

The **GSE** REPORT

All GSEs

- *Chairman of the House Banking Committee Encourages GSEs to Invest in Missions' Goals:*
 - House Banking Committee Chairman Jim Leach (R-IA) would like the regulators of Fannie, Freddie, and the FHLBank System to assure that the GSEs' investments are consistent with their missions. Rep. Leach believes that it is critical for regulators to focus not just on whether GSE investments are safe and sound but also on whether investments are directly related to the GSEs' missions. In a letter to Finance Board Chairman Bruce Morrison, Rep. Leach wrote: "Given the evidence of increasing non-mission-related investment activity across all major GSEs and the desirability of maintaining a level playing field with private industry, I believe that every major GSE regulator should establish criteria to evaluate systematically the extent to which enterprise investments are consistent with mission goals, and set limits on such investment activity as appropriate."
 - Rep. Leach also noted the results of a recent GAO Report that found that Fannie, Freddie, and Farmer Mac are "holding growing amounts of non-mortgage investments, collectively amounting to \$78 billion as of the second quarter of 1997." Rep. Leach also noted that according to a recent FHFB staff study, many of the FHLBank System's investments were found to be unrelated to its mission of assisting housing. Rep. Leach observed that the FHFB staff study found that FHLBanks held \$98 billion of short-term, non-mortgage money market investments last year.

Rep. Leach Applauds FHFB for Reviewing the FHLBanks' Investment Policies

- Rep. Leach wrote the letter to FHFB Chairman Morrison to applaud the FHFB for planning an upcoming hearing on the activities and mission of the FHLBanks. The hearing, scheduled for May 11th, will address the FHLBanks' investment policies and Finance Board policy. The FHFB is expected to approve regulations that would make the FHLBanks' investments more closely related to its mission. Rep. Leach wrote: "I am pleased and encouraged that the Finance Board, as the safety and soundness regulator of the Federal Home Loan Bank System, shares this view and is considering placing

appropriate regulatory limits on the non-mission-related investments made by the Federal Home Loan Banks.”

- Panelists expected to testify at the upcoming FHFB hearing include representatives from: America’s Community Bankers, the Independent Bankers Association of America, the National Association of Home Builders, the Coalition of Community Development Financial Institutions, the National Congress for Community Economic Development, the National Community Reinvestment Coalition, the Local Initiatives Support Corp., and the Center for Community Change. Representatives from the FHLBanks are also expected to testify. (*BNA Daily Report for Executives*, 5/7/98; *Dow Jones Newswire*, 5/1/98, 5/4/98)

Fannie Mae & Freddie Mac

- *Fannie Mae & Freddie Mac Introduce Low Down Payment Mortgage Products Nationwide – Program Could Damage the MI Industry and Captive Reinsurance Structures:*

Fannie Mae

- Fannie Mae announced a new low down payment product – the Flexible 97 Mortgage. The new mortgage product offers a conventional (up to \$227,150) 30-year fixed-rate mortgage that can be bought with a 3% down payment. The 3% down payment can come from several sources – a gift, or unsecured loan from the family; a nonprofit agency or municipality; a loan secured by a marketable asset; or a grant from an employer, nonprofit, or government agency. This is the first time Fannie has permitted all down payment funds to be a gift or a loan on a standard, conventional mortgage. Previously, at least 3% of the down payment had to be from the borrower’s own funds. There will be no minimum credit score levels to qualify for the program, according to a Fannie Mae official. But your credit profile will need to demonstrate not only responsible use of credit in the past, but also an availability to pay the future monthly mortgage debt for the home you’re buying. The product is also available to current homeowners who want to trade up but do not have sufficient equity in their current home to pay for a down payment or closing costs.
- The Flexible 97 will be available by early June through the network of 500 lenders that use Fannie’s Desktop Underwriting System. The product has been tested in pilots in a few states over the last 18 months. According to Fannie Mae, first-time homebuyers accounted for 58% of the pilot participants, and 48% of the borrowers had incomes less than 100% of the area median income. Mortgage insurance companies participating in Flexible 97 include Mortgage Guaranty Insurance (MGIC) and Commonwealth Mortgage Assurance Company (CMAC). Fannie Mae stated that it had received 7,000 calls from lenders and consumers interested in participating.

Freddie Mac

- One week after Fannie Mae introduced their Flexible 97, Freddie Mac introduced their version of a low down payment program. Freddie's program, Alt 97, requires a 3% down payment that can come from a gift, unsecured loan from certain sources, or grants from non-profits or municipalities. The mortgage insurance companies participating with Freddie Mac in this program are United Guaranty and Commonwealth Mortgage Assurance Company (CMAC). Fannie's Flexible 97 is 30-year fixed-rate mortgage, while Freddie Mac's Alt 97 will be offered as 15-, 20-, or 30-year fixed rate mortgages. Neither agency has an income limitation or counseling requirement for the loans and both will offer mortgages up to the conventional limit of \$227,150 for Fannie and Freddie loans. (*American Banker*, 4/29/98, 5/8/98; *Business Wire*, 4/27/98; *Dow Jones Newswire*, 4/27/98; *Fannie Mae Press Release*, 4/27/98; *Freddie Mac Press Release*, 5/6/98; *Lexington Herald-Leader*, 5/1/98; *Reuters*, 4/27/98; *Washington Post*, 5/2/98)

Agencies' Low Down Payment Program Will Cause Damage to the MI Industry and/or Lenders:

