

The **GSE** REPORT

Fannie Mae & Freddie Mac

- *Cato Study Calls Fannie Mae and Freddie Mac “Financial Time Bombs”:*
 - The Cato Institute recently released a policy paper that says Congress should privatize Fannie and Freddie because the GSEs distort the market and place taxpayers at risk. The study – “The Mounting Case for Privatizing Fannie Mae and Freddie Mac” - was written by Vern McKinley, a Washington lawyer and past analyst for the FDIC, FRB and RTC. Mr. McKinley feels that the GSEs use their implicit government guarantee to earn above-market returns and then use their profits to buy political clout and enrich their shareholders and executives. “Fannie Mae and Freddie Mac preserve their privileged status through a multi-million-dollar lobbying effort that includes massive ‘soft money’ campaign contributions and the payment of exorbitant salaries to politically connected executives and lobbyists.” “The GSE structure is a classic use of a narrowly provided legislative subsidy that the beneficiaries will fight vigorously to maintain,” he said. “But the unhealthy and disproportionate political influence wielded by the GSEs only underscores the need for privatization.”
 - Fannie and Freddie receive subsidies estimated to be worth \$6 billion and an estimated \$2 billion of that money goes directly as income to their shareholders and employees (not homeowners). That makes the subsidies “one of the most expensive forms of corporate welfare in Washington today.” The other \$4 billion in benefits is passed along largely to middle- and upper-income households, “a classic case of white, middle- and upper-class welfare.” The market failure argument and rationale for the initial creation of the GSEs is suspect today. With the innovation and changes in the financial marketplace today, the “GSEs may impede innovation and competition rather than foster it.” Mr. McKinley refers to the agencies as “financial time bombs,” and that they should be stripped of their special status and government subsidy. The agencies are taking on more risk by holding an increasingly higher proportion of their assets in portfolio (exposing them to both interest rate risk and credit risk), purchasing more loans with high LTV ratios, and the entrance of the GSEs (specifically Freddie Mac) in the subprime market. “Other participants in the financial service industry cannot compete with them because of the benefits of their quasi-government status,” McKinley notes. Fannie Mae and Freddie Mac “have taken on greater risks that may ultimately threaten their viability” and “may

expose the federal taxpayer to an ever-increasing potential contingent liability that could ultimately cost tens of billions of dollars to rectify.” (*Cato Policy Analysis No. 293; American Banker*, 1/9/98)

- *Editorial Questions Whether Fannie and Freddie are “Another Bailout Brewing?”*:
 - The *Investor’s Business Daily* recently published an editorial on the housing GSEs cautioning that the GSEs could cause another government bailout. Lawmakers created Fannie and Freddie to maintain a secondary market because they felt that the free market could not perform the job – so the government did. That argument is suspect now given the changes in the financial marketplace in the last 60 years. The editorial reports that we should care about the housing GSEs because they could become a huge problem for taxpayers. According to Vern McKinley, a Cato Institute analyst, there is a market conception that Fannie and Freddie, because of their quasi-government status, have an implicit federal guarantee against default. “Hence (they) expose the federal taxpayer to an ever-increasing potential contingent liability that could ultimately cost tens of billions of dollars to rectify.” The editorial goes on to say that not only has Congress provided them start-up money, it exempted them from the registration and reporting requirements of the SEC, and from paying state and local taxes.
 - Defenders of Fannie and Freddie claim that they do not get money from the federal government. Technically, that is true. Given their government-sponsorship, there is an implicit guarantee (noted in several reports on the housing GSEs) that taxpayers stand behind the debt and securities they issue should Fannie or Freddie default. Could they default? Defenders claim they are in solid health. But others note there is at least a chance of failure (as with any market activity). McKinley notes that Fannie and Freddie’s capital-to-asset ratio is less than 2% (less than banks, S&Ls, and FHLBanks) and Fannie and Freddie may be increasingly engaging in practices that threaten their viability. McKinley notes as signs of danger: Fannie and Freddie are holding an ever-larger share of their assets in their own portfolios instead of selling them through securitization; they are buying loans with high LTV ratios; they are also getting into new lines of business other than the ones they were originally set up (e.g., Fannie Mae’s entrance into the insurance business). If Fannie and Freddie get into any trouble, the taxpayers are going to be the likely group called on to bail them out (potentially billions of dollars). What can be done? A number of groups have presented the idea of truly privatizing Fannie and Freddie, but at the very least, all of the special breaks the housing GSEs have been awarded should be taken back because the benefits have signaled the market that they are special and are backed by the government. “For instance, the SEC exemption tells investors they don’t need such information because the securities aren’t as risky. Getting rid of these benefits would remove the implicit guarantee of government backing. But the most dramatic option would be to liquidate the two agencies. Sell off their assets, pay off their liabilities, and wind down their remaining securitizations. Anything left would be divided among their current shareholders.” Fannie and Freddie have strong political defenders but going from government- to market-backed is possible as evidenced by the privatization of Sallie Mae. (*Investor’s Business Daily*, 1/6/98)

