

The *GSE* REPORT

International "GSEs"

- *South Africa Eyes Securitizations for Township Mortgages:*
 - A complicated process created by international capital markets may be coming to the aid of poor blacks in South Africa's poverty-stricken townships and squatter camps. South Africa's National Housing Finance Corp. (NHFC) is studying the securitization of home loans to township customers in a bid to coax banks to lend to disadvantaged communities. Half of South Africa's estimated eight million households have extremely limited access to home finance with little prospect of this improving while the banks see little hope of making a profit from this low-end lending. NHFC Senior General Manager David Porteous believes that one solution is for the NHFC to buy the loans from the banks to remove the risk from the banks' balance sheets – then repackage them into bonds and sell them to investors. The interest payments made by the homeowners on the *loans are collected together and used to service the coupon payments to bond investors, although the responsibility for meeting the payments – the credit risk – would be the NHFC's alone. A small deal was done in South Africa in the early 1990s, but it has not been attempted since – one reason being that the country's central bank places heavy restrictions on the institutions that can issue such a security.
 - The NHFC is a quasi-government organization mandated to seek new and better ways to finance low-cost housing. The NHFC aims to bridge the gulf by intermediating its own credit-worthiness – using securitization to reach an otherwise remote group of investors and easing the burden on government by bringing in private finance. In effect, the NHFC sponsors the creation of a secondary market in rand-denominated mortgage-backed securities secured by pools of township home loans which, on their own, no one in the financial marketplace would “touch with a bargepole.”
 - Fannie Mae has visited South Africa and “thinks the idea could fly.” “My impression is that there is a real need which the NHFC can fill...The approach they are adopting shows promise,” said Martin Levine, managing director of Fannie Mae's international housing finance service, while visiting Johannesburg recently. The NHFC is reviewing tenders from a group of domestic and international banks and hopes to pilot a debut offering by

the middle of next year. Lacking a direct government guarantee, the NHFC is unlikely to command a coveted AAA credit rating, but will aim to structure the offerings to attract a solid AA, according to Mr. Porteous. (*Reuters*, 12/19/97)

Fannie Mae & Freddie Mac

- *Consumer Advocate Ralph Nader Suggests that House Budget Committee Should Include Fannie Mae and Freddie Mac in Hearings on Corporate Welfare:*
 - In a recent letter to House Budget Committee Chairman John Kasich (R-OH), Ralph Nader stated that Fannie Mae and Freddie Mac are a “particularly fertile area for corporate welfare hearings.” Mr. Nader believes the Committee should examine the subsidies given to Fannie and Freddie. Fannie and Freddie are private corporations, but because the market perceives the securities of the GSEs as guaranteed by the government, the debt of the GSEs trades at yields only marginally above those of Treasury debt. They are exempt by statute from state and local income taxes and have a \$2.5 billion line of credit from the U.S. Treasury. Their securities are exempt from SEC registration requirements and are issued and paid through the facilities of the Federal Reserve Banks. The biggest subsidy to the GSEs is the free use of the government power to raise money. According to the CBO, about 40% of their earnings could be traced to the benefits of the government-sponsored status. Many argue that the government subsidies flow though to the nation’s homebuyers in the form of lower interest rates, but he does not believe this analysis holds up under examination. CBO estimates that the credit-enhancement subsidies from the federal government to the GSEs total approximately \$6.5 billion a year – only about \$4.4 billion of that reaches the homebuyers. According to the CBO, the GSEs are a “spongy conduit- soaking up nearly \$1 for every \$2 delivered.”
 - The government-sponsored status of the GSEs has also been a windfall for its private shareholders. CBO cited a study that found that a 1% change in the overall market is accompanied by a 1.3% change in the same direction in Fannie and Freddie stock. Using the study’s ratio, CBO found that the GSEs’ stock could have been expected to go up 45% in 1995 – but the result was much greater – Fannie ‘s stock went up 70% and Freddie’s 65%, in large part, because of the government subsidy.
 - Subsidies from the federal government also benefit the executives of the GSEs. The last CEO of Fannie Mae retired with severance benefits that exceeded \$20 million. “It is outrageous to allow a corporation to dip into the trough of corporate welfare to support such excesses.”
- *Wall Street Analyst Notes Fear that Fannie and Freddie Will Become Direct Originators:*
 - Analysts on Wall Street note that they are keeping a watchful eye on the issuance of mortgage-backed securities. Craig Phillips, managing director at Morgan Stanley, Dean, Witter, Discover & Co., cautioned that consolidation among financial firms means fewer

investors – and more originators with the sophistication and clout to bring securities directly to investors – bypassing Wall Street firms, Mr. Phillips said. In addition, he noted there is some fear that Fannie Mae and Freddie Mac will become direct originators. (*American Banker*, 12/30/97)

