

# The *GSE* REPORT

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## ***Fannie Mae & Freddie Mac***

- *Freddie Mac Jumps into Subprime Pool; Fannie Dips a Toe in:*

### Freddie Mac

- Chairman Leland Brendsel announced that the company will begin purchasing loans to A-minus borrowers “before the end of the year” and move as far as possible into B/C credit by the end of next year or early in 1999. Mr. Brendsel downplayed the importance of the move and insisted his company’s entry was no big deal. He claims that Freddie Mac does not predict it will be a very large player since he believes the market itself to be relatively small (about \$125 billion). But others, including members of the Mortgage Bankers Association are very concerned – ranging “from concerned to scared to death,” according to Marc Smith, president of the MBA (*National Mortgage News*, 10/13/97, *American Banker*, 10/13/97).
- Freddie Mac, differing in strategy from Fannie Mae, seeks to produce a profit as well as expand homeownership. Freddie had launched a pilot program to buy home equity loans in order to get a sense of the subprime arena, and established subprime lenders are generally unenthusiastic about the government-sponsored enterprises’ venture into the market. They have historically enjoyed a wide profit spread, and fear the more competitive pressures brought upon by Fannie and Freddie’s involvement. Mr. Brendsel stated that smart subprime lenders would recognize that the industry is changing. “Those that try to create barriers from that happening are ultimately going to fail.” (*American Banker*, 10/13/97, *National Mortgage News*, 10/13/97).

### Fannie Mae

- At last week's Mortgage Bankers Association convention, Fannie Mae chairman James Johnson urged the mortgage finance industry to "try our hardest to make every loan an A loan", but admitted there will be some subprime borrowers who will not qualify for prime status. Unlike Freddie Mac who will begin purchasing A-minus loans and then move into B/C credits, Chairman Johnson said that Fannie will focus on counseling subprime (B and C rated borrowers) with the aim of turning them into A-caliber credits and buying their loans. Mr. Johnson further stated that "we never want to get to the point where consumers can say they could have qualified for a loan in the conventional market but instead were steered to the higher cost subprime market." Mr. Johnson denies that they will move to any deeper involvement. (*National Mortgage News*, 10/13/97 and *American Banker*, 10/8/97)

#### Concerns Over Fannie and Freddie in the Subprime Market:

- *Lenders Fear Fannie, Freddie Will Dominate Subprime Market:* At the Subprime 97 conference held two weeks ago in Las Vegas, lending executives expressed concern over the tremendous growth of Fannie Mae and Freddie Mac. "The voracious growth by Fannie and Freddie in recent years can't be sustained," unless they enter new markets, according to Gary Kopff, president of Heritage Management. "They can't make jumbo loans, so they're looking to see what they can nibble away from subprime...the only way that the industry could defeat Fannie and Freddie is to rise up and say that they're not needed," Mr. Kopff proclaimed. The advent of securitization has eliminated the need to rely on government-sponsored enterprises. An Irwin Capital executive added, "No one needs them to come in right now...If they're going to do this, they're going to have to play by the rules." (*American Banker*, 9/29/97)
- *Mortgage-Scoring Systems Not Necessarily Helpful for Subprime Borrowers:* According to Jennifer Schneider, an analyst with Duff & Phelps, the scoring systems utilized by Fannie and Freddie were developed using prime borrowers who have gone through credit problems, instead of traditional subprime borrowers. Thus these systems may not necessarily be useful in predicting subprime loans' performance. (*American Banker*, 9/29/97)
- *Fannie and Freddie Shift to Risk-Based Pricing of Loans:*
  - Fannie Mae and Freddie Mac have been pushing lenders toward risk-based pricing. Leland Brendsel, chairman of Freddie Mac, predicted that it would rely exclusively on risk tiers for pricing loans purchased from lenders by the year 2000. Fannie Mae is implementing tiers within its conventional loan program that is facilitated by its separate automated underwriting system. This emphasis on risk-based pricing could determine prices for subprime loans, and eventually pricing policy for the entire industry. (*American Banker*, 10/15/97)