- *“How Can there be a Budget Surplus When There are Contingent Liabilities like Fannie and Freddie that Mask the Real Deficit?”*
- President Clinton is expected to propose a balanced budget in the coming weeks, but even if the budget runs a surplus, some budget experts question what that really means. For example, Social Security, Medicare and other programs have promised far more in benefits than they can deliver and federal loan programs and guarantees put taxpayers on the hook for added billions. The total cost of these “unfunded liabilities” is more than \$18 trillion, according to the National Taxpayers Union. Direct loans from the SBA, the Agriculture Dept. and other entities also assume risks for billions of dollars each year. Another class of loans is guaranteed loans by the government. Even further removed from government accounting are GSEs. In all, the face value last year of GSE loans was \$1.7 trillion; compared with \$46 billion in 1971 (the last time there was a balanced budget). Vern McKinley in a recent Cato study said he thinks Fannie and Freddie have grown too big. In addition to the subsidies they receive from the federal government, McKinley called them “financial time bombs.” Although on sound footing now, during the 1980’s, Fannie Mae was rocked along with the rest of the mortgage industry. A similar meltdown in the future could trigger a bailout costing billions. “If it were a private company, they would disclose an estimate of what they would cost and the likelihood of it happening,” McKinley said. But Fannie and Freddie don’t have to do that. McKinley also points out that Fannie and Freddie are now holding more loans in portfolio, not securitizing them or simply guaranteeing them. That is more risky, but it is also more profitable. “They’ve got a lot of pressure from Wall Street and their shareholders to keep these 20%-plus returns on equity they’ve had these last few years,” he explained. But don’t expect changes in the way the GSEs operate. The man who will operate Clinton’s budget, Office of Management and Budget Director Franklin Raines, was vice chairman of Fannie Mae before moving to the White House in 1996. (*Investor’s Business Daily*, 1/12/98)
- *HUD May Oversee GSE Non-Mortgage Investments:*
 - An advance notice of proposed rulemaking by HUD was issued on December 30, 1997 to consider expanding HUD’s oversight of Fannie and Freddie to include regulations on the GSEs’ non-mortgage investments. HUD is seeking comments on whether Fannie and Freddie should be permitted to make non-mortgage investments, and if so, what types of investments should be allowed. Also, HUD wants to know whether it should set numerical or percentage-of-assets limits on non-mortgage investments. Particular comment is sought on the legal rationale for such limits. HUD also asked the following:
 1. What criteria would be reasonable and feasible for HUD to employ to distinguish mortgage-related investments from other investments;
 2. What would be a reasonable and feasible basis for HUD to use to limit the size (in dollars or relative to mortgage investments) and/or type of the companies’ short term and/or long term non-mortgage investment holdings;

3. Should HUD prohibit the companies from borrowing for the purpose of reinvesting the proceeds in non-mortgage investments in order to profit on the yield or spread. If so, how should the restriction be formulated and on what legal basis;
 4. How should HUD monitor the GSEs' non-mortgage investments; and
 5. Should the department establish special reporting rules on non-mortgage investments.
- A controversy over Freddie Mac's purchase of Phillip Morris bonds last year drew attention to the non-mortgage investments of Fannie Mae and Freddie Mac for the first time. Freddie Mac sold the tobacco company bonds in the heat of publicity after House Banking Committee Chairman Jim Leach (R-IA) asked HUD and congressional legislators to examine whether these investments in long-term corporate bonds are appropriate under the GSEs' charters. Chairman Leach indicated that the investment in the bonds represented a subsidy to the tobacco industry and that Freddie Mac "used its privileged GSE status to go to the capital markets and borrow \$125 million at 6.99 percent. It then turned around and bought \$125 million in identical maturity Phillip Morris bonds at 7.68 percent." Freddie Mac said at the time that it sold the bonds to avoid tarnishing its image among legislators and the public. Chairman Leach has also said that these ventures are signs that Fannie and Freddie are abandoning their charter of providing benefits to low-income citizens.
 - About 16% of Fannie Mae's balance sheet assets and 11% of Freddie Mac's were non-mortgage investments at the end of 1996, according to the GAO. Fannie Mae had total assets of \$342.87 billion at the end of 1996, while Freddie Mac had \$153.79 billion. More than half of Freddie Mac's non-mortgage investments and more than 40% of Fannie Mae's were short-term investments in cash, cash equivalents, term federal funds, and eurodollar deposits. Fannie Mae and Freddie Mac have previously defended diversifying their investment portfolios by saying it secures them against changes in interest rates. (*Milwaukee Journal Sentinel*, 1/1/98; *BNA Daily Report*, 1/2/98; *National Mortgage News* web site, 1/6/98)
 - *OFHEO to Start Annual GSE Examinations:*
 - After three years of preparation and development, OFHEO will start conducting regular annual examinations of Fannie Mae and Freddie Mac this month. Scott Calhoun, OFHEO's Director of Examination and Oversight, said the examinations are designed to continuously monitor risk, such as credit and interest rate risk and monitor operational changes as well as new business initiatives. In 1998, for example, the agency intends to look at Freddie Mac's plans to enter the B&C market and Fannie Mae's plans to enter the manufactured housing market. OFHEO has come under scrutiny by Congressional legislators who are concerned that the agency's oversight of Fannie Mae and Freddie Mac is insufficient. Some critics advocate merging OFHEO with the Federal Housing Finance Board. In the past, OFHEO tested Fannie and Freddie's ability to identify, measure and control risks to capital resulting from shocks to six areas including credit, interest rates and in-house operations and published its results separately. Under the new

program, OFHEO would perform one test over the course of a year that would cover all those areas. "Instead of closing the book on one exam and then going on to another, we will be studying these risks year round," said OFHEO spokeswoman Jill Weide. OFHEO is more than two years delinquent on a pledge to deliver rules concerning how much capital Fannie Mae and Freddie Mac must hold in reserve to survive economic trouble. In October, Chairman of the House Banking Subcommittee of Capital Markets Rep. Richard Baker (R-LA) said he would push to merge OFHEO with the FHFB if OFHEO cannot release its recommendations on capital reserves by September 30. OFHEO representatives will meet with Rep. Baker and other legislators over the next year to create the capital standards, Weide said. (*National Mortgage News* web site, 1/6/98; *Bloomberg News*, 1/2/98)

