

The **GSE** REPORT TM

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Fannie Mae and Freddie Mac

- Fannie & Freddie Announce Separate Initiatives to Open Access to Other Automated Underwriting Technology Systems
 - (Mortgage Industry Believes the GSEs' Announcements are "smoke and mirrors")

- *American Banker* Runs Article on Newly Formed Private Sector Coalition Created to “Contain” the GSEs to their Original Charters – Article Notes that Coalition may have Support of Consumer Advocate Ralph Nader
- Another Example of “Charter Creep” – Fannie & Freddie are Entering the Commercial Real Estate Market
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- *Business Week* Publishes an Article on the Private Sector Concerns over Fannie & Freddie’s Expansion into their Business
- Fannie & Freddie Report another Record First Quarter of Earnings
 - Fannie’s Earnings Per Common Share up 14% over First Quarter 1998 – Freddie Reported a 26% Increase in Diluted Earnings per Common Share over First Quarter 1998
- Fannie & Freddie Revise Private Mortgage Insurance (PMI) Cancellation Policies
- Fannie & Freddie Rank in “*Forbes*’ Super 100”
- *Washington Post Business Journal* Reports that Fannie, Freddie & SLM Holding (Holding Company for Sallie Mae) are the 3 Largest Financial Institutions (Respectively) in the Washington, DC Region
 - The article notes that Fannie’s Assets Alone are More than the Combined Assets of the Remaining 29 Financial Institutions on the List of the Largest Financial Institutions in the Area
- *National Mortgage News* Website Takes Informal Poll on Fannie & Freddie – Results are Still Running in Favor of Confining Fannie & Freddie’s Activities to Providing Liquidity for Lenders

Fannie Mae

- Fannie Reportedly Spent more than \$31.8 Million in 1998 on Television (This does not count the considerable amount of money Fannie spends on print advertising.)
 - Lenders are Concerned that Fannie’s Ads “Cut them out of the Picture”
 - Fannie Agrees that their Advertisements are too “Fannie Mae-Centric” and will try to Incorporate Lenders into their Advertisements
- AFL-CIO Alleges that Fannie has Conflicts of Interest on the Committee that Determines Executive Compensation
- Fannie Expands into Home Improvement Loans
- Fannie would Like the Financial Accounting Standards Board’s (FASB) new Derivative and Hedging Rule to be Delayed – Reportedly the Rule would Inhibit Companies like Fannie from Selling Bonds Overseas
- Top 40 Lender Expresses Concerns about Fannie’s Entrance into the Servicing of Loans
- *Barron’s Online* Ran an Extensive Piece on Fannie entitled “*Fannie’s Foes: Mortgage Giant Faces a New Challenge from a Surprising Source*”
- Fannie’s CEO Claims Most Predatory Lending Practices Occur in the Subprime Market and the Goal Should be to Make B,C, and D Credit Borrowers into A Credits and Borrow from the Conventional Market
 - The National Home Equity Mortgage Association (NHEMA) Notes that Predatory Lending Practices Don’t Just Exist in the Subprime Market but also in the Conventional market – Counsel for NHEMA states that Most Abuses Occur in the “Lower End of the Market...where Fannie and Freddie are Looking Hardest is the Upper End of the Market. They’d Like to Cream-Skim.”
- Fannie Continues to Argue that it is a Private Company with No Implied Government Guarantee Just like Depository Institutions; Claims that its Charter is Similar to National Banks’ Charters
- Despite Fannie’s False Insistence that it is a Private Company just like any other Depository Institution, Investors, Reporters, and Consumers View the Company as a Government Agency Backed by the Government – Newspaper Corrections Setting the Record Straight that Fannie and Freddie are “Private” Companies Not Backed by the Government are Virtually Non-Existent
- Fannie Partners with an Electronic Commerce Network to Provide Automated Title Insurance & Flood Information through Fannie’s Automated Underwriting Technology System Network
 - (Fannie Moves a Step Closer Towards Vertically Integrating the Mortgage Market by Combining the Use of the Federal Subsidies with Technology)
- Using its Technology and Foundation to Promote the Company’s “Brand Name” and Reach to Consumers, Fannie Unveils a New “Consumer Friendly” Website for its Foundation
- Columnist Notes that Threat of User Fees on Fannie & Freddie Causes Fannie to “Reach Out” to Republicans

- Fannie is Majority Owner (84%) of New Mixed-Use “Environmentally Friendly” Community in Arizona which Includes Retail Shops, a Copying Center, and an Art Gallery – Since the Development is So Far Away from Downtown Tucson, Some Critics believe the Community will Contribute to Traffic and Air Problems – Only 20% of the Community is Dedicated to “Affordable Housing” (House Prices begin at \$90,000) and the House Prices in the Community are Approximately 10% Above a Typical Tucson Subdivision
- Fannie Begins New Program that would Allow Homebuyers to Purchase a Home without Buying the Land Underneath the Home
- Former Fannie Chairman Jim Johnson Details the Chairman Transition at Fannie
- Fannie Announces a Grant to Fund Fellowship at National American Indian Housing Council
- Fannie Announces New Members of its Housing Impact Advisory Council
- Fannie Further Expands its Political Reach by Including Federal and State Officeholders in its Press Conferences and Press Releases and by Increasingly Using its Partnership Offices (currently 36 offices – another reportedly will be added in Newark, NJ) in Press Events – Senators Thomas and Enzi are also Urging Fannie to Open a Partnership Office in Wyoming
- Former Fannie Chairman & CEO Appointed as Outside Director of Goldman Sachs

Freddie Mac

- Freddie Begins Selling “Estate Notes” which Add a Death Benefit to Retail Buyers of its Callable Debt – Making its Debt More Attractive to Individual Investors
- Freddie Uses its Technology to Move Further into “A-” Market

Federal Home Loan Banks

- FHLBank of New York Joins the FHLBank System’s Mortgage Partnership Finance (MPF) Program
 - FHLBank of Pittsburgh is Expected to Join the MPF Program
 - The MPF Program is Becoming a Real Competitor to Fannie & Freddie – Four FHLBanks are Now Offering the Program
- Status Report of Legislation Containing FHLBank Expansion Provisions
- FHFB Issued Final Rules Expanding Eligible Collateral Requirements for FHLBank Advances
- FHFB Issued Interim Final Rule Prohibiting FHLBanks from Imposing or Accepting a Fee in Lieu of Redeeming a Member Institution’s Excess Capital Stock in the Bank
- US Appeals Court Sets a Date for Oral Arguments in the FHFB Case Involving the Dismissal of FHFB Member Lawrence Costiglio
- FHFB Demands a Refund for a FHLBank Study that was Supposed to Quantify the Value to the FHLBank System for its GSE Status

Private Sector Items to Note

- GE Capital Mortgage Insurance Begins New Program that Allows Homebuyers to Purchase a Home with No Downpayment – Fannie & Freddie will Not Purchase these Loans – Bear Stearns and GE Capital Mortgage Services will Provide the Secondary Market
- PMI Mortgage Insurance Co. Moves its GSE Liaison to Washington to be Closer to Fannie & Freddie
- Bear Stearns Develops a New Model to Analyze Nonagency Loans

Farmer Mac

- Farmer Mac Reports a 50% Increase in its First Quarter Earnings

Ginnie Mae

- Senior Executive of Ginnie Mae States that the Privatization of Ginnie Mae May Still be Considered a Possibility as a Revenue Raiser in the Federal Budget (Since a Privatized Ginnie Mae would No Longer Carry the Full Faith and Credit of the US Government, or Have the Implied Backing Provided Other GSEs, there is a Question as to whether a Privatized Ginnie Mae would Actually be able to Compete with Existing GSEs)

