

## Close to Home ✓

### Fannie Mae Irks Rivals With Ads By Its Foundation

Giant Mortgage Buyer Denies It Is 'Branding,' Points To IRS Seal of Approval

Long Lists of Friendly Lenders

By JOHN D. MCKINNON

WASHINGTON—The heart-tugging ads are a fixture on American television. One shows a father standing in the doorway of a cramped apartment and holding a scruffy yellow dog for his children. It's a signal to his teary wife that their mortgage to buy a house has been approved.

The tagline: "Fannie Mae Foundation. Showing America a New Way Home."

The nonprofit foundation says the ad campaign aims to benefit the public by helping to put Americans, as the ad says, "on the path to homeownership." Critics say the ads aim to benefit Fannie Mae Corp., which once again finds itself in a gray area and drawing fire.

A huge publicly traded mortgage buyer, Fannie Mae retains vestiges of its government-agency origins. Formed with the purpose of helping more people get mortgages to buy homes, it books billions in profits. Now critics, including many of Fannie Mae's competitors, say the foundation's ads burnish the company's image, cut its tax bill and expand the business base that earned it \$6 billion in profits last year.

"It's highly unethical," says Pablo Eisenberg, a senior fellow at Georgetown University's Public Policy Institute who co-founded the National Committee for Responsive Philanthropy, a watchdog group concerned with charities that has long had concerns about the arrangement. The advertising campaign, once conducted by Fannie Mae itself, "is not a philanthropic enterprise," he adds, and "should never have been included in the foundation's activities." Mr. Eisenberg's group has considered investigating, but hasn't had the resources.

## IRS Rulings

Fannie Mae spokeswoman Janice Daue says the company has sought and received favorable rulings from the Internal Revenue Service for every activity transferred to the foundation. At every step of the way, Fannie Mae has bent over backwards to make sure it has done everything within the letter and spirit of the law.

Congress established Fannie Mae during the Depression to shore up the crippled home-loan industry. It buys mortgages from lenders and packages them into securities sold to investors on Wall Street. That disperses the risk of retail lending and frees up capital for more loans.

In 1979, Fannie Mae set up the foundation, which made annual grants, financed by its corporate sponsor, totaling an unremarkable \$13 million to \$14 million in the early 1990s. In 1996, Fannie Mae assigned the advertising campaign to the foundation and gave it \$350 million of its own shares to pay for the ads and other activities. Additional hefty gifts followed, including \$63 million of stock last year in a dot-com Fannie Mae helped set up and an additional \$300 million of Fannie Mae stock this past January and February. The foundation's assets currently total \$444 million, more than any other corporate foundation reported on its tax returns for 2000, the latest year for which comprehensive figures are available.

## Where Money Goes

Unlike other foundations, the Fannie Mae Foundation spends more of its money on advertising than on anything else. In 2001, it spent almost \$48 million, or 44% of its overall budget of \$110 million, on ads and related expenses, compared with \$35 million on grants to nonprofit groups involved in housing, university researchers and cultural groups in and around Washington, where it is based. The balance of its total outlays that year went to in-house research and administrative costs.

Several nonprofit industry associations—including Pharma, the drug-company group—spend a lot on advertising. Some consumer-product companies also lavish funds on cultural and sporting events, and enjoy the resulting publicity. But several experts say they are un-

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# Fannie Mae Draws Fire on Ads

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aware of any other large foundation affiliated with a single company that conducts advertising on the same scale as the Fannie Mae Foundation.

The Fannie Mae Foundation ads offer viewers a toll-free number to call to order free booklets that help them navigate the homebuying process. The foundation also sends lists of mortgage lenders that are composed almost exclusively of banks that have a history of doing more business with Fannie Mae than with its main rival, Freddie Mac. The ads appear on channels across the television spectrum, from BET and Spanish-language Univision to network hits and cable and broadcast news shows.

The mortgage giant's competitors and critics see the ads principally as a way of building a Fannie Mae brand among consumers, which they say could lay the groundwork for Fannie Mae to get into mortgage lending. Its charter now prohibits that.