- *Financial Research Consultant Cautions Lenders about GSEs:*
 - At a recent Mortgage Bankers Association conference in NY, Stuart A. Feldstein, president of SMR Research, cited lack of profitability as a key concern for senior mortgage banking executives. Mr. Feldstein said that Fannie Mae and Freddie Mac are far more profitable than mortgage lenders and that lenders need to do something to "prevent the two agencies from absorbing literally every dollar of "profit" in the industry." (*American Banker*, 1/13/98)

Fannie Mae

- *Fannie Mae's New Joint Partnership Website Allows Consumers to Get Fannie Mae-Quality Approval Directly Without A Loan Officer - Website is Now Nominated for Computerworld Smithsonian Award:*
 - In our December 12th issue of the *GSE Report* we reported that Monument Mortgage's new website, iQualify, is allowing consumers to take over as loan officers and secure widely acceptable approvals for themselves in minutes. According to Monument Mortgage's SVP Lee Decker, "It's the most streamlined underwriting that the consumer could get, and it's independent of any lender." For \$59, users can get a Fannie Mae-quality approval and start shopping for a lender, essentially taking the loan officer out of the loop. Users can also pull their credit histories and identify factors that would jeopardize their approvals. According to an Inman News Feature, "for all the lenders, real estate and Internet content providers partnering up in cyberspace, Monument's Web site, iQualify, is one of the few that fit in the ground-breaking category." (*Inman News Feature Web site*, 11/25/97)
 - Recently, Fannie Mae and Finet Holdings Corp. (Monument Mortgage Inc. is the automated mortgage banking unit of Finet) were nominated for a Computerworld Smithsonian Award for their joint development and interlinking of HomePath.com®, Desktop Underwriter®, and iQualify.com. The iQualify.com website is hyperlinked to Fannie Mae's website so any consumer can submit a streamlined mortgage application through Desktop Underwriter and, within minutes receive a loan decision and

requirements for closing. Approvals are transferable to whichever participating Fannie Mae lender consumers choose to fund their loan. According to Roger Conley, vice president of technology marketing for Fannie Mae, "The recent arrival of iQualify.com on the Internet gives birth to a profound change in the mortgage industry – one that redefines the consumer's relationship to the lender in ways that are more empowering than any changes that have come before." "iQualify empowers consumers to get a faster, easier and lower cost mortgage on their own. It is the only open, vendor-neutral website that delivers Fannie Mae's technology solely for the benefit of consumers," said James W. Noack, Finet's chief information officer. Nominations for the Smithsonian Award are made by members of a committee drawn from executive leaders of prominent U.S. information technology and telecommunications companies. Nominations are based upon the organization's innovative use of technology and worthy of being included in the Permanent Research Collection of the Smithsonian Institute. (*Business Wire*, 1/13/98)

- The iQualify web site advertises that a buyer can get their application approved faster than any banker or mortgage lender without any commitment and a buyer no longer has to pay broker origination fees or get approval through a bank or mortgage lender. iQualify describes itself as a vendor-neutral Internet service, providing potential homebuyers direct access to Fannie Mae's automated underwriting system. When using the iQualify website, there is a hyperlink box marked "lenders" that leads directly to another subsidiary of Finet, PreferenceAmerica - a private mortgage broker that brokers loans to other lenders (approximately 75 lenders). Finet can conduct both retail and wholesale market transactions over the Internet through Monument Mortgage, Finet's automated seller/servicer mortgage banking unit and PreferenceAmerica Mortgage Network, the electronic mortgage broker representing other mortgage lenders. Finet has also developed, the Agent Connector through its subsidiary, the Property Transaction Network. Debuted at the National Association of Realtors convention late last year, the Agent Connector allows instant posting of personalized Web pages and Internet home listing, and connectivity to a variety of electronically delivered real estate transaction services. (*iQualify website*, 1/14/98; *Business Wire*, 11/25/97)

