Federal Housing Finance Agency
Office of Inspector General

Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce

Management Alert • OIG-2018-004 • September 6, 2018

OFFICE OF INSPECTOR GENERAL

Federal Housing Finance Agency

400 7th Street SW, Washington, DC 20219

September 6, 2018

TO: Melvin L. Watt, Director, Federal Housing Finance Agency

FROM: Laura S. Wertheimer, Inspector General, Federal Housing Finance Agency

SUBJECT: Management Alert—Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce

Executive Summary

Since September 2008, Fannie Mae has been under the conservatorship of the federal government. Currently, there is no plan by which it will emerge from conservatorship in the near future.

This is the fourth report issued by the Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG) arising from a whistleblower complaint alleging, among other things, excessive spending by Fannie Mae to consolidate its staff and relocate its offices.

In three prior reports, we questioned the reasonableness of build-out costs related to Fannie Mae's consolidation and relocation of multiple offices into leased space in Washington, D.C., and in Plano, Texas. In these locations, "action forcing" events required prompt responses from Fannie Mae: in Washington, D.C., those events included the poor condition of its leased and owned buildings, expiration of its leases, and the significant costs necessary to repair deficiencies and restore its owned buildings to good working condition; and in Dallas, Texas, those events included a significant reduction in its loss mitigation staff and concomitant need to decrease office space by at least 175,000 square feet.

The subject of this Management Alert is Fannie Mae's decision to consolidate and relocate its workforce in Northern Virginia from three owned and one leased office buildings into leased space built out to Fannie Mae's specifications in a new building to be constructed by Boston Properties at the Reston Town Center. Fannie Mae has executed a lease with Boston Properties, and its new space is projected to be ready for occupancy in 2022. Fannie Mae intends to remain in its current offices in Northern Virginia until that time.

Four officials in FHFA's Division of Conservatorship (DOC), responsible for oversight of Fannie Mae's move from its Northern Virginia offices, separately reported to us that Fannie Mae faced no "action forcing" event requiring it to either incur significant costs to repair or maintain its offices, or to shrink (or grow) its square footage. Three officials acknowledged that Fannie Mae could continue to operate out of its current Northern Virginia offices for the indefinite future, without sustaining a negative impact on its operations. The fourth reported that he was "not up to speed" on this issue but subsequently acknowledged that Fannie Mae could continue to operate out of its three owned buildings, in their current state. These four DOC officials further advised that the driver for Fannie Mae's consolidation and relocation was the implementation of a Workplace Strategy (WPS) developed by Fannie Mae management (management), adopted by the Fannie Mae Board of Directors (Board), and accepted by FHFA. Elements of WPS include a standard template for an open office environment with less rentable square feet/person and moves from owned to leased facilities in one consolidated location per region.

During the first half of 2017, management considered three possible options for its Northern Virginia offices and workforce of approximately 4,000 individuals (of whom roughly 40% are contractors and consultants, not Fannie Mae employees). These options were:

- <u>Option A</u>: Reconfigure/renovate the three Fannie Mae owned buildings and enter into a sale/leaseback for 15 years; and obtain a new 15-year lease in a to-be-determined building, all at an estimated net present value (NPV) (a measurement of the expected cash flows created by that property less the present value of the amount invested) of $889 million;

- <u>Option B</u>: Consolidate the Northern Virginia workforce at one location; reconfigure/ renovate an existing Fannie Mae-owned building in that location; build balance of space requirements in a new building at that location; enter into a sale/leaseback transaction for 15 years for both buildings; and sell the other two Fannie Mae-owned buildings in Northern Virginia, at an estimated NPV of $862 million; and

- <u>Option C</u>: Continue operations in the three buildings currently owned by Fannie Mae in Northern Virginia and one leased building until 2022; and consolidate and relocate the workforce into leased office space to be constructed by 2022, built out to Fannie Mae's specifications, at an estimated NPV of $727 million.

Management selected Option C because it fully implemented WPS at the lowest NPV. It advised the Board of its selection at a July 13, 2017, Board meeting.

Our review of management's June 7, 2017, presentation to FHFA, and of its July 13, 2017, Board presentation and minutes for that meeting, found no evidence that management considered a fourth option: continuing to operate out of the three owned and one leased buildings in Northern Virginia, making any repairs necessary to maintain the buildings in good working condition, and foregoing additional costs to reconfigure and restructure these buildings to implement WPS (referred to in this report as the Status Quo Option). Management did not calculate an NPV for such an option.

The four DOC officials confirmed our finding: neither Fannie Mae nor FHFA considered a Status Quo Option. Minutes for the July 13, 2017, Board meeting report that "Board members expressed their support of the Company's decision to move to a new location" under Option C. FHFA issued a non-objection letter to Option C on September 21, 2017.

The current FHFA Director has acknowledged that his statutory responsibilities are to "preserve and conserve" the assets and property of Fannie Mae while operating it in a manner consonant with the public interest. On February 14, 2018, Fannie Mae reported that it required an additional draw of $3.7 billion from the Treasury to eliminate its net worth deficit, bringing the taxpayers' investment in it to $119.8 billion.

Notwithstanding the lack of any "action forcing" events, management determined to implement WPS by consolidating and relocating to offices built out to Fannie Mae's specifications in a new building in the Reston Town Center at an NPV of $727 million. The Board endorsed this course of action, which FHFA accepted.

Fannie Mae asked, on July 18 and on July 20, 2018, for FHFA approval to sell its three owned buildings in Northern Virginia, for a total of $90.7 million. FHFA approved those requests on August 2, 2018. Roughly one year ago, management's expert provided an opinion stating that the sale of the three buildings in 2022 would produce an NPV of $140 million. The projected $140 million NPV from the sale of the three buildings was baked into the NPV for Option C. Because Fannie Mae will realize 35% less than projected on the sale of the buildings, the cost for its consolidation and relocation—and the NPV for Option C—will both go up while the savings from WPS promised to the Board by management will go down.

Reasonable people may disagree over the contours of the conservator's statutory duty to "preserve and conserve" the assets and property of Fannie Mae while operating it in a manner consonant with the public interest. Those contours, however, cannot be stretched to accommodate the expenditure of three quarters of a billion dollars solely to implement WPS. We found no analysis that management provided to the Board or to FHFA that demonstrates that Fannie Mae's willingness to spend three quarters of a billion dollars, just to implement WPS in one location, is in the best interests of the taxpayers.

As we cautioned in our 2016 Management Alert regarding Fannie Mae's proposed build-out of its new headquarters, Fannie Mae "arguably has little incentive to cabin its costs" because "any positive net worth it does not spend on itself will be swept into the Treasury as a dividend." In our view, the cost to consolidate and move Fannie Mae's Northern Virginia operations under Option C (NPV $727 million increased by $49.3 million for the smaller than projected amount from the sale of the buildings), less the NPV for the Status Quo Option (which Fannie Mae did not calculate), are funds that could, and should, be put to better use. A better use would include a sweep of excess funds to the U.S. Treasury as a dividend for the $119.8 billion investment by

U.S. taxpayers, pursuant to the terms of the Third Amendment to the Senior Preferred Stock Purchase Agreement.