Postal Service

- House Subcommittee Approves a Postal Expansion Bill that would Allow the Post Office to Compete with Private Sector Financial Services Companies – Private Sector Banking Groups Argue that the Postal Services’ Implied Government Backing would give the Postal Service an Unfair Competitive Advantage over the Private Sector

Major Events

OFHEO Officially Published its Proposed Risk-Based Capital Rule for Fannie & Freddie in the *Federal Register* for Public Comment

While Fannie Continues to Criticize the Proposed Rule on All Fronts – Fannie tells Investors that the Proposed Rule would have No Effect on its Earnings

Despite Fannie's Remarks that OFHEO's Risk-Based Capital Rule would Not Affect its Earnings, CIBC Oppenheimer's Analyst Downgrades Fannie & Freddie Due to Political Risk

- OFHEO officially published the long-awaited proposed risk-based capital rule for Fannie and Freddie in the *Federal Register* on April 13, 1999. Comments regarding the notice of proposed rulemaking are due August 11, 1999. (*Federal Register*, 4/13/99, pages 18083-18132)
- Reportedly, Fannie is still criticizing the risk-based capital rule even as it told analysts during an investor's conference call that there would be no perceptible difference in its earnings should Fannie have to comply with the risk-based capital rule as it is written in its current proposed form. "Even if the regulation doesn't change at all," said Timothy Howard, Chief Financial Officer at Fannie Mae, "Fannie Mae would be able to adapt to it with no measurable impact on our [earnings per share] growth." Yet he said the company could suffer in other ways. Howard said he believed the regulation would stifle innovation, micromanage how Fannie does business, and derail its affordable housing mission. (*American Banker*, 4/5/99)

Background

- The Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie and Freddie, was created by Congress in 1992 and was tasked by Congress to create a risk-based capital rule for Fannie and Freddie to be completed by December 1994. OFHEO has been working five years on the proposal. At issue, the risk-based capital proposal would determine the amount of capital Fannie and Freddie would be required to set aside to remain solvent during a 10-year period of severe credit and interest rate stresses. OFHEO sent the proposal to OMB for a 90-day review back in October of 1998, however, it took the OMB until March 26 to finish its review. The proposed rule was then sent immediately to Congress for a 15-day review period. After Congressional review, the proposed rule was officially published in the *Federal Register* for a four-month-long public comment period. The new rules could go into effect at the earliest in 18 months, after OFHEO heard public comments and gives Fannie and Freddie a year to comply with the new standards.

Fannie has Fought Release of Proposed Rule at Every Step of the Way

- Even prior to its release and before Fannie reportedly ever saw a copy of the proposed rule, Fannie has been fighting and strongly denouncing the proposed rule. Even as early as three days prior to OFHEO's submission to the OMB, Fannie's Vice Chair Jamie Gorelick wrote a letter to OFHEO voicing strong objection to OFHEO's inclusion of a specific capital number or percentage amount of capital required to be maintained by Fannie and Freddie. Fannie said that it objected to OFHEO disclosing a capital amount because it would create a misperception of capital inadequacy. Fannie

also reportedly launched a “frontal assault” on the proposed rule by complaining to the OMB that OFHEO hadn’t given Fannie any opportunity to engage in a dialogue about the proposal.

- Fannie then objected to the proposed rule stating that a risk-based capital rule would hurt its ability to serve low- and moderate-income borrowers. (GAO and HUD have both noted in reports and testimony that the private sector serves the low- to moderate-income homebuyer community substantially better than do either Fannie or Freddie, while at the same time holding substantially more capital than Fannie and Freddie.) However, OFHEO notes that the affordable housing efforts of Fannie and Freddie would not be affected by the proposed rule.
- Fannie also claimed that OFHEO never talked to Fannie officials to understand how their business works. However, OFHEO claims it had “hundreds of meetings” with Fannie and Freddie on how they measure and model risk and Freddie stated that it gave OFHEO extensive comments.
- Fannie also claimed that OFHEO’s proposal would mean lender’s guarantee fees might have to be raised. However, OFHEO points out that their proposed capital rule is unlikely to cause higher mortgage rates and would not give Fannie and Freddie incentives to raise their guarantee fees.
- Fannie also questioned the credibility of the proposed rule by citing a “AA-” S&P rating given to Fannie and Freddie. However, OFHEO notes that the S&P rating given to Fannie & Freddie was not based on capital. The S&P stated that the capital levels for Fannie and Freddie were relatively low when compared to what S&P would expect to see at fully private companies.
- The newest criticism by Fannie is that the proposed rule would stifle innovation, micromanage how Fannie does business, and derail its affordable housing mission. Timothy Howard, Chief Financial Officer at Fannie Mae, reportedly made these comments during an investor’s analyst call. (*American Banker*, 4/5/99) However, OFHEO has noted that the rule provides the GSEs with unprecedented flexibility and that OFHEO has the tools to review new products by the GSEs in a timely manner. According to OFHEO, the notion that the GSEs’ ability to produce innovative products would be diminished because the GSEs have to receive permission from OFHEO is ludicrous.

For more detailed comments about OFHEO’s proposed risk-based capital proposals and the criticisms by Fannie Mae, please see the April 2nd *GSE Report*.

Despite Fannie’s Remarks that the OFHEO’s Risk-Based Capital Proposal would not Affect its Earnings, CIBC Oppenheimer’s Analyst Downgrades Fannie & Freddie Due to Political Risk

- Fannie and Freddie’s shares fell 2% each after Steven Eisman, an analyst at CIBC Oppenheimer & Co. cut his recommendations on the two companies to “hold” from “strong buy.” Fannie shares fell 1 1/16 to 69 3/16 and Freddie’s shares fell 1 3/16 to 56 7/8. “For the first time in many years, political issues will dominate these stocks,” wrote Eisman. “These issues could plague the stock prices for most of the year.” The proposed rule was cited, however, Eisman did not consider the proposed rule an immediate threat because the final rule is a long way off. “The more important issue is the budding movement of the mortgage insurers, the mortgage lenders and other industries forming a new coalition to rein in the activities of Fannie and Freddie,” the report said. “As long as this second political issue exists and gains strength, we believe there is little upside in either stock.” (*Bloomberg News*, 4/6/99)

Under Current Non-Risk-Based Capital Rules, Fannie & Freddie were Determined to be “Adequately Capitalized”

- In related news, OFHEO announced that under current non-risk-based capital rules, Fannie and Freddie hold enough capital to meet US guidelines. (The current rule is not risk-based like the proposed OFHEO rule.) As of December 31, 1998, both companies were determined to be “adequately capitalized.” Fannie held core capital of \$15.465 billion at December 31, which is \$131 million above the federally mandated minimum capital requirement of \$15.334 billion. Freddie held core capital of \$10.715 billion, \$383 million above its minimum of \$10.332 billion. Core capital includes common stock; some kinds of preferred stock; paid-in capital, or money the companies receive in exchange for their stock; and retained earnings, or earnings that aren’t paid out to shareholders. (*Bloomberg News*, 4/9/99)
- The following charts were attached to a 4/6/99 OFHEO letter to Chairman of the House Banking Committee Jim Leach (R-IA) on the company’s capital classification as of December 31, 1998:

Federal Home Loan Mortgage Corporation (Freddie Mac)
Permanent Minimum Capital Levels
December 31, 1998

Summary (Dollars in Millions)

On-Balance Sheet Assets	8,035.53
Off-Balance Sheet Obligations	
PC and Equivalents	2,094.77
Commitments	149.78
Other Off-Balance Sheet Obligations	
Interest Rate and Foreign Exchange Rate Contracts	39.35
Sold Portfolio Remittances Pending	13.34
 Total Capital Requirements	 10,332.77
 Core Capital	 10,715.30
 Surplus/(Deficiency)	 382.53

Note: Totals may not add due to rounding.