- *OFHEO Reports Fannie Mae, Freddie Mac Adequately Capitalized as of September 30, 1997:*
 - The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the regulator (OFHEO) to rate the GSEs as either adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. According to OFHEO, the companies are considered to be adequately capitalized if core capital – consisting of common stock, non-cumulative preferred stock, paid-in capital, and retained earnings – equals or exceeds minimum capital. The agency’s risk-based capital standard is the amount of total capital (core capital plus a general allowance to absorb projected losses flowing from future severe interest-rate and credit-risk conditions, plus 30 percent to cover management and operations risk. According to OFHEO, as of September 30, 1997, Fannie Mae’s core capital of \$13.358 billion exceeded its minimum capital requirement of \$12.315 billion by \$1.042 billion. Freddie Mac’s core capital of \$7,021 million surpassed the \$6.780 million minimum capital requirement by \$241 million. (*BNA Daily Report*, 12/31/97)
- *Typo in New Texas Home Equity Amendment Could Prevent Loans from Being Sold Into Secondary Market:*
 - Glitches in the constitutional amendment approving home equity lending may delay reverse mortgages in Texas or perhaps derail them entirely. Agencies supporting the national market in mortgage loans appear reluctant to sign off on the state’s unique approach to the loans, which allows retirees to draw a monthly income based on the value they have built up in their homes. Reverse mortgages will be expensive and difficult to find if Texas loans can’t be sold in the national market. A Vice President with Fannie Mae stated that “the two areas pose some problems broadly to Fannie Mae and to our lenders.” Fannie Mae won’t immediately accept Texas loans for resale to investors because it needs to study the state’s tougher safeguards and because of a typographical error in the amendment.
 - HUD officials are trying to reconcile the state ban on open-end lines of credit with its congressional mandate to promote that type of reverse mortgage loan. HUD is poised to reject Texas loans for its FHA insurance program (nearly half of reverse mortgages carry FHA insurance). State Senator Jerry Patterson (a sponsor of the home-equity bill) thinks the typo can be fixed. The amendment intended to give lenders the right to call a loan if the home is unoccupied for six months or the borrower disappears. The typo, substituting the word “and” for “or,” requires both conditions in order to call a loan. State Senator Patterson thinks the attorney general can issue an opinion clarifying the Legislature’s intent. Patterson introduced a separate bill in the Senate to authorize reverse mortgages. “The House in its consumer-protection, sky-is-falling mode put them {the extra

safeguards} back in the general bill,” Patterson said. The House adamantly opposed home-equity lines of credit. Instead, reverse mortgage lenders in Texas must send regular monthly checks to homeowners for as long as they live in their homes. In both cases, lenders get their money back when the home is sold. Mortgage experts say that 80% of reverse mortgages nationwide are set up as lines of credit or fixed monthly payments. Attorneys exploring the conflict don’t think that HUD can resolve it. Texas lenders may be able to argue that federal law takes precedence over state law. The 5th Circuit Court of Appeals reached that decision in 1994, but former U.S. Rep. Henry Gonzales (D-TX), passed a law requiring Texans to vote first to authorize home-equity lending. In the meantime, retirees are being turned away. A manager at Fort Worth Mortgage reported that they “were able to write those types of loans. The problem is going to be finding investors to buy them from us.” According to Michael Hernandez, a VP with Fannie Mae, “until we can study the problems very thoroughly and figure out how we can work around these areas, how we can redo them, we won’t have a decision. It probably won’t go out January 1.” (*The Fresno Bee*, 12/21/97)

