

# The **GSE** REPORT

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

- *Fannie and Freddie May Oppose Higher FHA Limits:*
  - HUD Secretary Andrew Cuomo announced that President Clinton's 1999 budget proposal to Congress in February will propose that FHA have the same loan ceiling as Fannie Mae and Freddie Mac. Loans under the FHA program are now insured up to 75% of the Fannie/Freddie ceiling. Rep. Rick Lazio (R-NY), Chairman of the Housing Subcommittee of the House Banking Committee, opposes the FHA increase. "President Clinton wants to pay for pet programs by expanding government's intrusion into private markets," Rep. Lazio said in a statement in 1996, when the President first proposed the increase. "The only real outcome of this proposal will be to energize Fannie Mae to engage in another expensive campaign to protect their government-subsidized market share." Rep. Lazio and Secretary Cuomo both acknowledge that the debate over FHA is also a debate over market share. Through a complex set of subsidies and other privileges, the government has carved up the nation's home loan market among different players. Up to the conforming loan limit (now \$227,15), Fannie and Freddie dominate the market buying approximately 40% of the loans. For loans with downpayments under 20%, Fannie and Freddie require homebuyers to get private mortgage insurance. Fannie and Freddie have never supported the FHA's expansion. Secretary Cuomo said he did not "see any obvious reason" why Fannie Mae and Freddie Mac would oppose the expansion. (*American Banker*, 1/21/98)
- *Fannie and Freddie could Benefit from the Integration of Real Estate Closing Services:*
  - Beth Cobert, a principal at the management consulting firm McKinsey & Co, and Cathy Kenworth, a VP of marketing and strategic planning at GE Capital Mortgage wrote a two-part report on the new opportunities for integrating closing services for real estate mortgage loans. They found that there was a lack of integration in the closing services and that there were many players positioned to benefit if the process was restructured. The first group to capture a piece of the opportunity they believe are those that already enjoy substantial presence and influence in the transaction, such as Fannie Mae, Freddie Mac, Cendant Corporation (formerly HFS), State Farm, Allstate, Chicago Title, First

American, Norwest, Countrywide, and Chase. There are various ways they feel that a participant could exploit opportunities. The report stated that: "Within the existing business system, roughly a quarter of the total value up for grabs will come from cost and skill improvements – especially the upgrading of credit expertise. A further half of the value will be derived from the restructuring of the business system across categories that will occur when an individual player or type of player emerges as a dominant force within the transaction, unlocking additional cost and skill improvements. Such players may increase their dominance by knocking others out of the picture; it's not hard to imagine buying or selling a home without a realtor or mortgage originator or lawyer. Current players or new entrants may also create entirely new roles that draw together a range of closing products or services." (*Inman News Feature*, 1/26/98)

- *MBA Plans Industrywide Year 2000 Testing Project for Lenders, Servicers and GSEs:*
  - The Mortgage Bankers Association is planning a test project for the mortgage industry for Year 2000 computer compliance. The project, which would begin in 1999, would examine how a participant's systems handle exchanges of information on credit scoring, loan underwriting, and loan servicing. Participants include Fannie Mae, Freddie Mac, HUD, and important private sector players. The project would establish a database that participants could use to measure their performance. The framework for industry testing is expected to be completed in April. (*American Banker*, 1/27/98)

## ***Fannie Mae***

- *Fannie Mae Introduces New High LTV Product Nationwide – Fannie Expands HomeStyle (home rehabilitation) Program Across the Nation:*
  - Fannie Mae said it is expanding its home improvement and rehabilitation financing initiative. The national initiative, HomeStyle America will provide customers with a full range of affordable home repair and renovation financing options, and provide standard documents for the rehabilitation finance market. Fannie Mae's HomeStyle collection of renovation mortgages was introduced on a small scale during the past year and will now be available nationwide. (*Reuters*, 1/20/98)
  - Officials at Fannie Mae concede that Fannie Mae's new second mortgage program, HomeStyle Remodeler could result in borrowers owing more than their properties are worth. The new loan allows homeowners with "very little equity" to borrow up to \$50,000 for as long as 20 years to make practically any type of permanent home improvement. "Theoretically" said Herb Moses, director of single-family business in Fannie Mae's marketing division, "it's possible" the combined LTV ratio of the current first mortgage and the new Fannie Mae second could exceed 100% of the home's value. "Though it's not intentional, you can always end up with a set [a] circumstances in which the borrower will be underwater," Mr. Moses admitted. "But with the safeguards we've built into the program, we think we're on pretty safe ground." (*National Mortgage News* web site, 1/26/98)