"The foundation does many good things, but this amount of advertising is about corporate branding, not good works," says Mike House, a Washington lawyer and executive director of FM Watch, Fannie Mae's most ardent critic. The group is funded by big banks and financial-services companies that either fear Fannie Mae's intrusion into the retail market or compete with it in the secondary market.

Fannie Mae's chairman, Franklin Raines, once offered to tattoo on his forehead a promise that the company would never seek to become a direct lender. He rejects the idea that the foundation's ads are a brand-building exercise. But he doesn't dismiss the possibility that the Fannie Mae name could become valuable as a marketing tool for some lenders, and he suggests that companies that criticize the ads could be "trying to throttle their competitors."

Advocates for low-income people say the foundation should spend less on Fannie Mae's image and more on affordable housing. The foundation says it is the largest foundation in the U.S. devoted to affordable housing and since 1996 has distributed more than \$180 million in grants in 319 communities in all 50 states.

Fannie Mae also estimates that its secondary-market activities—and those of its cousin Freddie Mac—help consumers by lowering mortgage interest rates by as much as half a percentage point. The two dominate the huge secondary market for mortgages.

Fannie Mae and the foundation say the ads help promote affordable housing, too, and are legitimate charitable undertakings. Even critics gave the ads partial credit for boosting the fraction of American families who own homes to about 68% currently from 64% in 1994.

The foundation's capital gains, interest and dividends aren't subject to tax.

In one instance, Fannie Mae avoided capital-gains taxes on an investment it made in the dot-com it helped set up, Homestore Inc. of Westlake Village, Calif., by donating the shares to the foundation. Homestore runs real-estate Web sites.

In March 1999, as critics began questioning the propriety of Fannie's investment in a consumer-oriented dot-com, the company pledged to give its two million shares to the foundation. On July 3, 2001, as Homestore's stock was rallying, Fannie Mae transferred 1.75 million of its two million shares to the foundation. The stock closed that day at just over \$36. Based on its original purchase price of about \$10 million, the company avoided taxes on about \$54 million in gain, and also got a deduction of about \$63 million. Many businesses make similar gifts of appreciated stock to charities, including their own foundations.

The Fannie Mae Foundation sold its Homestore shares soon after getting them. It proved a smart move. Homestore is embroiled in an investigation of its accounting by the Securities and Exchange Commission, and its stock is now trading at around 75 cents.

## Ties to the Parent

Most corporate foundations reflect their parents' business or political interests to some degree. But usually they go about their good works with little direct tie to their parents' business or products. Freddie Mac's foundation, for example, gives money to prevent child abuse. It says it doesn't do image ads.

The American Express Foundation gives major grants to tourism groups such as the World Travel & Tourism Council and the Caribbean Hotel Foundation. The Merck Company Foundation gives large amounts to health-care research and education groups, including the Merck Institute for Science Education.

"Corporate philanthropy is getting more corporate," says Rick Cohen, president of the National Committee for Responsive Philanthropy. Still, he notes, those corporation foundations are doing what foundations have basically always done—giving grants to nonprofits.

By contrast, he says, the Fannie Mae Foundation is paying directly for an advertising campaign that Fannie Mae itself created and ran for several years. In effect, "the grant recipient is Fannie Mae," Mr. Cohen adds.

Competitors and critics have long complained that despite Fannie Mae's status as a publicly held corporation, the vestiges of its government origins give it unfair competitive advantages. Besides its congressional charter and exemption from state and local income taxes, Fannie Mae's debt has the implicit backing of the U.S. government. That has enabled it to borrow at advantageous rates and helped it grow rapidly in recent years. These competitors see the foundation as yet another taxpayer subsidy.

Using its foundation to run the ads provides Fannie Mae with tax breaks and other financial benefits. When it moved the ad campaign to the foundation in 1996, the company removed a big annual expense from its books. The company also got a large, upfront tax deduction when it donated its shares to the foundation, which sells them to help finance the ads and its other activities. The company also avoids paying tax on any appreciated non-Fannie Mae securities it contributes. Fannie Mae says the tax deductions weren't a factor in the decision to move the ads to the foundation and fund them with its stock, contending that the company could get equivalent deductions by running the campaign itself. Fannie Mae declines to specify the dollar amount of the tax break, and Mr. Raines says the break isn't signifi-

## Pressure From Congress

The corporate ad campaign was born at a time when Congress was pressing Fannie Mae and Freddie Mac to help increase homeownership among low-income families. After a survey found that prospective homebuyers regarded the home-buying process as intimidating and a big barrier to homeownership, Fannie Mae launched a nationwide ad campaign in 1993 to encourage people to learn how the process works. The cost of the ads—about \$31 million in 1995—was deducted on Fannie Mae's corporate tax returns as a business expense.