Federal National Mortgage Association (Fannie Mae)
Permanent Minimum Capital Levels
December 31, 1998

Summary (Dollars in Millions)

On-Balance Sheet Assets	12,118.98
Off-Balance Sheet Obligations	
MBS and Equivalents	2,867.14
Commitments	265.98
Other Off-Balance Sheet Obligations	
Interest Rate Contracts	17.61

Foreign Exchange Rate Contracts	22.22
Multifamily Credit Enhancements	42.37
Total Capital Requirements	15,334.29
Core Capital	15,465.30
Surplus/(Deficiency)	131.00

Note: Totals may not add due to rounding.

- As noted in the April 2 *GSE Report*, if OFHEO’s proposed risk-based capital rule (as published in the *Federal Register*) was in effect on specific test dates in 1996 and 1997, Fannie would have had sizable capital shortfalls (\$3.5 billion in 1996 and \$3.68 billion in 1997) and Freddie would have had adequate capital. In addition, OFHEO suggested that Fannie, which earned more than \$3.4 billion in 1998, could have met the June 1997 requirement by adjusting its debt structure at a cost of less than \$200 million a year.

GSEs May Lose SEC Exemptions - Congressional Budget Resolution Assumes Repeal of the GSEs’ SEC Exemption; CBO Recommends a 10-Basis Point User Fee, a Repeal of their SEC Exemption; and a 6-Basis Point Increase in the Ginnie Mae Guaranty Fee

- The Concurrent Budget Resolution passed by Congress assumes the repeal of the SEC exemption for all five GSEs. Senate Budget Committee Chairman Pete Domenici (R-NM) stated in his Senate Floor statement: “And in certain specific budget functions, to offset discretionary spending, some functions call for the sale of certain federal assets and other assume specific savings amounts in mandatory programs, *which include requiring securities registration for five government-sponsored enterprises and other incentives to encourage competition and rededication to their missions.*” (*Congressional Record*, S3755-3756, 4/15/99)
- The Congressional Budget Office in its annual report to Congress recommends imposing a 10 basis point user fee on Fannie and Freddie’s securities (including MBS), and a repeal of the GSEs’ SEC exemption. The proposals are expected to raise \$500 million per year over a 10-year period and \$2.1 billion over a 10-year period, respectively. CBO also recommends increasing the Ginnie Mae guaranty fee by 6 basis points. The increase in the Ginnie Mae guaranty fee is expected to raise \$400 million over 10 years. (*“Maintaining Budgetary Discipline: Spending and Revenue Options”*, Congressional Budget Office, April 1999)

HUD is Drafting Rules to Limit Fannie & Freddie’s Non-Mortgage Investments – Rule Expected to be Released this Summer

Chairman of the House Banking Committee Jim Leach (R-IA) Supports Regulating the Non-Mortgage Investments of Fannie & Freddie

- According to various news articles, HUD is writing a proposal to limit the non-mortgage investments by Fannie and Freddie and expects to release the plan this summer. An independent study conducted by Abt Associates Inc., a consulting firm in Cambridge, MA, reportedly persuaded HUD to make its decision. The report was critical of Fannie and Freddie and found “justifications for placing some limits on non-mortgage investments,” which the companies started

making in the 1980s. Given Fannie and Freddie's mandates to support housing, the report questioned the appropriateness of Fannie and Freddie's push into non-mortgage-related investments. "Both the shift to include non-government securities and the large increase in magnitude of non-mortgage investments relative to the early years of the enterprises raise questions about the role and appropriateness of non-mortgage investments relative to the enterprises' charter purposes," the report said. The report also noted that Fannie and Freddie's GSE status allows them to enjoy an exemption from state and local taxes and lower borrowing costs which allows them to earn more from instruments such as corporate bonds than could other investors. Also, due to an implied government guarantee from the US government, Fannie and Freddie are able to issue bonds at a very low yield relative to Treasury securities. The report examined the pros and cons of various options, including limits on the magnitude, maturities, or permissible asset classes of non-mortgage investments, and a requirement that the investments be considered "socially worthy purposes." While the report recommends some form of regulation, it also cautions against micromanagement.

- One senior HUD official who spoke on condition of anonymity stated that "The report has persuaded HUD officials that limits on non-mortgage investments are necessary in order to protect their public interest." According to senior officials, HUD has yet to work out the details of the plan, but "there has never been a more serious regulatory environment for the GSEs." HUD is reportedly considering allowing Fannie and Freddie to maintain some type of non-mortgage investment cushion but limiting its magnitude and its scope to "socially worthy purposes."
- This is not the first time concerns have been raised about Fannie and Freddie's non-mortgage investments. On December 30, 1997, HUD issued an advance notice of proposed rulemaking requesting comments on whether Fannie and Freddie should be allowed to make non-mortgage investments and, if so, what types should be allowed. Also, the Government Accounting Office (GAO) issued a report last summer which *Dow Jones Newswire* reported "essentially accused the two firms of running an ad-hoc arbitrage operation – using their government ties to borrow at preferential rates and then investing in higher yielding obligations – instead of focusing on providing minimal-rate loans to low-income families."
- Freddie's Spokeswoman Sharon McHale stated that the company could not comment on HUD's plans because the company did not have details of those plans. However, she defended Freddie's non-mortgage investments noting that they amount to only 4.9% of the company's total portfolio and provide a cushion against risks, including interest rate swings. Fannie did not return phone calls seeking comments. A *Dow Jones Newswire* article reported that at year-end 1998, Freddie and Fannie reported holding about 6.0% and 5.3%, respectively, of their total investment portfolio in non-mortgage investments. An *American Banker* article noted that at year-end Freddie had \$42.4 billion of non-mortgage investments and Fannie had \$59 billion, 13% and 12% respectively, of their total assets. Kenneth Posner, an analyst with Morgan Stanley Dean Witter, stated that he expects Fannie and Freddie to "fight hard to prevent HUD from meddling in their ability to manage the cash flows of their business." (*American Banker*, Joshua Brockman, 4/28/99; *BNA Daily Report for Executives*, Marc Selinger, 4/28/99; *Dow Jones Newswire*, Jerry Guidera, 4/23/99)

Report Finds that OFHEO's Risk-Based Capital Proposal Should Address Non-Mortgage Investments

- According to the *National Mortgage News website*, the Abt report noted that OFHEO's Risk-Based Capital Proposal does not address non-mortgage investments, only mortgage credits. "The larger these non-mortgage investments, the more important would be this omission in the [OFHEO] risk

modeling of the two government sponsored enterprises,” the report stated. The report recognized that OFHEO found that these non-mortgage investments do not raise safety and soundness issues to date. However, the reported stated that “Some consideration could be given...to placing limits on the types and amounts of assets held in the nonmortgage investment portfolio to assure that insolvency concerns remain minimal.” (*National Mortgage News website*, posted 4/27/99)

Chairman of the House Banking Committee Jim Leach (R-IA) Supports Regulating the Non-Mortgage Investments of Fannie and Freddie