- Reports are that Fannie charges lenders a 150 basis point delivery fee and the borrower will pay a 50 basis point MI premium, similar to the current FHA pricing.
 - Fannie will only require a minimal up-front MI coverage be purchased by the borrower: (a) currently Fannie requires that 30% coverage be purchased on 97% LTV loans. Fannie's Flex 97 program reportedly drops the coverage to 18%, which is the minimum amount. Fannie believes this is within their charter; (b) the current rate for 18% coverage on a 97% LTV loan is roughly 59 basis points. Fannie has requested that the MIs lower that rate to 50 basis points (would match FHA's current renewal rate). At this time, some MI companies reportedly declined to lower their rate on this coverage, while others have agreed.
 - To cover the "lost MI coverage," Fannie will purchase directly from the MI industry supplemental blocks of insurance on some portion of the Flex 97 business. This supplemental coverage will be paid out of the 150 basis point delivery fee. On good books of business, Fannie may choose not to purchase any of the supplemental coverage allowing them to profit from the full 150 basis point delivery fee.
 - While this program (low initial coverage amounts with supplemental coverage purchased on the back-end of the transaction) is being targeted to the 97% LTV market for now, if it's successful, the program could be extended to the 95% LTV and 90% LTV.
 - *The net effect of the lower coverage requirements, reduced premium rates and the negotiated purchase of supplemental blocks of coverage effectively eliminates the premium that has been shared with lenders in a captive reinsurance structure.*
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- *Freddie Mac Plans to Expand Into Subprime Market – Fannie Mae is more "Leery":*

Freddie Mac

- Addressing reporters at the Mortgage Banker's Association secondary market conference, Freddie Mac's President David Glenn said Freddie is expanding its reach into the subprime market with the expectation that it can reduce costs to consumers in the underserved market. "We think it's within our mission," said John Fisk, Freddie Mac's executive vice president of single-family securitization. In 1997, Freddie Mac purchased \$1.5 billion of B & C loans and they anticipate at least matching that figure this year. The amount of subprime loans Freddie Mac has bought since it entered into that sector in 1997 now appears near \$2.0 billion, less than half of the internal cap set at \$5.0 billion, said Glenn. According to Glenn, the internal cap was established to assure that the company entered the high-risk sector in a controlled gradual fashion. Glenn said that Freddie's underwriting system, Loan Prospector, would allow them to rule out riskier loans and give them the ability to predict defaults. The bulk of Freddie's purchases have been insured loan, but Glenn stated that they are beginning to buy uninsured loans using risk-based pricing, in which borrowers with lower credit quality pay higher mortgage rates.

Fannie Mae

- Fannie Mae, on the other hand, has not expanded into the B & C market, preferring to educate borrowers and helping them to boost their credit quality. Jamie Gorelick, vice chairman of Fannie, said her company is more "leery" of the lower-rated credits. She cited a recent Fannie Mae Foundation study that found that "most blacks and Hispanics would prefer to take the time to qualify for a prime loan" rather than "sentence themselves to a long period of subprime borrowing" at higher cost. Gorelick said Fannie's efforts would focus on the A-minus segment to help those lower-rated consumers reach that standard. (*American Banker*, 5/8/98; *Dow Jones Newswire*, 5/7/98; *Reuters*, 5/7/98)
- *Department of Justice Suggests Fannie and Freddie Could Aid the Justice Department's Anti-Discrimination Efforts:*
 - Bill Lann Lee, acting US assistant attorney general at the Department of Justice (DOJ), stated that Fannie and Freddie could help the DOJ fight home lending discrimination. Lee made his remarks during a conference sponsored by the Office of Thrift Supervision and hosted by Citibank. Lee stated that Fannie and Freddie's substantial loan databases (including price and credit-worthiness information) could assist in "a more systematic exploration" of fair lending issues. Lee praised the intentions of Fannie and Freddie to "dip their toes into the waters of subprime lending," adding that: "It is an area that needs their help." Lee believes that the agencies could be particularly helpful in developing standards of credit worthiness and related pricing in subprime lending. "I hope they will accept my offer to work with them on this subject in any way they think they can help." A Fannie Mae official said no specific proposal has been offered by the DOJ. (*Reuters*, 4/30/98)

- *Fannie Plans to Expand Global Consulting – Fannie Mae Wants to “Market” their Debt to Foreign Investors - Freddie Mac Also Observes Globalization of Its Investor Base:*

Fannie Mae

- Fannie Mae plans to expand their global consulting business in 1998, especially focusing on Asia and Latin America. Fannie’s managing director for internal housing finance services, Martin Levine, believes that expanding their international consulting would increase Fannie Mae’s name recognition overseas in the hopes that global investors would turn toward Fannie Mae debt. Fannie Mae is currently the top global debt issuer in the world. Levine sees Fannie Mae’s international consulting business as a marketing opportunity for Fannie Mae debt sales.
- Since 1990, Fannie has consulted 20 countries (sending approximately 54 employees on overseas consulting visits), and the fees to cover these expenses have been paid by outside parties such as the World Bank, the US Agency for International Development and the Asia Development Bank. By federal charter, Fannie Mae can only invest in home loans in the US, but federal charter does not preclude it, however, from such international consulting. Consulting services range from high-level policy guidance to basic legal structures for home lending. Fannie currently has two projects in Asia, as well as the development of a couple of projects in Latin America. Fannie Mae has consulted Russia over the past four years and Hong Kong, which according to Levine is the “closest to fully mirroring the US” mortgage system (of all the nations Fannie has advised). Fannie plans to phase out their work in Hong Kong. Fannie also plans to do some work in South Africa where Levine said, the “real issue isn’t liquidity but a more racial balance in lending,” and Ecuador, “where we’re still defining what the real needs are and how we can help.” Levine described Fannie Mae’s international efforts as “a global manifestation of our public mission.” He added, “it’s not about avoiding our mission at home.” (*Reuters*, 4/28/98)

Freddie Mac

- Freddie Mac said there has been a “globalization” of its investor base for their agency debt issuance and that the trend will likely continue as foreign investors become more comfortable with the US mortgage markets. Speaking at the recent MBA meeting, David Glenn, president of Freddie Mac, stated that Freddie’s Reference Note program, was placed with about 15% European investors and about 5% with Asian investors. Freddie Mac’s Reference Note program is similar to Fannie Mae’s Benchmark issue. Both agencies are offering the programs to investors as easily tradable securities as a substitute for the declining supply of Treasury. Glenn claimed that Freddie’s bonds were replacing Treasuries as a “reference point” of valuation for fixed-income investors “resulting in a sea-change” in the way Wall Street uses reference points on the yield curve. John Fisk, Freddie’s executive vice president of single-family securitization, said Freddie has also seen an increase in foreign investor interest in their mortgage-backed securities, but he was unable to quantify the amount of their investments. (*Dow Jones Newswire*, 5/7/98)