- *(Excerpted from the October 31<sup>st</sup>, 1997 GSE Report – Details about the HomeStyle High LTV Pilot Program in Long Island last year):*
- On October 27, Fannie Mae hosted a press conference with Senator Alfonse D’Amato, Representatives Peter King (R-NY), Carolyn McCarthy (D-NY), and Nassau and Suffolk County Representatives announcing its \$50 million new program, “HomeStyle Long Island.” The program offered a collection of mortgage products that allowed consumers to purchase homes that need fixing up or to renovate a home they currently own. The initiative included “HomeStyle Remodeler,” a new home improvement loan that provided second mortgages up to \$50,000 to homeowners with good credit but little equity who want to make moderate to major improvements to their existing home. HomeStyle Remodeler offered loan terms from 5-20 years, and the loan could also be used to improve a second home. Also available for the first time, was Fannie “Flexible 97 mortgage” that allowed a borrower to purchase a home with a very low down payment loan (as low as 3%) which could come from the borrower’s own funds, a gift from a family member, a grant or an unsecured loan. The “Flexible 97 mortgage” also could be used for home purchase and renovation in which case up to 30% of the as-completed value of the property might be used for renovation expenses. The loan amount under the purchase and renovation option was based on the value of the property after the repairs are completed up to a limit of \$214,600. There were no income limits for these “Flexible 97 mortgages. Other mortgage products offered included:
  - HomeStyle Standard Mortgage – provided financing for one- to four-unit properties, allowing up to 50% of the as-completed value of the property to be used to finance the costs of remodeling or repairs;
  - HomeStyle Investor Mortgage – allowed investors to purchase and rehabilitate single unit properties with a loan that would be assumed within 18 months by an owner-occupant;
  - HomeStyle Community Mortgage – product allowed down payments of as little as five percent for borrowers with incomes up to \$89,050 (130 percent of the Long Island area median income of \$68,500). Up to 50% of the as-completed value of the property could be used for renovation costs, and;
  - FHA Title I – Fannie Mae made available home improvement loans of up to \$60,000 for 5- to 12-unit properties. Fannie Mae increased its loan limits to match the Title I program. The loan limit is \$36,000 for three-unit properties and \$48,000 for four-unit properties;
  - HomeStyle Home Keeper Mortgage – allowed seniors 62 years and older to tap into the equity in their homes to make necessary repairs, with no obligation to repay the loan until they moved out of the house; and HomeStyle Remodeler – allowed owners of a condominium to borrow up to \$15,000 to finance renovations. *(Fannie Mae Press Release, 10/20/97, Business Wire, 10/27/97)*
- *Additional Details of HomeStyle High LTV Long Island Program:*
  - The HomeStyle Remodeler and Flexible 97 loan programs from Fannie Mae are only available in Long Island currently, but will be offered soon in Buffalo.

According to the Director of Fannie Mae's New York Partnership Office, Naomi Bayer, in order to qualify for a Fannie Flexible '97 loan, borrowers are required to get a contractor's estimate of the remodeling costs before they purchase the house. The lender instructs the bank's appraiser to value the home based on the improvements. If the loan goes through, the remodeling money is dispensed to the contractor as the work is completed. The lender monitors the work, withholding funds if there's a problem with the work. The lender becomes the buyer's partner in making sure the work is done right, Bayer said. The lender charges a small fee for monitoring the project. The amount varies by lender and can be built into the loan amount, she said. For borrowers who already own a home, the HomeStyle Remodeler loan allows up to \$50,000 to be borrowed as a first, second, or third mortgage. Standard home-equity loan guidelines determine the amount that can be borrowed based on the home's appraised value after the work is completed, giving the homeowner more equity to borrow against, Bayer said. Up to 90% of the appraised value can be borrowed, minus the amount of any existing loans. On loans of less than \$25,000, the lender pays the contractor the entire amount upfront and does not monitor the work. On larger loans, the money is doled out in two installments, half at closing and half when the work is done. The lender inspects the work before the final payment and charges a small fee for the inspection. (*Newsday*, 1/23/98)

- *Fannie Mae's Bully-Boy Tactics:*

- A recent *International Financing Review* Article stated the following: "Fannie Mae's preparedness to hold a large section of the underwriting community to ransom is unsavoury. Irritation with Federal Home Loans' habit of shadowing its borrowing strategy has clouded the agency's perception of what constitutes acceptable market practice ---- With investors placing an increasing premium on credit quality and on liquidity, benchmark borrowers like Fannie Mae have acquired too much leverage over the market. The borrower has shown itself willing to descend to bully-boy tactics in an attempt to scupper a competitor's bond offering. It matters little that the injured issuer should have a record for copy-cat transactions; or that Fannie Mae should be the darling of the international bond markets. Resorting to this sort of intimidation debases the whole market. Few market participants can afford to stand on principle when faced with a determined and vindictive borrower. Most will understandably bow to overwhelming pressure. Shorting the rival transaction, though, seems to go over and above the demands of conventional obsequiousness. Ironically, any attempt to short Federal Home Loan Bank's issue will also harm Fannie Mae's deal, as the performance of both deals is highly correlated." (*International Financing Review*)

- *Fannie Mac Doubles Automated Underwriting Projections After Refi Boom:*

- The refinancing boom has prompted Fannie Mae to double its projection for automated underwriting from what it was a couple of months ago. At a recent Mortgage Technology Conference, William Kelvie, chief information officer of Fannie Mae, announced that the projection for volume through Desktop Underwriter, Fannie's AU

system, is now 10,000 loans per day. At the MBA conference in October, Fannie was projecting just 5,000 loans per day. Fannie anticipates that the volume of originations for the current year, combining new home sales and refis, will total \$950 billion. The accept rate of users of DU has reached 70% according to Mr. Kelvie. Freddie Mac, as part of its entry into the subprime market, is set to initiate a pilot using Loan Prospector, its automated underwriting system. (*National Mortgage News* Web site, 1/26/98)