- *Fannie and Freddie's Balloon Mortgage Product Brings Higher Delinquencies*
  - Fannie Mae and Freddie Mac have seen their balloon mortgage product produce higher delinquency rates than expected. When these mortgages were introduced seven years ago, they boasted lower interest rates and quickly became very popular. Borrowers in California, where most of these loans are concentrated, have been especially hard hit – after watching their equity evaporate after a 20 percent decline in real estate value (while lenders refused to refinance), they are now facing their balloon payment deadline. Lenders are also increasingly anxious about the estimated \$15.5 billion in resets that are due this year. An estimated 800,000 Americans have balloon resets totaling more than \$82 billion. Officials at Freddie Mac are working to educate borrowers about the terms of their loans, and are encouraging companies who service these loans to give borrowers ample warning (*Orange County Register*, 10/13/97).
  
- *Fannie Mae and Freddie Mac's New Software for Streamlining of Documentation for Borrowers Emphasizes Verbal Verification of Borrowers' Records Over Written Documentation:*
  - Fannie Mae, along with Freddie Mac, have introduced new software that will allow lenders to assess credit-worthiness without two years of tax returns, without paychecks and without written verification from borrowers' employer about how much they earn. Under Fannie's system, the documentation includes a "verbal verification of employment as *the only* required income verification for borrowers with low-risk profiles." Under the new system, the lender will require a credit report, bank account records showing the borrower's assets, and verbal verification of income from the borrower's employer. In response to feedback that this might tempt borrowers to inflate their incomes to qualify for a bigger loan, a Fannie spokesman said "We've researched this very carefully, and we know that people who have certain risk profiles...in a very high percentage of the time, simply do not take on financial obligations they cannot handle." (*The Detroit News*, 10/13/97).

## ***Fannie Mae***

- *Fannie Mae Allows Buyers to Borrow Down Payment:* New loans available from Fannie Mae (or loans that Fannie Mae has agreed to purchase) allow homebuyers in Houston to borrow the 3 percent down payment for homes priced at less than \$214,600. Typically, borrowers must provide the down payment in cash, which has become a barrier to homeownership for some. The new program, called Flexible 97, allows homebuyers with good credit to get cash for their down payment through a family member, a loan from a non-profit organization, or a credit card. Flexible 97 is

expected to finance more than 300 houses in the Houston area. Another new Fannie Mae program is the “drive-to-work” program, which makes it easier for low- to moderate-income families with car payments to qualify for a mortgage. (*Houston Chronicle*, 10/15/97).

- *Condominiums Now Eligible for Home Keeper Reverse Mortgages*: Condominiums have now been added to the list of properties eligible for reverse mortgages for senior citizens age 62 and over. (*Fannie Mae Public Digest*, 10/97)
- *\$100,000 Challenge Grant for American Indians*: The Fannie Mae Foundation joined Operation Walking Shield in North Dakota in order to alleviate the housing shortage on U.S. reservations. Fannie Mae has granted \$100,000 to “recycle” homes scheduled for demolition, moving them instead to reservations where thousands of Native Americans are homeless or living in otherwise sub-standard conditions. To date, the Fannie Mae Foundation has awarded more than \$890,000 to support Native American Indian housing development programs. (*Fannie Mae Press Release* and *CNN*, 10/10/97)
- *“Help the Homeless” Campaign*: Fannie Mae is expanding its Help the Homeless mission in Washington, D.C. by giving \$5 million over the next four years. The annual Walkathon, chaired this year by Colin Powell, is planned for November 22. More than \$3.5 million have been raised to benefit more than 100 charities since the program’s inception in 1988, and last year’s Walkathon raised close to \$1 million. (*Fannie Mae Press Release*, 10/9/97)
- *Polish Home-Buying Guide Launched in Chicago*: The Fannie Mae Foundation will offer Polish-speaking immigrants a free homebuyers’ guide, printed in Polish, titled “Opening the Door to a Home of Your Own” and award a \$25,000 grant to the Polish American Association (PAA). The project’s objective is to break down barriers holding many recent immigrants back from homeownership. The guide is also printed in English, Spanish, Chinese, Vietnamese, Korean, Russian, Portuguese, and Haitian Creole. (*Fannie Mae Press Release*, 10/8/97)
- *Fannie Mae Reports Record Third Quarter 1997 Earnings of \$775 Million*: In the third quarter of 1997, up 12.2%. The total was \$775 million, up from \$690.6 million a year earlier. Per-share earnings rose 14% to 72 cents. Nine-month earnings were up 30.2%, to \$2.62 million. The company’s mortgage portfolio grew more than 13% during the three months, versus a 7.4% average rate during the first half. According to Fannie, the company bought significantly more seasons mortgage products this quarter. Also, Fannie Mae was able to match the execution of private securitizers because of market conditions, and commercial banks were more eager to sell recently originated mortgages. The company will begin an Alternative A program this quarter, lending to borrowers who do not meet its standard lending guidelines. According to their spokesperson, this program also contributed to the increase in portfolio lending (*Fannie Mae Press Release*, 10/9/97 and *American Banker*, 10/14/97).