- *Public Policy Consultant Compares Concerns Against Fannie and Freddie to Concerns Against Microsoft:*
 - In an *American Banker* article reporting about bankers’ fears of Microsoft, public policy consultant Bert Ely, compares the fears held against Microsoft to those held against Fannie Mae and Freddie Mac. Mr. Ely believes that bankers are reluctant to risk being associated with any “anti” effort. He feels that banks are a highly regulated industry that are fearful of alienating highly powerful forces. The federal mortgage agencies Fannie Mae and Freddie Mac are in that category, he said. “Whatever you think of them, you still have to do business with them.” (*American Banker*, 12/30/97)
- *Fannie and Freddie’s Credit Scoring System May “Inadvertently” Redline:*
 - The Greenlining Institute, a community rights organization in San Francisco, announced that the state’s economy has improved, but Latino and black families are getting fewer conventional loans. The problem is not overt discrimination by lenders, but the flawed credit-scoring system that reviews credit cards, auto loans and other debt history. The two main providers of the credit-scoring systems are Fannie Mae and Freddie Mac. The Institute’s general counsel Robert Gnaizda says that, if borrowers fall short on the Fannie Mae and Freddie Mac credit-scoring systems, lenders won’t make the loans for fear that they won’t be able to sell the loans into the secondary market. That, he said, results in lenders “inadvertently” redlining. For that reason, the Greenlining Institute is calling for a one-year moratorium on credit scoring so lenders can find an alternative that would boost minority home ownership. Angelo Mozillo, chairman of Countrywide Home Loans, echoed the Institute’s concerns. “I have serious concerns about all this,” he said, adding that the scoring formulas “leave out the most important ingredient: an individual’s motivation and what sacrifices will be made by them.” But Fannie Mae and Freddie Mac defended their systems and objected to the idea of a moratorium. “We never use credit-scoring as a single tool, and we don’t expect our lenders to use it as a single tool,” said

Barry Zigas, an executive vice president at Fannie Mae. (*San Jose Mercury News*, 12/24/97)

Fannie Mae

- *Fannie Mae to Launch New “Benchmark Note” Issues in 1998; Fannie Mae Hopes these Non Callable Securities Will Be An Alternative to Treasurys:*
 - Fannie Mae announced that starting in January it would offer large issues of intermediate non-callable notes every quarter, subject to market conditions. The company expects the new issues, called Fannie Mae Benchmark Notes, to be \$2 billion to \$5 billion in size. Furthermore, Fannie expects that close to half of its anticipated \$80 billion in long-term debt issuance in 1998 will be in non-callable securities. This level of non-callable issuance will allow Fannie Mae to build a yield curve of Benchmark Notes. Fannie Mae anticipates that Benchmark Notes will become its preferred method of non-callable debt issuance, superceding other distribution methods.
 - Government agency debt outstanding now is more than \$1 trillion and rising. This figure is less than new issuance because the bulk of new agency debt is short term. U.S. Treasury debt outstanding is about \$3.5 trillion and slowly declining. Fannie Mae’s debt issues are directly related to its needs in funding the growth of its mortgage portfolio, which has been expanding about 15% a year.
 - Fannie Mae’s new benchmark notes program hopes to offer investors and dealers an alternative to Treasurys. Fannie Mae’s announcement of its new program met with predictions from investors and traders that the new securities would likely be met with hot demand. But they also cautioned it will be some time before buyers and sellers alike treat the bonds as alternatives to Treasurys, even though the supply of new Treasurys has declined along with the shrinking federal deficit. “We certainly have seen and expect to continue to see a reduction in Treasury borrowing activity,” said Linda Knight, treasurer at Fannie Mae. She added that she expects the large size of Fannie Mae’s planned new issues make them easier to trade, enhancing the status of the securities as surrogates for U.S. Treasurys. “It’s a pretty intriguing idea from Fannie Mae,” observed James Keller, portfolio manager at the Pacific Investment Management Co., the largest bond fund manager in the U.S. “In the long term, they could step in where the Treasury is cutting back.” But investors and dealers cautioned Fannie Mae still has a way to go to match the advantages of size and the U.S. government guarantee offered by the Treasury market. “These could almost be a Treasury surrogate. But one must remember that a corporate bond can never be as efficient as a Treasury,” said Donald Devine, head of syndicate and investment-grade trading at Credit Suisse Boston.
 - Perry Beaumont, a managing director at Salomon Smith Barney, believes that the Fannie Mae benchmarks have another edge over Treasurys - Fannie Mae is selling global issues to attract investors worldwide. Nearly one-third of these are denominated in currencies other than the dollar, he says. “These global offerings are very large, and they are bought