After we learned from FHFA officials that Fannie Mae expects the sale of these buildings to close in September 2018, we asked FHFA to direct Fannie Mae to suspend its pending efforts to close the sale until FHFA reviewed the findings and recommendations of this Management Alert. FHFA promptly directed Fannie Mae, in writing, to place an "immediate hold on any actions to finalize the sale of your Northern Virginia properties until you receive further direction from" FHFA. Should FHFA permit Fannie Mae to continue with its plans, we question all costs to lease and build out the space in the Boston Properties building beyond the costs for the Status Quo Option. To eliminate the potential waste associated with Option C, we recommend that FHFA, consistent with its duties as conservator, direct Fannie Mae to record on its books a liability owed to the Treasury for the expenses it incurs to consolidate and relocate into leased space at Reston Town Center, built out to its specifications. In the event Fannie Mae emerges from conservatorship, FHFA should require Fannie Mae to pay Treasury in full for this liability before dividend payments are made to private shareholders.

We provided a draft of this Management Alert to FHFA on August 17, 2018, for its response. We received the Agency's response on August 31, 2018, which is attached as Appendix A, in which it did not agree with any of our recommendations.

Background

Management's Development of its Workplace Strategy

As we explained in our 2016 Management Alert, management faced a challenge in its workspace utilization in the District of Columbia and nearby metro areas (D.C. metro area). In late 2012, management created a workplace strategy steering committee to develop a long-term solution to Fannie Mae's workspace needs in the D.C. metro area, excluding five of its offices in Northern Virginia and Maryland.

One of the first decisions to be made was whether Fannie Mae should remain in its two owned buildings and pay to repair and upgrade them and renegotiate the terms of its leased space in three buildings (or find new leased space) or, in the alternative, consolidate and relocate all of its D.C. metro offices into suitable leased space elsewhere. Management, along with its consultants, conducted a comprehensive analysis of the viability of office space leased or owned by Fannie Mae in the D.C. metro area.[1] In November 2013, the Board approved management's recommendation to consolidate and relocate its D.C. metro offices. On January 22, 2015, it approved the consolidation of Fannie Mae's Washington area offices into leased space in Midtown Center. Thereafter, Fannie Mae submitted the same proposal to FHFA for its approval.

[1] *See* FHFA-OIG, *Management Alert: Need for Increased Oversight by FHFA, as Conservator of Fannie Mae, of the Projected Costs Associated with Fannie Mae's Headquarters Consolidation and Relocation Project* (June 16, 2016) (COM-2016-004).

On January 29, 2015, FHFA authorized Fannie Mae to enter into the lease. Fannie Mae began to move into its newly leased and built-out space in Midtown Center in December 2017.

Management codified the principles underlying the "Stay/Go" decision for the D.C. metro offices into a WPS that it intended to apply to all of Fannie Mae's offices nationwide, regardless of whether it confronted any "action forcing" events for those offices. In its written briefing to the Board for its July 9, 2015, meeting entitled "Enterprise-Wide Workplace Strategy Update," management explained that it "developed a workplace strategy in 2014 that commence[d] with the consolidation of the five buildings in D.C. into a single location and is intended to be instituted enterprise-wide."[2] This written briefing, which was provided to the Board "for information only" with "no action required," explained management's goals for its WPS:

- A standard template for an open collaborative office environment with less rentable square feet/person;
- Robust technology that permits working from anywhere and fosters safety, soundness, and resiliency;
- Move from owned to leased facilities in one consolidated location per region;
- Locate in dynamic areas that attract and retain employees and provide features that Fannie Mae can use but does not have to build (e.g., auditorium, fitness center, food services); and
- Floor plans that produce organizational efficiency and are flexible to grow or contract based on business requirements and staffing demands.

Management stated, in this written briefing, that application of WPS to all of Fannie Mae's offices nationwide should reduce its then-current total office space from 3 million square feet to 2 million square feet by 2018 and yield a projected cost savings of approximately $410 million over a 10-year period. It reported: "[f]or Dallas and all other offices, we have undertaken a **'Stay/Go' analysis consistent with our D.C. processes**" (emphasis added). It advised that, for Northern Virginia and Maryland, it had not commenced a Stay/Go analysis but projected that its analysis would begin in Fall 2015. Minutes for the July 9, 2015, Board meeting state that management "provided an update on the next steps in implementing the Work Place Strategy, which includes evaluating all of the regional leases, including Dallas, to reduce the overall real estate foot print, **reduce costs** and to make more efficient use of space" (emphasis added). Fannie Mae, on its public web site, represents: "[a]s we did in DC and Dallas, we will consider the cost-benefit of staying" in its current office spaces or moving to new spaces. "Any decision

[2] We found no written materials, prior to this presentation for the July 9, 2015, Board meeting, explaining to the Board that management codified the principles used for the analysis of the D.C. metro offices into WPS to apply across all of Fannie Mae's offices nationwide.

to relocate our other offices [apart from D.C. and Dallas] will **be in the best interest of the taxpayer** when the benefit outweighs the cost" (emphasis added).

Management's Implementation of WPS Across Fannie Mae

Management updated the Board on its planned next steps for WPS at the Board's September 15, 2015, meeting, which management called a "Deep Dive." Management provided a written presentation to the Board, titled "Enterprise-Wide Workplace Strategy Update," which reiterated management's WPS goals from its July 9, 2015, Board presentation and explained that these goals "will be applied to the entire Fannie Mae real estate portfolio." With respect to Fannie Mae's operations in the Dallas metro area, management explained that Fannie Mae faced an "action forcing" event: it needed to reduce its square footage by at least 175,000 square feet. For its offices in Virginia and Maryland, management's presentation represented that management's study of Fannie Mae's Virginia offices would "commence in late Q4 2015 or Q1 2016."

The Board meeting continued the following day, September 16, 2015. Management presented to the Board a draft of Fannie Mae's Strategic Plan for 2016-2021 (Strategic Plan) and sought Board input. One of the goals in this draft Strategic Plan was the implementation of WPS across all Fannie Mae offices:

> We will consolidate all current offices in Washington, DC, into a single workplace that enables better use of technology, provides a flexible and efficient infrastructure that fosters safety and resiliency, and is located in an area with resources that help attract and retain employees. We will also apply the same approach to our sites in Northern Virginia and Dallas, and our regional offices in Philadelphia, Atlanta, Chicago, and Pasadena.

