

The **GSE** REPORT

All GSEs

- ***GAO Issues Report on Potential Liability of Financial Institutions, Including the GSEs:***
 - In response to a request by Senator Robert Bennett (R-UT), the GAO reported that commitments and contingent liabilities of financial services institutions sponsored wholly or in part by the federal government was \$5 million to \$2.7 trillion in 1996. In the GAO Report, “Financial Services Institutions: Information for Assessing the Government’s Potential Financial Exposure (GAO/GGD-98-125), the GAO examined 22 institutions: (12 government corporations, 6 government-sponsored enterprises; and 4 other types of government entities). The six government-sponsored enterprises were the Farm Credit System, Fannie Mae, Freddie Mac, the FHLBanks, Farmer Mac, and Sallie Mae. According to the GAO Report, “Government-sponsored enterprises generally do not receive government appropriations. Although the enterprises’ charters state that their obligations must include a statement that they are not guaranteed by the United States, the enterprises’ federal ties cause their securities to receive preferential treatment in financial markets. For example, the enterprises generally can borrow at rates that are only slightly above Treasury rates.” The GAO found that the GSEs had \$1.7 trillion in on- and off-balance sheet obligations and assets at the end of 1996.
 - The GAO was concerned that the Federal Housing Finance Board did not have an “arms-length” relationship with the agency it was intended to regulate, the FHLBanks, because the FHFBB was also involved in the corporate governance or management of the FHLBanks. The GAO believes that independence and objectivity is a key criteria for effective regulatory oversight.
 - The following is a chart prepared by the GAO reflecting the contingent and potential liabilities of the GSEs: (The GAO cautioned that the “commitments and contingent liability amounts shown reflect the maximum theoretical exposure to the federal government. The actual loss, even under fairly extreme economic conditions, is likely to be significantly lower and could even be zero.”)

**GSEs' Indicators of Potential Exposure Based on the 1996 Financial Statements:
(Dollars in Millions)**

GSE	Assets	Liabilities	Explicit Federal Backing	Commitments and Contingencies
Farm Credit System	\$73,254	\$62,664	No	\$41,958
Federal Agricultural Mortgage Corp.	\$603	556	No	254
FHLBanks	292,035	275,159	No	333,909
Federal Home Loan Mortgage Corporation	173,886	167,135	No	597,765
Federal National Mortgage Association	351,041	338,268	No	782,000
Student Loan Marketing Association	47,630	46,582	No	60,237

(“Financial Services Institutions: Information for Assessing the Government’s Potential Financial Exposure (GAO/GGD-98-125); BNA Daily Report for Executives, 7/17/98)

Fannie Mae and Freddie Mac

- ***Countrywide CEO Does Not Believe the Mortgage Market Should Fear Fannie & Freddie:***
 - Speaking at a Western Secondary Market and Lending Conference in San Francisco, Countrywide’s CEO Angelo Mozilo, stated that the mortgage market has nothing to fear from Fannie and Freddie. In his opinion, Fannie and Freddie “should not be viewed as rivals or adversaries.” He believes that the fears raised by some in the industry that Fannie and Freddie are trying to bypass traditional lenders and go directly to consumers are “nonsense” and thinks it is unlikely to occur. The conference was co-sponsored by the Western League of Savings and the California Mortgage Bankers Association. “Originating loans is heavy lifting,” he said. “But they’re not stupid. They want to leave the lifting to us.” While Fannie and Freddie may have stepped on the industry’s toes occasionally, he believes that Fannie and Freddie have “responded positively” everytime industry leaders have called them to task. “The GSEs are your friend, not your enemy,” he said. (*National Mortgage News website, posted 7/23/98*)

- ***PMI Bill with Provision Allowing Fannie & Freddie to Determine “High Risk” Borrowers is Ready for President’s Signature:***
 - The House and Senate both approved a modified version of the Senate PMI bill (S. 318) by voice votes. The bill provides for the automatic cancellation of PMI when a homeowner has 22 percent equity in the house. Homeowners with a good payment history and owning a home that has not depreciated below the purchase price may request termination of PMI when the homeowner has 20% equity in the house. The automatic cancellation provisions only apply to new mortgage loans made one year after the legislation is enacted. The bill also allows lenders to require PMI beyond the 22 percent equity for “high risk” borrowers as defined by Fannie Mae and Freddie Mac. Such “high risk” borrowers may not be able to cancel their PMI until half the term of the mortgage has passes – that is, 15 years into a 30-year mortgage. The modified bill would also require the General Accounting Office to study the volume and characteristics of "high risk" mortgages. The bill is now ready for President Clinton to sign. (*Washington Post*, 7/18/98)