- *One Trillion Dollar Commitment:* Fannie Mae has committed to provide \$1 trillion in targeted lending for 10 million homes by the year 2000, and has implemented an action plan encompassing 11 broad initiatives. These initiatives attempt to ensure broader access to mortgage finance, approve more prospective homebuyers for loans, serve the nonprofit housing community, and to reach out to people with special housing needs - new Americans, minorities, low- and moderate-income families, and residents of central cities. (*Fannie Mae "Initiatives"*, 10/15/97 and *Business Wire*, 10/14/97)

### ***Freddie Mac***

- *U.S. Department of Veterans' Affairs Approves Loan Prospector:* Freddie Mac's Loan Prospector, will now be used to automate and re-engineer the underwriting of VA loans. Freddie Mac is looking to expand the use of Loan Prospector, and a pilot program is currently in progress with the Federal Housing Administration (*Freddie Mac Press Release*, 10/1/97).
- *Freddie Streamlines Affordable Second Mortgage Rules:* Freddie Mac has revised the guidelines of the Affordable Gold loans that are supported by second mortgages subsidized by a government agency, nonprofit or religious group, or the borrower's employer. The revised Affordable Seconds program offers more flexible criteria and eliminates the need for completing a checklist. (*Mortgage Banking*, 10/97)
- *Freddie Mac Revises Guaranteed Rural Housing Loan Program:* Freddie Mac revised its guaranteed rural housing loan program to match guidelines for the government's Sec. 502 program. The changes include a higher permitted seller contribution, 6 percent of the home value, and inclusion of settlement costs in the loan amount up to 100 percent of the appraised value. (*Mortgage Banking*, 10/97).

### ***Federal Home Loan Banks***

- *FHLB Seattle's Plan to Buy Mortgages Called "Risky":* According to comment letters filed with the government, allowing the Federal Home Loan Bank of Seattle to buy mortgages from member institutions would be unnecessarily risky. "A pilot program in which a Federal Home Loan Bank holds an equity interest in mortgage loans exposes the system to additional credit and interest rate risks," wrote Dean Schultz, president of the Federal Home Loan Bank of San Francisco. World Savings senior vice president Dan R. Dixon argued that Congress has not authorized the 12 Federal Home Loan Banks to directly own mortgages, and adds that "there does not appear to be any compelling reason for this pilot." However, other industry officials

have been more supportive, including the Western League of Savings, which has opposed other pilots in the past (*American Banker*, 9/10/97).