Neither management's Deep Dive presentation nor its Strategic Plan commits to comparing the costs and benefits of consolidation and relocation against the costs and benefits of maintaining the status quo. We also found no evidence that management advised the Board, either at the Deep Dive session or in its presentation of the draft Strategic Plan, that recent broad-based studies had called into question the value of an open workspace plan—an integral element of WPS—based on findings of significant adverse impacts on employee health, productivity, and morale or of a growing body of commentary critical of open workspaces.[3] Similarly, we found

[3] *See* The Guardian, Open-plan offices were devised by Satan in the deepest caverns of hell (online at www.theguardian.com/news/2013/nov/18/open-plan-offices-bad-harvard-business-review) (open-plan offices have been associated with less persistence at challenging tasks, lower motivation, higher stress and blood pressure; to the extent that easier communication did make open-plan offices a little less bad, to some, than they might otherwise have been, this "failed to offset the decrements by negative impacts of noise and privacy."); *see also* Inc.com, 9 Reasons That Open-Space offices Are Insanely Stupid (online at www.inc.com/geoffrey-james/why-your-company-will-benefit-from-getting-rid-of-open-office-spaces-first-90.html) (open-plan offices are so incredibly destructive to productivity that they're a net huge loss; open offices decrease workers' well-being by 32% and reduce productivity

no evidence that management advised the Board that "leading practices" by public companies and government organizations in capital decision making were to "first consider the use of existing assets" before deciding to obtain new assets.

Minutes for the September 16, 2015, Board meeting reflect that the Board Chair "complimented the management team on the quality of the strategic plan" and the "process used to develop the plan" and other directors "praised the succinctness and directness of the Single-Family strategic pillars" of the Plan. The Board resolved unanimously to adopt the final version of the Strategic Plan (which contained no changes to the WPS implementation goal) at its November 12, 2015, meeting.

Management's Due Diligence on WPS Implementation in Northern Virginia

Starting in late 2016, management began to consider the application of WPS to Fannie Mae's four Northern Virginia offices, situated in three buildings Fannie Mae owns and one of which it leases. Fannie Mae has characterized the functions performed by its Northern Virginia workforce as primarily "operations" and information technology. Fannie Mae documents state that, in 2017, these four buildings housed 4,075 individuals, 40% of whom were contractors and consultants. These documents do not report whether these contractors and consultants are contractually required to be embedded full-time in Fannie Mae's Northern Virginia offices.

Management retained two consulting firms that it directed to assist in applying WPS to its Northern Virginia facilities—a marked departure from the due diligence that management conducted for its D.C. metro offices. There, management directed its consultant to identify the costs necessary to repair its then-owned and leased buildings to maintain them in good working condition.

Here, the two consulting firms undertook studies of the costs to implement management's two WPS objectives: the three Fannie Mae owned buildings would "need to be upgraded to meet the new Fannie Mae workplace standards"; and its intention to operate from these reconfigured and restructured buildings for the foreseeable future. One of the consultants recommended that Fannie Mae "renovate all three buildings down to structure…" to meet these two objectives, but did not provide cost information. The other consultant provided cost estimates to achieve the two objectives, but did not clearly differentiate between the costs for meeting the two objectives

by 15%; open-plan offices cause high levels of stress, conflict, high blood pressure, and high staff turnover; employees take 62% more sick leave); *see also* Harvard Business Review, Research: Cubicles Are the Absolute Worst (online at https://hbr.org/2013/11/research-cubicles-are-the-absolute-worst) ("[T]he loss of productivity due to noise distraction was doubled in open-plan offices compared to private offices, and the tasks requiring complex verbal process were more likely to be disturbed than relatively simple or routine tasks. This loss of productivity is not offset by increased collaboration.").

(e.g., the cost to reconfigure and recondition the three buildings to implement WPS) and the costs to make necessary repairs to maintain the buildings in good working condition.[4]

Management's Three Options for Fannie Mae's Future Operations in Northern Virginia

By June 2017, management developed three options for Fannie Mae's future operations in Northern Virginia. As we discuss, none of management's options maintain the status quo, notwithstanding that management labeled its options as a Stay/Go analysis. These options were:

> <u>Option A</u>: Reconfigure/renovate the three Fannie Mae owned buildings and enter into a sale/leaseback for 15 years; and obtain a new 15-year lease in a to-be-determined building, all at an estimated net present value (NPV)[5] of $889 million;
>
> <u>Option B</u>: Consolidate the Northern Virginia workforce at one location; reconfigure/ renovate an existing Fannie Mae-owned building in that location; build balance of space requirements in a new building at that location; enter into a sale/leaseback transaction for 15 years for both buildings; and sell the other two Fannie Mae-owned buildings in Northern Virginia, at an estimated NPV of $862 million; and
>
> <u>Option C</u>: Continue operations in the three buildings currently owned by Fannie Mae in Northern Virginia and one leased building until 2022; and consolidate and relocate the 4,400-person workforce (of whom 40% are contractors) into leased office space to be constructed by 2022, built out to Fannie Mae's specifications, at an estimated NPV of $727 million. This NPV calculation included an estimated $140 million to be received by Fannie Mae for the "as is" sale of the three buildings.

Four officials in DOC responsible for oversight of Fannie Mae's consolidation and relocation of offices in Northern Virginia, including the Acting Deputy Director, separately reported to us that WPS was the driver for Fannie Mae's move to new space. Three acknowledged that Fannie Mae could continue to operate out of its current Northern Virginia offices for the indefinite future, without incurring costs to reconfigure and renovate to implement WPS, without significant costs to repair deficiencies and restore those offices to good working condition, and without sustaining a negative impact on its operations.[6] The fourth reported that he was "not up to speed" on this

---

[4] Because Fannie Mae planned to vacate the existing leased building by 2020, it did not ask either consultant to provide an assessment of it.

[5] NPV measures the expected cash flows created by that property less the present value of the amount invested, and considers future cash flows associated with leases, and the timing of the lease payments, over a specified period of time. The cash flows are discounted back to present value using a discount rate that reflects borrowing costs over the term of the lease. NPVs are used to measure the relative financial cost of different properties. NPVs for these options were calculated by a Fannie Mae contractor.

[6] For example, one of these officials reported that Fannie Mae could continue to operate from the three buildings it owns for an indefinite period with no additional costs, beyond taxes and other routine operating

issue but subsequently acknowledged that Fannie Mae could continue to operate out of its three owned buildings, in their current state. According to these four officials, the Status Quo Option was simply not considered either by Fannie Mae or FHFA, because it is inconsistent with WPS, which FHFA supports.[7] Because management did not consider a Status Quo Option, it never calculated an NPV for it and FHFA never asked for such an NPV.

In a memorandum to FHFA dated June 7, 2017, management stated that Option C was its preferred option because it fully implemented WPS with the lowest NPV. Two days later, Fannie Mae submitted a written memorandum to FHFA that, among other things, explained the basis for its decision to extend WPS to its Northern Virginia offices. Those reasons included:

- Fannie Mae was "at or near capacity" in its current Northern Virginia offices with little flexibility for growth;
- Three owned buildings "range in age from 21 to 31 years and will soon require critical building systems replacements at significant cost";
- Current offices "do not have easy access to public transportation";
- Need to address additional space needs when the lease for one building expires in 2020;
- Current offices do not meet WPS guiding principles; and
- WPS goals envision a transition from owned to leased buildings.

Our review of this memorandum found that Fannie Mae either did not provide support for many of these reasons or the support it provided was incomplete. For example:

- <u>Size of workforce</u>: Fannie Mae documents report that its Northern Virginia workforce in 2017 was 4,075 individuals, 40% of whom were contractors or consultants, and project that its workforce would be about 4,400 by 2022. However, Fannie Mae now reports that its existing offices currently accommodate over 4,500 individuals (employees, contractors, and consultants).