- *Fannie and Freddie's Foreclosed Homes Sell Below Market Value – But Not As Discounted as HUD and the VA:*
 - Experian RES, a nationwide real estate information company, completed a study that found that homebuyers looking to buy a foreclosed home could expect a discount of approximately 6% below market value. Experian's study looked at a sample of Real Estate Owned (REO) home sales by Fannie Mae, Freddie Mac, HUD, and the VA in 14 major metropolitan counties around the nation, and then compared the sale price to their open market values to establish discount levels. Foreclosure sales by the government and quasi-government agencies account for the majority of the nation's supply of repossessed homes. The Experian study also found a wide range of discount by sellers of foreclosed properties. HUD sold its foreclosed homes at almost 12% below market value, while the VA averaged about 10%. Discounts by Fannie and Freddie, on the other hand, are below the average discount. (*Business Wire*, 5/5/98)
- *PaineWebber Upgrades Fannie and Freddie:*
 - PaineWebber upgraded Fannie and Freddie to "buy" from "attractive" based on price. According to PaineWebber, neither company is a takeover candidate; nor is either an improvement story – they both just have solid earnings growth. PaineWebber finds their current prices compelling given what they believe are the agencies' long-term earnings prospects. Currently, Fannie and Freddie trade at approximately an 85% P/E ratio relative to the S&P 500. PaineWebber believes that both stocks can achieve a relative P/E ratio of 100% in 1999, as investors focus on the agencies' superior relative earnings growth. "This valuation improvement suggests 12-month price targets of \$80 for Fannie Mae and \$60 for Freddie Mac, an increase of more than 30% from current prices for both. PaineWebber expects both Fannie and Freddie's earnings to outpace the S&P 500 in 1998 and 1999. "We expect Fannie and Freddie to post long-term earnings growth of 13% and 16% respectively, versus the 6% earnings growth for the S&P 500 over the next two years that has been forecast by PaineWebber's equity strategist Edward Kerschner." PaineWebber also reported that Fannie and Freddie's earnings growth is relatively immune to large interest rate swings and from economic weakness. "The implied government guarantee on their debt should protect them from the excess competition present in other sectors of consumer lending." In their opinion, "risks to the Fannie Mae and Freddie Mac stories are the prospect of a change in the agencies' political status, a serious recession or a 300 bp or greater change in interest rates." (*PaineWebber, Portfolio Managers' Spotlight*, Gary Gordon, 4/17/98)
- *Fannie Mae, Freddie Mac, and Ginnie Mae Relying on New Mortgage Programs to Keep their Volume High:*
 - At a recent Mortgage Bankers Association meeting, officials from Fannie Mae, Freddie Mac, and Ginnie Mae said they are relying on new mortgage programs to help keep their volume high. Fannie Mae and Freddie Mac both touted their respective 3% down payment programs ("Flexible 97" and "ALT 97") as examples of programs that will help the mortgage industry and expand housing. Jamie Gorelick, vice chairman of Fannie

Mae feels that they must use programs such as these to “expand into new and different markets as the pool of buyers change.” (*Dow Jones - Capital Markets Report*, 5/6/98)

- *Fannie and Freddie Participate in Auction for First-Time Homebuyers:*
 - Fannie and Freddie are one of the lead partners in the Los Angeles Partners in Home Ownership, a 2-year-old coalition of 100-plus government agencies, nonprofits, consumer groups, lenders and realty brokers. The LA Partners’ first major endeavor will be a first-time homebuyers’ auction of foreclosed homes in Los Angeles County on June 6th at the Los Angeles Convention Center. HUD, Fannie, Freddie, and others own the foreclosed properties. To be eligible to participate in the auction, prospective homebuyers must complete a 2½ hour first-time homebuyers workshop and meet certain income limitations. (*Los Angeles Times*, 5/3/98)
- *Fannie and Freddie Participate in Campaign for Home Ownership 2002:*
 - Fannie and Freddie are both national partners in the NeighborWorks® campaign, a joint initiative among banks, insurance companies, government, and the real estate community. The NeighborWorks® network is planning its Campaign for Home Ownership 2002 in Chicago’s West Humboldt neighborhood. The Campaign’s goal is to educate 200,000 families, create 25,000 new homebuyers and generate \$1.8 billion of investment in under-served communities. Federal Reserve Board Governor Laurence Meyer is acting chair of the Neighborhood Reinvestment’s board of directors and honorary chair of the NeighborWorks® Campaign for Home Ownership 2002. Office of Thrift Supervision Director Ellen Seidman, National Credit Union Administration Chairman Norman D’Amours, and Freddie Mac Chairman Leland Brendsel are also involved in the program. US Representatives Luis Gutierrez (D-IL) and Danny Davis (D-IL) have also lent their support. (*PR Newswire*, 5/5/98)

Fannie Mae

- *HomeCapital’s Operating Unit Files for Bankruptcy after Fannie Terminates Mortgage Selling and Servicing Contract:*
 - After running into trouble with Fannie Mae just two months ago, HomeCapital Investment Corporation’s (HCAP) operating subsidiary, HomeOwners Mortgage & Equity Inc. (HOME), filed for reorganization under Chapter 11 of the Bankruptcy Code on May 4th and its managers are considering liquidating the company. Austin-based Home Capital is the holding company for HOME, a consumer finance company that originates, purchases, and sells home-improvement loans and second mortgages, primarily FHA Title I home improvement loans. HOME listed assets of \$32.7 million and liabilities of \$31 million, including an unspecified amount of unsecured debt owed to Fannie Mae. Fannie Mae threw five-year-old HCAP into financial disarray when it withdrew as a buyer for most of HomeCapital’s FHA Title 1 home improvement loans in March.