- ***FHA Loan Limit Increase Passes Senate, Despite Opposition from Fannie:***
 - Despite opposition by Fannie Mae, the Senate approved a plan in the VA-HUD Appropriations bill to raise the FHA loan limits to \$109,032 from \$86,000 in low-cost areas and to \$197,600 from \$170,000 in higher-cost areas. Raising the FHA loan limit would cut into Fannie and Freddie’s market share. *Inman News Feature* notes the following about the FHA loan limit vote in the Senate VA-HUD Appropriations bill: “Today’s vote provided some insight on who’s got more political power on Capitol Hill: The 750,000-member-strong National Association of Realtors, or the powerful Federal National Mortgage Association. NAR’s support of higher FHA limits and Fannie Mae’s staunch opposition to the measure has driven a wedge between the two groups, which previously enjoyed a good working relationship. In the past officials at NAR and Fannie Mae have partnered to ensure the approval of dozens of bills. The proposal to raise the FHA’s loan limits introduced new friction to that cozy relationship, insiders at both Fannie Mae and NAR said. (*Inman News Feature*, 7/17/98)

- ***During a Period when Many Money Manager are Using Aggressive Hedge Funds to Offset Prepayments, Fannie & Freddie’s GSE Benefits Prove an Advantage Over Even the Most Aggressive Hedge Funds:***
 - The hedging strategy of buying options to hedge mortgage prepayments has not been successful recently. In the past, prepayment waves were accompanied by a spike in volatility. The jump in volatility boosted the value of options, so increasing the value of options should offset losses due to prepayments. While this strategy has worked in the past, it has not worked in the last few months. While mortgage prepayments are approaching record levels, volatility continues to decline, dipping 110-180 basis points during the second quarter.

- One reason for this volatility decline is the dramatic increase in the supply of securities. The supply is related to the proliferation of put/call corporate bonds. The greater transparency of the fixed-income markets is also limiting volatility. Additionally, the Federal Reserve, which has been a renowned source of volatility, has been dealing with the Asian crisis. Finally, improved technology has made refinancing speeds much more sensitive to dips in interest rates. Until these factors subside, another increase in mortgage prepayments is unlikely to be accompanied by an increase in volatility. All of this has given some hedge fund managers a headache – including Fannie and Freddie.
- Fannie & Freddie issue callable debt designed to correspond with mortgage prepayments as interest rates fall. While high leverage employed by many hedge funds intensifies losses, Fannie and Freddie are far more leveraged than even the most aggressive hedge funds. For example, according to Freddie Mac's latest earnings report, Freddie's assets total \$230 billion compared to stockholders' equity of \$8.4 billion – a leverage of roughly 27 times. If hedge funds are being hurt because prepayments are soaring while volatility remains low, it makes sense that these agencies are being affected as well. Both Fannie and Freddie did report significant erosion of their interest rate margins during the second quarter (figures are included in this *GSE Report*). In both cases, the margins tightened by about 7 basis points. “But the agencies' plights are clearly much different than that of poor hedge fund managers.”
- Fannie & Freddie have an advantage in that they have a triple-A rating which keeps their borrowing costs low, despite their being leveraged nearly three times higher than the 10-to-one level that a single-A rated finance company is required to maintain. The combination of high leverage and triple-A rating makes both Fannie & Freddie incredibly hard competition for commercial banks. These characteristics mean that the agencies are likely to shrug off the options problem. Fannie & Freddie are interested in keeping their borrowing costs below the income from their investment portfolio, and while their interest margin has thinned, it has not done so any more than to be expected given the continued decline in interest rates, according to some analysts. Fannie & Freddie have also continued to step up their redemption strategies for higher-cost debt. (Deutsche Bank Securities, for example, is currently undertaking a \$2.48 billion debt repurchase for Fannie Mae as the agency seeks to redeem higher cost non-callable obligations). (Further information on the Deutsche debt repurchase is included in this *GSE Report*.) According to one analyst, “If they had not managed their redemptions so well, their interest margins would have shrunk further.”
- Finally, Fannie & Freddie have one advantage over all other hedge funds. While it has never been tested, everyone assumes that the government and taxpayer money are standing behind the two agencies.” (*Dow Jones, Capital Markets Report, 6/21/98*)
- ***Jesse Jackson Chairs Trillion Dollar Roundtable Discussion on Minority Investment with Fannie Mae and Freddie Mac CEOs:***
 - The Reverend Jesse Jackson hosted a conference called the “Trillion Dollar Roundtable” (a take-off on Fannie's Trillion Dollar Commitment) on July 15th. Reverend Jackson and