Two years after starting the ad campaign, Fannie Mae shifted it to the foundation, along with the company's housing-research programs, which study issues such as community development and predatory lending. The main reason, executives say, was to protect the campaign from internal budget wars and provide enough funds so it could last several years.

At the same time, the foundation—previously known as the Federal National Mortgage Association Foundation—changed its name in 1996 to match the corporate parent. "If we're going to get the reflected glory, we want it to be reflected in the right direction," Mr. Raines says.

Little about the ad campaign changed. One Fannie Mae executive still helps craft the foundation ads. Foundation executives make the final decisions on the TV campaign, says foundation President Stacey Davis. Mr. Raines serves as chairman of both Fannie Mae and the foundation, but carefully observes the legal distinctions between the two entities, foundation officials say. The foundation paid Ms. Davis, a full-time employee, about \$329,000 in 2000, the last year available.

People who respond to the foundation's ads get lists of lenders virtually identical to the list of "select" lenders that Fannie Mae itself mails out to consumers who make inquiries. Those lenders tend to do more of their business with Fannie Mae than with its chief rival, Freddie Mac. Some lenders say that consumers now often ask for "Fannie Mae loans," and some lenders advertise them as such.

On its Web site, Pacific Northwest Mortgage Corp. of San Jose, Calif., touts "Fannie Mae loans" as one of its services, alongside its first-time-homebuyer and low-income programs. Unlike big national lenders, some regional banks see Fannie Mae as an ally and the ads as helpful, since they cannot afford to spend much to promote mortgage services themselves.

To ensure that having the foundation run the ads was legal, the foundation formally asked for approval from the IRS. Even if the ads influenced a homebuyer to get a mortgage, the foundation said, there was no guarantee that Fannie Mae would end up with it. In 1996, the IRS agreed. The ads "will only incidentally benefit the private purposes" of Fannie Mae, it said. The IRS broadly prohibits charities from providing "nonincidental benefits" to "private interests."

Experts are divided over the Fannie Mae Foundation's advertising arrangement. On the uncritical side, Frances Hill, an expert on nonprofits at the University of Miami law school, says, "All you have to do is have a defined charitable purpose, and do something that's substantially related to it—which the ad does." Regarding its charitable purpose, the foundation says homes are the most important vehicle for retirement savings for lower-income people. There is even evidence that growing up in an owner-occupied home can enhance a child's educational achievement and help reduce teen pregnancy, foundation officials say.

More than 90% of the 150 or so lenders on the foundation's lists typically appear on separate state-by-state lists that Fannie Mae Corp. provides to consumers through its own toll-free number and its Homepath.com Web site. In California, Texas, Florida and Washington, D.C., the larger lenders on the foundation-provided lists sold between \$126 billion and \$130 billion nationally in loans to Fannie Mae in 2000—and only \$53 billion to \$58 billion to Freddie Mac, according to Inside Mortgage Finance newsletter. That works out to a split of about 70%-30% between Fannie and Freddie. In the overall market, the split is about 60%-40%.

Mr. House, the executive director of Fannie Mae critic FM Watch, says the use of the foundation to promote the business of key Fannie Mae affiliates makes the ads "even more self-serving."

Fannie Mae and foundation officials deny that the lender lists are intended to steer business to Fannie's preferred lenders or to have that effect. They say the lists are so similar because the foundation took over Fannie Mae's list when it took over the campaign. Any lender can add itself to the list, they say, though the foundation doesn't seek them out.

Some lenders on the lists sell little or nothing to Fannie Mae, says Mr. Raines, adding, "It is illogical to assert we were using this as a marketing tool."

—*Kelly Spors*  
contributed to this article.