[Corporate Background of Finet Holdings Corp: Finet Holdings Corp. (NASDAQ: FNHC) was organized in 1988 as William & Clarissa, Inc. to develop and market upscale children's skin care products. There was an initial public offering in 1989 but the company was unable to compete successfully in the national market, and in 1991, the Company reorganized and discontinued the skincare business with losses of \$9.3 million. The company then redirected itself and in December 1991, through an exchange of stock, Finex Corporation, a mortgage brokerage firm, became a wholly owned subsidiary. The company was then renamed Finet Holdings Corp (Company), and Finex Corporation was renamed Finet Corporation ("Finet"). Finet was founded in 1990 and began operations in 1991 where it focused on delivering technology driven point of sale presentations to realtors. When the Company acquired Finet it dropped the Realtor focus and focused growth instead on franchising. However no franchises were ever licensed and the Company's approval to franchise expired and was not renewed. In 1993, Finet engaged in a venture with a group of Mexican investors in the mortgage credit business in Mexico. The deal went sour and attempts by the Mexican investors to purchase Finet's interest in the venture are still ongoing and no expectations are available. In 1994, the company acquired a comparably sized, multi-office Bay Area Mortgage broker but the integration of the firm was troubled and in late 1995, three Finet branches defected and four of the Company's five senior executives left the firm. Since inception in 1988 through 1995, the Company experienced continuous operating losses. The Company decided to shift toward a one-stop shopping enterprise by creating a spectrum of homeowner servicers, which resulted in Finet's decision to acquire Monument Mortgage and PreferenceAmerica on December 31, 1996. According to their SEC filing in December of 1996 (before its acquisition of Monument Mortgage and PreferenceAmerica)- on the

date of their SEC report on 12/30/96, the previous (12/23/96) closing price was \$.04 per share, and the opening and low prices per share were \$1.625 per share and the high and closing prices per share were \$1.85. On August 5, 1997, the sales price for the Common Stock was \$3.18 per share and on January 14, 1998, the price was up to \$4. (*SEC Filings for 1996 and 1997*)

- *Fannie Mae Issues \$4 Billion in Global Bonds – Only \$2 Billion Was Expected:*
 - Bankers report that the enormous volume of new issues in the international market, traditional for January, is misleading as large unsold positions remained with underwriters, who currently are willing to build inventory as issuers rush to lock in the favorable terms now available. An exception to this trend is the \$4 billion of five-year global bonds sold recently by Fannie Mae. Originally targeted to be at least \$2 billion, the issue attracted huge interest from institutional investors as a higher yielding surrogate for Treasury notes and the promise of liquidity. The notes are the first of an expected \$35 billion that the agency will raise this year through a series of benchmark issues that will be sold in a range of maturities from three to 10 years. The minimum size of each issue is to be \$2 billion, and additional supplements may be sold in increments of \$500 million. Underwriters estimated that more than half of the issue would be placed outside the United States. The paper was priced to yield 19 basis points over comparably dated Treasury notes; this is a spread of 2 basis points less than Fannie has traditionally paid issuing just domestic debt. On a \$4 billion issue, that amounts to an \$800,000 annual saving on interest payments. The new issue was very broadly distributed and well oversubscribed, said Linda Knight, senior vice president and treasurer of Fannie Mae. The record size benchmark bond sale dwarfs Fannie Mae's "usual" offerings, which range in size from around \$125 million to nearly \$700 million, she said. "The investment community has told us liquidity is very important to them, and we've provided it with this deal." Fannie Mae is also mulling a 10-year benchmark for the first quarter. The five-year bond was priced close to the session's high, with a yield of 5.328%, says MCM Corporate Watch. (*International Herald Tribune*, 1/12/98; *Investor's Business Daily*, 1/13/98)

- *Fannie Mae Reports Record 1997 Earnings:*
 - Fannie Mae reported earnings for 1997 of \$3 billion and \$3.83 per common share. This compares with earnings of \$2.725 billion or \$2.48 per share for 1996. The 1997 earnings per common share were 14.1% over 1996. Improved credit quality and a jump in net interest income helped Fannie Mae report an 11% increase in fourth quarter net income. An active national housing scene and low interest rates aided the company in the second half of the year, which generated demand for the fixed-rate mortgages bought by Fannie Mae and Freddie Mac. Lawrence Small, Fannie Mae's president and chief operating officer, said that after growing at a 4.9% rate over the first half of the year, growth in Fannie Mae's total business rose to a 9.5% rate in the second half, and was 7.3% for the full year. Fannie Mae's Chief Financial Officer said he sees 1998 as a solid year for Fannie Mae, but said typical risks include growth of business volumes, credit costs and interest margins. Fannie Mae's mortgage portfolio grew 10.5%, from \$286 billion in 12/96 to \$316 billion in 12/97. The company issued \$149.4 billion of MBSs in 1997,

ending the year with \$710 billion in MBSs outstanding. (*Business Wire*, 1/14/98; *Dow Jones Online News*, 1/14/98)