Sanford Weil, the chairman and chief executive of Travelers Group, chaired the Trillion Dollar Roundtable, held in New York City. High-profile panelists at the conference, included Hugh McColl of NationsBank, Jack Smith of General Motors, White House economic advisor Gene Sperling, Fannie Mae Chairman and Chief Executive-Designate Franklin Raines, Freddie Mac Chairman & CEO Leland Brendsel and House Minority Leader Dick Gephardt (D-MO).

- As we noted in the June 26th *GSE Report*, when Jackson first announced in June that he was planning the conference, it was in the context of Freddie Mac's racial discrimination suit controversy. In announcing this conference, Jackson advocated the idea of creating a private sector rival to Fannie and Freddie to facilitate low- and moderate-income lending, generating low-cost capital to invest in low-income underserved communities without raising taxes. According to Jackson, "An entity similar to Fannie Mae and Freddie Mac could be positioned...to generate capital and invest in areas under-served, without raising taxes." (*American Banker*, 6/12/98; *Business Wire*, 6/10/98; *Dow Jones Newswire*, 7/15/98; *National Mortgage News website*, posted 6/15/98; *PR Newswire*, 7/13/98)

Fannie Mae

- ***Analyst Notes that Fannie Needs to Make their Benchmark Notes Larger:***
 - Shirkant Ramamurth, fixed-income analysts at Prudential, noted that Fannie Mae needs to make its Benchmark Notes bigger if they want to be a viable alternative to Treasuries. He praised Fannie Mae for re-opening its May Benchmark Note for its monthly deal in July. In his opinion, Fannie increased its liquidity and made the bonds more competitive to 10-year Treasuries when they added \$ 2 billion to \$3 billion of 6% Benchmark Notes due May 15, 2008. He does not feel that initial deal sizes of \$3 or \$4 billion are large enough to make the Benchmarks alternatives to Treasuries, either from a trading or hedging standpoint. According to Ramamurthy: "Deal sizes need to be larger to accomplish these types of goals, and reopenings allow for deals to become bigger without burdening the agencies with an excessive amount of funds at any one time." (*Dow Jones, Capital Markets Report*, 7/22/98)
- ***Fannie Mae's \$2.48 Billion Exchange Offer Will Lead to Tax-Windfall for Fannie Mae (and a Taxable Event for Investors) – Exchange Offer will Allow Fannie Mae to Repurchase Higher Cost Non-Callable Obligations, Exchanging Shorter for Longer Maturities with Very Low Spreads:***