- *Analysts Raise Earnings Expectations for Fannie and Freddie:*
  - After Fannie and Freddie's strong fourth-quarter results, analysts have raised the earnings expectations of the GSEs. Robert Hottensen, Jr., an analyst at Goldman Sachs & Co, lifted his 12-month price target on Fannie Mae stock to \$68 from \$65 and lifted his Freddie's price target to \$55 from \$53 after seeing the fourth-quarter reports. Mr. Hottensen predicted that the GSEs would benefit from increased mortgage lending and widening spreads between mortgage and Treasury rates. (Fourth Quarter Reports – Fannie Mae reported fourth-quarter earnings of 74 cents per share, a 13.8% gain from the 65 cents earned in the 1996 earlier quarter and net income also rose to \$749 million from \$712.1 million. Freddie Mac reported fourth quarter earnings of 51 cents per share, a 19% gain from 43 cents in the 1996 quarter and net income for the quarter rose from \$321 million to \$372 million.)
  - Analyst Thomas O'Donnell of Salomon Smith Barney also lifted his stock price targets to \$68 (from \$66) for Fannie Mae and \$52 (from \$47) for Freddie Mac. He credits the revival in mortgage portfolio growth in the second half of last year as the most important development of last year. He also credits reduced credit losses due to better servicing programs and deeper mortgage insurance, mild and consistent housing appreciation, strong national economy and low mortgage rates as benefits. "An improvement in credit quality at both Fannie and Freddie has essentially baked in strong earnings per share growth for the next two years at least," Mr. O'Donnell said. He set earnings estimates for this year and next to reflect a growth rate of more than 13% for Fannie Mae and 15% for Freddie Mac.
  - Jonathan Adams, senior analyst with Prudential Securities set his earnings even higher at \$70 (from \$64) for Fannie Mae and \$54 (from \$49) for Freddie Mac. He felt that both companies were developing products that will serve them well in the long-term and he also felt that both had improved credit quality. He felt that Freddie Mac's automated underwriting and its emphasis on purchasing loan pools through risk-based pricing, gave Freddie some competitive advantages and Fannie's introduction of a five-year benchmark note would provide Fannie Mae with an important tool for reducing Fannie's funding cost. He further stated that Fannie Mae was focused on expanding its mortgage portfolio, and many of its fourth-quarter purchases were from seasoned securities, REMICs, or alternative products. (*American Banker*, 1/23/98)
  - Speaking at an investors conference hosted by Salomon Smith Barney, A. Marshall Acuff, a widely respected Wall Street strategist, placed Fannie Mae alongside stock market titans General Electric Co., Microsoft Corp., and Wal-Mart Stores Inc. as one of

the few sure bets for 1998. Mr. Acuff stated “This is a time when we have to focus on individual stocks...the key is on consistency of growth, and Fannie Mae has delivered for the last 10 years.” Fannie Mae is likely to remain a solid bet because of low interest rates and strong demand for housing, Mr. Acuff said. (*American Banker*, 1/27/98)

- *Fannie Mae to Launch \$4.0 Billion 10-Year Bond on February 2<sup>nd</sup>:*
  - Fannie Mae intends to launch a \$4.0 million 10-year benchmark note at a spread of 25-26 basis points over U.S. Treasury notes, lead managers for the deal said on Friday, January 30th. The deal will be launched in Asia on Monday, February 2<sup>nd</sup> and priced early morning New York time the same day. (*Reuters*, 1/20/98)
  
- *Fannie Mae MBS Backs Subprime Title One FHA Home Improvement Loans:*
  - HomeCapital Investment Corp., a TX-based finance company has begun securitizing home improvement and renovation loans thanks to new accounting regulations that allow the company to obtain the advantages of securitization while postponing payments until income is received. The company’s production of loans has resulted in it executing two deals in the mortgage-backed securities market. The first in September 1997, was for \$47.15 million with a 7.335% coupon. It was backed by \$48.12 million of Fannie Mae mortgage-backed securities with an average passthrough rate of 12.25%. The second, in December, was for \$39.19 million, with a 7.261% coupon, which was backed by \$39.59 million of Fannie Mae MBS with an average pass-through rate of 12.25%.
  
  - The deals begin with sub-prime Title One home improvement loans carrying Federal Housing Administration guarantees. These typically have an interest rate in the 14% vicinity. HomeCapital exchanges the raw collateral for Fannie Mae-guaranteed passthroughs backed by the same loans. This step eliminates all the remaining credit risk and results in securities paying a coupon of 12.25%. Fannie Mae’s 50-basis-point guarantee fee and HomeCapital’s 125-basis-point servicing fee account for the drop in interest rate from the original 14%. The roughly 5% margin between the Fannie Mae MBS and the rate on the asset-backeds sold to investors is kept by HomeCapital. For the investor, the deals are straightforward and subject only to prepayment risk, Fannie Mae having eliminated the credit risk, noted Michael Thimmig, executive vice president for capital markets. “Fannie Mae makes the structure simple, a lot easier than whole loans,” Thimmig said. Making the securitization possible is a recent change in accounting rules, explained Thimmig. For Generally Accepted Accounting Principles (GAAP) purposes, the transaction counts as a sale, he said. But the Financial Accounting Standards Board’s statement 125 allows “debt for tax” treatment, permitting HomeCapital to defer taxes on the asset sales until interest payments are received on the mortgage-backed securities. (*Capital Markets Report*, 1/20/98)
  