- In response to HUD’s plans to regulate the non-mortgage investments and the recent Abt report, Cong. Jim Leach (R-IA) stated that he supports regulating the investment activities of Fannie and Freddie outside their Congressionally mandated missions. “When GSE activities go beyond their public mandate as in arbitrage activities, regulators have an obligation to take careful notice,” Leach stated in a statement. (*Reuters*, 4/26/99)

Government Accounting Office (GAO) Suggests Fannie & Freddie Pay for their Mission Oversight

- According to an article by John Connor with *Dow Jones Newswire*, the GAO issued a new report suggesting options that Congress could use to increase revenues and reduce spending. Included in the report, the GAO suggested that Fannie and Freddie could pay for their mission oversight. The Department of Housing and Urban Development (HUD) regulate Fannie & Freddie’s mission. The GAO also noted that Fannie & Freddie’s mission regulation would be strengthened should the government sponsored enterprises pay for their mission regulation. The GAO report noted that HUD’s regulation of Fannie and Freddie’s mission is currently funded with taxpayer dollars from HUD appropriations. "Accordingly, HUD’s capability to strengthen its enterprise housing mission oversight may be limited because resources that could be used for that purpose must compete with other priorities,” the Report stated. Connor further noted that the GAO Report stated that “Requiring Fannie Mae and Freddie Mac to reimburse HUD for mission oversight expenditures would not only result in (savings estimated at \$10 million a year) but would also enable HUD to strengthen its mission oversight.”
- The GAO Report included the following chart outlining the five-year savings should Fannie and Freddie be assessed for the cost of their mission oversight.

Dollars in Millions	FY00	FY01	FY02	FY03	FY04
Savings from the 1999 funding level					
Budget Authority	10	10	10	10	10
Outlays	10	10	10	10	10

Source: Congressional Budget Office

(*Dow Jones Newswire*, John Connor, 4/21/99; GAO Report, “*Budget Issues: Budgetary Implications of Selected GAO Work for Fiscal Year 2000*”, GAO/OCG-99-26, April 1999)

HUD Increases its Regulatory Scrutiny of Fannie & Freddie’s Automated Underwriting Technology. (Fannie’s and Freddie’s systems have 95% market share.)

- As reported in the March 19th *GSE Report*, reporters were noting that HUD fair lending specialists were planning to examine Fannie and Freddie's automated underwriting technology systems. (*Mortgage-Backed Securities Letter-American Banker*, 3/8/99; *Mortgage Marketplace-American Banker*, 3/8/99). In a *Real Estate Finance Today* article, it was reported that HUD sent a second letter to Fannie requesting Fannie's CEO Franklin Raines' sign-off on information about the company's automated underwriting system. The article noted that HUD Assistant Secretary for Fair Housing Eva Plaza had sent a letter to Fannie and Freddie requesting detailed loan-level information on their automated underwriting systems. Reportedly, the General Counsel of HUD, Gail Laster sent a letter to Fannie on March 26 noting that Fannie's March 12 transmittal letter accompanying the data was signed by Fannie's Vice Chairman Jamie Gorelick and not Franklin Raines. Laster wrote, "Please provide me the certification requested in the February 9, 1999 letter. Also, provide an explanation of why Mr. Raines was prohibited from signing the documents in this matter." (*Real Estate Finance Today*, Electronic Edition, 4/9/99)

All GSEs

<p>Wall Street Dealers are Suggesting that the Federal Reserve Purchase GSE Debt, which would further Strengthen the Value of the GSEs' Implied Government Guaranty</p>
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- According to a *Reuters* article by Steven Scheer, several Wall Street dealers – big banks and brokerages that sell Treasuries to the Fed – said they have suggested that the Fed supplement US Treasuries with securities issued by the GSEs. The Fed said it had no plans to start purchasing GSE debt, but the article noted that many Wall Street dealers said it was only a matter of time before it does so. "It's just a question of when rather than a question of if," said Vincent Verterano, Head Government Trader at Nomura Securities International Inc. "They almost have to because they own too many Treasuries." "The Treasury market will shrink...and the Fed will have to change its operating procedures," said Ward McCarthy, Managing Director of Stone & McCarthy. "It may require doing things going forward that they have not been doing up to now, and that includes buying agencies." "It's something," he said, "the Fed is almost certainly headed for." (*Reuters*, 3/30/99)
- The Bond Market Association said it hoped to meet with the Fed this spring or early summer to repeat its recommendation of purchasing GSE securities. "They have to do something and this is the most logical," said Mike Sears, Chairman of the Bond Market Association's Agency Committee. He noted that the GSE debt is AAA-rated and has the implicit full faith backing of the US government. He said, "it is inevitable" the Fed will renew agency debt purchases. (*Reuters*, 3/30/99)
- As reported in the November 6th and November 20th, 1998 *GSE Reports*, the Bond Market Association reportedly met with the Federal Reserve of NY to recommend that the Federal Reserve of New York purchase additional GSE debt as part of its open-market operations. The Bond Market Association reportedly advised the Fed that purchasing GSE debt would benefit the Fed's portfolio management, particularly since recent reductions in federal debt and US Treasury bill issuance have led to more demand by foreign and institutional investors for GSE debt. "They were in to see us," said Peter Bakstansky, Spokesman for the New York Fed. "We heard them. We appreciate their input. We have no current plans to change our operations." Thomas Stanton, a

Washington lawyer who has written extensively about the GSEs, noted that **there is already an implied, or mistakenly inferred, federal guarantee on the GSEs already. By having the Fed actively use GSE securities in open market operations, the implied federal guarantee would be strengthened and would put the Fed in the position where it would pay for potential shortfalls in GSEs' financial safety and soundness rather than be free to make decisions on the good of the financial system. Stanton noted that "The Fed then becomes a major creditor of GSEs."** (*Barron's Online*, 11/9/98; *Dow Jones Newswire*, 10/30/98)

- The Fed began buying agency debt back in 1971, but hasn't added to its permanent holdings of agency securities since the early 1980s and has allowed its holdings to mature without replacement. The Fed, which now holds only about \$387 million of these securities, announced in 1997 that it would allow its remaining holdings to mature without replacements. (*Barron's Online*, 11/9/98; *Dow Jones Newswire*, 10/30/98)

Fannie, Freddie & the FHLBanks Launch New Large Callable Note Programs

GSEs Cite Liquidity Reasons for Offering Large Callable Note Programs. *Dow Jones Newswire* Reports that the Issues Don't Exactly Represent "Super Liquidity"

Fannie Believes the Callable Benchmark Notes will be Attractive to Overseas Investors. Many Bankers in Europe Doubted that there would be Much Demand – Previous Attempts by Fannie to Introduce Callable Notes to Global Market had Limited Success

Just Two Weeks After Fannie Announces its Large Callable Note Program, Freddie & the FHLBanks Announce the Introduction of Large Callable Note Programs

Article Notes that Treasurys will Suffer From Onslaught of Corporate and Agency Bonds

Fannie

- Fannie, which last year began its successful Benchmark Note program of selling sizable offerings of noncallable notes, announced that it has expanded the Benchmark Note program to include selling large offerings of callable securities. The program will be called "Callable Benchmark Notes." Fannie plans to sell regular issues of at least \$500 million of callable securities (re-openings will total at least \$100 million) – a considerable change from their average offerings of approximately \$125 million. Fannie said it intends to sell \$10 billion to \$20 billion of Callable Benchmark Notes in 1999. The Callable Benchmark Notes will be offered monthly in the following structures: five-year bonds callable after two years; five-year bonds callable after three years; and ten-year bonds callable after three years; and ten-year bonds callable after five years.
- Fannie reportedly will use the callable debt as a tool to manage interest-rate risk on its \$433 billion mortgage portfolio. *Dow Jones Newswire* reported that with larger callable issues, Fannie also hopes to save on the cost of borrowing, because investors are willing to pay a little extra for a liquid or easily tradable issue. Fannie's Chairman Franklin Raines stated that "Fannie Mae's new callable benchmark notes will significantly increase liquidity in our callable debt securities and reinforce our firm commitment to respond to investor's needs." Joe Niedzielski of *Dow Jones* noted that while liquidity in the callable sector should improve, there are already more than 40 outstanding callable issues greater than \$500 million, about 24 of them issued by Freddie Mac.