- HOME's FHA Title 1 home improvement loans were typically sold to Fannie Mae. Fannie Mae demanded that HomeCapital repurchase \$6 million of the loans, according to the company. Fannie Mae had purchased \$206 million in home improvement loans that were being serviced by HomeCapital at the end of 1997 for resale to investors in the secondary market. Fannie Mae also complained to HomeCapital that too many of its home improvement loans were for multifamily residences rather than preferred single-family. On March 24, Fannie Mae notified its termination of its mortgage selling and servicing contract and its loan repurchase arrangements with HOME. Efforts by the company have failed to restore the seller/servicer contract with Fannie Mae.
- Under the protection of the bankruptcy court, HOME will seek to develop a plan of reorganization. Under Chapter 11, a company is protected from claims by creditors while it reorganizes its finances. E. Jeff Bommer, Chairman of the Board of HOME, in announcing the bankruptcy filing stated that "Since Fannie Mae sought to terminate HOME's Seller/Servicer Contract on March 24, 1998, the Company has been pursuing alternative financing sources and means of restoring HOME's lending activities. The decision to seek reorganization for HOME was precipitated by our desire to preserve its enterprise value while developing a business strategy. If we are unable to implement a plan for continuing operations, then we will seek an orderly liquidation of HOME."
- Since Fannie's termination in March, HCAP reduced its work force "significantly" (firing 30 of its 150 employees) and pursued other cost-cutting measures, seeking additional capital and outside financing as it tried to stay in business. In another attempt to work out of the problems triggered by Fannie Mae's action, HCAP sold about \$32.4 in MBSs to discharge its obligation to Fannie Mae associated with those securities and help its cash flow. The company also tried selling about \$10 million in FHA Title I loans currently held by warehouse lenders to discharge those obligations and generate some cash flow. The announcement by Fannie Mae in March also led to several firings and resignations at the senior management level at HCAP. HCAP recently replaced their Chairman and CEO with a former managing director at Citicorp Mortgage who resigned after only two days when he also failed to restore the seller/servicer contract with Fannie Mae. The effects of bankruptcy filing will reach beyond Texas' borders, however, as 70% of HCAP's Title 1 loans were made in California, and just 7% in Texas. Also, many of HCAP's creditors are outside Texas. In all, nearly 500 creditors are owed money by the company, according to court filings. A spokesman for Fannie Mae declined to discuss why it quit doing business with HCAP. [Please see April 10th *GSE Report* for more information about Fannie Mae's seller/servicer termination of HOME] (*Austin American Statesman*, 5/6/98; *Business Wire*, 5/5/98; *Dow Jones Newswire*, 5/5/98; *Reuters*, 5/5/98)
- *Fannie Mae Pilot Allows Borrowers with High LTV Loans to Refinance with No Money:*
 - Fannie Mae has partnered with a number of community groups in a new community-based experiment refinance option that offers "no cash-out" refinances of up to 97% of the value of the home, or to the maximum LTV ratio permitted under the experiment's parameters. This will be the first time this refinance option is available for high LTV

mortgages not previously owned or securitized by Fannie Mae. By showing a history of successfully meeting their monthly mortgage obligations for at least a year, and participating in required homebuyer education sessions, borrowers under this program can qualify for the same credit and underwriting parameters available in underwriting experiments between Fannie Mae and its partners. The community-based refinance option is available to owners of single-family homes, including a townhouse or condominium. The refinanced mortgage may be a fully amortizing fixed-rate mortgage with a term of 10, 15, 20 or 30 years. Borrowers can include the unpaid principal balance of the first mortgage, plus up to 2.5% of the new mortgage amount, as closing costs. Homeowners with existing subordinate financing can take advantage of this opportunity as long as the subordinate financing meets the guidelines of Fannie Mae's Community Seconds mortgage. Borrowers also have to meet the specific income or eligibility guidelines of the community group participating in the new pilot with Fannie Mae. The refinancing option is available under the following community-based mortgage underwriting experiments: ACORN Housing Corp., Community Mortgage Loan Pilot Initiative, Consumer Credit Counseling Service (CCCS), HomeChoice, National Council of La Raza, National Training and Information Center, Native American Conventional Lending Initiative, NeighborWorks Product, and Neighborhood Infill and Stabilization Program. (*Business Wire*, 5/5/98)

- *Economist Accuses Fannie and Freddie of Bullying Market:*
 - Mortgage Economist, Thomas LaMalfa, accused Fannie and Freddie of bullying every sector of the market. In his opinion, the agencies are bullying duopolies on shaky financial ground. LaMalfa made his remarks during a Wisconsin Mortgage Banker Association conference. "They have the lion's share of the conventional conforming mortgage market – 60%. They operate with unrivaled privilege, sort of a 'heads I win, tails you lose' arrangement," said LaMalfa. "They have no competitors, either on Wall Street or among large banks. And they set the rules, everything from accounting practices to credit policies and, most worrisome, technology," stated LaMalfa. He believes the GSEs have grown at phenomenal rate but have very little capital and large liabilities. "They have 11 consecutive years of record earnings," LaMalfa said in an interview, "but very little capital. Freddie Mac has \$9 billion and Fannie has \$12 billion, and they have mega-huge liabilities - \$2 trillion in debt. Their 25-to-1 debt-to-equity ratio is an invitation to disaster, he contended. "With most companies, the ratio is 1 ½ or 2 ½ to 1. Neither has capital sufficient to cover anything in the neighborhood of a 5% default rate, LaMalfa said. He raised the issue of taxpayer bailouts similar to those for Amtrak and the savings and loan industry should Fannie and Freddie encounter problems. "One big earthquake in California could really unglue these agencies," he said.
 - A Fannie Mae spokeswoman called LaMalfa's comments "absurd." Freddie Mac spokesman Douglas Robinson called LaMalfa "a longtime critic of government-sponsored enterprises" whose charges are unfounded and untrue. Robinson stated that Freddie's regulators have said Freddie is safe and sound and that they "do not by any means dominate mortgage purchases." Jill Weide, acting director of public affairs for OFHEO, said they subject Fannie and Freddie to quarterly reviews and detailed

examinations “to assure they have enough capital to withstand economic pressures and to protect taxpayers,” and that both agencies consistently pass the tests. A more refined test, designed to withstand stressed market conditions, is being developed for expected use around 2000, she said. (*Milwaukee Journal Sentinel*, 4/23/98)