- *Fannie Mae Works to Create Moscow Mortgage Market:*
 - Moscow Mayor Yuri Luzhkov and Harvard University's John F. Kennedy School announced an agreement in which Moscow's city government would join with BankBoston Corp, Fannie Mae, the International Finance Corp. and the law firm of Day, Berry & Howard to create a Moscow mortgage market. The group plans to outline a plan within 90 days for the necessary legal, regulatory, institutional and financial elements for a mortgage market in Moscow, where none exists now. Under the current system, the city pays contractors who build housing and then the homes are sold through official realtors without financing. Only the wealthiest residents can afford new homes and apartments, which must be paid for in one lump sum. (*Reuters*, 1/11/98; *Associated Press*, 1/11/98)
- *New Home Equity Conversion Software Compares HUD's and Fannie Mae's Reverse-Mortgage Program:*
 - Lenders can now receive a seal of approval from the not-for-profit National Center for Home Equity Conversion (NCHEC) by offering the NCHEC's software program that compares the major reverse mortgage loans that are available. Two programs dominate the reverse-mortgage market: The Home Equity Conversion Mortgage (HECM), insured by HUD and the HomeKeeper Mortgage from Fannie Mae. Two smaller programs are available in a limited number of states. For the majority of homebuyers, HUD's HECM loan is by far the better buy, says NCHEC president Ken Scholen. But some lenders offer only the HomeKeeper loan. If they have both, HomeKeeper may be the one they push. HomeKeeper pays the lenders higher fees. Banks generally collect up to \$4,543 for selling to HomeKeeper versus a maximum of \$1,8000 for selling HUD's HECM loan. In certain circumstances, the HomeKeeper may be the better buy, Scholen says – for certain single people with home worth more than the median in their county. But every application has to be analyzed separately – considering your age, marital status, where you live, the equity in your home and the loan's term. Only NCHEC's software compares HECM and HomeKeeper by exactly the same standard, to get a fair result. (Jane Bryant Quinn Article ran in the *Beacon Journal Online*, 1/13/98; *Buffalo News*, 1/7/98; *Chicago Tribune*, 1/8/98;; *Lexington Herald Leader*, 1/6/98; *Pantagraph-Bloomington, IL*, 1/7/98; *Sun Sentinel-Ft. Lauderdale*, 1/6/98; *Times Union*, 1/13/98)
- *Analyst Considers Fannie Mae the Biggest Risk to Market Share for "D" Lenders:*
 - Fox-Pitt, Kelton analyst Reilly Tierney believes that the biggest impact from Countrywide's entrance into the "D" market will be on First Alliance, because it is the biggest player in the "D" market. He further stated that Countrywide is a large player, but no single mortgage lender has a dominant market share. The bigger risk to lenders like First Alliance would be if Fannie Mae were to join the D market, he said. (*American Banker*, 1/16/98)

- *Fannie Mae's American Communities Fund Invests in Modular Home Manufacturing Plant:*
 - Fannie Mae's venture fund, the American Communities Fund (ACF) has made a \$1.2 million equity investment in Chicago Building Structures (CBS). The investment will help fund renovation of a 60,000 square foot modular housing manufacturing plant in the City's West Pullman neighborhood. CBS will renovate a long-vacant property to house the new plant. The plant will manufacture wood-framed single and multifamily modular housing residences, small commercial and retail buildings, and pre-assembled components to support new home and rehabilitation projects for low- and moderate-income families. CBS estimates it will produce between 250 and 400 homes in 1998. U.S. Congressman Jesse Jackson, Jr. (D-IL) stated that "this is a win/win situation for Chicago. This housing manufacturer will create quality homes while providing jobs and job training where they are needed most." The CBS factory is also creating approximately 200 factory-related jobs, job training for unskilled workers and job opportunities for some welfare recipients. CBS will build nine to 10 standard models that will include split-level, two-story, townhouses, row houses and two and three story multifamily units. The homes will range in size from 1,000 square feet to 1,600 square feet and will range in price from \$70,000 to \$140,000. Certain models of modular homes will be affordable to individuals and families with incomes below \$40,000. The factory-built homes will be marketed through developers and not-for-profit groups in underserved Chicago communities. (*Business Wire*, 1/12/98; *Chicago Tribune* website, 1/13/98)

- *Fannie Mae, Montgomery County HFC, and Congressman Kevin Brady Announce New Source of Affordable Mortgage Funds for 200 Low- and Moderate-Income Home Buyers:*
 - Fannie Mae and the Montgomery County Housing Finance Corporation (HFC) have developed a \$10 million home mortgage bond finance agreement that will help more than 200 Montgomery County, TX families have access to below-market mortgage rates. Fannie Mae has agreed to purchase the entire \$10 million single-family, tax-exempt mortgage revenue bond (MRB) issuance from the Montgomery County HFC. The bond proceeds will be made available through six mortgage lenders to provide financing for 30-year, fixed-rate mortgages with a below-market interest rate of 6.8%. The Montgomery County HFC will pay 3% of qualifying borrowers' down payment or closing costs. Fannie Mae's Community Home Buyer's Program and Fannie 97 – flexible, low down payment mortgage products – can be used by eligible applicants in conjunction with the HFC's down payment and closing cost assistance. "These reduced interest rate mortgages can shave hundreds of dollars off families' mortgage payments," said Congressman Kevin Brady (R-TX) who recently met with Fannie Mae officials to discuss new avenues of community development. (*Business Wire*, 1/8/98)

- *Fannie Mae Chairman Attends Washington Elite Fundraiser for MA District Attorney Race:*
 - Jack Corrigan, a Democratic candidate for district attorney for Norfolk County raised \$14,000 during a fundraiser at the home of consultant Tony Podesta. Corrigan established a national reputation as a Democratic political operative in the presidential

campaigns of Senator Edward Kennedy, Walter Mondale, and Michael Dukakis before his eight-year tenure as a Norfolk County prosecutor. Among those attending the fundraiser were Fannie Mae Chairman James Johnson; White House Presidential aides John Podesta (assistant to the President & Deputy Chief of Staff), Doug Sosnik (Counselor to the President), Susan Brophy (Deputy Assistant to the President & Deputy Director of Legislative Affairs; also newly married to Portugal Ambassador, Gerard McGowan) and Victoria Radd (Assistant to the Chief of Staff to the Chief of Staff); Peace Corps Director Mark Gearan; FAA director Jane Garvey; AFL-CIO officials Gerry Shea and Tom Donahue; former Democratic Party Chairman Paul Kirk, and Representative William Delahunt (D-MA). (*Boston Globe Online*, 1/10/98)