Niedzielski believes that Fannie's monthly callable program will bring a degree of certainty for investors seeking particular structures, price transparency and issue support from the dealer community. (*American Banker*, Joshua Brockman, 4/13/99; *Dow Jones Newswire*, Steven Vames and Joe Niedzielski, 4/8/99; *Dow Jones Newswire*, Cecile Gutscher, 4/7/99; *Dow Jones Newswire – Capital Markets Report*, Joe Niedzielski, 4/13/99; *Fannie press release*, 4/7/99)

- Fannie sold its first issue of Callable Benchmark Notes (\$2 billion) on April 20 due 2004. The notes yielded 5.879% or 83 basis points more than comparable US Treasuries. Traders said they narrowed to about 82.5 basis points when they were freed from underwriter restrictions to trade in the secondary market. Fannie then sold its second Callable Benchmark Note issue on April 29 - \$2.5 billion of 10-year callable notes, due April 29, 2009. The issue was priced at 100.00 with an interest rate and yield of 6.50% and a spread of 121.6 basis points over the 4.75% US Treasury due November 2008. The issue will be noncallable for the first three years, with a first call date of April 29, 2002. (*Bloomberg News*, 4/20/99; 4/26/99; *National Mortgage News website*, posted 4/26/99)

Callable Notes are Not Exactly “Super Liquid”

- Greg Kitter, a columnist with *Dow Jones Newswire* wrote the following about Fannie's new callable program, “While we applaud the efforts of the agencies to create a more liquid market for their securities, the minimum size of the benchmark issues will be \$500 million (with \$100 million reopening size)... True, the structure of the outstanding notes could be significantly different from the proposed benchmark issues. And the issue dates could be well in the past, with much higher coupons than that would be issued today. But a size of \$500 million doesn't exactly represent super liquidity. Several large institutions could come along and gobble up the lion's share of the issue. Then where's the liquidity?” (*Dow Jones Newswire*, Greg Kitter, a former economist, trader and marketer of fixed-income cash and derivatives products, 4/12/99)

Fannie Might Find it Difficult to Attract International Investors

- Fannie is hoping to attract international investors to its new large Callable Benchmark Notes. Fannie even announced the introduction of the program during a press briefing in London in conjunction with Fannie's 15th annual investor visit to the United Kingdom. According to *Euroweek*, previous attempts by Fannie and other US agencies to introduce callable products to the global markets in the mid-1990s achieved limited success. Fannie now believes the time is right. According to the article, while many bankers in Europe understood the rationale behind Fannie's new program, they doubted how much demand could be generate outside the US. “You can argue all you like about the attractions of callable debt, but investors in Europe don't understand it and therefore don't want it,” said one London-based syndicate head. (*Euroweek*, 4/9/99)

Just Two Weeks After Fannie Announces its Large Callable Note program, Freddie and the FHLBanks Announce the Introduction of Large Callable Note programs

- Weeks after Fannie's announcement of its callable note program, Freddie announced a monthly callable version of its Reference Note program (similar to Fannie's Benchmark Note program) with an inaugural transaction involving a 10-year \$3 billion note callable after three years. According to Freddie, new issues of the program will be at least \$500 million, and will be sized to meet market demand, with re-issues from time to time. Notes will be issued in a range of structures, including: five years, callable after two years, five years, callable after three years, 10 years, callable after three years, and 10 years callable after five years. (Freddie press releases, 4/22/99, 4/23/99; *National Mortgage News website*, posted 4/26/99)

- The FHLBanks launched a \$1 billion large callable offering on April 26. The bonds have a five-year maturity and are non-callable for one year. John Darr, a FHLBank Managing Director said they would offer large callable transactions when market opportunities present themselves. The bonds will be issued off of FHLBank's global debt shelf facility, Darr stated. Darr said the FHLBank doesn't have defined plans for its large callable offerings. (*Capital Markets Report – Dow Jones Newswire*, Joe Niedzielski, 4/26/99)

Article Notes that Treasuries will Suffer From Onslaught of Corporate and Agency Bonds

- Umberto Torresan with *Dow Jones International News* reported that “Treasuries will continue to suffer from the onslaught of new corporate and agency bonds, as more investors turn to these assets and away from government securities.” “The Treasury market has lost some sponsorship,” stated Steve Kane, Portfolio Manager at Los Angeles-based Metropolitan West Asset Management. “The new money on the margin is being put to work in the agency area, the corporate area and in the asset-backed area,” said Kane. (*Dow Jones International News*, Umberto Torresan, 4/23/99)

Foreign Investors are Increasingly Attracted to GSE Debt

- A *Dow Jones Newswire* article reported that the GSEs (Fannie, Freddie, and the FHLBank System) are finding that foreign investors have become a growing market for their debt securities. According to a FHLBank report, ownership of GSE securities has more than tripled since 1992 with most of the growth occurring in Caribbean offshore banking centers like the British West Indies, Bermuda, and the Bahamas. According to Treasury market data, in 1998, foreign purchases of US government corporations and federally sponsored agencies were \$522.50 billion, up from \$259.30 billion in 1997.
- The article noted that the FHLBanks issued \$277.3 billion of securities in 1998, surpassing the US Treasury as the largest debt issuer, drawing the criticism of the Clinton administration which believe that the FHLBanks are focusing too heavily on its arbitrage activities and less on its core mission of promoting housing.
- The article notes that the private debt issued by the GSEs has represented almost a quarter of the total growth in non-US ownership of world debt securities over the past three years and foreign investments in the agencies has grown in every quarter over the last five years. The article further noted that over 60% of foreign purchases pass through the Caribbean islands (offshore banking centers in the British West Indies, Bermuda and the Bahamas). In 1998, investors in the British West Indies, Bermuda and the Bahamas bought a total of \$288.31 billion of GSE securities. Analysts caution that this data is not a reliable indicator of who actually owns the securities because banks and other institutions may be moving the funds through the islands before shipping them elsewhere. “Just because money moves to the British West Indies or Bermuda doesn't mean that's where the money actually resides,” stated Bob Petrine, the FHLBanks Director of Planning Policy and Structure. “All we really know is that the securities are owned by foreign investors.” Petrine further noted that foreign central banks, pension funds and institutional investors are the typical international investors in GSE securities, but hedge funds could also be buying the debt because they frequently do business offshore to avoid more stringent US regulation. While it is impossible to determine the amount owned by hedge funds, Petrine stated that “I would expect that hedge funds are big users of offshore banking sites.” (*Dow Jones Newswire*, Henry Pulizzi, 4/7/99)

Fannie Mae and Freddie Mac

Fannie & Freddie Announce Separate Initiatives to Open Access to Other Automated Underwriting Technology System

(Mortgage Industry Believes the GSEs' Announcements are "smoke and mirrors")

