new communities frequently are approved where the number of projected new workers far exceeds the number of new housing units. Consequently. new housing gets built even further away from the core—as far away as West Virginia or even Pennsylvania. Today, fewer than half of the area's workers live and work in the county. In 2002, the average peak period commuter in this area spent a record high of 67 hours per year stuck in traffic, the third worst record in the country behind such legendary gridlock leaders as Los Angeles and San Francisco.

What are the implications of these trends? The Foundation report issues several warnings. As our economy continues to grow, so will sprawl and congestion. As housing demand outpaces supply, home prices will continue to squeeze working families. It will drive workers further from their jobs. It will widen the gap between rich and poor and black and white. It will create more housing hardship, more house-poor families, and more homeless families. Unchecked, these problems will undermine the quality of life that makes the region so attractive and squelch the economic growth and prosperity we have come to enjoy.

We could risk becoming like what Yogi Berra once said about a popular New York City nightclub. He said, "No one goes there anymore. It is too crowded." The authors of the report emphasize that none of this is inevitable or irreversible if we considered a three-part strategy for addressing our challenges. First, we could make Smart Growth smarter with public policies that discourage sprawl, encourage close-in, in-field development and promote tighter communities. Second, we could make the preservation and expansion of affordable housing a regional priority and spread it throughout the region, rather than confining it to areas that have historically served low-income households. Finally, the authors of the report recommend that the region pursue a balanced-growth policy. They suggest that local governments should work together to manage employment growth and in trying to recruit employers to locate throughout the region.

Some of these proposals raise tough political issues. In fact, development issues, particularly pro-growth versus no-growth, are among the most hotly contested in local elections. Every member of the region's business community has a major stake, however, in our region's housing issues. Fannie Mae, in particular, has a huge interest and a major responsibility to help address these issues, because housing is what we do and Washington is where we live. Fannie Mae helps local jurisdictions and local housing leaders address housing issues all over America every day. But, we are especially committed to helping our hometown region. Fannie Mae is the region's largest single provider of housing finance. I would like to share with you just a few examples of our work and to make it a little more concrete for you. Let me just focus on what we have been doing in the District.

Five years ago, Fannie Mae announced our House Washington Strategy to expand affordable home ownership and affordable rental housing in the city. Under this plan we have provided over $2 billion to serve more than 21,000 families with a particular focus on under-served families and communities. By investing in housing based community development, we've tried to make a tangible difference in the City. The crown jewel so far is our partnership with Howard University to bring historic but dilapidated LaDroit Park neighborhood back to its full glory. We brought some pictures here to show you. When we started, the neighborhood was pretty blighted. Indeed there was a street, Oakdale Place, where only one person in one place continued to live. Every other house was boarded up and abandoned. Where there weren't abandoned homes, there were simply vacant lots. Howard University, one of America's great institutions of higher education, lives next door to LaDroit Park. But, it is not a great environment in which to have a college or to teach. So, we teamed up with Howard University, local lenders, developers, the District government and civic associations. We contributed $23 million in investment capital, and our partners put in another $47 million. Together we have restored over 275 units of affordable housing. Then we helped the University set up a program under which faculty and staff and employees could obtain low down payment mortgages with flexible terms to help them purchase new homes. Now, Oakdale Place looks like this.

But the best part is not the aesthetics, it is the economics. It is a fact that, when you build homes, people will come and they will attract grocery stores and dry cleaners and restaurants and other retail commerce to serve them. The homes can become fantastic investments for the people who buy them. When the first homes on Oakdale Place were completed 5 years ago, they were worth $89,000 on average. Recently, one of them sold for $210,000. That is an equity gain of over $100,000, and many other owners of LaDroit Park properties in the initiative have experienced even greater gains. LaDroit Park is just one example of the kind of wealth that can be provided to those who are willing to move into these communities, and the kind of impetus we can give to the local economy.

All over the region—from Anacostia to Fairfax County—we join with local banks, developers, and other housing partners to build affordable housing and transform communities with venture capital investments through our American Communities Fund. We are buying low-income housing tax credits and mortgage revenue bonds. You might be surprised at how much we have done so far just in DC. This is a map of the community development and multi-family projects that we have financed in all four quadrants of the

City. If you then take all that we have done, including single-family, and you add it all together with what have been able to do with our partners, Fannie Mae has invested in the District of Columbia today nearly $5 billion.