---

and maintenance costs. Another stated that some technology updates would have been required but provided no specifics of those updates.

[7] In its Management Response, FHFA contends that, to the extent that its officials reported to us that Fannie Mae could remain in its current facilities in Northern Virginia for the indefinite future, they either misspoke or were misunderstood by us. These four officials in DOC are charged with oversight of Fannie Mae's consolidation and relocation of offices in Northern Virginia and each separately reported to us that Fannie Mae could remain in its owned buildings for the indefinite future. We do not find FHFA's contradictory assertion in its response that Fannie Mae could not remain in its three owned buildings for the indefinite future to be credible.

- Need to replace critical building systems at significant cost "soon": Neither of the consultant reports identified the critical building systems that required replacement "soon" or at all, nor the cost of that replacement.

- Lack of easy access to public transportation: Each of Fannie Mae's four Northern Virginia office buildings, which are within an eight-mile radius, currently has either "easy access" to the Metro's Silver Line or to public buses. Even assuming that Fannie Mae's current offices lack easy access to public transportation, which they do not, Fannie Mae does not anticipate that most of its workforce will use public transportation: its lease with Boston Properties provides a total of 3,400 parking spaces in and adjacent to the building to be constructed, even though that building is located adjacent to the Reston Town Center Metro station, which is scheduled for completion in early 2020.

- Need to address additional space needs when lease for one building expires in 2020: Issue exists for all of management's options, including Option C, the option selected by management.

- Current offices do not meet WPS guiding principles: Fannie Mae has been operating in four Northern Virginia offices that are not configured with an open collaborative office plan. Under Option C, it plans to do so until 2022. Management did not demonstrate why WPS should apply to a workforce with 40% contractors and consultants given that FHFA officials stated that Fannie Mae can continue to operate from its three owned buildings for the indefinite future, without upgrades or renovations, and without sustaining a negative impact on its operations.

- WPS goals envision a transition from owned to leased buildings: Although this is an accurate statement, management failed to show the Board and FHFA that consolidation and relocation to leased space would "be in the best interest of the taxpayer," as it committed publicly to do.

Management met with FHFA on June 23, 2017, to review its recommendation to adopt Option C for Northern Virginia. At that meeting, FHFA and its expert, Jacobs Engineering Group, Inc., raised questions about Fannie Mae's proposal to "reskin" the facades of the three owned buildings (one element of the proposed costs of Options A and B to reconfigure/renovate owned buildings). At the request of FHFA, Fannie Mae ran "additional NPVs to test the option of not re-skinning the owned buildings" and to use a "conservative versus an expected sales price for the buildings" for Options A and B. For Option C, Fannie Mae ran an additional NPV to test the sensitivity of its construction cost estimates.

On July 6, 2017, Fannie Mae provided FHFA with lowered NPVs for Options A and B. The NPV for Option A was reduced from $880 million to a range between $874–$880 million, and the NPV for Option B was reduced from $862 million to a range between $855–$858 million. The revised NPV for Option C increased by roughly $36 million, from $727 million to $762 million, but did not change management's recommendation to pursue Option C. Baked into the NPV for Option C was management's intent to sell the three Fannie Mae owned buildings for $140 million.

Management's Presentation to the Board of its Stay/Go Decision on July 13, 2017

Management made a presentation to the Board at its July 13, 2017, meeting relating to Fannie Mae's offices in Northern Virginia. Its written presentation, entitled "Workplace Strategy Update—Northern Virginia Campuses" contained a cover sheet that stated that the presentation reviewed management's Stay/Go analysis for informational purposes for the Board, with "no action required." According to that presentation, Fannie Mae's four offices in Northern Virginia house its "largest concentration of staff, predominantly technology and operations related resources." Its then-current workforce of 4,075 (consisting of employees, contractors, and consultants) was projected by management to grow by roughly 8%, to 4,400, by 2022, which management acknowledged could be accommodated in Fannie Mae's current facilities. This presentation also provided:

- A summary analysis of Options A, B, and C based upon four criteria: alignment to WPS; comparison of their respective NPVs; the speed at which each selection could be implemented; and expected disruption to ongoing Fannie Mae operations/business attributable to each option;

- Management's original NPV for each option, notwithstanding the recalculated NPVs (both lower for Options A and B and higher for Option C) provided to FHFA on July 6, 2017;

- Management's conclusion that relocating to a "new, consolidated leased office space provides $135–$162 million favorable NPV, can be delivered within the shortest timeframe, and is least disruptive to FM operations/business" and met 100% of WPS principles; and

- A discussion of next steps (consult with FHFA, select a site, negotiate a lease, etc.).

Fannie Mae confirmed to us that no other materials were provided to the Board for its consideration of this subject at this July 2017 meeting.[8]

[8] At this July 2017 meeting, Fannie Mae management did not provide the Board with the two reports from the consultants it retained.

No Evidence that Management Conducted Due Diligence to Determine What Repairs, if any, Were Required to Maintain Fannie Mae's Owned Buildings in Good Working Condition to Enable Fannie Mae to Continue Operations in Them Without Incurring WPS-Related Implementation Costs

As discussed previously, three DOC officials, including the Acting Deputy Director, responsible for oversight of Fannie Mae's consolidation and relocation of offices in Northern Virginia, separately reported to us that Fannie Mae could continue to operate out of its current Northern Virginia offices for the indefinite future, without incurring significant costs to repair deficiencies and restore them to good working condition, and without sustaining a negative impact on its operations. (The fourth reported that he was "not up to speed" on this issue but subsequently acknowledged that Fannie Mae could continue to operate out of its three owned buildings, in their current state.) According to these four officials, FHFA recognized that Fannie Mae faced no "action forcing" event requiring it either: to incur significant cost to repair deficiencies in order to maintain those offices in good working condition (in contrast to Fannie Mae's D.C. metro offices) or to shrink (or grow) its existing square footage (in contrast to Fannie Mae's Dallas metro offices); or to consolidate and relocate those offices. Each acknowledged that a Status Quo Option was not pursued by Fannie Mae or FHFA because it is inconsistent with WPS, which FHFA supports.

Our review of management's written presentation for the Board's July 13, 2017, meeting and minutes for that meeting found no evidence that management advised the Board that:

- Fannie Mae faced no "action forcing" event compelling it to move from its Northern Virginia offices (although the documents do indicate that its determination to consolidate and relocate was driven solely by WPS);

- Even though no "action forcing" event compelled the move and the only rationale for the move was WPS, at least four broad-based studies called into question the value of an open workspace plan based on their findings of significant adverse impacts on employee health, productivity, and morale[9] or of a growing body of commentary critical of open workspaces;

[9] *See, e.g.*, Brennan, Chugh and Kline, Traditional versus Open Office Design: A Longitudinal Field Study, *Environment and Behavior*, 34:279 (2002); Evans and Johnson, Stress and Open Office Noise, *Journal of Applied Psychology*, Vol. 85, No. 5, pp. 779–783 (2000); Kim and de Dear, Workspace Satisfaction: The Privacy-Communication Trade-Off in Open-Office Plans, *Journal of Environmental Psychology*, Vol. 36, pp. 18-26 (Dec. 2013); Davis, M.C., Leach, D.J., & Clegg, C.W., The Physical Environment of the Office: Contemporary and Emerging Issues, *International Review of Industrial and Organizational Psychology*, Vol. 26, pp. 193-235 (2011); Bernstein and Turban, The Impact of the Open Workspace on Human Collaboration, *Phil. Trans. R. Soc. B*, 373 (2018).