by foreign financial institutions and central banks.” An agency’s global debt may be a better benchmark in places like Europe, which is moving toward a single currency, the Euro. In this case, Fannie’s debt “can go places and do things that Treasurys either cannot or will not,” Beaumont said. Besides issuing debt in foreign currencies, Fannie Mae can allow the foreign currency debt to be swapped back into dollars. According to Fannie Mae Treasurer Linda Knight, global benchmarking is a bit ambitious. But global demand for Fannie Mae debt has been good and broadly distributed. “It’s possible we could sell about a third outside the U.S. this year,” she said. “We have a good following among central banks. (*Business Wire*, 12/15/97; *Investor’s Business Daily*, 12/19/97; *Wall Street Journal*, 12/16/97)

- *A Former Congressman, A Former Chief of Staff for Gov. Dukakis and A Former ED of Kansas City Neighborhood Alliance Were Named to Fannie Mae Foundation Board:*
 - Floyd Flake, John Sasso and Colleen Hernandez were recently appointed to the Fannie Mae Foundation Board of Directors. Mr. Flake was the U.S. Representative for New York’s 6th Congressional District. (Before his retirement from Congress, former Congressman Flake served on the U.S. House Banking Committee and was a Member of the Capital Markets, Securities and Government Sponsored Enterprises Subcommittee and the Domestic and International Monetary Policy Subcommittee.) John Sasso joined the Fannie Mae Foundation Board in September 1997. Mr. Sasso is the President of Advanced Strategies, a consulting firm specializing in public affairs and communications where he advises corporate executives on business strategies, government relations and public policy. Mr. Sasso was Chief of Staff to Massachusetts Governor Michael Dukakis and has held various senior positions in the 1980 and 1984 presidential campaigns. Colleen Hernandez is the Executive Director of the Kansas City Neighborhood Alliance, a nonprofit organization that creates solutions to the problems of neighborhood stability and the shortage of affordable housing. She served as the Chair of the Consumer Advisory Council to the Federal Reserve Board of Governors in 1992. (*PR Newswire*, 12/18/97)
- *Fannie Mae Lenders Team Up to Fight Bias:*
 - Fannie Mae is teaming up with Cobb Housing, Inc., First Southern Bank Mortgage Services and Wachovia Mortgage Co. to combat discrimination in mortgage lending. It is part of Fannie Mae’s efforts to improve the availability of funds to underserved markets. Nationwide, Fannie Mae is working with the Mortgage Bankers Association of America and local lenders. The lenders serve as mentors, usually to women-and-minority-owned lenders in underserved markets. Cobb Housing, however, is the first nonprofit housing organization to participate in the project. Participation will enable Cobb Housing to access the secondary lending market and services, increasing the options available to potential home buyers and lowering requirements for down payments. (*Atlanta Journal*, 12/12/97)
- *Fannie Mae Ranked as One of the 100 Best Companies to Work For:*