Another thing we try to do to aid in this effort is something we call employer assisted housing. Essentially, we help companies, organizations, and institutions to help their own workforce deal with the housing challenges of the region. Housing is a huge workforce issue. Most people tell our surveys that owning a home is their number one economic priority—a good home in a good neighborhood to raise their kids, a home they can afford and one that doesn't take an hour or more to get to work. Employers that help employees realize this goal are providing a highly valued benefit. We can help with whatever companies and organizations prefer. We offer free technical assistance to help you set up a program to help with down payments or closing costs. Or to send your employees to lenders that provide our flexible low-cost mortgage options. Or simply to provide your employees with homebuyer education and counseling.

If you can help your employees to own a home close to work, you can improve their quality of life and productivity and help to reduce sprawl and congestion. So far, we have 20 employer-assisted housing programs in this area with organizations of all shapes and sizes, everyone from BB&T Bank to Providence Hospital and we would like to do more. If you are interested, we want to help. We also have what we call “smart commute” loans, which give homebuyers a break if they buy a home near public transportation. The program is working in places like Minneapolis and Salt Lake City and Columbus, Ohio. We just introduced it here last year in Washington and we want people to take advantage of it.

We also fund the Fannie Mae Foundation. The Foundation supports a wide range of housing and community related organizations in the District. In the past 10 years, they have invested over $100 million in the city’s future. One of the Foundations important activities is its sponsorship of the annual “Help the Homeless Walk-A-Thon.” Since it began in 1988, the Walk-a-Thon has raised over $40 million for groups dedicated to preventing and ending homelessness in the area. It is a terrific event, and every dollar that you provide goes directly to help homeless organizations in the city and in the suburbs.

Finally, you might have read that Fannie Mae has obtained an option to build a new office facility at Waterside Mall in Southwest Washington. This is a prospect that we are very excited about. Right now, we have about 4.000 employees scattered over the region. Some are in our four buildings on Wisconsin Avenue in DC, some are in our offices in Bethesda, some are in Reston, some are in Herndon, and some will be at a new technology facility that we are just finishing in Urbana, Maryland. Our business and workforce have been outgrowing our space, and we would like to have as many people as possible under one roof. But, as we started thinking about where to move, we began with one immovable condition: we wanted to be in Washington, DC. We are very interested in moving to the Waterside Mall location. We have been talking to the neighborhood residents about our plans, and after some initial skepticism they seem to like what it is that we and the developers hope to do. We are hoping to build a 2 million square foot world-class facility. We envision a mix of office, retail, and residential space with 20% of the residential space set aside for affordable units. Our new facility will support the Anacostia Waterfront Development Initiative that Mayor Williams has proposed to revitalize Southwest Washington. As part of the transaction, we would provide the National Capital Revitalization Corporation with a $55 million revolving fund targeted at affordable housing developments. On top of that, we would make an additional $5 million affordable housing grant targeted specifically for the Southwest community.

We are still at the beginning of this project, but we plan to work closely with the city and the community every step of the way. We are in good company in Southwest. There is a lot that can potentially happen. At one end, the new baseball stadium that the Mayor has proposed will go up, and I hope none of you are taking it for granted. That is not going to happen until it is actually approved by the City Council, and to the extent that you can be helpful with that, I think the entire community would be grateful. Next to us, less than a block away is Arena Stage. You may have heard that my wife and I are deeply involved with what I hope will be the only capital campaign I am ever involved in my life, that is to help Arena Stage build a world-class facility for one of the most important theater companies in America, one that is not just about the art but is also about the community. We think these combined developments will spark a renaissance in the forgotten quadrant of this city and will make an enormous difference for the economic vitality of this country, as an example of what can be done by enlightened city leadership and for-profit and non-profit enterprises that dedicate themselves to making urban America work.

Our interest in Waterside reflects Fannie Mae's commitment not just to be in the District, but also to be of the District permanently and to use our presence to bring about as much positive change as we possibly can. If you or anyone else wants to make a positive change through housing and community development, we want to be your partner wherever you are in the region. We have the capital, we have the commitment, but we need more local housing investment partners. So, in this region we set up local partnership offices, one in DC, which also covers Montgomery and Prince George's County, and one in Northern Virginia. Their job is to make sure that we know the region, know the housing needs, know the housing, business, and community leaders, and to see that we can help make a difference.