- Approximately 40% of Fannie Mae's Northern Virginia workforce consisted of contractors and consultants, not Fannie Mae employees, for whom management did not demonstrate that Fannie Mae was required to provide office space;[10]

- It knew, from the recalculated NPVs provided to FHFA on July 6, 2017, that the NPVs for Options A and B had decreased and the NPV for Option C increased from $727 million to $762 million, but did not share those revised NPVs with the Board. Put another way, the purported savings from the open workspaces in leased office space in Option C would be less than the savings represented to the Board; and

- It never considered a Status Quo Option, under which Fannie Mae would perform the repairs necessary to maintain the buildings so that it could continue to operate out of them indefinitely without incurring the costs necessary to reconfigure and restructure its three owned buildings to implement WPS, and did not calculate an NPV for that option.

Board Oversight of Management's Decision to Select Option C Was Less Than Robust

According to minutes for the July 13, 2017, Board meeting, this meeting lasted 97 minutes during which the Board discussed a number of topics. The Board's discussion of management's three options for Fannie Mae's Northern Virginia offices was reported on 3 of the 17 pages of minutes for this meeting and the remaining 14 pages were devoted to other topics. Although management committed to the Board, at its July 9, 2015, meeting that "…we have undertaken a 'Stay/Go' analysis consistent with our D.C. processes," the Board knew, or should have known, from management's July 13, 2017, presentation that its Stay/Go analysis for the Northern Virginia offices was incomplete in that it was limited to which option best aligned to WPS. Minutes for this meeting show no request by any director to management to provide a Status Quo Option and its NPV.

Prior to the July 13, 2017, Board meeting, we issued two reports in which we questioned whether Fannie Mae's plans for its build-out of leased space in Washington, D.C., and Plano, Texas, were consistent with the conservator's statutory duties, given increases in projected costs of the build-outs and, for the Washington, D.C., space, extravagant features included in the build-out. Our review of minutes for the July 13, 2017, Board meeting found no evidence that any director questioned management about whether it was feasible for Fannie Mae to continue to operate out of its three owned buildings in Northern Virginia for the indefinite future, without the reconfigurations and renovations contemplated by Option A, and whether the cost of such an alternative would be lower than the NPVs for management's three options.

---

[10] We recognize that management advised the Board that contractors and consultants worked in Fannie Mae's Northern Virginia offices but found no evidence that management explained that this workforce consisted of 40% contractors and consultants.

Similarly, we found no evidence that any director asked management at the meeting to provide a detailed justification of the reasons to implement WPS for Fannie Mae's Northern Virginia offices, in light of the significant percentage of consultants and contractors (roughly 40%) in that technology and operations-related workforce, or to quantify the cost savings, increases in productivity, and customer and employee satisfaction that would be gained by implementing WPS in Northern Virginia.

The current FHFA Director has acknowledged that his statutory responsibilities are to "preserve and conserve" the assets and property of Fannie Mae while operating the Enterprise in a manner consonant with the public interest. FHFA has delegated responsibility for oversight of general corporate matters to the Board, which is appointed by the FHFA Director. Unlike directors of public companies who owe fiduciary duties to the shareholders, directors of Fannie Mae owe those duties solely to the conservator. For matters delegated to Fannie Mae, the Board acts as agent for the FHFA Director and must carry out his responsibilities to conserve and preserve Fannie Mae resources as it operates the company in the public interest.

Minutes for the July 13, 2017, meeting report three questions asked by directors: whether Fannie Mae planned to sell the three buildings it owns in Northern Virginia; whether Options A and B assumed the sale/leaseback of these three buildings; and whether management had a high level of confidence in its NPV analysis. None touch on whether management considered a less costly option and we found no evidence in the minutes for this meeting that directors pressed management about whether consolidation and relocation of the Northern Virginia workforce in newly constructed, leased space was consistent with operating Fannie Mae in the public interest. The minutes reflect that: "…Board members expressed their support of the Company's decision to move to a new location" under Option C.

In its Management Response, FHFA seeks to dismiss our analysis of the Board's oversight of management on the grounds that it rests on the "faulty premise" that "Fannie Mae should operate in a state of suspended animation, and avoid affirmative management decisions" during its conservatorship of "uncertain duration," which it labels "irresponsible" and "ill advised." Our body of work demonstrates the lack of merit in FHFA's claim. In two Management Alerts issued in 2016 involving Fannie Mae's decision to consolidate and relocate into rented space in Washington, D.C., and in Plano, Texas, we recognized that Fannie Mae undertook a reasoned analysis of its options in each location and had a sound basis for its determination to consolidate and relocate. Here, we found that no such analysis was conducted by management and it was, in the words of FHFA, "irresponsible" and "ill advised" for the board to support management's decision without insisting on an in-depth consideration of potentially less costly options.

FHFA Issued a "Non-Objection" Letter to Option C Without Requiring Fannie Mae to Consider a Status Quo Option

On July 14, 2017, Fannie Mae requested that FHFA, as conservator, approve its selection of Option C under the 2012 Revised Letters of Instruction. In August 2017, DOC recommended to FHFA's Conservatorship Committee that it approve Option C, notwithstanding the fact that the sole reason for the consolidation and relocation of Northern Virginia offices was implementation of WPS and DOC's understanding that Fannie Mae could continue to operate out of its current Northern Virginia offices for the indefinite future, without incurring significant costs and without sustaining a negative impact on its operations.

Minutes for the August 17, 2017, meeting of the Conservatorship Committee report that the Committee agreed with DOC's recommendation that "the option for Fannie Mae to relocate to a new-leased building is the best option." On September 21, 2017, FHFA issued a non-objection letter to management's request to proceed with Option C.

FHFA, in its Management Response, maintains that we seek to substitute our judgment for that of FHFA in determining those management decisions that "can responsibly be made by Fannie Mae during this protracted period of conservatorship." We disagree. U.S. taxpayers, through Treasury, have invested nearly $119.8 billion in Fannie Mae since 2008, and Fannie Mae operates under the conservatorship of the federal government. We have long recognized that FHFA, as conservator for Fannie Mae and Freddie Mac (collectively, the Enterprises), has delegated the responsibility for a significant portion of day-to-day management to each Enterprise, which it can revoke at any time. As the Enterprises' conservator, FHFA must do more than monitor management's execution of delegated authority because it is ultimately responsible for such actions. In our Management and Performance Challenges Memorandum, we identified that FHFA is challenged to improve the quality of its oversight of matters delegated to the Enterprises.