Fannie

- During the Mortgage Banker's Association annual National Secondary Market Conference, Fannie called for "open access" to automated underwriting systems and proposed a technology initiative in which lenders can pay one fee (to Fannie Mae MORNETPlus) for access to any automated underwriting system approved by Fannie Mae. Once a lender has access to Fannie's new MORNETPlus network, Fannie said there would be no further charge to use its Desktop Underwriter proprietary automated underwriting system. Fannie said it would invest as much as \$100 million each year to advance the system through MORNETPlus. Fannie said it was also willing to place Freddie's proprietary automated underwriting system, Loan Prospector, on Fannie's MORNETPlus system. Fannie also said they would waive the Desktop Underwriter fees for its Flexible 97 program, alternative A and high LTV adjustable-rate mortgages that are underwritten by Desktop Underwriter (DU) and delivered to Fannie. "We have listened to lenders who say that requiring them to use DU to originate market-expanding products such as Flexible 97 places a financial burden on them. We will now waive the DU fee for these products, which require the use of DU," stated Fannie's Chairman Franklin Raines. (*Fannie press release, 4/19/99; National Mortgage News website, posted 4/19/99*)

Freddie

- Freddie announced that it would offer a choice of programs at the point-of-sale through a common platform available over the Internet. The four major point-of-sale software vendors – Contour, Byte, Calyx, and Genesis 2000 – which together make up an estimated 90% of the wholesaler-broker channel – have agreed to build interfaces supporting the common platform. Freddie also announced that they would be putting a new version of its propriety automated underwriting system, Loan Prospector (LP), on the Internet. The system appears to allow brokers to access the systems at the point-of-sale. After brokers access LP at point-of-sale, they must share the data with one approved lender using the lenders approved access code, for a fee (paid to LP). If the broker chooses to use a different lender, it will cost another access fee to enter a new approved lender access code. (*Freddie press release, 4/19/99; National Mortgage News website, posted 4/19/99*)
- **Editorial Note:** It is unclear how Fannie and Freddie's initiatives could be considered truly "open access" to automated underwriting systems since lenders' access to the automated underwriting systems would be controlled by two companies – Fannie Mae and Freddie Mac. Under the Fannie initiative, it appears that Fannie would have the ability to choose which systems would be on the network (MORNETPlus) and Fannie would have the sole ability to decide the amount and collect the fees from lenders for using the network. Further, it would be difficult to define this as "open access" to automated underwriting systems, since Fannie requires that its Flexible 97 product can only be underwritten through Fannie's Desktop Underwriter system and no other system. Just because Fannie is waiving the fee does not mean that lenders can use their own proprietary systems, or any automated underwriting system on the MORNETPlus system if they want to use the Flexible 97 product. Lenders would still have to use Fannie's DU system instead of their own

proprietary systems if they wanted to use the Flexible 97 product. There is also a question as to whether lenders would be able to receive the same reps and warranty waivers that they receive when they use Fannie or Freddie's system, if they decide to use another system. Freddie's new initiative appears to be more "open" than Fannie's, however, Freddie would still be in control of which automated underwriting systems would be included on the common Internet platform.

***American Banker* Runs Article on Newly Formed Private Sector Coalition Created to "Contain" the GSEs to their Original Charters – Article Notes that Coalition may have Support of Consumer Advocate Ralph Nader**

- An *American Banker* article by Joshua Brockman and Marc Hochstein reported that a new private sector coalition – the Competitive Consumer Lending Coalition - had been formed whose mission is to prevent Fannie and Freddie from expanding their lines of business beyond the secondary market for mortgages. The article noted that the Coalition would be able to claim the support of the "best known consumer advocate in the nation" Ralph Nader. Reportedly in an interview, Nader stated that the agencies' implied government guarantee threatens to cause a "traditional antitrust problem." "Any effort by business groups to level the playing field and roll back the monopolistically headed market share of Fannie Mae and Freddie Mac is important," Nader stated. "It's about time that the private sector organized to try and dilute the almost mystical power that Fannie Mae has over the Congress and the White House."
- The Coalition's Chairman Gerald Friedman, who founded bond insurer Financial Guaranty Insurance Co. and the mortgage insurer Amerin Guaranty Corp., outlined the Coalition's planks in an interview with *American Banker*. Friedman emphasized that the Coalition's mission is "about balance. We're not denying the wonderful role [the GSEs] have been playing in providing liquidity. They've fulfilled their responsibility and added a great deal of value to housing in America." (*American Banker*, 4/26/99)

Another Example of "Charter Creep" – Fannie & Freddie are Entering the Commercial Real Estate Market – Commercial Lenders are Having Difficulty Competing with GSEs on Price due to GSEs' Implied Government Guarantee

- According to a *Barron's Online* article by John Levy, the market is avidly seeking apartment mortgages and investment banks are eager to make multifamily mortgages because buyers of commercial mortgage-backed securities (CMBS) like to see apartments make up a large percentage of securitization pools. However, Fannie and Freddie "seem to be gobbling up every multifamily loan they can find at prices that Wall Street simply can't duplicate." (*Barron's Online*, John Levy, 4/5/99)
- On a related note, Town and Country Trust, a real estate investment trust (REIT), financed three of the communities it acquired in 1998 with loans totaling over \$33 million (\$33,175,000) from Freddie. The loans, which mature in April 2009, bear interest at 6.81% with the proceeds of the financings used to repay borrowings under the Trust's lines of credit. The loans are secured by mortgages on the Villages at Forest Ridge and The Fairlington communities in Charlotte, NC and the Windermere Lakes community in Orlando, FL. (*PR Newswire*, 3/23/99)
- Fannie issued a press release to announce the grand opening of "Seven Oaks of Florence" Apartments for Seniors. Fannie was the sole equity investor in the project, investing \$1.4 million in

the renovation of the project. (*Fannie press release, 4/19/99*) Fannie also recently issued a press release announcing the laying of foundation for the Whitcomb Apartments to provide affordable housing for 90 low, moderate- and middle-income families. Fannie purchased nearly \$4.3 million of HUD-insured, tax-exempt and taxable multifamily mortgage revenue bonds from the city of Sterling to finance construction of the property. Half of the Apartments' units will be reserved for low-income residents. (*Fannie press release, 4/19/99*)

- Freddie announced that it securitized \$55 million of multifamily seniors housing and assisted living mortgages originated by GMAC Commercial Mortgage Corp. It is the first seniors housing mortgage securitization by Freddie Mac. The transactions consist of nine mortgages, with an average balance of \$6.1 million. The borrower is ALS Financing II, a subsidiary of Alterra. Nine properties secure the mortgages, with five located in New York, one in New Jersey, two in Michigan and one in North Carolina. (*Freddie press release, 4/26/99*)
- According to the *Mortgage-Backed Securities Letter – American Banker*, HUD is working on plans to securitize unguaranteed municipal commercial loans, despite economic road blocks that would force the commercial mortgage backed securities (CMBS) to be offered at a discount and with charter constraints of “likely” program partner Fannie. A source for the article noted that Fannie has specialized staff that could provide the expertise and has the mission orientation, making it the best candidate to assist HUD with the program. However, as the article notes, Fannie’s current charter limits it to residential finance, and would likely require Congressional action to be involved in HUD’s initiative. (*Mortgage-Backed Securities Letter-American Banker, 3/29/99*)
- **Editorial Note:** Fannie and Freddie are increasingly moving into the commercial MBS market. Due to the GSEs’ implied government guarantee, the GSEs are able to undercut private commercial lenders which cannot match the GSEs’ pricing. The commercial market (apartment complexes) seems to be a stretch on the GSEs’ charters of promoting homeownership. The GSEs participating does not increase homeownership or decrease rents. The GSEs participation does increase profitability to real estate developers.