- *Fannie Mae Spent \$2.5 Million in Lobbying for the First Half of 1997:*
 - According to a study by the Center for Responsive Politics, Fannie Mae spent approximately \$2.5 million (\$2,460,000) on lobbying in the first half of 1997 (Jan. 1-June 30, 1997), ranking it No. 36 among the 106 organizations that spent more than \$1 million on lobbying for that period. (*American Banker*, 4/29/98; *Center for Responsive Politics Website- Million Dollar Spenders*, 5/1/98)
- *What will Fannie Mae Chairman Jim Johnson Do Next?:*
 - The decision by Fannie Mae Chairman Jim Johnson to step down has created a lot of speculation about what he will do next. Many consider the options fairly short – secretary of the Treasury, president of the World Bank, and less likely, U.S. Senator. One Washington observer who thinks Johnson only wants to be Treasury Secretary noted that “He’s a Washington player, and I think he’ll want to remain one.” The observer further stated that if he does not get that position, “he might just want to be one of the Wise Men – somebody whom presidents would call on when they have problems.” Rumors have circulated that Treasury Secretary Robert Rubin may resign before President Clinton’s term ends. Rubin is an old friend of Johnson’s and one observer noted that “if Rubin recommended him, it would help.” Johnson also has ties to James Wolfensohn, president of the World Bank, whom Johnson replaced as the unpaid chairman of the Kennedy Center. Johnson has also been discussed as a possible Senate candidate from his home state of MN, but insiders noted that this position may be less appealing than Treasury Secretary. Louis Nevins, president of the Western League of Savings Institutions wrote Johnson to ask him to work for the city of Washington, DC – a city widely perceived as poorly run. (*American Banker*, 5/8/98)
- *Fannie Mae Publishes Consumer Brochure on Credit Scoring & Automated Underwriting:*
 - Fannie Mae published a free consumer brochure explaining credit scoring and automated underwriting to consumers. Fannie Mae states that credit scoring is not discriminatory, referring to credit scoring as “a bias-free tool that helps lenders evaluate the likelihood that you will repay the loan based on how you have managed debt in the past.” The brochure notes that credit scoring and automated underwriting are tools for lenders and that computers do not make the final decision on mortgage loan approvals or denials. “The final decision whether or not to approve or deny your mortgage loan application is made by the lender, not a computer.” (*Business Wire*, 5/6/98; Fannie Mae “*Credit Scoring & Automated Underwriting*” Brochure)
- *Fannie Mae Adds Standard & Poor’s Risk Evaluation Tool to their Automated Underwriting System:*

- Fannie Mae’s automated underwriting system, Desktop Underwriter, has added Standard & Poor’s LEVELS™ model to their underwriting system. The model will allow lenders to obtain S&P’s risk grades, loss estimates, and credit enhancement requirements for non-conforming loans that have been underwritten through Desktop Underwriter. The model has been pilot tested for the past eight months with five lenders before becoming widely available. S&P’s LEVELS™ is a econometric model of the rating criteria used by S&P when analyzing residential mortgage loans. The LEVELS™ model generates a loan-by-loan analysis and provides users with the S&P’s Risk Grade, a range of loss estimates, and credit enhancement requirements for ratings from AAA to B (or reserve requirements for portfolio lenders). The information can be used to manage risk associated with non-conforming residential mortgage loans in functions such as risk-based pricing, portfolio valuation, best execution, and setting loss reserves. (*Business Wire*, 5/6/98)
- *Fannie Mae Introduces New Seniors Product:*
 - Fannie introduced a new standard mortgage product for owners and developers of congregate care and assisted-living facilities for senior citizens. The single-asset seniors’ product will be available for existing facilities through selected lenders, but it can’t be used to finance properties with skilled nursing care components. According to Fannie, loans can be delivered for cash or mortgage-backed securities, or by credit enhancement of fixed- or variable-rate tax-free bonds. The new product is designed to provide financing of up to \$20 million but “larger loans will be considered,” Fannie Mae said. The maximum LTV is 75%, except for properties financed by tax-free bonds, which may have an 80% LTV. The new product is targeted to private-pay facilities, but properties with up to 20% Medicaid-eligible residents will be considered on a case-by-case basis. (*National Mortgage News website*, 5/4/98)
- *Fannie Participating in Administration’s PATH Program for Environmentally Efficient Housing:*
 - President Clinton announced a new program called PATH – the Partnership for Advancing Technology in Housing – a partnership between the federal government, the homebuilding sector, insurance industry, and state and local governments. The specific goals of PATH are to build houses that are 50% more energy efficient within the decade for new homes; to have a goal of 30% more energy efficiency for retro-fits, for existing homes that get improved, with a goal of hitting 15 million homes, again, within a decade. At the same time, PATH’s goal is to improve affordability by 20% - to have monthly payments on houses be 20% better – as well as having houses 50% more durable, with a 10% lower risk of loss from hazard or destruction. The first PATH pilot program is in Los Angeles, consisting of 186 energy-efficient homes. According to President Clinton, this Los Angeles project will save homeowners more than \$230 a year on their energy bill and \$7,000 during the life of the mortgage. Specific details of Fannie Mae’s involvement in the project were unclear, however, according to remarks by President Clinton on the Los Angeles project: “Fannie Mae will make it possible for more homeowners to qualify for home mortgages, giving them credit for the energy savings

they will collect in terms of the eligibility for their mortgage.” Also, Todd Stern, Assistant to the President for Special Projects stated that “there’s a considerable amount of financing by Fannie Mae.” Other pilot programs that are underway are in Tucson and Pittsburgh. The project in Tucson will be the largest sustainable master-planned community in the US, and is a public-private partnership between the City of Tucson and the Community of Civano LLC, comprised of Case Enterprises and Fannie Mae’s American Communities Fund. (*Press Briefing by Todd Stern, Assistant to the President for Special Projects, 5/4/98; Remarks by President Clinton to Community Members on Climate Change, 5/4/98; White House Press Release, 5/4/98, PR Newswire, 5/4/98*)