As demonstrated in our body of work, we have not sought, and do not seek here, to substitute our judgment for that of FHFA. We make clear in this Management Alert that we do not know the most cost-effective one for Fannie Mae. In our view, it is "irresponsible" and "ill advised" for FHFA to defer to management's decision to consolidate and relocate, rather than to determine whether management's decision was the most cost-effective option.

The Estimated Costs to Consolidate and Relocate Fannie Mae's Northern Virginia Operations to Leased Space and the Costs to Build Out that Space are Funds that Should be Put to Better Use

The current FHFA Director has acknowledged that his statutory responsibilities under HERA are to "preserve and conserve" the assets and property of Fannie Mae while operating it in a manner consonant with the public interest. On February 14, 2018, Fannie Mae, an entity in FHFA's conservatorship, reported that it required an additional draw of $3.7 billion from the Treasury to eliminate its net worth deficit, bringing the taxpayers' investment in it to $119.8 billion.[11]

[11] The enactment of the Tax Cuts and Jobs Act of 2017, PL 115-97 (2017) required each Enterprise to re-measure its net deferred tax asset using the new law's lower corporate tax rate, which triggered a one-time charge through the provision for federal income taxes and caused each Enterprise to take a draw.

On July 18 and July 20, 2018, Fannie Mae sought consent from FHFA, as conservator, to sell its three owned Northern Virginia buildings now, at a total price of $90.7 million. FHFA, as conservator, approved the sale of the three buildings on August 2, 2018. The proceeds estimated to be realized from the sale of its three owned buildings are $49.3 million less (35%) than the $140 million NPV baked into the cost of Option C as of July 2017. According to Fannie Mae, the structure of the purchase, which allows Fannie Mae to lease back the buildings until 2022 at a dollar per year for each building, accounts for the difference between the $90.7 million and the $140 million NPV included in Option C. It asserts that the purchasers imputed a value of $50 million in rent for the 4.5-year leaseback term in their offer, which explains the delta between the estimated and actual sales price. We note that Fannie Mae currently pays no rent for its three owned Northern Virginia buildings. If those buildings are sold and leased back, Fannie Mae will continue to be responsible for payment of taxes, insurance, and maintenance.

Reasonable people may disagree over the contours of the conservator's duty to "preserve and conserve" the assets and property of Fannie Mae while operating it in a manner consonant with the public interest. Those contours, however, cannot be stretched to accommodate the expenditure of three quarters of a billion dollars solely to implement WPS. We found no analysis that management provided to the Board or to FHFA that demonstrates that Fannie Mae's willingness to spend three quarters of a billion dollars, just to implement WPS in one location, is in the taxpayers' best interests.

In justifying its proposed move, Fannie Mae states on its website: "[a]fter extensive review and analysis, Fannie Mae determined that it would be in the best interest of the taxpayer and the company to move to a single leased facility to reduce costs and increase productivity by providing a more efficient work environment that consolidates its workforce into one location and reduces the services required to operate the facilities." Because Fannie Mae never pursued a Status Quo Option nor calculated an NPV for such an option, it lacks a basis on which to claim that its move to a single leased facility would reduce costs. As discussed previously, the cost savings projected by Fannie Mae for its Option C was based largely on the $140 million estimated from the sale of its three Northern Virginia buildings, which has now been shown to be too generous by $49.3 million.[12]

As we cautioned in our Management Alert issued in 2016 regarding Fannie Mae's proposed build-out of its new headquarters, Fannie Mae "arguably has little incentive to cabin its costs" because "any positive net worth it does not spend on itself will be swept into the Treasury as a dividend." In our view, the estimated $727 million NPV for Option C, increased by $49.3 million for the smaller than projected amount from the sale of the buildings, offset by the NPV for the Status Quo Option (which Fannie Mae never calculated), are funds that could, and should, be put to better use. A better use would include a sweep of excess funds to the U.S. Treasury as

[12] In its Management Response, FHFA argues we should have calculated an NPV for the estimated $140 million from sales of the owned buildings. We note that the Board and FHFA relied on management's projection of a $140 million sales price and did not direct management to calculate an NPV.

a dividend for the $119.8 billion investment by U.S. taxpayers, pursuant to the terms of the Third Amendment to the Senior Preferred Stock Purchase Agreement.[13]

After we learned from FHFA officials that Fannie Mae expects the sale of these buildings to close in September 2018, we asked FHFA to direct Fannie Mae to suspend its pending efforts to close the sale until FHFA reviewed the findings and recommendations of this Management Alert. FHFA promptly directed Fannie Mae, in writing, to place an "immediate hold on any actions to finalize the sale of your Northern Virginia properties until you receive further direction from" FHFA.

Unlike our prior reports on the reasonableness of build-out costs for Fannie Mae's newly leased spaces in Washington, D.C., and Plano, Texas, this report does not address the reasonableness of the build-out costs for Northern Virginia because Fannie Mae, an entity in the conservatorship of the federal government, has failed to demonstrate that consolidation and relocation into newly leased space, built out to its specifications, would be in the best interests of the taxpayers. To the extent that FHFA permits Fannie Mae to continue with its plans, we question all costs to lease and build out the space in the Boston Properties building beyond the costs for a Status Quo Option.

Conclusion and Recommendations

Fannie Mae has been in conservatorship since September 2008 and there is no current plan for it to emerge from conservatorship. As conservator of Fannie Mae, FHFA is charged with the responsibility to "preserve and conserve" its assets while operating it in a manner consonant with the public interest.

Based on the information learned during our administrative inquiry, Fannie Mae failed to demonstrate that consolidation and relocation of its Northern Virginia offices into newly leased space, built out to its specifications, would be in the best interests of the taxpayers. As Fannie Mae documents show and FHFA officials acknowledge, the sole driver of the consolidation and relocation of these offices is WPS, even though Fannie Mae did not demonstrate the reasons why this strategy should be implemented for these offices or quantify the associated cost savings in light of the actual condition of the owned buildings. For the reasons set forth in this Management Alert, we believe that the estimated NPV for Option C (increased by $49.3 million for the smaller-than-anticipated amount from the time of sale proceeds of the three buildings), offset by the NPV for the Status Quo Option (which Fannie Mae never calculated), constitutes, in our view, funds that could, and should, be put to better use.

To reduce the waste from Option C, we recommend that FHFA, consistent with its duties as conservator:

[13] Because Fannie Mae never calculated the NPV of the Status Quo Option, we are unable to determine the net amount of the funds that could, and should, be put to better use.

1. Cause Fannie Mae to calculate the NPV for a Status Quo Option, and calculate the costs associated with terminating the lease with Boston Properties; and

2. Direct Fannie Mae to terminate the lease, cancel the sale of the three owned buildings, and implement the Status Quo Option, should the NPV for a Status Quo Option and the termination costs be lower than the adjusted NPV for Option C.

Should FHFA permit Fannie Mae to continue with its plan to consolidate and relocate into newly leased space in a building to be constructed at Reston Town Center by Boston Properties, we question all costs to lease and build out the space in the Boston Properties building beyond the costs for the Status Quo Option.