- Fannie Mae has offered to exchange nearly \$2.48 billion of non-callable debt via Deutsche Bank Securities, which is likely to produce a tax windfall for the agency. The offer will allow holders of 13 different debentures, which have coupons ranging from 7.02% to 10.35%, and remaining maturities from seven to 28 years, to exchange them for either cash or a 30 or 40 year bond, depending on the original holding. What is uncertain is what impact this exchange will have on both taxable and non-taxable investors.
- Fannie says this exchange is an effort to create a more liquid market for its securities and build a "ladder" of maturities as an alternative to Treasuries. "Fannie Mae is billing the deal as one seeking to add liquidity to the market," said one analysts who requested anonymity. "They just don't want it to be viewed by the IRS as a tax-driven deal, which it is." Since these debentures are now trading at a premium and Fannie Mae will be taking a paper loss on the exchange (while lowering its monthly carrying costs by lowering coupons and strengthening maturities), it is clear that the transaction will be tax-deductible for Fannie Mae. The fact that Fannie Mae is willing to offer investors a 1.5% premium is an indication of the size of the tax benefit the agency is seeking to get its hands on, observers note. Unlike an earlier Freddie Mac offer, it will be a taxable event from an investor standpoint. Fannie Mae has declined to comment on the tax implications for the transaction.
- Some analysts predict a high participation rate, so long as investors do not have a tax problem. However, Fannie Mae doesn't need a high level of participation for this to be successful. Even if only 50% of the face amount is exchanged, over \$1 billion of new debt will be created in 30 and 40 year maturities. (*Dow Jones, Capital Markets Report, 7/20/98*)
- ***Fannie Mae Adds "Credit Network" to Automated Underwriting System:***
 - Fannie Mae added "The Credit Network" to its automated underwriting system. The new system works as follows: If Desktop Underwriter responds to an application with a "referred" message or has a "caution" notification for more credit work, then lenders can order an escalated report, such as a Concorde or RMCR, from the origination system. The Credit Network will already have a copy of the credit report on file from Fannie Mae and can work immediately to resolve any credit-related issues and re-submit the file or help the lender explore alternative funding avenues. (*Business Wire, 7/23/98*)
- ***House Banking Committee Member Tom Barrett & Fannie Mae Discuss Lending Initiatives for Milwaukee Neighborhoods:***
 - House Banking Committee Member Congressman Tom Barrett (D-WI) and Fannie Mae officials toured Milwaukee neighborhoods to discuss lending or investment initiatives. Joining the group were representatives from Congressman Jerry Kleczka's office. (*Business Wire, 7/14/98*)
- ***Fannie Reports Record Second Quarter 1998 Earnings:***

- Fannie Mae reported earnings for the second quarter of 1998 of \$848.0 million (\$0.80 per common share), up from \$824.2 million (\$0.77 per share) in the first quarter of 1998. The earnings per common share were up 16% over second quarter 1997. Net income rose 13%, rising to \$848 million or 80 cents a diluted share, compared with net income of \$752.7 million, or 69 cents a diluted share. Lawrence Small, Fannie's President and chief operating officers, said that Fannie's fees and other income rose by \$24.0 million between the first and second quarters of 1998, stemming from rises in multifamily fees, fees for technology services, and lower operating losses from tax-advantaged investments. Analysts, however, said they continue to be concerned about Fannie Mae's dropping net interest margin. Fannie Mae's net interest margin, or the spread between what it receives on its investments and what it pays on its borrowings, dropped. Some of that reflects a flat yield curve. (*Business Wire*, 7/14/98; *Dow Jones Online*, 7/14/98; *Fannie Mae press release*, 7/14/98; *Wall Street Journal*, 7/15/98)
- Fannie Mae Announces Pilot for Custom Homes:***

 - Fannie Mae is investing \$75 million in a pilot program for custom homes. Under the pilot, borrowers will be allowed to finance the construction and permanent phases of their new homes with a single 30-year mortgage and borrowers will be permitted to lock in a single mortgage rate. Fannie Mae will purchase the loans from lenders as soon as the loan is closed. According to Fannie Mae, the lenders will be able to offset the possibility that they could lose the permanent loan if rates should rise before construction is completed. (*National Mortgage News website*, posted 7/23/98)
- Fannie Mae – Staff Changes:***

 - The Fannie Mae Foundation announced that Ann Wheelock, presently Executive Vice President and Chief Operating Officer, will become President and CEO of the Fannie Mae Foundation. (*PR Newswire*, 7/22/98)
 - Fannie Mae announced Senior Management changes in their Housing and Community Development Division – Ken Bacon will now head the new Community Development Capital Corporation and John McIllwain will become Senior Managing Director of the American Communities Fund. Fannie Mae's new Community Development Corporation will use non-mortgage financial tools to revitalize communities. An example of a non-mortgage financial tool is Fannie Mae's \$100 million American Communities, an equity fund dedicated to making equity investments in "neighborhoods that lack adequate access to traditional capital." (*PR Newswire*, 7/22/98)
- Fannie Mae's Vice Chair is on DOD Threat Reduction Advisory Committee:***