- *Fannie Mae Assisting in Program to Provide Loans to American Indians:*
 - Mortgage lenders have found it difficult to make mortgage loans to American Indians due to a number of legal restrictions and outright prohibitions. The biggest problem for mortgage lenders is that reservation trust can't be used for collateral without the express consent of the government, which holds title to the land in trust for the indigenous people on it. A second problem is that due to tribes' status as sovereign nations, local courts have no jurisdiction on tribal lands. Some lenders may feel that won't get a fair shake in tribal courts when it comes to foreclosure, and some tribal courts don't even have foreclosure and eviction codes in place. Another problem is that most tribes must be willing to grant limited waivers of their sovereign immunity in order to allow mortgage lending, which some tribes are zealous in protecting. In response to these problems, Fannie Mae has been negotiating for the last year with the nation's largest Indian tribe to allow Fannie Mae to buy conventional mortgages made there by private lenders. Fannie Mae and the Navajo Nation, which has 200,000 people and is as big as West Virginia, have an agreement in principle. Now both parties must give final approval and the government, in the form of the Bureau of Indian Affairs, must okay the deal as well. Foreclosure has been one of the most difficult areas in the Navajo deal. The Navajo Solicitor General has issued an opinion clearing away the sovereign immunity issues and stating for lenders that foreclosure, eviction, and lien priority codes are in place to allow them to perfect a security interest on the reservation. Fannie Mae has accommodated the tribe's reluctance to lose any land in foreclosure by allowing it to find another tribal borrower if the first one defaults, or even to assume the mortgage itself. (*US Banker*, Dec. 1997)
- *Fannie Mae Contributes to Housing Counseling Program for First-Time Homebuyers:*
 - The Community Development Corp., a 28-year old nonprofit housing group, recently received funding from Fannie Mae for a new housing counseling program. The program works with people trying to buy their first home, teaching them about the purchasing process. The group received a \$15,000 grant from Fannie Mae to help fund the program and hopes to be approved by the New York State Mortgage Coalition, a consortium of 10 lenders, that would make low-down-payment loans to buyers who complete counseling. (*Newsday*, 1/2/98)

- *Fannie Mae Foundation Participates in DC Area Partnership to Assist Legal Immigrants:*
 - The Fannie Mae Foundation is a participant in the Washington Area Partnership for New Citizens, a grantmaking coalition of corporations, foundations, and local governments in the Washington area. The primary goals of the Partnership are to increase the number of naturalized legal immigrants in the Washington area, build new community-based services for legal immigrants, encourage groups and companies to contribute to immigrant issues in the Washington area, and to encourage partnerships between the private sector philanthropies and local governments to support immigrants. The Partnership recently received a \$450,000 grant for a period of two years from the philanthropist, George Soros. (*PR Newswire, 1/7/98*)

Freddie Mac

- *U.S. Department of Veterans' Affairs Approves Loan Prospector- Will FHA Be Next?:*
 - In October of 1997, the Department of Veteran's Affairs agreed to unquestioningly accept any loan that passed streamlined underwriting by Freddie Mac's Loan Prospector. Freddie Mac says it is confident that the Federal Housing Administration (FHA) will do likewise for FHAs. Sarah Rosen, special assistant to the FHA Commissioner, said recently, "We're pleased with the progress of our review of Loan Prospector and expect to conclude the process by year end." Freddie Mac recently concluded two separate pilots, one for FHAs, in which 11,000 loans were underwritten, and one for VAs, in which 6,000 loans were underwritten. FHAs and VAs combined represent between 20% and 25% of total mortgage lending. Freddie Mac's is the only automated underwriting system to have been tested by the agencies that guarantee government loans, although several systems underwrite such loans. Neither FHA nor the veterans department have scheduled other tests of underwriting systems, although they are open to such tests, according to their spokespersons.
 - According to PMI Mortgage, PMI and Fannie Mae together are seeking FHA-underwriting approval from HUD for a forthcoming version of pmiAURA. HUD requested that a new version, based on HUD's database of loans be developed. A point of criticism on the pmiAURA system has been that the system was developed from conventional loans and just validated against government loans. Freddie Mac's Loan Prospector was the first government loan-underwriter developed from government loans after Freddie Mac asked HUD for a sample. Freddie received 1.5 million in FHA loans, originated between 1990 and 1991 and the first FHA loan was underwritten by Loan Prospector in March, 1996, and in September, HUD was confident enough to let a group of 10 lenders rely on Loan Prospector's underwriting methodology alone. PMI's system, which first underwrote a government loan in 1993, will get documentation relief from HUD once it approves the forthcoming version of pmiAURA.
 - A pilot participant, Zions Mortgage, is now trying to determine by how much it can cut its cost to government loans applicants. Steve Carlson, vice president, says Zions has to

quantify the cost savings and compare them with the cost of using Loan Prospector. (One lender who preferred not to be named, said FHA dictated that Freddie Mac charge \$35 per FHA loan, which is less than the rate Freddie charges for an acceptance decision on its own loans- typically \$50.) Zions does not use pmiAURA because, Carlson says, "We didn't feel it gained us anything if we didn't have the blessing of the loan guaranteeing agency."