- In a new *Fortune* magazine survey of the 100 best companies to work for, Fannie Mae was ranked number 76. *Fortune* surveyed 238 firms that had been in business at least 10 years and had at least 500 employees. Each company distributed a 29-page questionnaire to 250 randomly selected employees. Benefits of working at Fannie Mae include on-site backup care center for children, on-site exercise classes, free annual health check, \$5,000 adoption aid, and ten paid hours every month for community work. (*Washington Post*, 12/22/97; *Fortune Magazine*, 1/12/98)
- *Fannie Mae Underwrites Loans to Credit-Impaired Homebuyers:*
 - Fannie Mae has teamed up with San Francisco-based Union Bank of California and the Consumer Credit Counseling Service in Santa Clara County and Los Angeles to offer \$6.5 million in loans to consumers with sketchy credit history. The 2,000 members that have been active for at least 18 months in CCCS' local debt-management and counseling program and those clients that have "graduated" from the program within the past year will be eligible for those funds. Under Fannie Mae's standard underwriting and credit guidelines, such consumers normally would not be eligible to apply for a mortgage for one to two years after exiting a debt-management program. The funds will be issued by Union Bank and underwritten by Fannie Mae. Fannie Mae has introduced the program in 13 other cities within the past 90 days. Participants in the new program must complete a four-hour homebuyer education course before their purchase, followed by 12 months of post-purchase counseling. (*Business Journal*, 12/15/97)
- *Netstock Direct Offers Fannie Mae's Newly Available Direct Stock Plan Online:*
 - Fannie Mae is the newest addition to the list of companies offering direct stock plans online with Netstock Direct. Fannie Mae's new Direct Stock Plan represents the 38th company to provide online access to their Direct Stock Plan through Netstock Direct, an online channel for direct investment companies. (*Business Wire*, 12/15/97)
- *"The Simpsons" TV Show Includes an Inaccurate Description of Fannie Mae in a Jingle:*
 - Fannie Mae's quest for new markets has led this year to reverse mortgage programs, higher loan limits, minority programs, and lesser-quality mortgages. Now, Fannie Mae has entered the cartoon city of Springfield, home of "The Simpsons" show family. And there, the secondary market agency has an even bigger role in fostering homeownership than in the real world: It "backs the banks." The Fannie Mae reference was included in a jingle sung by the Simpson family when Mrs. Simpson was training for her real estate license. Fannie Mae spokesman Gene Eisman, whose job is to head off inaccurate or muddled notions of Fannie Mae's role, let this reference slide. "It's great to receive that kind of attention," he said. "They gave a nod to Fannie Mae for the help it supplies." (*American Banker*, 12/16/97)
- *Fannie Mae Predicts Economy Will Slow but Mortgage Activity High in 1998:*

- Fannie Mae announced at a presentation on the economy and the mortgage markets that the U.S. economy would slow next year partly because of the Asian crisis and partly due to slower spending, but mortgage activity would remain strong because of refinancings. Mortgage markets are likely to “continue to power ahead at levels that are outstanding,” said David Berson, vice president and chief economist. Mr. Berson said he thinks the economy and housing market will be solid in 1998 – but doubts they will be as strong as this year. “We probably will continue to see a good economy and a good housing market,” he said, while adding, “but not quite a record.” Originations are expected to increase 6.5% next year to \$878 billion, despite modestly slowing home sales. Mr. Berson’s prediction of over \$875 billion in 1998 compares with an estimated \$825 billion for 1997. (The industry had its best year in 1993 when originators produced \$1.01 trillion in loans.) Of the \$875 billion expected for next year, \$550 billion will be purchase-money loans. However, the increase in production will be fed by the current spate of refinancings – which spells both good and bad news for lender/servicers. Refis now account for 44% of all loan applications. Mr. Berson also predicted strong homebuying in California, the Pacific Northwest, Arizona, Idaho, Georgia, and North Carolina. (*Dow Jones*, 12/16/97; *American Banker-Bond Buyer*, 12/17/97; *National Mortgage News* web site, 12/29/97)
- Fannie Mae Contributes to Redevelopment of Historic Baltimore Warehouse into Site for Information-Technology Firms:*

 - The old American Can Co. factory in Baltimore is being redeveloped into an “incubator” for emerging information-technology firms. Slated to open by mid-1998, the Emerging Technologies Center is expected to house up to 80 tenants in the information-technology field. As an “incubator,” the center will offer tenants breaks on rent and other administrative costs to foster growth and encourage the firms to stay in the Baltimore area. The site is being redeveloped at a cost of \$22 million, financed with a loan from Riggs Bank, help from the Enterprise Social Investment Corp., and the Fannie Mae American Community Fund. Another \$3 million of public funding is also being spent to build the incubator. (*Baltimore Business Journal*, 12/22/97)
- Fannie Mae Foundation Helps Family Repair Roof for Holidays:*

 - The Fannie Mae Foundation and Christmas in April joined efforts to repair the roof of a family in Washington, DC for the holidays. The Foundation is covering the cost of the roof repairs and has donated gift certificates, food and Christmas presents to the family. Since 1985, the Foundation has given grants totaling \$140,000 to support Christmas in April’s local efforts. (*PR Newswire*, 12/22/97)
- Fannie Mae Contributes to Ronald McDonald House in Fairfax, VA:*