 - Fannie Mae's Vice Chair Jamie Gorelick is on the Department of Defense's Threat Reduction Advisory Committee – "a panel of distinguished defense experts." The group was established by Secretary of Defense William Cohen to provide advice and initiatives

on implementation actions as directed by the Defense Reform Initiative in the consolidation of four threat reduction organizations into the Defense Threat Reduction Agency. (*Presswire*, 7/16/98)

- ***Fannie Mae Announces Common & Preferred Stock Dividend:***

- Fannie Mae announced the following dividends on its common and preferred stock:
 - A dividend on its outstanding common stock of twenty-four cents per share;
 - A dividend on its outstanding preferred stock, Series A, of \$.80125 per share;
 - A dividend on its outstanding preferred stock, Series B, of \$.81250 per share;
 - A dividend on its outstanding preferred stock, Series C, of \$.80625 per share.(*Business Wire*, 7/21/98)

- ***S&P Gives AAA Rating to Fannie Mae Credit Enhanced Bonds:***

- S&P assigned its AAA rating to California Statewide Communities Development Authority's revenue bonds series 1998X. The rating reflects Fannie Mae credit enhancement of the mortgage backing the bond, AAA rated investments, and cash flows evidencing the full and timely payment of debt service and program fees. Bond proceeds will be used to fund a \$13.75 million mortgage for construction of Bouquet Canyon Seniors Apartment Development, a 264-unit independent living complex in Santa Clarita, CA. The mortgage is backed by a Fannie Mae collateral agreement to cover missed mortgage payments and any shortfalls following an involuntary mortgage prepayment or acceleration of bond maturities. (*PR Newswire*, 7/15/98)

- ***Fannie, Ford Foundation, and Non-Profit Form Affordable Housing Partnership:***

- Fannie Mae, the Ford Foundation, and Self-Help, a North Carolina-based nonprofit community development organization, formed a partnership to make \$2 billion in affordable mortgages available to 35,000 minority and "low-wealth" homebuyers. The Ford Foundation is providing a \$50 million grant to expand Self-Help's Home Loan Secondary Market Program nationwide. Self-Help will use the \$50 million to provide credit enhancement to the loans it purchases. Self-Help will acquire \$400 million in loans from select national and regional banks each year for five years. Fannie Mae will purchase or securitize the total \$2 billion in loans Self-Help will acquire. (*National Mortgage News website*, posted 7/23/98; *PR Newswire*, 7/23/98, *Reuters*, 7/23/98)

- ***Fannie Named #4 on Fortune's List of 50 Best Companies for Asians, Blacks & Hispanics:***

- Fannie Mae was named Number 4 on Fortune Magazine's list of the 50 best companies for Asians, Blacks and Hispanics. Fortune ranked the companies based on minority employment and minority representation among top executives, among top wage-earners and on corporate boards of directors. At Fannie Mae, minorities account for 16.7% of the Board, 16.8% of corporate officers, 22.8% of officials and managers, 12% of the 25 highest-paid employees, and 38.7% of its total work force. Fannie Mae's new Chairman

and Chief Executive Designate, Franklin Raines, will become one of the highest-ranking African Americans in corporate America. Pacific Enterprises (Southern CA utility holding company) was Number 1, Advantica (parent company of Denny's) was Number 2 and BankAmerica Corp. was Number 3. (*Fortune Magazine*, 8/3/98; *PR Newswire*, 7/13/98; *Washington Post*, 7/20/98)

- ***Fannie Mae Survey Finds that Renters are More Confident of Owning Home:***
 - According to Fannie Mae's Annual National Housing Survey, 58% of renters say they are "somewhat confident or totally confident" they would get a mortgage if they applied for one, compared with 52% in 1996. Fannie Mae also reported that barriers to homeownership, such as not enough money for a down-payment to discrimination, have "collapsed to the lowest levels since Fannie Mae began doing their survey in 1992." (*Reuters*, 7/16/98)