- If HUD approves Loan Prospector, as many expect, it will mark a change in the government agency's attitude toward automated underwriting. In a letter to lenders last year, HUD said, "As was stated in [letter] 95-7, the FHA will not approve an individual automated underwriting system. It will not approve Loan Prospector per se, but it will consider its use." The seed of change might date back to a March 1996 report by the OMB that expressed fear that-without their own advanced methods for gauging mortgage risk-the government loan programs could be adversely selected, targeted by conventional lenders' scoring systems. (*ABA Banking Journal*, December 1997)
- *Freddie Mac Announces Record Earnings for 1997 – Up 15%:*
 - Freddie Mac announced record basic earnings per common share of \$1.90 for 1997, a 15% increase over 1996 earnings of \$1.65 per share. Net income for 1997 was \$1.395 billion, a 12% increase over 1996 net income of \$1.243 billion. "We increased earnings per share by 15 percent and our return on common equity exceeded 20 percent for the sixteenth consecutive year," said Leland Brendsel, Chairman and CEO. Freddie Mac's retained mortgage portfolio ended 1997 at \$164.421 billion, up 19.3% from \$137.755 billion at the end of 1996. The average balance in the retained portfolio was \$150.7 billion through 1997, up 21.4% from \$124.1 billion, the average portfolio balance in 1996. (*PR Newswire*, 1/15/98; *Dow Jones*, 1/15/98)
- *Maxim Group Enters Exclusive Floorcovering Arrangement with Freddie Mac:*
 - The Maxim Group has entered into an exclusive arrangement to provide floorcovering products for HomeSteps, the home sale division of Freddie Mac. HomeSteps repaints and repairs repossessed homes before placing them on the market in move-in condition. Homes marketed by HomeSteps are properties owned by Freddie Mac. The program offers seller-financing arrangements with lenders around the country. Under the plan homebuyers can obtain mortgages for up to 95% of the purchase price and are not required to pay mortgage insurance. HomeSteps also can waive the appraisal costs. Homebuyers can locate HomeSteps houses either over the Internet or by telephone. (*Business Wire*, 1/6/98; *PR Newswire*, 11/18/97; *Inman News Feature*, 11/17/97)
- *Loan Prospector VP Promoted at Freddie Mac:*
 - Peter Maselli, former vice-president of automated loan evaluation service Loan Prospector, has been promoted to senior vice president of business development at Freddie Mac. Michael May, former vice president of Loan Prospector business management, will assume responsibility for the operations of the loan service. The

company credited Mr. Maselli for the success of Loan Prospector, which debuted in February 1995 and has evaluated half of the mortgages Freddie Mac purchased in 1997. The tool is expected to evaluate 80% of loans purchased in 1998. (*Inman News Feature*, 1/7/98)

International "GSEs"

- *Thailand's Secondary Mortgage Corporation Opens for Business:*
 - Thailand's new Secondary Mortgage Corporation (SMC) plans to buy the first mortgage loans in the second quarter of 1998 and hopes to begin to securitize mortgage portfolios near the end of the year. Surabhon Kwunchaithunya, SMC's new president, said that he expects to hire Fannie Mae to advise on operations and technical matters and is also talking to several investment banks about a contract to provide advice on funding strategy. The SMC will closely resemble the Hong Kong Mortgage Corporation (HKMC), in turn based on Fannie Mae. Initial funding is in place, with the Bank of Thailand providing one billion baht (\$22.6 million) of start-up capital. Starting early next year, the SMC will raise another four million baht (\$90.4 million) of capital by issuing bonds guaranteed by the government. (*Mortgage Marketplace-American Banker*, 1/5/98)

Federal Home Loan Banks

- *FHLBank of Des Moines Aides Flood Victims:*
 - The FHLBank of Des Moines is assisting people in the Grand Forks, ND area who suffered losses during last spring's flooding through its Affordable Housing Program grants. The Bank of North Dakota's Victory Rehabilitation Program received a \$70,000 grant on December 23rd from the FHLB that will be used to provide loans to families with incomes below 50% of the area's median income. The United Prairie Bank of Slayton, along with its partner, the United Community Bankers' Development Corp., received a \$448,000 AHP grant for the Minnesota Flood Relief Buy-out and Replacement Housing Program. The FHLBank of Des Moines has committed more than \$100 million through member institutions in an effort to assist flood victims with below-market rate loans. (*National Mortgage News Web site*, 1/12/98)
- *FHLBank of Topeka Donates to Homeless and Low-Income Families:*
 - Since February 1997, the employees of the FHLBank of Topeka have been a partner of Cornerstone of Topeka, Inc., donating more than \$10,3000 and volunteering more than 400 hours of community service. Cornerstone is a local nonprofit organization that provides housing to homeless and low-income families. Cornerstone's Transitional Housing and Education Program (THEP), allows families to reside for up to six months in one of 12 rent- and utilities-free apartments. During that time, family members take

classes on budgeting, parenting and nutrition. After completing the program, most graduates find permanent housing. (*The Topeka Capital-Journal*, 12/30/97)