 - A new Ronald McDonald House will be opening in January in Fairfax, VA. The Ronald McDonald House provides temporary housing for families who have children with serious illnesses. The 10,000 square foot facility will be near Fairfax Hospital. Most of

the \$2 million in construction costs were donated by local businesses, including Bell Atlantic Corp. and Fannie Mae. (*Washington Business Journal*, 12/22/97)

- *Fannie Mae Foundation and San Antonio Spurs Help to Construct New Homes:*
 - The San Antonio Spurs Basketball team and the Fannie Mae Foundation helped build two new homes in San Antonio's Eastside neighborhood. The construction crew included Spurs players along with staff and volunteers from the Foundation and Neighborhood Housing Services (NHS). The effort was part of the Fannie Mae Foundation's "Home Team" partnership with the San Antonio Spurs which began in 1993 and has provided more than \$375,000 to help NHS construct or landscape 20 homes in San Antonio's Southside and Alamodome neighborhoods. This recent project was made possible by a \$75,000 grant from the Fannie Mae Foundation and a \$15,000 donation from the Spurs. (*PR Newswire*, 12/19/97)
- *Fannie Mae Factoid: 90% of People Decorate their Homes for Holidays:*
 - According to a recent Fannie Mae poll, only 10% of the respondents said they don't decorate their homes for the holidays. But of those who do, more than half (56.6%) said they start with the living room, followed by 13.4% who start with the front door, and 9.0% who start in the family room or den. The Fannie Mae factoid is a monthly poll by Fannie Mae designed to provide consumer insight on a variety of current topics related to the home and family. (*Business Wire*, 12/12/97)

Freddie Mac

- *Freddie Mac, First Union Launch \$407 Million Subprime Issue:*
 - Freddie Mac has dramatically increased its presence in the subprime mortgage market, assisting in a \$407.4 million securitization last week by First Union Capital Markets Corp. The offering, backed by more than 7,500 first and second mortgages originated or acquired by divisions of First Union, is its largest subprime securitization with Freddie Mac. Observers said the deal signals the advent of a wider market for riskier loans. Freddie Mac's involvement sweetens the deal for First Union and for investors because Freddie's implied government connection provides a sense of security. "For investors, that's an important issue, particularly right now with the nervousness investors have with regard to some of the riskier products," said David Dale-Johnson, associate professor of finance and business economics and director of the program in real estate at the Marshall School of Business at the University of Southern California.
 - To package its loans for investors, First Union created a security, which it swapped for a Freddie Mac security. First Union Capital Markets then sold the Freddie Mac certificates to investors. First Union Capital Markets and Lehman Brothers completed Freddie Mac home equity securitizations for \$260 million in August and for \$234 million in May. This most recent offer of Real Estate Mortgage Investment Conduits, or REMICs,

included primarily A-minus and B loans, with some C and D mixed in. Wesley Jones of First Union, said the transaction traded “approximately 6 to 7 basis points tighter than private-label securitizations have been trading.” (*American Banker*, 12/16/97)

- *Freddie Mac to Slash REMIC Fees by \$120K:*
 - Freddie Mac, in a bid to boost its share of the market, has sharply cut its guarantee fee it charges dealers structuring Real Estate Mortgage Investment Conduits (REMICs) that pool Freddie Mac loans, market sources said. A spokesman for Freddie Mac declined to comment on reports that it had cut the fees charged to investment banks to \$30,000 from \$150,000 on REMIC transactions of \$500 million or greater. The \$120,000 fee cut applies only to deals that are priced in December and settle in January, according to market participants who characterized the fee cut as “pretty aggressive.”
 - Sources said Freddie Mac probably slashed its fee to build up support for its mortgage securities. Freddie Mac is “trying to gain market share and this allows them to advertise their success in guaranteeing REMIC issuance,” said one Wall Street source involved with structuring REMICs. The agency appears to now be guaranteeing REMICs at its own expense. One market observer said the reduced fee Freddie Mac is charging “does not appear to be enough to cover the costs incurred by Freddie Mac for issuing and administering the transactions.” “In a sense, Freddie Mac is subsidizing the dealers to put transactions together,” he said. A market observer at a New York firm involved with REMIC structuring said Freddie Mac was “trying to make dealers indifferent as to whether they (the dealers) will use Gold PCs or Fannie Mae collateral for REMICs.” The fee cut was part of an economic incentive, he said. “It is a tact concession there is a difference in the (value of) collateral” between Fannie Mac and Freddie Mac, said the observer. Meanwhile, the observer said Fannie Mae reportedly refused when asked by dealers to match the fee cut. A Fannie Mac spokesman declined to comment on the agency’s REMIC fees. A market participant with a New York firm said that the fee cut is welcome because assembling deals in recent market volatility has been difficult. He noted concern about prepayments that have eroded demand for mortgage-backed product. (*Reuters*, 12/12/97; *American Banker-Bond Buyer*, 12/15/97)
- *Freddie Mac Sees Its Second Best Month:*
 - Freddie Mac purchased \$11,83 billion worth of loans in November, its second best month of the year and a 29% increase from the same month last year. Fixed-rate 30-year purchases jumped by 38% while 15-year acquisitions were up 66%. Through November, it has bought \$104 billion worth of product, but the company likely will not match 1996’s purchase volume of \$128 billion. However, the months ahead should be good for Freddie Mac and Fannie Mae, as refinancings swell and the new home buying season gets under way. (*National Mortgage News* web site, 12/29/97)