Beverly Willborn and Charles Jones of our DC Partnership office are over here, and so is David Jeffers from our Virginia Partnership office. If you are interested in any ideas, please don't hesitate to contact them. They are looking for as many ideas as anyone has for where we can be affective.

As Vernon said, I have spent a great deal of my life here in Washington and I don't think in that period of time I have seen so much activity and so much optimism, so much of a chance that we really can make a difference in a very short period of time. Almost two centuries ago, many years after having helped General Washington liberate the nation, the French officer and statesman Lafayette gave a dinner toast in honor of this city. It was still in its miserable huts period, not terribly attractive, but Lafayette nevertheless lifted his glass and declared, "To Washington, central star of the constellation, may it enlighten the whole world." We are well on the way to making that hope come to pass. Thank you very much.

Questions and Answers

Jordan: Thank you Frank, I have two questions here. The first is, home ownership has reached record levels in part due to low interest rates, but also because of the advent of new products such as interest-only mortgages and mortgages with very low down payment requirements. How do you assess these trends, especially as it appears we are heading into an era of rising interest rates?

Raines: This has been a great time for housing. The highest housing starts, highest home sales, highest re-sales, and it has been driven a lot by low interest rates and the connection of housing to international capital markets, not just to local financial institutions. A lot of innovations have helped people to get into homes, to get past the down payment barrier, to get past the credit barrier, to help them get past the knowledge barrier. These innovations on the whole have been helpful. We are a little concerned about some of them. There is now a big movement away from fixed-rate mortgages to adjustable-rate mortgages, and also to interest-only mortgages where you don't make any principle payments. What can happen to someone after the interest rate begins to adjust, is that on some of these loans, the payments can actually double from what they were in one year to the following year. Now, when people are being qualified for loans with that kind of a structure, the chance of what we call payment shock can be quite high. We are on the cusp here of people having to stretch to the far limits to be able to continue to afford housing. That is why the solution, ultimately, is production. We are going to have 30 million more people in this county at the end of the decade than we had at the beginning. Whether we have additional housing or not, there will be 30 million more people. We have to face the fact that we must have capital in place to finance the housing. What we don't have is the political will to make the decisions to make the housing possible.

Jordan: How can we can we flow significant parts of the growth dividend into education in the District?

Raines: I spent a lot of time in public finance coming up with brand new ideas on how to finance things. In the end, there is only one way to finance things, which is to pay for them. We can dress it up and make it look like you are not paying for them, but in the end we have to decide, can we make that commitment? What we need to do in the District is to have a school system that has management that gains the confidence of the taxpayers. That is number one. We have a new school superintendent I just met, and we are going to do everything we can to help make him successful in doing that. Second, the old fashioned way of paying for schools is still the best way, and that is through the property tax. We as a property owner in the District of Columbia pay property taxes and we would be prepared to do that to support investment in education. But the investment can't just be opening up the spigot. There have to be the reforms necessary to make the money work for kids. We are beginning to get the kind of coalitions together necessary to make that happen.

But, make no mistake about it, not just in the District but also around the country, there are a lot of interests around education that aren't necessarily about the kids. Until we get very clear about that and we understand how we can focus new resources on the kids in the classroom, and not have the money disappear for other purposes, we aren't going to have that broad base of support. But, if we can make that commitment, there can be and enormous amount of support for public education in the District, because if the District had a high-quality public education system, this would be the most successful city in America. We have every other ingredient in this city except a high-quality public education system. We have high-quality education for some kids.

Public schools are not educating all the kids. In fact, they are educating a decreasing percentage of the kids, as the independent schools, charter schools, and parochial schools continue to be a large part of the educational system. If we can have a high-performing public education system, this city and this region would be an enormous beneficiary, because a lot of the trends that I talked about are exacerbated by the condition of schools. If we can get people living in the denser environs of a city, we can get a lot of people off the roads. We can save a lot of energy. We can save a lot of open space. It is a win-win for the entire region in order to have quality public education in the District.

Jordan: There was much talk early in the summer about a housing bubble, particularly in areas such as Washington where there has been a very rapid appreciation in recent years. Are you worried about a bubble?