Auditor Finds that FHA is Losing Market Share to Fannie & Freddie because the GSEs are Skimming the Cream of FHA’s Business

Auditor Warns that the Automated Underwriting Technology Developed by Fannie & Freddie Might Increase the Risk of FHA’s Portfolio

- According to an actuarial report obtained by *MortgageWire*, the *National Mortgage News* website reported that the Federal Housing Administration (FHA) single-family mortgage program is continuing to lose market share despite an increase in FHA production from \$90.5 billion in fiscal 1998 from \$65.1 billion in fiscal 1997. The actuarial report by Pricewaterhouse Cooper LLP contained preliminary data that showed FHA’s market share may have fallen as low as 7.9% last year from 9% in fiscal year 1997. In the 80’s the FHA’s market share was reportedly over 20%. The report noted that FHA’s market share was decreasing while Fannie and Freddie’s entrance into the low-downpayment market with their 97% LTV products was skimming the cream of FHA’s business. “As conventional lenders continue to increase their activities in the high LTV market, we expect FHA’s market share to decline over the next few years.”
- According to a column on the *National Mortgage News* website by Brian Collins, the actuarial report also warned that the automated underwriting systems developed by Fannie and Freddie

“might increase the adverse selection effect already seen in FHA’s portfolio. That is, without modifying its underwriting rules, FHA might end up endorsing loan populations with progressively higher average risk.” As Collins reported, Freddie adapted its automated underwriting system technology to FHA loans and Fannie is in the testing stage. The auditors reportedly said it was too early to determine how FHA’s approval of these automated underwriting systems would affect the fund’s performance but this area should be “closely watched.” (*National Mortgage News column*, Brian Collins, 4/21/99; *National Mortgage News website*, posted 4/8/99)

Freddie’s Automated Underwriting Technology System is Increasingly Used to Process VA Loans – However, the VA is Considering Requiring Lenders to Pay a \$25 Fee Per Loan to Assist the VA in Upgrading its Information Systems

- Freddie’s automated underwriting system, Loan Prospector, is processing 15-20% of all loans guaranteed by the Department of Veteran’s Affairs, according to Keith Pedigo, Director of the Loan Guarantee Service. Pedigo also noted that the VA is starting the testing phase for Fannie’s automated underwriting system, and Countrywide Home Funding Inc. just received approval to process VA loans through its automated underwriting system. The *National Mortgage News* website, *MortgageWire*, reported that the VA was considering a proposal requiring lenders to pay a \$25 fee per loan to assist the VA in upgrading its information systems. Reportedly, the agency floated the \$25 fee proposal last year, but Congress did not approve of it. (*National Mortgage News website*, posted 4/6/99)

Business Week Publishes an Article on the Private Sector Concerns over Fannie & Freddie’s Expansion into their Business

- In the April 12, 1999 edition of *Business Week*, Gary Silverman reported that Fannie and Freddie are both poised to expand – raising the concerns of private insurers and lenders who fear Fannie and Freddie will use their government subsidies to drive them out of business. Silverman cites Fannie and Freddie’s use of automated underwriting systems, along with Freddie’s attempt to enter the mortgage insurance business last fall as examples of “ambitious agencies” looking to expand their dominance. The article notes that returns on equity at Fannie and Freddie were a huge 25% and 23% last year, respectively. In contrast, the mortgage banking industry is a tough commodity business with lenders who often buy loans themselves from brokers, living on “razor-thin” margins – usually less than 1% on the loans they sell to Fannie and Freddie.
- In response to the GSEs’ expansion, Silverman notes that industry “heavyweights” are discussing a lobbying response to Fannie and Freddie. Silverman notes, “What shape this effort will take remains uncertain. But rumblings have been heard on Wall Street. ‘For the first time, a coalition has been formed in Washington of financial entities that may ultimately become a counterweight to Fannie and Freddie’ says Salomon Smith Barney analyst Thomas C. O’Donnell.”
- While complaints about Fannie and Freddie are far from new, Silverman notes that these complaints heated up considerably when Freddie Mac attempted to join the mortgage insurance business, angering members of Congress, the U.S Department of Treasury, and the private mortgage industry. “The Freddie Mac attempt was galvanizing,” stated Suzanne C. Hutchinson, executive vice president of the Mortgage Insurance Companies of America.” Simultaneously, private lenders were growing increasingly concerned about the GSEs’ practice of buying low-downpayment mortgages that were only run through their automated underwriting systems – with a

fee paid for each use, not recognizing the automated systems of other big lenders that were in place before Fannie and Freddie's systems. "Ours was in place before either of the two had automated underwriting," says Mark Oman, Chairman and CEO of Norwest Mortgage Inc., a subsidiary of Wells Fargo & Co., the nation's largest mortgage originator. "We have invested tens of millions of dollars in technology." The article noted that Fannie and Freddie's technology charges were not insignificant: A bank that makes only \$200 to \$800 on a \$100,000 loan sold to the GSEs would pay a fee of \$30 to \$50.

- However, as Silverman notes, the GSEs do not always move in tandem. He cites the deal between Norwest Mortgage and Freddie Mac, as proof. In that deal, Norwest agreed to sell almost all of their mortgages exclusively to Freddie, in return, Norwest will be free from almost all fees associated with running loans through Freddie Mac's automated underwriting system.
- While this was seen as a hopeful sign on Wall Street, Silverman predicts much more conflict. He quotes Luke Hayden, executive vice president of Chase Manhattan Mortgage as saying, "While the GSEs dominate the secondary market for conventional loans, they shouldn't dominate the whole industry." Likewise, John M. Buckley, Fannie senior vice president, likened the new industry coalition as "the coalition for higher mortgage rates," and notes "there are folks who just want to put the higher-cost toothpaste back into the tube ... we are relentless in our drive to lower consumer costs." In the words of Silverman, these "sound(s) like fighting words." (*Business Week*, April 12, 1999 issue)

Fannie & Freddie Report another Record First Quarter of Earnings

**Fannie's Earnings per Common Share up 14% over First Quarter 1998
Freddie Reported a 26% Increase in Diluted Earnings per Common Share
over First Quarter 1998**

Fannie Mae

- Fannie reported earnings for the first quarter of 1999 of \$942.9 million, or \$0.88 per common share, diluted, compared with earnings of \$888.5 million, or \$0.84 per common share, for the fourth quarter of 1998 and \$842.2 million, or \$0.77 per common share, for the first quarter of 1998. Fannie's first quarter business grew at an 18% rate, paced by more than \$100 billion in mortgage-backed securities issues and annualized portfolio growth of 25%. Fannie said the 25% annualized growth rate for its mortgage portfolio during the first quarter was down only moderately from last year's strong 31% pace. Fannie's net interest income rose by 12% to \$1.16 billion between the first quarter of 1998 and the first quarter of 1999, reflecting a \$104 billion increase in the average net mortgage balance, stemming from a surge in mortgage purchases beginning in the second quarter of last year. The company issued a record \$106 billion in mortgage-backed securities during the first quarter of 1999, surpassing the previous record issuance of \$98 billion in the fourth quarter of 1998. Net interest income was \$1.16 billion in the first quarter of 1999, compared with \$976.5 million in the fourth quarter of 1998 and \$1.035 billion in the first quarter 1998. The company said its credit loss rate, or total credit losses as a percentage of total mortgages and mortgage-backed securities outstanding, declined further to 0.017 percentage point for the latest first quarter from 0.02 percentage point in the 1998 fourth quarter.