Freddie Mac

- ***Freddie Mac Announces New Multifamily Housing Loan Program – First Credit Enhancement of Tax-Exempt Housing Bonds (Freddie is Double-Dipping By Using GSE Status and Tax-Exempt Status):***
 - Freddie Mac's first credit enhancement of tax-exempt housing bonds, under a program that was announced earlier this year, has now been completed. The new credit enhancement program targets tax-exempt multifamily housing bonds by securing a \$5.825 million deal from the Crystal, MN housing agency. For a fee, Freddie Mac agreed to assume monthly payments if the borrower cannot afford to do so. The arrangement places a bank letter of credit on floating-rate housing bonds issued in 1985 by the Housing and Redevelopment Authority for the City of Crystal. Freddie Mac noted that this deal was the first of a larger initiative that will focus on members of its Program Plus group of lenders. Freddie hopes to close \$200 million under this Bond Credit Enhancement Program this year. The lender in the deal was Northland Financial Company, which noted that the deal closed quickly (in a little over a month) and that the bonds still got a Prime-1 rating from Moody's Investor Service. Freddie Mac said the risks to Freddie were not unusual, were profitable, and were consistent with its mission. (*The Bond Buyer*, 7/20/98; *Freddie Mac press release*, 7/16/98; *National Mortgage News website*, posted 7/17/98)
- ***Freddie & IMX's New System Will Control the Link between Lenders and Brokers:***
 - Freddie Mac and IMX are establishing an electronic link to enable lenders to bid on loans posted by mortgage brokers. Using Freddie Mac's GoldWorks network, lenders will be able to query, select, and bid on loans posted by brokers using IMX's MatchMaker software. The system works as follows: Brokers will post borrower and loan

information when a lender places a bid, the broker will be notified by MatchMaker as well as via e-mail or alphanumeric pager. Once a bid is accepted, the identities of the lender and the broker are revealed. The lock-in will be binding for both, and loan file delivery will proceed as it would in a traditional transaction. IMX president Mark Korell said loans would be placed “not in hours or days, but in a matter of minutes.” (*American Banker*, 7/16/98; *Freddie Mac press release*, 7/14/98; *National Mortgage News website*, posted 7/14/98)

- ***Freddie Mac VP Advocates Risk-Based Pricing:***

- Dwight Robinson, Freddie Mac’s vice president for industry relations stated that risk-based pricing could eventually save homebuyers as much as \$6 billion annually in unnecessary interest payments. Robinson made his statement during a Western Secondary Market and Lending Conference. He believes the majority of the savings would occur in the subprime market, estimating borrowers’ monthly payments would fall an average \$120. Risk-based pricing would cut costs by reclassifying borrowers to reflect their true risk and bringing efficiency and greater competition to the subprime market. Robinson noted that the majority of subprime borrowers are minorities, and 38% of all African Americans obtain their conventional loans in the subprime sector. Freddie Mac’s research on subprime borrowers has found that many subprime borrowers are “misclassified” which “shows at a minimum the relatively poor job being done in this market in matching rates to underlying risks.” (*National Mortgage News website*, posted 7/23/98)

- ***Freddie Mac Reports Record Earnings Per Share:***

- Freddie Mac has reported second quarter net income of \$414 million, up from \$340 million last year and \$393 million in the first quarter. Diluted earnings per common share were a record \$0.56, up 24% from \$0.45 a year ago. Total revenues rose from \$872 million in the first quarter to \$881 million. The retained portfolio balance grew by \$11 billion during second quarter 1998. Freddie anticipates that retained portfolio growth for the full year 1998 will be in the range of \$40 billion to \$45 billion. (*Freddie Mac press release*, 7/15/98; *National Mortgage News website*, posted 7/16/98; *PR Newswire*, 7/15/98)

- ***Freddie Mac & Bank of America Announce Homeownership Initiative in Watts:***

- Freddie Mac, Bank of America and the Enterprise Foundation announced a low-income homeownership initiative in Watts, Los Angeles. As part of the initiative, a Watts Homeownership Center was opened offering one-stop housing services. The Watts Homeownership Initiative offers home loan products developed by BankAmerica Mortgage that are designed to help individuals with lack of funds for a downpayment, prior credit problems, and limited or lack of traditional credit experience. As an example, BankAmerica Mortgage’s Neighborhood Advantage Credit Flex™ home loan enables qualified borrowers to purchase a home with just a 3% downpayment and just \$5000 of their own funds. The remaining downpayment could come from a second mortgage

provided by the Los Angeles Housing Department. Freddie Mac has agreed to purchase the mortgages under the initiative. Joining the press conference were Congresswoman Juanita Millender-McDonald (D-CA), Los Angeles City Councilman, Rudy Svorinch, Jr., the former Mayor of Los Angeles Tom Bradley, and Alice Harris, Executive Director, Parents of Watts. (*Business Wire*, 7/17/98, 7/20/98)