Raines: I spent much of the past several years saying there is no national housing bubble, and there is the potential for housing bubbles in a few localities. I still believe there is no national housing bubble, but I think some of the trends we are seeing now lead me to be very concerned about housing prices in some regions. Not in this region. But in some regions we are seeing very large numbers of homes being bought by investors, not by people who intend to live in them. These same investors are using those techniques I mentioned earlier about zero interest and in some cases very low down payments, not paying any principle on their loans, all with the expectation that within a few months they will be able to flip the house to someone else.

I have always thought it was a losing game to think that over the long run I could buy a house from a homebuilder and do nothing but sit on it for 6 months and have a guaranteed profit. I always thought that the homebuilder would figure this out at some point. And they know a lot more than I do. But, that is in fact what many people have done, and so we are seeing this in some areas where we are seeing this investor group growing up very fast. So, I think you will hear some stories in the next 6 months to a year about the bursting of local housing bubbles in certain places, primarily in California and perhaps a little bit in New England. But, on the whole, housing is going to be just fine. The reason is simple: supply and demand. You can’t add 30 million more people needing shelter without that providing strength to housing over the long run. But, just as anything else, when greed takes over, you will see people get ahead of markets. So, you will see some headlines.

I don’t think it’s going to be a problem here in DC, simply because of the very tight supply. This is still a very popular place. We are still adding jobs. We are not adding housing as fast as we are adding jobs, so that will continue to keep up housing prices.

That's the blessing for those who own homes and a curse for those who don't. We have to find a solution through production that makes it possible for more people, particularly work force housing. We can delude ourselves for a while that we don't have to provide housing for firefighters and teachers. Then, when we find we can't hire them, when we find they are not available when we need them, then we will know otherwise. I think this is our big challenge. Amidst our prosperity, we are sewing the seeds of the potential downfall of the region and we are just going to have to grapple with this issue. You cannot set aside entire swaths of the county and say no construction here or, even worse, 20-acre lot minimum, which means no farms and just isolated houses, but not set aside some part of that county for dense development. That will not work in the long run, and one way or another we are going to face up to it in advance and deal with the problem or it will simply hit us, and we are going to start reading stories about Washington that you currently read about California, which is, businesses are saying they are leaving because, not just because of local regulation, but because they can't find any workers who can get to work. As tough as it is to build roads, it is a lot easier to build housing and build it in a way that we don't need to keep building roads and we don't need to keep driving up the real cost for your employees for getting to work.

Thank you all very much. I am delighted to have a chance to be with you.

Franklin D. Raines is Chairman and Chief Executive Officer of Fannie Mae, a New York Stock Exchange company and the largest non-bank financial services company in the world. Fannie Mae is the nation's largest source of financing for home mortgages. The Fannie Mae Board of Directors designated Mr. Raines as the successor to James A. Johnson in April 1998. He became Chairman and Chief Executive Officer on January 1, 1999.

Under his leadership Fannie Mae has continued its record of double-digit operating income growth to 16 years, expanded its product and technology leadership, and committed to invest $2 trillion to finance affordable homeownership and rental housing for 18 million families. Mr. Raines also serves as Chairman of the Fannie Mae Foundation, the largest foundation focused on housing and community development.

Mr. Raines served in 1996-1998 as Director of the Office of Management and Budget and a member of the President's Cabinet. He was the first OMB Director in a generation to balance the federal budget.

Mr. Raines serves as a member of the board of directors of Fannie Mae, Pfizer Inc., AOL Time Warner Inc., and PepsiCo, Inc., and is an Overseer for TIAA-CREF. He serves on the boards of The Enterprise Foundation and the National Urban League. He formerly served as Chairman of the Visiting Committee of the Harvard Kennedy School of Government and President of the Board of Overseers of Harvard University. Mr. Raines was elected a Fellow of the American Academy of Arts and Sciences, and is a member of The Business Council, The Business Roundtable, the Trilateral Commission, the National Academy of Social Insurance, and the Council on Foreign Relations.

Mr. Raines graduated *magna cum laude* with a B.A. from Harvard College. He received his J.D. *cum laude* from Harvard Law School. He attended Magdalen College, Oxford University, as a Rhodes Scholar.