Federal Home Loan Banks

- *Federal Housing Finance Board Limits Debt Issuance Authority to Study FHLBanks' Investment Practices:*
 - The FHFBB voted on December 17th to extend its 1998 debt issuance authority for three months to determine how the agency's current methods of raising cash in the nation's capital markets affect the FHLBanks' investment strategies. The FHFBB put the FHLBank System's borrowing on a short leash, after being told the system has issued some \$1.5 trillion in short-term debt in the first nine months of this year. The board voted to continue the Home Loan Bank System's borrowing authority only through March 31, 1998, but indicated it would likely be extended before then but probably with limits. The shorter debt issuance authority is intended to give the finance board time to review how a previous decision to remove all limits on the agency's authority to issue debt had coincided with a dramatic increase in money market investments by the FHLBanks. The proportion of non-mission-related investments on the FHLBanks' books has raised concern in Washington, and has led to persistent questions of whether the system is properly carrying out its statutory mission, or taking advantage of its government agency status to borrow and lend at preferred rates for profit-making purposes. As a result, the Finance Board has become concerned that short-term debt issued by the FHLBank System has become a preferred way for the FHLBanks to finance investments in assets unrelated to their mission, such as short-term money market funds, which have a higher return than mission-related advances to member institutions.
 - FHFBB Chairman Bruce Morrison encouraged the FHLBanks to invest in more assets that support the statutory mission of facilitating the availability of housing and community development financing. Mr. Morrison urged the FHLBanks to refocus their investment strategies on mission-related assets at a time when lawmakers on Capitol Hill have openly questioned whether the system still serves a useful public purpose in today's housing market. Critics charged that the FHLBanks invest too many assets in non-mission-related investments, such as short-term money market funds. By extending the 1998 debt issuance authority until March 31, the finance board plans to study the extent to which the FHLBanks are using money raised in the capital markets to purchase non-mission-related investments, rather than for local housing and community development projects (*BNA*, 12/18/97; *Dow Jones Newswire*, 12/18/97)
- *FHFBB Chairman Believes that the Home Loan Banks Still Play a Vital Role:*
 - Bruce Morrison, Chairman of the Federal Housing Finance Board, believes that the FHLBanks have not outlived their purpose. In a comment letter to the American Banker, Mr. Morrison outlined his conclusions about the system's role now and in the future:
 - The Home Loan banks provide competition in housing finance, by funding residential mortgages through member institutions. He acknowledged that the secondary markets have developed and altered mortgage finance in irreversible and efficient ways, but with their enormous concentrations of credit risk (\$1.4 trillion in residential mortgages held or guaranteed by Fannie and Freddie), they can also "spring a leak, a leak taxpayers will be

unaware of until the government is called upon to build an ark.” The Home Loan banks compromise a triple-A-rated system that offers healthy competition to Fannie and Freddie. In defense of the Chicago pilot program, Mr. Morrison stated that “by finding more appropriate ways of allocating market risk among the players in mortgage finance – which is what the Chicago bank’s pilot most obviously represents – the system can provide mortgage lenders with a new choice, and that can lead to lower costs to homebuyers.”