To eliminate the potential waste associated with Option C, we recommend that FHFA, consistent with its duties as conservator, direct Fannie Mae to record on its books a liability owed to the Treasury for the expenses it incurs to consolidate and relocate into leased space at Reston Town Center, built out to its specifications. In the event Fannie Mae emerges from conservatorship, FHFA should require Fannie Mae to pay Treasury in full for this liability before dividend payments are made to private shareholders.[14]

[14]FHFA takes issue with this recommendation, arguing that recording the cost of the consolidation and relocation as a liability is inconsistent with generally accepted accounting principles (GAAP). However, it fails to explain the basis in GAAP for its argument and we are unaware of any such basis.

APPENDIX A: FHFA's Response to OIG's Alert and Recommendations

Federal Housing Finance Agency

MEMORANDUM

TO: Laura S. Wertheimer, Inspector General

FROM: Melvin L. Watt, Director   for MLW

SUBJECT: Response to Draft Management Alert – *Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce*

DATE: August 31, 2018

The essence of the dilemma posed by this draft Management Alert to be issued by the Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG) is captured in the following first two sentences of the Alert's Executive Summary: "Since September 2008, Fannie Mae has been under the conservatorship of the federal government. Currently, there is no plan by which it will emerge from conservatorship in the near future." The entity that possesses the authority to act for the federal government during this protracted conservatorship, and which by virtue of its day-to-day engagement and statutorily mandated conservator role is in the best position to make and approve business judgments to ensure the effective ongoing operations of the Enterprises, is FHFA.

While there are a number of factual and analytical flaws in the draft Alert, some of which are discussed below, key to the conclusions in the OIG's Alert are two faulty premises:

1. That Fannie Mae should operate in a state of suspended animation, and avoid affirmative management decisions of the type responsible management officials of ongoing business entities make, while it remains in a conservatorship of uncertain duration; and
2. That the OIG, rather than FHFA, has the prerogative to determine what management decisions can be responsibly made by Fannie Mae during this protracted period of conservatorship.

As noted in this Alert, this is the fourth OIG report/alert on FHFA's oversight of Fannie Mae's workplace consolidation program. Unfortunately, these faulty premises have been advanced in each of these OIG reports/alerts. While FHFA agreed to and fully implemented the constructive process and oversight recommendations made by the OIG in the first of these reports/alerts dated

1

June 16, 2016, including the retention of an independent subject matter expert to review the projects and advise FHFA, we have consistently taken issue with many of the facts, unsupported assertions and conclusions in each of these reports. We have also consistently objected to the OIG's attempts to "substitute its judgments for legal judgments and decisions made and approved in good faith by FHFA as conservator." (See Management Response dated September 27, 2017.)[*] We again respectfully object to the OIG's attempt to do so in this Alert. The notion that the OIG is authorized to substitute its judgment and attempt to make management decisions, in place of FHFA as conservator, on questions such as whether Fannie Mae may implement a particular Workplace Strategy is dramatically inconsistent with and beyond any reasonable interpretation of OIG legal authority.

As I did in my Management Response dated September 27, 2017, I again fundamentally disagree with the interpretation in this Alert of FHFA's statutory responsibilities as conservator, and I especially disagree with the OIG's view of the standards FHFA is required to apply in fulfilling its obligations to "preserve and conserve" conservatorship assets. Under the Housing and Economic Recovery Act of 2008, FHFA's responsibilities as conservator include both the obligation "to carry on the business of the [Enterprises]" and the obligation to "preserve and conserve the assets and property of the [Enterprises]." The draft Alert fails to fully acknowledge FHFA's statutory responsibilities to carry on the business of the Enterprises. Nor does it recognize or attempt to reconcile FHFA's obligation to balance these statutory responsibilities throughout our work as conservator. The draft report also fails to recognize the substantial legal authority supporting FHFA's right to use its own judgment to make decisions about that balance.

In addition to the faulty premises underlying the Alert, its analysis and conclusions reflect a fundamental misunderstanding of the valuable lessons that Fannie Mae and FHFA took from the experiences of private-sector firms in the implementation of lean management strategy, workspace design, and the net present value (NPV) analysis that informed our decision.

Fannie Mae's Workplace Strategy, which supports its business management strategy discussed below, was initiated in 2013 in response to the need to address a large, dispersed portfolio of owned, leased, and subleased office buildings across the nation, including many with aged and outdated infrastructures that did not support technology advances needed for operational security, resiliency, and sound operations or collaborative and efficient use of workspaces. In response, Fannie Mae, in consultation with FHFA, conducted extensive analysis and decided on a Workplace Strategy that would simplify its real estate portfolio and support its business

[*] Included in FHFA OIG's September 28, 2017 Special Report.

strategy featuring an integrated, collaborative, and cost-efficient work environment. In recognition of the uncertainty regarding the future state of housing finance reform and its uncertain role in that future state, the plan also included a priority for leased workspace that would facilitate expansion or contraction of the business in the future.

Fannie Mae's business management strategy (way of working) is the implementation of "lean management" principles, the benefits of which are documented in *The Lean Management Enterprise, McKinsey and Company, 2014* among others. Lean management strategy, which can include smart approaches to the configuration and planned use of office space, is not simply open-plan office space, the focus of the studies cited in the draft Alert. It is a best practice management strategy for staff organization and functions among technology companies and major financial service and other large firms that makes extensive use of a teamwork structure, including the use of a "customer service team" model that brings together a broad range of expertise in one group to provide high quality customer service. After extensive study over several years and testing through pilots, Fannie Mae decided in 2016, in consultation with FHFA, to implement the lean management strategy company-wide. While the McKinsey report referenced above includes examples of productivity gains and significant savings in similar firms, Fannie Mae's experience with lean management from its piloting of the approach indicated that it, too, would directly benefit from this organizational and functional approach. In its customer service team pilot, Fannie Mae's Net Promoter Score – a measure of customer satisfaction – rose from the third decile among similar firms to the top decile, it reduced staffing by 10 percent, and its employee engagement scores rose by 16 percent.

The northern Virginia consolidation and relocation of Fannie Mae's workspace reflects the continued implementation of the integrated workplace and lean management strategies it has adopted company-wide. Fannie Mae's northern Virginia staff is almost exclusively operations and technology, and its current workspaces are in four noncontiguous buildings spread across eight miles in a heavily congested traffic corridor that impedes efficient and effective team deployment and interaction. In fact, Fannie Mae's current dispersed physical workspaces in northern Virginia require staff to drive to other buildings to collaborate and runs directly contrary to the lean management strategy that Fannie Mae has adopted company-wide. The new consolidated space is designed to increase collaboration, productivity, and innovation among team members by providing team-structured spaces but fewer individual offices (24 vs. the current 422). The company and FHFA expect that implementation of the lean management strategy will produce significant benefits for Fannie Mae and for the taxpayers from lower real estate costs and higher productivity.