- *S&P Assigned Preliminary Ratings to Fannie’s Multifamily REMIC Trust:*
  - Standard & Poor’s preliminary ratings reflect the credit support to be provided by the subordinate classes of certificates, the liquidity to be provided by the servicer and the

trustee, the economics of the underlying mortgage loans, and the geographic diversity of the collateral. The preliminary ratings are as follows:

Class	Preliminary Rating
B	BBB-
C	BB
D	BB-
E	B
F	B-

- Standard & Poor's analysis of the portfolio determined that on a weighted-average basis, the multifamily loans have a debt service coverage ratio of 1.32 times, a beginning LTV ratio of 86.8%, and an ending LTV ratio of 75.1%. The cooperative loans have a beginning LTV ratio of 27.2% and an ending LTV ratio of 23.2% on a weighted-average basis. (*Business Wire*, 1/28/98)
- *Fannie Mae Boosts Quarterly Dividend to 24 Cents from 21 Cents:*
  - The Fannie Mae Board of Directors voted new dividends on the company's common and preferred stock: (1) a dividend on its outstanding common stock of 24 cents per share (increase of three cents); (2) a dividend on its outstanding preferred stock, Series A, of \$.80125 per share; (3) a dividend on its outstanding preferred stock, Series B, of \$.81250 per share; and (4) a dividend on its outstanding preferred stock, Series C, of \$.80625. (*Business Wire*, 1/20/98)
- *Fleet's Loansoft WORKS System Will Interface with Fannie Mae Desktop Underwriter:*
  - Loansoft signed a contract with Fleet Mortgage to license Loansoft's WORKS point-of-sale system for nationwide deployment. Fleet plans to deploy WORKS on notebook PCs and plans to have 300 loan officers using the system by the end of March 1998. According to officials at Fleet Mortgage, WORKS will be integrated into Fleet's proprietary processing system. Fleet will be using Loansoft's new Automated Underwriting interface into Fannie Mae Desktop Underwriter™, as well as credit agency interfaces. In September, Fannie Mae announced that Loansoft was selected as the first software vendor to provide seamless access into Desktop Underwriter™ using reduced data set guidelines for easy and quick underwriting decisions at the point-of-sale. (*Business Wire*, 1/29/98)
- *Fannie Mae Presented Award to Congressman Joseph Moakley (D-MA):*
  - U.S. Representative Joseph Moakley (D-MA) was honored recently for his support of affordable housing throughout his 25 years in Congress. The citation was presented at a ceremony in Brockton, MA where Congressman Moakley joined representatives from Fannie Mae and The Community Bank to announce Fannie Mae's \$100,000 deposit in The Community Bank. The funds would help support The Community Bank's

residential rehabilitation and lead abatement efforts in Brockton's underserved communities, as well as support the housing and educational needs of Brockton residents. Fannie Mae made the \$100,000 deposit as part of its Community Development Financial Institutions (CDFI) initiative. (*Boston Herald*, 1/16/98; *Boston Bus. Journal*, 1/26/98)

- *Fannie Mae Exceeded Affordable Housing Goals for 1997:*
  - Fannie Mae announced that more than 45% of the units it financed in 1997 were low- and moderate-income homes, with 29% located in underserved communities. "Fannie Mae's 1997 financing activity surpassed all of the housing goals included in the legislation that reaffirmed the company's mission and modernized its charter in 1992," said James Johnson, Fannie Mae's Chairman and CEO. Preliminary business activity showed the 45% for low- and moderate-income households (those with incomes less than or equal to 100% of the area's median) – was above the HUD-regulated goal of 42%. Special affordable housing (low- and very low-income households) accounted for 19% of total units financed in 1997, exceeding HUD's goal of 14%. Fannie Mae also delivered \$3.18 billion in multifamily special affordable financing compared with a minimum goal of \$1.29 million in 1997. Of low and moderate-income units, Fannie Mae said 70% went to households with incomes at or below 80% of the area's median. More than 35% went to those with incomes between 60% and 80% of the median, and almost 35% went to those with incomes at or below 60% of the median. Minority borrowers represented more than 17% of the households financed by Fannie Mae, and more than 19% went to first-time homebuyers. (*Fannie Mae press release*, 1/28/98; *Reuters*, 1/28/98)
- *Fannie Mae and FHLBank Provide Funding for Low-Income Program in KY:*
  - A low-income program sponsored by Community Ventures Corp. and Central Christian Church's Foundation for Affordable Housing will assist as many as 14 low-income Central Kentucky homebuyers who have bad credit or no money for a down payment to begin buying a house during the next 12 months. To be eligible, a family or individual must earn less than \$34,000 a year and live in Bourbon, Clark, Fayette, Franklin, Jessamine, Madison, Mercer, Scott or Woodford counties. Under lease-purchase, a would-be buyer selects a new or remodeled house that costs approximately \$70,000. The house will be bought by Community Ventures or Central Christian with a 30-year mortgage that has a 5.5% interest rates. The buyer pays rent for 24 to 30 months, with part of the money going into an escrow fund for a down payment. The buyer completes a counseling program, then, when the down payment is accumulated, assumes the 5.5% loan and becomes a homeowner. Funding for the program will come from Fannie Mae and the FHLBank, plus New South Federal Savings Bank, Republic Bank, Kentucky Housing Corp., the Urban County Government and Vine Street Trust Co. Speakers at the press conference announcing the new program included Lexington Mayor Pam Miller and U.S. Rep. Scotty Baesler (D-KY). (*Herald-Leader*, 1/24/98)
- *Fannie Mae Foundation Gives First Community Service Award to NBA Player:*