- *Fannie Mae Announces New CRA Initiative:*
 - Fannie Mae announced a new \$2 billion initiative to help depository institutions meet their Community Reinvestment Act (CRA) goals. There are five elements to Fannie’s CRA initiative: (1) expanded CRA portfolio transactions; (2) special CRA-targeted investments; (3) capital markets structured CRA transactions; (4) enhanced FannieMaps Plus; and (5) CRA-focused lender and community forums. Expanded CRA portfolio transactions – Fannie Mae will invest an additional \$2 billion by purchasing seasoned CRA loans with \$100 million dedicated to multifamily portfolio loans. Fannie Mae will offer, through negotiated transactions, swaps of multifamily CRA portfolios, including pools of cross-collateralized mortgages, for MBS and REMICs. In addition, Fannie Mae will now offer Multifamily Credit Risk Insurance where institutions can achieve 100% sale treatment for MBS when sold. Special CRA-targeted investments – Fannie will offer a special CRA-backed MBS where 100% of the loans backing this MBS will be to borrowers with incomes below 80% of the are median income. Capital Markets Structured CRA Transactions – Fannie is offering structured CRA REMIC securities for lager CRA portfolio sales (approximately \$100 million or more). Fannie will use a REMIC called “Wisconsin Avenue Securities” (WAS) that will allow the creation of senior securities guaranteed by Fannie Mae and may be considered “qualified investments” under the CRA. According to Fannie: “Because of this superior credit guaranty, the senior securities trade at higher prices than comparable private-label AAA-rated issues.” Enhanced FannieMaps Plus – Fannie’s newest release will contain new improvements for lenders to match CRA requirements, including the ability for lenders to import Fannie’s Form 1003 Loan Application fields for income, race, and address from Fannie’s Desktop Originator software. CRA-Focused Lender and Community Forums – Fannie plans to launch a series of CRA-focused seminars for lenders and community groups representing five parts of the country with high percentages of low- to moderate-income African-American and Hispanic families. (*Business Wire, 5/6/98*)
- *Fannie Mae Launches \$3 Billion 10 Year Benchmark Note:*
 - Fannie Mae launched another Benchmark Note on May 5th – a \$ 3 billion 10-year note. This is the fifth issue from Fannie’s Benchmark Note program and Fannie’s second new issue of 10-year notes and just the second time it has sold a complete second offering in a maturity. Since January, Fannie has issued a \$4 billion deal each month, and re-opened February’s 10-year sale in March for another \$750 million, bringing total Benchmark

issuance (excluding this new sale) to \$16.75 billion so far. By promising large, regular bond issues, Fannie hopes to profit from offering investors an alternative to Treasurys (becoming scarcer as federal budget deficit disappears). Freddie Mac subsequently followed with their own program. Investors foresee a less exuberant response to this new Fannie deal as the market for giant global bond issues matures. Investors said that the maturity of the market also means there will likely be less rush to buy the securities. (*Dow Jones Newswire*, 5/5/98; *Reuters*, 5/5/98)

- *Fannie Mae Announces \$100 Million in Down Payment and Closing Cost Assistance:*
 - Fannie Mae will provide \$100 million in new funds to homebuyers nationwide for down payments and closing cost assistance through housing finance agencies (HFAs) and other local government homebuyer assistance programs. Fannie Mae's program is called the Down Payment Assistance Investment Note initiative, which Fannie has piloted on a limited basis, purchasing eight taxable down payment assistance notes from HFAs in 1997. Fannie Mae will purchase the taxable, collateralized note directly from an HFA or other local government agency. The proceeds of the purchase will be used to fund secured second mortgages that finance part of a borrower's down payment or closing costs in conjunction with a first mortgage from a state or local HFA program, or other local government home-buyer assistance program. (*Business Wire*, 4/27/98)
- *Fannie Mae Creates First Homebuyer Guide for Persons with Disabilities:*
 - Fannie Mae and the National Home of Your Own Alliance announced "A Home of Your Own Guide," the first manual specifically created to provide homebuying guidance for persons with disabilities. (*Business Wire*, 4/28/98)
- *Fannie Mae Foundation will Advertise in Nation's Oldest Spanish-Language Daily Newspaper:*
 - The Fannie Mae Foundation will be among the advertisers involved in a homebuyers' guide that will be published in *el diario/La Prensa* – the nation's oldest Spanish-language daily newspaper. The homebuyers' guide will be a special supplement in the paper that will offer information on all facets of purchasing a residence. (*PR Newswire*, 4/28/98)
- *Fannie Mae Foundation Commissioned Study on Immigrant Housing:*
 - The Fannie Mae Foundation commissioned a study on immigrant housing prepared by the Center for Real Estate and Urban Policy at the New York University School of Law. Among its findings, the study found that black and Hispanic immigrants – particularly those from the Dominican Republic – live in New York City's most dilapidated housing, pay among the highest percentages of income for rent and have the lowest rates of home ownership. The study also found that European, Russian and Asian immigrants tend to live in better housing, though Russians pay more of their income for rent than any other ethnic group. Data for the study was taken from the 1996 New York City Housing and

Vacancy Survey conducted every three years by the Census Bureau. (*New York Times*, 5/4/98)

Freddie Mac

- *Freddie Mac Using Derivative Securities As Reinsurance to Mitigate Default Risk –Drawing Cautious Response from Investors:*