- *Seattle FHLBank Wants to Buy FHA Loans:* The FHLBank of Seattle proposed a pilot program to purchase \$25 million in FHA-insured rent-to-own mortgages. Local nonprofit groups would get FHA-insured mortgages to purchase units that would be rented to low- and moderate-income households. A portion of monthly payments would be accumulated for a down payment that the tenant would use to buy the unit and assume the FHA loan. Under the program, both Seattle FHLBank members and nonmembers approved as FHA lenders could sell loans to the bank. The bank is offering aggressive pricing and guaranteed servicing fees for the loans, which it would hold in portfolio. (*Mortgage Banking*, 10/97)
- *Federal Home Loan Bank of Pittsburgh Provides \$4.44 Million in Subsidies to Low-Cost Housing Development:* Forty-two low-income housing programs were awarded funding under the Federal Home Loan Bank of Pittsburgh's Affordable Housing Program. Bank President James D. Roy announced, "Our \$4.44 million in loans and subsidies to member institutions will help to finance 1,079 units of affordable housing in Pennsylvania, Delaware, and West Virginia...the total development costs are more than \$88.9 million." The programs chosen for funding include new construction and rehabilitation projects (*FHL Bank Press Release*, 10/9/97).
- *FHLB Chicago Amasses \$100 Million in Commitments:* The Federal Home Loan Bank of Chicago's new "mortgage partnership finance program ("MPF") has amassed \$100 million in master commitments in its first 90 days, and interest is growing among other FHLBs. The MPF program allows the Chicago bank to fund residential originations (including conventional product) through its members. The fact that the FHLB is funding – and portfolioing loans – with its own money, puts it in direct competition with Fannie Mae and Freddie Mac. (*National Mortgage News*, 10/13/97).
- *Community Banks Face Crisis:* Community banks are finding it increasingly difficult to meet deposit and withdrawal demands as customers shift their deposits into higher-yielding investments like mutual funds. While deposits are leaving banks of all sizes, the problem is worst at small banks because they have fewer funding sources. As a result, community bankers have been turning to Federal Home Loan Banks to increase liquidity. Membership in the system has doubled in the last six years to roughly 6,300, and through August loans were up 10.3 percent to \$177.8 billion. (*American Banker*, 10/14/97).

### ***Farmer Mac***

- *New Loan Products Available to Lenders:* Farmer Mac recently announced that three new loan products are now available to lenders – a part-time farm real estate loan and

two new variable rate farm real estate loans with flexible prepayment terms. “Farmer Mac has come forward to meet the needs of a major segment of the agricultural mortgage market, the part-time farmers...the new 1- and 3-year ARMs allow Farmer Mac borrowers access to competitive, intermediate rate loans with greater freedom to make principal prepayments,” stated Henry D. Edelman, President of Farmer Mac. The Farmer Mac part-time farm mortgage is designed for borrowers who live on agricultural properties but derive a significant portion of their income from off-farm employment. Part-time farm loans are available for single-family, owner-occupied detached residences located on agricultural production properties of at least 5 acres or with annual gross income of \$5,000 from production of crops or livestock. Farmer Mac’s traditional agricultural mortgage product line has been expanded to include a new 3-year ARM mortgage with flexible prepayment terms. (*Farmer Mac Press Release, 10/7/97*).

- *Five Regional Lenders Approved as Loan Sellers in Farmer Mac Program:* Five lending institutions were recently approved as “sellers” in the Farmer Mac I secondary market program – AgFirst Farm Credit Bank, Firststar Bank, Glendale Federal Bank, Northwest Farm Credit Services, ACA, and Wells Fargo Bank. “Seller” approval in the Farmer Mac program permits a lender to sell qualified loans directly to Farmer Mac through its cash window program. Seller status also permits these lenders to offer Farmer Mac loans in the agricultural regions they serve, significantly increasing the number of lending outlets available to farmers, ranchers, and rural home owners (*Farmer Mac Press Release, 9/24/97*).

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**Canfield & Associates, Inc.**  
801 Pennsylvania Ave., NW, Suite 625  
Washington, DC 20004  
Phone: (202) 661-2100  
Fax: (202) 661-2101  
[www.canfieldassoc.com](http://www.canfieldassoc.com)