- Avery Johnson of the San Antonio Spurs NBA Basketball team was presented the first Fannie Mae Foundation “Home Team” Community Service award during a Spurs game for his volunteer work in the community. The award included a \$25,000 grant that the Foundation will contribute to a nonprofit housing and community development organization of Mr. Johnson’s choice. For the past five years, Mr. Johnson has volunteered for the Fannie Mae Foundation’s “Home Team” program. The “Home Team” Community Service Award was created this year to honor Fannie Mae’s fifth anniversary of the “Home Team” program. Each year, one role model NBA player who participates on one of the Foundation’s partner teams will receive the award. Players are nominated for the award by their team organization and a panel of judges selects the winner based on consistency and impact of his volunteer service. (*PR Newswire*, 1/21/98; *NBA Press Release*, 1/25/98)
- *Fannie Mae Board has Four Female Directors:*
  - Catalyst, a non-profit group that studies women in business, released their annual count of Fortune 500’s female representation on corporate boards. The study found that 84% of the Fortune 500 companies have a woman on the board, however, the majority of the boards have only one female. The study found 3 Fortune 500 companies with 5 female directors and 6 Fortune 500 companies, including Fannie Mae, with 4 female directors. (*Herald-Leader*, 1/24/98)

## **Freddie Mac**

- *Freddie Mac Announces Pilot of Internet-Based Mortgage Origination System for Freddie’s GoldWorks® Subscribers:*
  - Freddie Mac will join with Montreal-based MPACT Immedia to pilot, through GoldWorks®, an Internet-based mortgage origination system called Online Mortgage Explorer (OME). “OME through GoldWorks® will level the competitive playing field by enabling all lenders, regardless of size, to compete for the mortgage consumer,” Griff Straw, Freddie Mac director of GoldWorks® marketing said. “At the same time, OME will empower consumers by providing them Internet access to a broad choice of lenders, products and loan terms.” GoldWorks® offers a single-network line that is open to eligible mortgage industry participants, including more than 100 lenders, brokers, real estate professionals, title companies, appraisers, mortgage insurers, credit and information service providers. The pilot will start with a few GoldWorks® subscribers by the end of March and Freddie expects to make the system available to all GoldWorks® subscribers by the summer.
  - The pilot system works as follows: A borrower accesses the OME web site and anonymously answers approximately 20 questions addressing basic parameters such as home location and loan product preference. OME then compares the borrower’s responses to the criteria of 1,100 lenders, brokers and real estate professionals on Freddie Mac’s GoldWorks® network and provides prequalifications accordingly. In turn, the

borrower selects a lender, completes an application and submits it for approval. The lender approves the application by e-mail or off-line and subsequently makes arrangements to gather the required documentation. The role of MPCAT Immedia in this system is to manage, store and route information to both lenders and borrowers by connecting Internet users from the OME web site to GoldWorks ® subscribers. Brian Edwards, president and CEO of MPACT Immedia, believes that this system could change the way mortgage financing is done in North American and stated that the “public is sure to catch on very quickly to this system of applying for home loans, and the potential for huge numbers of transactions is enormous.” The Bank of Montreal and The Canadian Imperial Bank of Commerce (CIBC) are currently originating mortgages using Online Mortgage Explorer (OME) software. There are no companies analogous to Fannie Mae and Freddie Mac in Canada. (*Freddie Mac Press Release*, 1/26/98; *MPACT Immedia Press Release*, 1/28/98; *Reuters*, 1/27/98; *American Banker*, 1/29/98)

- *Freddie Mac Plays Subprime Market:*

Freddie Believes Its Entrance into Subprime Market is “No Big Deal”:

- At a MBA conference last year, Freddie Mac Chairman Leland Brendsel announced that Freddie Mac would begin purchasing loans to A-minus borrowers “before the end of the year” and move as far as possible into B/C credit by the end of next year or early in 1999. This statement was made less than 20 months after Mr. Brendsel vowed that Freddie was not interested in purchasing mortgages made to borrowers with anything less than superior credit. Mr. Brendsel downplayed the importance of the move and insisted his company’s entry was no big deal. “We don’t anticipate being a large player because the market itself isn’t that large, only about 5% of originations or maybe 10% if you go down to the weakest credits,” he remarked. Mr. Brendsel has stated that the move into the subprime market is a “no brainer” and “totally consistent” with their congressional mandate. “Freddie Mac was chartered to make mortgages more available and more affordable to more borrowers,” he explained. “That’s our mission, to drive inefficiencies out of the market.” And the company’s experience in purchasing seasoned A-minus loans, Brendsel added, “has convinced us that moving down the risk spectrum will bring needed efficiencies to this market.”