The Alert's conclusion that there was no "action forcing" event and that Fannie Mae could stay in its existing space – the OIG "status quo" option – ignores factors and property conditions that had to be addressed. First, Fannie Mae's current northern Virginia offices are at 97 percent of capacity, with three of the four locations over 100 percent of capacity. As a result, when a team grows, its new members must be accommodated where there is space even if it is in a different building, reducing team efficiency and effectiveness. These are real costs.

Second, Fannie Mae's current buildings range from 21 to 31 years old and would need major investments to remain viable for the future. Based on third-party evaluations, these buildings require replacements of HVAC systems, elevators, lighting systems, flooring, roofing, fire alarm and fire sprinkler systems, back-up emergency power generation equipment, and food service equipment; restroom renovation; updated technology and electrical infrastructures; and structural concrete, waterproofing and exterior repairs. Some of these repairs and renovations would require staff to relocate to swing space and then move back after renovations are completed. The costs of anticipated repairs and renovations, not including the productivity losses Fannie Mae would experience, would be substantial and were considered by Fannie Mae and FHFA in assessing the NPV for the Stay option.

Third, the lease on Fannie Mae's Reston Crescent building was due to expire in 2020. Fannie Mae was able to extend the lease only through 2022 and only with restricted parking rights. While the owner's plans to further develop that site are uncertain, based on the lease terms provided, we believe that Fannie Mae likely would have had to relocate staff from that building under any option, and certainly we cannot assume that Fannie Mae could stay.

The Alert reports that several FHFA staff members acknowledged that Fannie Mae could continue to operate out of its current northern Virginia offices "for the indefinite future" without significant costs for repair and without negative impact on operations. We are uncertain how these exchanges and the underlying assumptions were expressed or what time period was being referred to, but in any case, the conclusion applied to the indefinite future was either misstated by FHFA staff or misunderstood by FHFA OIG.

Both FHFA and Fannie Mae, however, did consider Option A – reconfiguring and renovating the existing three Fannie Mae-owned buildings, including conducting an NPV analysis of the cost of "the use of existing assets" – which the draft Alert suggests was not considered. In considering this option, FHFA had Fannie Mae also calculate NPVs for more limited building improvements and for continuing to own their buildings using the same 15 year planning horizon. Significantly, not only did these variations on Option A fail to produce an NPV more favorable than the chosen option to consolidate and relocate (Option C), they also failed to address the other important business objectives: space consolidation and elimination of commutes between offices, space growth and shrinkage flexibility, proximity to the Metro, and the ability to attract and retain talent. Of course, the NPV analysis does not include benefits that are difficult or impossible to quantify. Thus, the NPV calculations did not include the efficiency, effectiveness, and innovation benefits of all these factors, nor of lean management, or take into account the productivity that would be lost if staff were displaced in order to facilitate renovation of their current office space. That these factors were not included does not mean that they do not exist. In sum, the analysis of the option to reconfigure and renovate the existing spaces for use over a 15 year horizon supported a conclusion that consolidation and relocation was the better option both from a cost (NPV) and a functional perspective.

The draft Alert also makes an extremely misleading and inflammatory statement (pages 4 and 16) that Fannie Mae is spending "three quarters of a billion dollars [$750 million] solely to implement" its workplace strategy in northern Virginia. This is flatly incorrect. The NPV analysis for Option C captures costs related to the option over a period of 15 years. This includes rent and operating expenses and one-time build-out costs, less the estimated proceeds from the sale of the three buildings Fannie Mae currently owns in northern Virginia. The comparison the OIG is trying to make between its "status quo – repairs only option," which FHFA has concluded is irresponsible, and the consolidation and relocation Option C, which FHFA concluded is the best option, would be the difference between the NPV of those two options, <u>not</u> the difference between the NPV costs for Option C and zero.

The draft Alert also missteps in treating the $140 million estimated value of Fannie Mae selling its buildings in 2022 as if it were 2018 dollars. The NPV analysis FHFA and Fannie Mae used applied a four percent discount rate to ensure all values in the NPV analysis were comparable. Corrected, the 2022 estimated value of the sale in 2018 dollars would be $117 million, $23 million less. Thus, by selling now, instead of speculating on future value, Fannie Mae is receiving $26 million less (not $49 million less, as suggested in the draft Alert) than the 2022 estimated sales price. The $91 million sales proceeds will be available for dividend payment to Treasury in 2018 shortly following the sale, a substantial benefit to taxpayers. Nor do the reduced proceeds affect the conclusion of the NPV analysis that Option C had the lowest cost.

The decision to allow Fannie Mae to consolidate into a single building in northern Virginia was fully consistent with FHFA's conservatorship obligations. It is our expectation that it will result in a more effective and efficient organization that will benefit the housing finance system and the taxpayers in the following ways, among others:

- It will significantly reduce the costs of operating Fannie Mae relative to its current multi-building northern Virginia footprint by millions of dollars;
- It will decrease the square footage of Fannie Mae's northern Virginia workplace and result in more efficient use of space;
- It will allow the company to continue to implement lean management, a new way of working with significantly fewer individual offices and more common, shared space that enables Fannie Mae teams to work in a more collaborative and efficient environment;
- In light of the uncertain future of Fannie Mae under housing finance reform and the uncertain timing of reform, it will allow Fannie Mae to conduct its business efficiently and effectively while it operates in conservatorship and will maximize the opportunity to reduce square footage in the future if that becomes necessary; and
- The consolidation of functions in northern Virginia will allow Fannie Mae to improve efficiency through the use of upgraded and updated technology, compete for and retain highly skilled employees in the financial services industry, and enable it to more effectively serve its customers. Successful management of the critical business functions that are executed by workers in northern Virginia is essential to the successful operations of the company while in conservatorship.

FHFA has made and approved decisions regarding Fannie Mae's operations in northern Virginia in good faith and with what we deem to be appropriate oversight consistent with the commitments made in response to the OIG's June 16, 2016 Management Alert and our statutory obligations. We believe the OIG's status quo option is ill advised as it would preclude Fannie Mae from implementing its lean management strategy throughout its organization and would result in an inconsistent approach across Fannie Mae's business operations. In addition, forcing Fannie Mae to maintain the status quo in four separate buildings subject to capacity limitations in northern Virginia and letting its operations, technology, and facilities become outdated until it someday emerges from conservatorship would be both inefficient and disruptive to the effective management of the Enterprise and create risk of cascading negative effects to the market. We, therefore, respectfully decline to agree to the first recommendation made in this OIG Management Alert.

Further, because we believe that the status quo option is ill advised and contrary to FHFA's statutory obligations to conserve and preserve the value of the Enterprise and to protect the ability of the Enterprise to carry out its critical role in the housing finance system, we strongly disagree with the conclusion that Option C constitutes waste or provides a basis for questioned costs beyond the costs of the status quo option. The recommendation that FHFA should direct Fannie Mae to record a liability on its books owed to the Treasury is contrary to our conclusion that the Option C approach should prove to be beneficial to Fannie Mae's operations and thus to taxpayers. We believe the recommendation would also be inconsistent with generally accepted accounting principles. We, therefore, also respectfully decline to agree to the recommendation.

cc: John Major, Internal Controls and Audit Follow-up Manager
Larry Stauffer, Acting Chief Operating Officer