Freddie Mac's MODERNS Deal

- In order to offset the risk of default that Freddie Mac retains when it securitizes mortgages, Freddie is pioneering a new innovative bond offering and bringing approximately \$200 million of rated derivative securities (MODERNS) to market. The innovative securities, MODERNS or mortgage default recourse notes, are a derivative vehicle that will be used to transfer the default risk of a portion of Freddie's mortgage portfolio to investors – effectively acting as a reinsurance policy. MODERNS will transfer to investors the risk of homeowners defaulting on mortgages owned by Freddie Mac. MODERNS aren't directly backed by a pool of loans like private-label mortgage-backed securities – their value depends on the performance of a sample, or reference portfolio, of Freddie Mac loans. Payments on MODERNS will be based on the performance of the \$15 billion proposed reference portfolio. The MODERNS act as interest-bearing bonds, with Freddie agreeing to pay reinsurance premiums that help pay interest to investors. Investors will lose money on the bonds if there are problems with the loans in the reference pool and will accept that default risk in the form of reduced principal they receive at maturity. MODERNS have no prepayment risks.
- Michael Young, managing director and head of mortgage-backed securities research at Chase securities, believes that “Freddie Mac's interest in this innovation seems a perfectly legitimate response to building and longstanding Congressional concerns about their potential exposure to loss.” If Freddie Mac's MODERNS deal is successful, market players say that these innovative securities could transform the way Freddie Mac and Fannie Mae do business, and give finance companies of all kinds a new way to use the bond market. Some say it could even be used by other lenders provided they have a longstanding history of portfolio performance. According to Young, “If this works it becomes a template for everyone with mortgage or other consumer credit exposure... This could potentially be used by anyone with a mortgage or credit-card portfolio so long as they have adequate history of loss experience.”

Moody's Ratings of MODERNS

- According to Moody's the reference pool includes approximately 147,500 loans (representing about 17.4% of the 30-year, fixed-rate, one-to-four-family mortgage loans than Freddie purchased in 1996). The mortgage loans in the reference pool are also geographically diverse, were originated over the span of one year, and exclude any loan that is 30 or more days delinquent when the pool was formed. The reference pool will also exclude all loans that Freddie purchased with credit enhancement other than standard primary mortgage insurance, Moody's said. The loans will be serviced by Freddie Mac-

approved mortgage-loan servicers. The offering consists of four floating-rate tranches and one equity tranche. Moody's rated the deal's class A bonds Baa2, class B Baa3, class C Ba2 and class D B2. The issuer, is G3 Mortgage Reinsurance Ltd. – a special purpose reinsurance company in Jersey, Channel Islands that is not owned by Freddie Mac. The loans are not publicly registered with the SEC. Freddie Mac had no comments about the securities.

- A Moody's Investors Service report said the complex derivatives would have the effect of a reinsurance policy. Experts on Wall Street believe that the derivatives could provide an inexpensive way for Freddie and Fannie to handle their residual risk. Experts also said insurance companies have used similar types of transactions involving securities (catastrophe bonds) to get reinsurance against certain risks. The concept of securities isn't new, but it's the first instance it has been applied in the rated mortgage-securities market, according to Andrew Lipton, vice president and senior credit officer at Moody's Investors Service. "This basically liquifies the residual portfolio that agencies have," said a Wall Street analyst. "In essence, they are buying reinsurance against defaults in the home mortgages that they have underwritten."

Concern by Potential Investors

- Some potential buyers have speculated that these securities could provide the first of a whole new asset class, however, some fear the residential mortgage market has peaked and warn that the securities are difficult to value. One money manager who does not plan to participate in the deal commented about the securities: "Going forward, you may see higher losses and more delinquencies in that market. Those securities are super sensitive to losses and delinquencies on the portfolio." One portfolio manager noted that the extended economic expansion has been extremely kind to lenders but should that accommodative tone turn, these bonds would be highly volatile. "I would not want to project what the real risk is in this credit," he said. However, one investor who is considering the deal said that MODERNs is an innovative structure that transfers concentrated risk from one party that doesn't want it to a group of parties who are eager to accept it in exchange for a high yield. (*American Banker*, 4/28/98; *Capital Markets Report – Dow Jones*, 5/5/98)
- *Freddie's Automated Underwriting System Achieves Rapid Growth after HUD's Approval of Use on FHA Loans:*
 - Freddie Mac is reporting strong demand among lenders for its automated underwriting system, Loan Prospector, since HUD approved its use for FHA loans nine weeks ago. Since earning the FHA's approval of Loan Prospector, the service's daily usage has grown by 146%, with the total number of FHA loans processed each week soaring to more than 1,000. Freddie Mac reported that since March 3rd, 108 lenders have signed up for the service (bringing the number up to 236 users). In addition, Freddie Mac reported that the number of FHA loans evaluated each week has increased four-fold since January. (*American Banker*, 5/5/98; *Freddie Mac press release*, 4/28/98)
- *Freddie Mac Employees Will Repair Home:*

- More than 100 Freddie Mac employee volunteers will repair a home in Fairfax, VA as part of their “Christmas in April.” The Freddie Mac Foundation is a corporate sponsor of “Christmas in April,” providing volunteer support to repair one home as well as a \$3,000 grant to repair two homes. (*PR Newswire*, 4/23/98)

Federal Home Loan Banks

- *Senator D’Amato Proposes Abolishing FHLBank’s Oversight Board:*
 - Senate Banking Committee Chairman Alfonse D’Amato (R-NY) proposed a bill that would abolish the FHLBanks’ Oversight Board (Federal Housing Finance Board (FHFB)) and transfer its responsibilities to HUD and OFHEO. The bill, “Federal Home Loan Bank System Regulatory Restructuring Act of 1998” (S. 1986), is co-sponsored by Senator Richard Shelby (R-NC). Senator D’Amato believes that the FHFB is “outdated and needs to be reformed,” and he believes that the FHFB has an inherent conflict of interest because it oversees both the mission and the safety and soundness of the FHLBanks. His proposal would transfer regulation of all the GSEs under the same regulators.
 - Sen. D’Amato’s bill would: (1) transfer safety and soundness regulation responsibilities to OFHEO (currently the safety and soundness regulator of Fannie and Freddie); (2) transfer mission compliance oversight to HUD (current mission regulator of Fannie and Freddie); (3) dissolve the FHFB; and (4) transfer all employees of the board to OFHEO. According to his statement, the GAO testified that one regulator should be responsible for overseeing the safety and soundness of the FHLB and Fannie Mae and Freddie Mac and the current FHFB chairman himself has endorsed the GAO’s safety and soundness consolidation recommendations. At a Housing Banking hearing on July 1997, FHFB Chairman Bruce Morrison testified that “Conceptually I am in accord with the premise of the GAO report that a single independent agency regulating safety and soundness and mission for Fannie Mae, Freddie Mac, and the FHLBank System is preferable to the current system.” However, during the same hearing, Morrison also said that because there was no crisis, Congress should be careful not to do anything that might disrupt the FHLBank System or delay OFHEO’s capital requirements rulemaking process. Morrison also did not specifically recommend at the hearing that Congress eliminate the Finance Board. Senator D’Amato did not mention the recent controversial firing of FHFB Member, Lawrence Costiglio, as a factor in his decision to introduce FHFB reform legislation, however, the Senator has made statements in the past about his extreme displeasure with the firing. (*BNA Daily Report for Executives*, 4/28/98; *Congressional Record Statement by Senator D’Amato*, S3589; *Dow Jones Newswire*, 4/24/98)
- *Financial Services Experts Oppose FHLBanks’ Expansion and Recommend Privatizing the FHLBanks:*