Groups are Concerned about Freddie’s Expansion into Subprime Market:

- Members of the MBA range “from concerned to scared to death,” according to Marc Smith, president of the MBA. “Everybody’s in [the subprime market]; it’s the one market that is not yet fully commodotized.” Christine Clifford, vice president of Wholesale Access, called their entry unnecessary stating that “I don’t think we need them because there’s already a big secondary market,” she noted. “Besides, B/C lending has nothing to do with homeowners. It is for people who are out of control with consumer debt, and that is not the business [Freddie Mac] is supposed to be in.” The Association of Financial Guaranty Insurers (AFGI), the trade association representing the bond insurers, agreed and wrote a letter to Banking Committee Chairman Jim Leach (R-IA) expressing “deep concerns” that Freddie would bring its federally supported guarantee to a market already well served by the private sector.

“The risks associated with subprime loans are not appropriate for an agency with the implicit guarantee of the U.S. Treasury,” AFGI wrote.

“Back-Door” Approach to Entrance into Subprime Market – Redefining Investment-Quality Loans through Risk-Based Pricing:

- Mr. Brendsel believes that with the advent of risk-based pricing, there is no longer any reason to deny the benefits of the most streamlined loan processing to any segment of the housing market. Brendsel predicted that the industry will “embrace” the concept, transforming a segmented market in which different players specialize in different sectors into a single “seamless” market in which there will be no specialization. “No longer will you have to turn borrowers away simply because they don’t fit the parameters, instead you will be able to offer borrowers a wider array of products at the best possible prices, allowing you to expand into new markets.”

Freddie’s Description of their Entrance Into Market:

- Mr. Brendsel said his company had “no interest” in purchasing loans that exceed the value of their underlying properties and it will want a form of credit enhancement – perhaps mortgage insurance or subordination – for the subprime loans it does purchase. He refused to set a purchase goal – “Except for pilot programs, we never state our expectations,” he noted. “But we will buy the loans we can that meet our parameters and can be priced properly.”
  - Mr. Brendsel stated that highly “aggressive, innovative [subprime] lenders with vision will take advantage of the opportunity” to deal with his company. And what about those who don’t? They “will ultimately fail,” he said. “It’s just a matter of time.” (*Urban Land*, December 1997)
- *American Stock Exchange will Trade LEAPS on Freddie Mac:*
    - The American Stock Exchange will trade LEAPS® (Long-Term Equity Anticipation Securities ®) on the listed stock of Freddie Mac beginning January 26<sup>th</sup>. Freddie Mac LEAPS will open with strike prices of 35, 45 and 55. LEAPS trading under the ticker symbol VFA will expire in January of 1999, while those trading under the ticker symbol LFM will expire in January of 2000. (*PR Newswire*, 1/22/98)
  - *Freddie Mac Announces Plans for Year 2000:*
    - Freddie Mac will distribute Year 2000 versions of its software free to its customers and it has required that all seller and services must be ready for the Year 2000 by the end of the year so that 1999 can be spent monitoring and evaluating systems. Freddie Mac is also sending out Year 2000 “readiness confirmation forms” to its customers to fill out by January 31, 1999. (*Inman News Feature*, 1/30/98).

## ***International “GSEs”***

- *Many Countries are Working to Build Secondary Markets:*

Country	Status	MBS Issued?***
Argentina*	BHN, the Argentine National Mortgage Bank, issued the first Latin American MBS for international market, denominated in dollars. Bank is in the process of being privatized. Looking at issuing peso-denominated MBS. Other private wholesale lenders could be securitizing new production costs.	Yes
Australia	Securitization issues come primarily from the nonbank originators. Demand exceeds supply. CMBS issuance is limited.	Yes
Brazil*	CIBRASEC, a private sector, stockholder-owned secondary market corporation is in the final stages of development. It will operate much like Fannie Mae, with some variations. Securitization is not yet available.	No
Canada	MBS still represents relatively small percentage of market compared with U.S. but growth in past six years has been dramatic. New products and structures being developed continuously. [There are no companies analogous to Fannie Mae and Freddie Mac in Canada. (American Banker, 1/29/98)]	Yes
Chile*	Well-developed financial market, with strong domestic investor base. A number of MBS have been issued and sold domestically. Strong potential for future growth. Good potential for commercial sector.	Yes
Colombia*	Actively developing securitization market. Strong economic and investor base, with quality loan production. Competitive market. [Davivienda, Colombia's leading mortgage originator and servicer, has been working with IFC and other home mortgage lenders in Colombia to create a privately owned, government-chartered securitization corporation similar to Fannie Mae – the initial shares are to be owned by Davivienda and other lenders. (Mortgage Banking, 1/98)]	Yes
France	CMBS issues are progressing more quickly than MBS. Residential mortgage bonds are common, but true securitization is slow to take off.	Yes (CMBS)
Germany	Well-established "Pfandbrief" system where bonds are issued by authorized mortgage banks, collateralized by mortgages. Not quite the same as MBS, but similar liquidity.	Yes
Greece*	National Mortgage Bank and investment bankers have been working to design a securitization vehicle. Fannie Mae has been consulting in program design.	No
Hong Kong	100% government-owned Hong Kong Mortgage Authority was recently created, which will issue bonds as well as MBS. Expected to be privatized eventually. Well-established CMBS market. [The Hong Kong Mortgage Corporation completed the purchase of its first block of mortgages at the beginning of November 1997 and plans its second early this year. Pamela Loamoreaux, SVP of the HKMC, is on a one-year sabbatical from Fannie Mae. According to a study conducted by Fannie Mae last year: "Hong Kong is in an enviable position compared to many other economies as the development of a mortgage corporation is driven by a long-term vision, not in reaction to a crisis in the housing market or credit system." (Asset Sales Report, 12/1/97)]	Yes
India*	HDFC is the dominant private-sector mortgage lender. It has issued corporate bonds, but no pass-throughs or MBS are being used. Aside from HDFC, housing finance is generally funded by the government and multilateral agencies.	No
Indonesia*	In the final stages of creating a secondary market facility, which would purchase loans and issue long term bonds in domestic market. Private banks are working on issues of MBS using offshore SVPs because country lacks "trustee" structure.	No (but close)
Italy	New legislation has been proposed this summer that would remove tax and transfer fee barriers to MBS. Investment bankers using alternative methods for now.	No
Japan	Ministry of Finance is developing comprehensive legislation for securitization. Some banks have issued private CMBS using offshore SPVs.	Yes (limited, but expected to grow rapidly)