- ***Freddie Mac Provides Home for DC Sextuplet Family:***
 - Freddie Mac purchased and renovated a home for a DC family that gave birth to sextuplets (the first known case for an African American family). Freddie Mac purchased the home for \$210,000 and oversaw \$100,000 in renovations donated by Washington area contractors. Freddie Mac presented the home during a “housewarming party” on July 21st. Invitations for the “housewarming party” were extended to President Clinton and Mrs. Clinton, DC Mayor Marion Barry, and Congresswoman Eleanor Holmes Norton. (*Associated Press*, 7/21/98; *PR Newswire*, 7/14/98, 7/21/98; *Washington Post*, 7/21/98)

Federal Home Loan Banks

- ***Federal Home Loan Banks: The New “SUPER GSEs”***
 - On Capitol Hill: In a recent “compromise” struck by Senators Hagel and D’Amato and New York Federal Home Loan Bank President Al Dellibovi and Federal Housing Finance Board Chairman Bruce Morrison, the Federal Home Loan Banks would become “super GSEs.” The “compromise” agreement would eliminate any restrictions and all regulatory oversight over the FHLBanks non-mortgage investments; would lower the FHLBanks capital standards to match those of Fannie Mae’s and Freddie Mac’s; and would allow the FHLBanks to make advances to fund small business and community development lending by small banks. The non-mortgage investment powers of the FHLBanks will not limit the Banks authority to engage in loan origination activities. Senator Hagel is expected to offer this “compromise” as an amendment to the Bank Regulatory Burden Relief bill being marked up on July 29th, or will attempt to move his bill as a stand-alone measure with the support of Senate Banking Committee Chairman Al D’Amato. A prominent financial services industry CEO recently commented that “if this bill were to be enacted, a major step towards the nationalization of the most competitive, private financial services system in the world will have unfortunately been taken.”
 - On the regulatory front: Not wanting to wait for legislative approval, the Federal Home Loan Bank Board is seeking comments by August 6th on two proposed rules that would expand their activities by regulatory fiat. One rule would expand the use of letters of credit by FHLBanks; the second rule establishes a community investment cash advance program allowing the FHLBanks to make direct community investment loans. The proposal would create a funding vehicle for members and non-members. The definition of “community development” would include any and all non-mortgage loans -- including construction loans and small business loans -- granted in low and moderate-income

neighborhoods. In addition, letters of credit could be collateralized with any secured or government-guaranteed small business loan, as well as with an expanded list of other permissible collateral. If finalized, the rule would allow FHLBanks to offer members and non-members letters of credit to back venture capital loans, small-business loan-backed securities, and investment grade state and municipal bonds. This action would place the FHLBanks in direct competition with private providers of credit enhancement services for investment grade state and municipal bonds, as well as portfolio lenders for small business loans and venture capital. The proposal also expands the use of advances to fund agriculture lending by allowing the FHLBanks to offer letters of credit to credit enhance small farm loans. (Keep in mind that their definition of a small farm loan includes “farms of 5 acres or more that earn \$5,000 or more per year.”)