- The Shadow Financial Regulatory Committee, a group of industry experts and academics that meet periodically to offer recommendations on key issues in the financial services industry, said they strongly oppose efforts to expand the role of GSEs. According to Paul Horvitz of the University of Houston, it is “unwise and risky to the taxpayer to expand the role of the [Federal Home Loan Banks]...It is undesirable to see any expansion of GSEs.” The Shadow Committee is concerned that Senator Chuck Hagel (R-NE) and Cong. Richard Baker (R-LA)’s bills would result in the FHLBanks becoming “general purpose lenders to depository institutions.” The Committee recommended privatizing the FHLBanks to help alleviate any potential risk to taxpayers that could result as more loans are approved by the FHLBanks. “The FHLBanks are now profitable and expanding their lending within current constraints. There is no financial need for any expansion of their role,” Horvitz said. (*BNA Daily Report for Executives*, 5/5/98)
- *Ousted FHFB Member Files Court Brief Questioning the Validity of any Actions Taken by FHFB in his Absence:*
 - Lawrence Costiglio, the Federal Housing Finance Board (FHFB) Member, who was dismissed from his Board seat by President Clinton, filed a court brief with a federal court in his lawsuit to regain his seat. Costiglio stated that every FHFB action taken during his absence will have to be re-voted upon his reinstatement. Costiglio said denying his motion for a preliminary injunction to block the President’s move until his case is decided on its merits will have a “profound negative impact on the FHFB.” Costiglio said: “If a preliminary injunction is not granted, perhaps scores of Board decisions will need to be reviewed and possibly reversed. For some Board decisions, it may be too late for a re-vote.” A Department of Justice brief maintained that President Clinton’s dismissal of Costiglio was perfectly legal. “The President clearly had the authority to remove plaintiff from the FHFB,” and that a court order reinstating Costiglio “would be disruptive to the FHFB’s ability to conduct its affairs,” the department said. In his brief, Costiglio also argued that FHFB Member, Art Agnos (acting deputy assistant HUD secretary) “is too low in the order of succession” at HUD to qualify as a Board member. The Justice Department stated that Costiglio “lacks standing” to question the validity of Agnos’ standing on the FHFB. Costiglio believes that the FHFB statute is not ambiguous – “each director may continue to serve until a successor has been appointed and qualified.” Costiglio maintains that “he has no right to remain in office as long as he is removed by the President in the manner the statute provides, namely that a successor is appointed and qualified,” according to his brief. (*Dow Jones Newswire*, 5/7/98)
- *FHFB Hires Psychologist to Facilitate Dialogue:*
 - The Federal Housing Finance Board (FHFB), regulator of the FHLBank System, has hired an organizational psychologist, David Berg, to facilitate dialogue at a meeting in June to discuss changing the FHLBank System. Controversy has been swirling around the FHFB recently – (1) the firing of Board Member Lawrence Costiglio who is suing President Clinton to regain his seat; (2) Senator D’Amato’s bill that would abolish the FHFB; and (3) FHFB Chairman Bruce Morrison’s attempts to rein in the FHLBank System’s non-mortgage investment. Berg will “facilitate the discussion of the issues

currently facing the FHLBank System during the Directors' Conference in June.” Numerous FHLBank directors are expected to attend the meeting with Board officials. A Finance Board spokeswoman stated that Berg “is an expert in organizational development, a person who looks at how to effect institutional change by changing behavior.” Berg proposed in a memo to FHLBank officials that the groups of 12 System officials meet with him in early May to design the content and flow of the upcoming June meeting. (*Dow Jones Newswire*, 4/29/98)

- *Dallas FHLBank Joins Council of Federal Home Loan Banks:*
 - The Dallas FHLBanks voted unanimously on April 18th to join the council, a trade group that was formed in January to represent members of the FHLBank System on policy and legislative issues. With the FHLBank of Dallas' inclusion, there are now 10 out of 12 FHLBanks that are members of the council. The FHLBanks of Chicago and New York are the only FHLBanks that are not members of the council. (*American Banker*, 4/29/98)

Farmer Mac

- *Farmer Mac Reports \$1.7 Million First Quarter 1998 Net Income:*
 - Farmer Mac reported net income of \$1.7 million for first quarter 1998. Net income for first quarter 1998 includes a \$200,000 tax benefit associated with the future use of operating losses incurred in prior years. Excluding the tax benefit effect, net income would have been \$1.5 million for first quarter 1998, an increase of \$687,000 compared to net income of \$858,000 for first quarter 1997. (*PR Newswire*, 4/22/98)

Farm Credit Administration

- *Farm Credit Administration Issues New Rating System:*
 - The Farm Credit Administration issued a policy statement in the *Federal Register* on April 22nd that outlines a new financial institution rating system. The Financial Institution Rating System (FIRS), effective April 9, 1998, will be the rating system used by FCA examiners for evaluating the safety and soundness of the Farm Credit System (FCS). (*Federal Register*, 4/22/98, Pages 19918-19919).

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