- The System may be the last, best hope for maintaining the viability of small institutions. Consolidation of banks and dwindling deposits may cause a crisis. “Without local institutions, smaller local borrowers will have little choice, and local communities may die.” In response to the problem that small institutions have in accessing the capital markets, the House Banking Committee and Senator Chuck Hagel have proposals to make it easier for small banks to become Home Loan bank members and borrowers. For institutions with assets of under \$500 million, pending legislation would (1) waive the requirement that residential mortgages make up at least 10% of assets; (2) expand eligible collateral to allow secured loans for small business, agriculture, rural development or low-income community development; and (3) expand authorization of long-term advances for these purposes. The FHFBS also issued a proposed rulemaking to address the problem of small institutions that would enable banks to reclassify some rural and urban mortgage loans on “combination properties,” as mortgages, and to use them to qualify for system membership.
- The Home Loan banks target underserved markets. The system offers institutions a way to funnel housing and community investment funds to projects that might otherwise go unfunded. GSE status provides a borrowing advantage that is intended to serve a public purpose. That advantage can be used to fund nonconforming home mortgage loans and loans for multifamily dwellings that cannot be sold into the secondary market. The FHLBanks could also add value with a new role in economic development. The FHLBanks could provide technical and funding assistance needed to put together difficult community investment deals. The Chicago pilot program “may offer a model of how to make it profitable to ‘portfolio’ economic development loans by allocating risk in a more appropriate way. The Home Loan Bank System made homeownership affordable in the 20th century; it can do the same for community development in the 21st.”
- The four pilot programs approved to date by the Finance Board have been controversial, but they are modest proposals to chart the new territories he discussed - new ways of allocating risk, new ways of providing liquidity, and new ways of funding otherwise underserved populations. The government-assisted creation of long-term fixed-rate amortizing mortgages helped bring homeownership to millions of Americans. He believes that today small businesses -- rural and urban, small multifamily projects, and local economic developments investments are the ones that can’t “pay their way.” He believes that the Federal Home Loan banks and their members are uniquely qualified to help these groups with the financial structure reengineering magic that remade homeownership opportunities. (*American Banker*, 12/29/97)

- *FHLBank of Seattle Participates in Seattle Pilot Program for Low Income Families:*
 - The Federal Home Loan Bank of Seattle, Seattle Housing Authority, Washington Mutual Bank and the Community Home Ownership Center are participating in a pilot program operating in the greater Seattle-Everett-Tacoma area. The pilot program, Home\$tart Plus, is a new program designed to move families receiving public housing assistance into homeownership. To be eligible for Home\$tart Plus, families must either live in public housing or receive Section 8 housing assistance, and sign an FSS contract with their local housing authority. Through the contract, the family pledges to complete a variety of requirements to work toward economic independence. In addition, Home\$tart Plus requires completion of homebuyer counseling and a minimum of five hours of homebuyer education. As a Home\$tart Plus family's earnings rise, its monthly rent (which is 30% of income) grows, and the housing authority directs the rent increases into an escrow account. These funds are earmarked for a downpayment on a home. Through Home\$tart Plus, the Seattle Bank matches every \$1 in a family's escrow account with \$2, up to a maximum of \$10,000, for downpayment and closing costs. The Seattle Bank set aside \$250,000 and expects to serve 25 families through the pilot program. To date, five families have purchased homes through the program. The pilot will be continued in 1998 as a component of the FHLBank of Seattle's Home\$tart Savings Program, which also provides downpayment assistance. Families throughout the region who are receiving public housing assistance may be eligible to receive a matching grant of \$2 for every \$1 saved in their escrow accounts, up to \$5,000. (*PR Newswire*, 12/13/97)
- *U.S. Senator Barbara Boxer Announces \$22 Million in Affordable Housing Grants Awarded by FHLBank of San Francisco:*
 - Senator Barbara Boxer (D-CA) announced that the FHLBank of San Francisco is awarding \$22 million to 124 housing programs in this year's Affordable Housing program competition. The grants will help create over 5,200 homes for low- and moderate-income homebuyers and renters. Most of the initiatives are located in California, with the remainder serving communities in Arizona, Connecticut, Nevada, Washington and other cities nationwide. (*Business Wire*, 12/23/97)

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