- The proposal goes further than putting the FHLBank System in direct competition with Fannie and Freddie in providing credit enhancement for mortgages, because the FHLBanks would not have the charter limitations that currently restrict the other GSEs (e.g., dollar amount and underwriting standards). (Proposed Rule published in the *Federal Register*, 5/13/98, pages 26532-26560)
- ***Ousted FHFBB Member Costiglio Loses Court Case:***
 - Ousted FHFBB Member, Lawrence Costiglio lost his court case in US District Court trying to regain his seat on the regulatory board. Judge Thomas Jackson of the US District Court rejected Costiglio’s claim that his March 9th firing from the FHFBB by President Clinton was illegal because no successor had been named. Judge Jackson ruled that the President has the power to remove appointees once their terms have expired and the Judge asked the case be dismissed. Costiglio’s lawyer, Salvatore Martoche, said his client plans to appeal the decision. The White House fired Costiglio citing his conservative views on several affordable housing issues. Costiglio’s firing has left two vacancies on the five-member FHFBB. *National Mortgage News* reported that President Clinton is expected to nominate Franz Leichter, a long-time Democrat and New York State Senator, as Costiglio’s replacement, and there are rumors that Republican staff director on the House Banking Committee, Tony Cole, is also being considered for the other vacancy. (*American Banker*, 7/13/98; *Dow Jones Newswire*, 7/9/98; *National Mortgage News website*, posted 7/13/98)
- ***Consultant Urges Banks to Use the FHLBank System:***
 - Consultant Robert Colvin urged community banks to use the FHLBank System to boost liquidity and fund growth. Colvin gave his remarks during the annual Illinois Bankers Association meeting. Colvin believes that community banks should use the FHLBanks as an alternative source of funding because deposits have left banks permanently for mutual funds and other investments. Many community banks have a stigma of borrowing money to fund loan demand, but Colvin believes that idea has to change because “wholesale deposits have to increase if you want to grow.” He noted that in the next five years, wholesale deposits are expected to nearly triple, to 28% of banks’ total funding. Much of those deposits are expected to come from Home Loan banks, but brokered

deposits and certificates of deposit sold over the Internet would also be factors.
(*American Banker*, 7/20/98)

Farmer Mac

- ***Farmer Mac Reports \$1.8 Million Second Quarter Net Income:***
 - Farmer Mac reported net income of \$1.8 million for the second quarter of 1998, compared to \$1.3 million a year ago. For the year-to-date, its net income totaled \$3.5 million. The net income for the second quarter and year-to-date 1998 included tax benefits of \$325,000 and \$525,0000 respectively, related to the future use of previously deferred tax benefits. Diluted earnings per share for second quarter 1998 were \$.016 for Classes A and B common stock and \$0.48 for Class C common stock. Diluted earnings per share for the year-to-date were \$0.32 for Classes A and B common stock and \$0.95 for Class C common stock. Net interest income for the second quarter and year-to-date was \$2.5 million and \$4.9 million, respectively, compared to \$1.8 million and \$3.2 million for the same period a year ago. This increase in net income has been attributed to the balance of program assets and non-program assets. Other income totaled \$1.4 million for the second quarter and \$2.6 million for the year-to-date, compared to \$1.7 million and \$2.9 million, respectively, in 1997. (*Farmer Mac press release*, 7/22/98)

Ginnie Mae

- ***Ginnie Mae Rations Commitments:***
 - Ginnie Mae is worried that it could run out of commitment authority in September, so it is asking lenders to cut back on Ginnie Mae security issuances over the next two months. “Effective immediately, Ginnie Mae is instituting temporary procedures to ration commitment authority,” according to a July 10th memo. Ginnie Mae is asking investors to estimate their commitment needs in July and August and submit a request. “Ginnie Mae will carefully review all requests from issuers, but may approve requests for less than the full amount,” according to the memo. Ginnie Mae notified Congress several weeks ago that it had exceeded 75% of its fiscal 1998 commitment authority, which totals \$130 billion. The fiscal year ends September 30. (*National Mortgage News website*, posted 7/21/98)

Sallie Mae

- ***Sallie Mae’s Parent Company Posted 24% Profit Gain:***

- SLM Holding Corp., parent of Sallie Mae reported that earnings rose 24% in the second quarter, fueled by growth of its student loan portfolio as well as reductions in expenses. For the quarter ending June 30, SLM had net income of \$144.2 million (84 cents a share), up from \$116.5 million (63 cents) in the year-earlier period. The results beat analysts' predictions by 5 cents. Net income also rose 22%, to \$283.2 million (\$1.64), from \$232.7 million (\$1.25). The company's portfolio of managed student loans increased 7%, to \$44.6 billion, from \$41.5 billion in the year-earlier period. SLM came into being last year when the company converted from a GSE to a fully private company. (*Washington Post*, 7/11/98)

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