Country	Status	MBS Issued?***
Malaysia*	Cagamas is the secondary market entity, owned by the central bank and private financial institutions. Purchases loans with full recourse from originators and sells corporate unsecured bonds and notes to finance them. All securities are rated and sold domestically. Looking at introduction of pass-through securitization.	No
Mexico*	FOVI, the Mexican equivalent to FHA, is issuing the first MBS and developing a securitization system that will allow a source of liquidity for mortgage bankers on seasoned as well as new production.	Yes
Netherlands	Active and well-developed real estate and securitization market. Investors generally come from the EC.	Yes
Panama*	A limited number of pass-through securities have been issued and sold to domestic investors.	No
Philippines*	Securitization is possible, but due to a number of legal and tax restraints, has not been active. A few private asset-backed bonds were floated domestically in February 1997. A government-owned housing agency has issued one MBS.	Yes (very limited)
Poland*	The Securitization and Mortgage Bank Act will go into effect January 1, 1998. The act establishes a specialized mortgage bank entity that will accept deposits, but also anticipates the use of securitization as a source of long-term funding.	No
Russia*	The Agency for Mortgage Lending has been created to issue MBS. The first issue was expected by the end of 1997, and will be guaranteed by the Russian government. Legal framework still needs fine-tuning. [Moscow Mayor Yuri Luzhkov and Harvard University's John F. Kennedy's 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)]	No (but soon)
S. Korea*	Housing and Commercial Bank, which is the largest mortgage lender, was privatized last year. It issues bonds as part of its funding activities, but securitization is not legal, nor has a secondary market been established. (It is being considered.)	No
Spain	Securitization has been available to banks for some time. Residential lending is very strong; banks are actively developing Latin American markets.	Yes
Thailand*	Enabling legislation for the creation of SPVs was passed in June 1997. The Secondary Market Corporation was also created as a government-owed corporation to purchase loans for portfolio and securitization. [Thailand's new Secondary Market Corporation (SMC) plans to buy the first mortgage loans in the second quarter of 1998 and hopes to being securitizing mortgage portfolios soon. 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, 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)]	None Yet
United Kingdom	Has been the most active securitization market in the EC, but recent volume is light. There has been some recent MBS and CMBS activity from building societies.	Yes

Country	Status	MBS Issued?***
<p>** "MBS" refers to the off-balance sheet method of securitizing real estate loans. There are a number of alternative methods in use around the world that are versions of pass-throughs, collateralized bonds or general obligation bonds.  * So-called "developing countries," or "emerging markets," these countries represent varying levels of economic development in terms of GDP.</p>		

(Table Excerpted from *Mortgage Banking*, 1/98 with comments from previous *GSE Reports*)

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

- *Proposed Rule Would Require FHLBanks to Meet SEC Disclosure Standards:*
  - The Federal Housing Finance Board proposed to codify requiring the FHLBanks to comply with SEC quarterly and annual reporting rules. The proposed rule was in an effort to address recent congressional concerns that the FHLBanks were not meeting SEC disclosure standards when the FHLBanks issued debt securities. According to the Finance Board, certain securities issued by the Finance Board and the FHLBanks are exempt from registering and reporting requirements of the Securities Exchange Act of 1934 and are treated as government securities.
  - Under the proposed rules, the FHLBanks would be required to submit unaudited quarterly financial statements and audited annual financing reports to the board and FHLBank members in general accordance with SEC's financial disclosure and accounting requirements. According to the FHFBB, all the FHLBanks submit annual financial statements but not all of them issue quarterly financial reports.
  - The FHFBB issued a policy statement that required the reports generally follow the guidelines set by the SEC rules, except for SEC disclosure rules on: (1) derivatives; (2) related-party transactions; (3) information about directors and officers; (4) compensation; (5) submission of matters to a vote of stockholders; and (6) exhibits. Bruce Morrison, Chairman of the FHFBB, stated that the exceptions were appropriate because the FHLBanks are wholesale institutions with a different structure from the typical SEC-regulated entity and because the costs of requiring FHLBanks to meet SEC standards would be too high. Morrison said that many of the SEC's disclosure requirements for the FHLBanks would be "unwieldy and less useful for the users." (*BNA Daily Report for Executives*, 1/22/98)