Farm Credit System

- *Farm Credit System Heats up Competition with Banks:*
 - The Farm Credit System is aggressively trying to boost its 25% share of the agricultural lending market - eleven years after the system nearly collapsed during a farm crisis. Commercial banks, which have long viewed the system warily, already are feeling the heat. "They're getting tougher all the time- they're getting bolder," said Duane W. Foelske, senior vice president at State Bank of Waverly in Iowa. John Blanchfield, manager of agricultural banking for the American Bankers Association stated that "They're doing a lot of stuff – and our guys don't like any of it." In the view of many bankers, the system is an unfair competitor and they view it as a monolithic agency bent on stealing their customers. Bankers also point out that the system is able to fund itself with bonds that carry the implicit guarantee of the government. "We're competing with our own government," said Dennis White, chairman of First Bankshares in ND. "They compete head to head with us for agricultural operating loans and cattle loans and real estate loans. But they're able to buy their money a lot cheaper than we can."
 - The Farm Credit Administration argues that the system keeps food prices down, by giving farmers and ranchers another funding option. The CEO of the Farm Credit Administration maintains that the cost of credit would rise one percentage point in most markets if the system disappeared tomorrow. "They are a vital part of the rural credit landscape," said Bret Healy, legislative assistant to Senator Tim Johnson (D-SD), who specializes in agriculture and international trade.
 - Commercial banks still hold a majority of farm debt (approximately 40%) but the industry lost some ground to the Farm Credit System in 1996 – the first time in 14 years that banks lost market share. An aggressive cost-cutting program including the closure of 31 Farm credit banks and associations helped to revive the system. The Farm Credit Administration's CEO Marsha Pyle Martin believes that the GSE will grow stronger and that Congress will not need to bail out the system again. Congress bailed out the system in 1987 and since then, the system has been increasing its capital nearly 50% in the past five years.
 - Banks are anxious about the system moving beyond its original areas of serving mainly farmers and ranchers. The Farm Credit system launched a program aimed at giving agribusiness, such as seed dealers and farm equipment manufacturers, equipment and operating loans and accounts receivable financing. The ABA and IBAA believe that the Farm Credit's entrance into this business will cut further into banks' business and the groups are deciding whether to appeal a U.S. District Court judge's recent decision allowing the practice to continue. A heavy advertising campaign is also hitting the bankers by the system. Mr. Foelske, the Iowa banker, said the Farm Credit banks in the Midwest are pummeling commercial banks by advertising five-year, fixed-rate

agricultural loans and 15-year, fixed-rate farm real estate loans at 7.75%. He said his bank could offer the five-year loan at no lower than 8.5%. (*American Banker*, 1/14/98)

- *Farm Credit System Opens New Agribusiness Trade Credit Program:*
 - The Farm Credit System has announced a new agribusiness trade credit program called AgSmart. AgSmart provides equipment loans and leases, operates loans, and an accounts receivable financing program to national and regional agribusinesses that can, in turn, offer them to their customers. The program can serve a broad set of agribusiness needs including equipment, chemical, fertilizer, and seed dealers, wholesalers, and manufacturers, along with a variety of other input suppliers and cooperatives. AgSmart has a National Director, three national sales managers and more than 100 relationship managers – Farm Credit System representatives across the county who are responsible for providing service and programs to AgSmart clients. AgSmart is headquartered in St. Paul, MN and its customer service center in Dallas, TX. AgSmart is owned by banks and associations in the Farm Credit System. (*PR Newswire*, 1/5/98)

Farmer Mac

- *Gaining Acceptance by Agricultural Bankers, Farmer Mac Plows Deeper into the Black:*
 - The once-struggling Farmer Mac program is slowly winning over agricultural bankers. The dollar total of loans bought by Farmer Mac has risen nearly 64% in the last two years, and the formerly-money losing corporation turned a profit in 1997 for the second year in a row. Farmer Mac's class C stock has also soared to more than \$60 a share (from a low of \$4.25 in 1995). Initially, Farmer Mac lost money and generated little interest among bankers. Officials say the original program failed because it would not let banks sell loans directly to Farmer Mac. Instead, banks had to sell loans to a pooler – a large commercial bank or insurance company. Bankers said the third party added costs, which translated into higher interest rates for farmers. In 1996, Congress changed the law to allow Farmer Mac to act as its own loan pooler and also to eliminate a requirement that banks hold 10% in cash reserves for the loans they sold. It also gave the corporation two years to reach a minimum capital level of \$25 million. Bankers said the program lets them move long-term, fixed-rate agricultural real estate loans off their books. Farmer Mac has used workshops, direct mail and cold calls to drum up business with banks. In addition to securitizing agricultural loans under the Farmer Mac 2 program, the government-sponsored enterprise also buys the securitized portion of Farm Service Agency loans through the Farmer Mac 2 program. So far, 150 lenders, most of them community banks, are selling loans to Farmer Mac, according to Tom Stenson, vice president for agricultural finance at the agency. The lenders include some Farm Credit System banks, government-sponsored enterprises that compete with community banks by lending directly to farmers. (*American Banker*, 1/5/98)
- *Farmer Mac Stock Hits Banner-Year:*

- The hottest stock of 1996 was Farmer Mac. When investors discovered Farmer Mac last year, the stock jumped to \$30.75 a share from \$5. Last year, Farmer Mac stock doubled – to \$61. Farmer Mac stock is likely to have legs and could continue to outperform the market, at least until the company matures into a moderate-growth blue-chip business like Fannie and Freddie. (*Washington Post*, 1/12/98)

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