### ***Farm Credit System***

- *Bank Groups Appeal Court Decision that Would Allow Expansion of Farm Credit System:*
  - The Independent Bankers Association (IBAA) and the American Bankers Association (ABA) appealed the recent U.S. District Court ruling that allows unprecedented expansion of the Farm Credit System. The original suit (filed in March and decided in November) asked the Court to force the Farm Credit Administration (federal regulator of the System) to rescind new "customer eligibility" rules that would allow the System to

expand their lending services and eligible borrowers beyond the original intent of the law. The IBAA and the ABA contend that the federal judge erred when he gave the GSE permission to extend credit to businesses that serve farmers, such as seed and equipment dealers. The two groups are appealing the decision and have asked the U.S. Court of Appeals for the District of Columbia to overturn the judge's decision and block a January 1997 rule expanding the Farm Credit System's operations allowing member institutions to extend credit to companies that derive more than 50% of net income from farm-related services. The loans may be used to finance portions of the businesses that serve farmers. Prior to the rule, Farm Credit institutions could lend to such companies only if almost all of their net income came from farm-related businesses, resulting in lenders extending credit mostly to ranchers and farmers, with only 1% of loans going to farm-related businesses.

- The IBAA and the ABA feel that the Farm Credit System is using its special status as a GSE to compete unfairly with banks. According to the Chair of the IBAA's Agriculture-Rural America Committee, Terry Jorde, "the FCA is allowing the FCS to leverage its implicit government guarantees against default, its guaranteed funding window and its special tax privileges to transform itself into a general provider of credit in rural markets rather than as a GSE with the specialized niche of serving farmers and ranchers." Mark Scanlan, agricultural lobbyist for the IBAA stated that "A lot of bankers have said, 'Enough is enough.' "They want to challenge the Farm Credit System" The past chairman of the ABA's Agricultural Bankers Committee, said the FCA regulation makes it more difficult for bankers to form partnerships with the Farm Credit System to serve farmers and ranchers. The bank groups feel that Congress never intended for the Farm Credit System to compete directly with commercial banks, but wanted the System to serve farmers and ranchers who had difficulty obtaining credit elsewhere.
- The Farm Credit Administration (FCA) said they were "extremely disappointed" to learn of the appeal, saying the FCA and taxpayers "must now continue to foot the bill to defend the authority of this Federal agency to carry out the laws as passed by Congress." FCA CEO Marsha Pyle Martin said in a statement that "we have consistently stated, and the Court has affirmed, that this regulation is well within the original intent of the law and that the broad, permissive language of the statute clearly covers the lending parameters of the new regulation." (*American Banker*, 1/21/98; *BNA Daily Report for Executives*, 1/21/98; *PR Newswire*, 1/20/98)

### ***Farmer Mac***

- *Farmer Mac Announces Favorable Results for 1997, however, Building Seller Network Has Slowed Growth Plans:*
  - Farmer Mac reported net income of \$4.6 million for 1997 and \$1.3 million for the fourth quarter of 1997. Net income for 1997 and fourth quarter 1997 includes a \$20 thousand tax benefit associated with the future use of operating losses incurred in prior years. Excluding the effect of the tax benefit, net income would have been \$4.4 million for 1997, an increase of \$3.6 million compared to net income of \$777 thousand for 1996, and

\$1.0 million for fourth quarter 1997, compared to \$1.2 million for third quarter 1997 and \$14 thousand for fourth quarter 1996.

- Farmer Mac said its loan program growth in 1997 was disappointing and was held back by the slow pace of adding new sellers to its network. Farmer Mac's president and chief executive officer, Henry Edelman noted that "due, in part, to the longer than expected lead-time between marketing initiatives and the commencement of seller activities, Farmer Mac's loan purchase volume has not been increasing as rapidly as management anticipated following the passage of the Corporation's revised legislative authorities." He continued by stating, "loan volume continues to be primary focus of Farmer Mac's current program development efforts. Aggressive efforts have been undertaken to boost near-term volume, including the expansion of the number of field representatives marketing the program and providing customer service support, and the recruitment into the program of new sellers, particularly mortgage bankers and non-traditional agricultural mortgage lenders, who have the potential to generate large volumes of business and are receptive to the securitization of loans through Farmer Mac."
- Agency officials believe that Farmer Mac is poised for much stronger growth this year. Farmer Mac re-entered the mortgage-backed market in 1996, purchasing loans and issuing guaranteed securities, operating much as a farm version of Fannie and Freddie. The agency issued \$197.5 million of agricultural mortgage-backed securities in 1997, compared to \$149.3 million in 1996, a 32% jump. Farmer Mac now has about 150 sellers in its program, but the bulk of volume comes from about 18% of them, according to Tom Clark, vice president of corporate relations at Farmer Mac.
- Farmer Mac is aiming to issue a new batch of agricultural MBS every 60 days, but that can be changed depending on volume, according to Mr. Clark. "We do not make predictions of future volume, but we have done a lot of work developing the 'seller network' including through some non-traditional sources, such as mortgage bankers and farm equipment manufacturers that offer financing services. And we anticipate that those efforts will result in larger volume in the future." (*PR Newswire*, 1/21/98; *Capital Markets Report*, 1/23/98)

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