Freddie Mac

- Freddie announced record diluted earnings per common share of 68 cents for first quarter 1999, a 26% increase over first quarter 1998 diluted earnings per common share of 54 cents. Net income for the first quarter was \$513 million, compared with \$393 million for the same period a year ago and \$468 million for fourth quarter 1998. The company's total revenues were \$997 million in first quarter 1999, an increase of 24% over the same period last year, and up from \$902 million in the fourth quarter of 1998. Net interest income earnings assets totaled \$626 million in the first quarter, compared with \$444 million in the first quarter of 1998 and \$537 million in fourth quarter 1998. The 17% increase in net interest income from the fourth quarter was reportedly driven by a \$25 billion, or 10% increase, in the average balance of the retained portfolio. On a fully taxable equivalent basis, the net interest yield on earnings assets was 0.82%, down from 0.84% in the fourth quarter and 0.91% a year ago. During the first quarter of 1999, the retained portfolio grew by \$23 billion to \$278 billion. The company anticipates that retained portfolio growth for the full year will be in the \$40 billion to \$50 billion range. Credit-related expenses totaled \$50 million in the first quarter, down from \$19 million for the fourth quarter and \$54 million in the first quarter of 1998. In addition, chargeoffs totaled \$13 million, down from \$18 million in the fourth quarter and \$49 million a year ago. (*Real Estate Finance Today, Electronic Edition*, 4/16/99; *National Mortgage News website*, posted 4/13/99; 4/15/99; *Wall Street Journal Interactive*, 4/14/99; *Fannie press release*, 4/13/99; *Freddie press release*, 4/15/99)

Fannie & Freddie Revise Private Mortgage Insurance (PMI) Cancellation Policies

- Fannie and Freddie are expected to make formal announcements in early May that the companies will extend to existing loans some of the PMI provisions in the Homeowners Protection Act that passed last year. The Act requires lenders to automatically cancel MI when the LTV ratio falls to 78% of the property's original value and to provide an annual statement informing borrowers of their cancellation rights. While the law only applies to mortgages originated after July 28 of this year, Fannie and Freddie will soon issue guidelines that extend some of the benefits under the Act to existing loans. Freddie announced that its guidelines would give mortgage lenders the option of automatically terminating mortgage insurance on loans currently owned by Freddie that are halfway through their amortization term. (*Freddie press release*, 4/27/99; *National Mortgage News website*, posted 4/27/99; *Washington Post*, 4/24/99; *American Banker*, 4/29/99)

Fannie & Freddie Rank in "Forbes' Super 100"

- This month, *Forbes* released its 31st annual *Forbes* 500 issue, dated April 19, 1999, ranking the top 500 companies in separate lists according to 1998 sales, profits, assets, and market value. In addition to the four *Forbes* 500 lists, *Forbes* also compiled a list of the "Super 100" companies, ranking the companies by their composite scores of the four separate lists. General Electric placed first in the "Super 100" list, followed by Citigroup, and BankAmerica. Fannie was ranked eleventh and Freddie placed 33rd.
- The following is an abridged version of the "Forbes Super 100" list for 1998:

Super 100 Rank	Company	Sales	Net Profits	Assets	Market Value
1	General Electric	5	1	5	2
2	Citigroup	7	8	1	13
3	BankAmerica	11	11	2	16

5	IBM	6	5	33	11
9	Chase Manhattan	19	16	4	33
11	Fannie Mae	21	21	3	36
12	General Motors	1	30	11	44
23	Wells Fargo	55	40	14	43
32	Microsoft	84	4	89	1
33	Freddie Mac	73	44	6	56
50	Fleet Financial Grp	154	50	27	92
78	PNC Bank	197	80	36	138

- Comparison to the 1997 “*Forbes*’ Super 100” list:
Freddie, while still ranking below Fannie Mae in every category, showed increased performance in every category, even increasing as much as 65% in the *Forbes* 500 Assets list. Fannie showed higher rankings in the Sales and Profits categories, but slipped in the Assets and Market Value lists from its 1997 rankings.
- Sales:
Fannie placed 21st in sales rankings, with over \$31 billion in sales. Last year Fannie ranked 29th in this category, a 13% increase. Freddie, with a little over \$18 billion in sales ranked 73rd in the *Forbes* 500 Sales list, up 25% from placing 89th in 1997.
- Profits:
Fannie was 21st in Net Profits as well, with \$3.4 trillion in profits in 1998. Last year, Fannie ranked 27th in profits, a 12.2% change. Freddie ranked 44th in profits with over \$1.7 trillion. Freddie rose from 58th place in 1997.
- Assets:
With over \$485 billion in assets, Fannie placed third in the *Forbes* Assets list, behind only Citigroup and BankAmerica. Last year, Fannie was first in this category. Freddie rose from 13th place last year to 6th, a 65% change, with \$321 billion in assets.
- Market Value:
Fannie fell in Market Value rankings from 1997, where it was 24th. This year, Fannie placed 36th, with \$72.5 billion. Freddie increased to 56th place in 1998, with \$42 billion in market value. Last year Freddie ranked 60th in this category.

(*Forbes* Press Release, 4/1/99; *Forbes* Magazine, April 19, 1999 issue, www.forbes.com)

***Washington Post Business Journal* Reports that Fannie, Freddie, & SLM Holding (Holding Company for Sallie Mae) are the 3 Largest Financial Institutions (Respectively) in the Washington, DC Region**

The Article notes that Fannie’s Assets Alone are More than the Combined Assets of the Remaining 29 Financial Institutions on the List of the Largest Financial Institutions in the Area

The *Washington Post Business Journal* listed the 30 Largest Financial Institutions in the Washington, DC area. The following are the top three listings for the DC area:

1998 Rank	1997 Rank	1996 Rank	Company	Assets (Millions)	Net Income (Millions)	Earnings per Share	Revenue (Millions)	Stockholders' Equity (Millions)	Annual Dividend	Fiscal Year	Employees
1	1	1	Fannie Mae	\$485,014.0	\$3,418.0	\$3.23	\$31,499.0	\$15,453.0	\$1.08	Dec. 31	3,800
2	2	2	Freddie Mac	321,421.0	1,700.0	2.31	3,337.0	10,835.0	0.48	Dec. 31	3,400
3	3	3	SLM Holding Corp.	37,210.0	501.5	2.95	3,064.6	653.6	0.57	Dec. 31	3,873

(Washington Business Journal, 4/26/99)

National Mortgage News Website Takes Informal Poll on Fannie & Freddie – Results are Still Running in Favor of Confining Fannie & Freddie’s Activities to Providing Liquidity for Lenders

- The *National Mortgage News* website (<http://nmnews.fgray.com>) included the following survey question on its website: “Should Congress confine the activities of Fannie Mae and Freddie Mac to those that provide liquidity for lenders?”
- The following are the results from the website (on 4/30/99):

“We continue to be flabbergasted by the results of our survey question on restricting Fannie Mae's and Freddie Mac's activities. Two weeks ago we reported the dramatic turnaround in the results, which shifted from nearly 3-to-1 in favor to more than 50% opposed and then tipped back to a razor-thin margin of 692 for and 687 against. Last week we reported Paul Donoghue's suggestion that maybe the GSEs had encouraged employees to visit our website to vote against restrictions. Since then, the numbers have skyrocketed on both sides of the question, but the surge has been greater among the ayes. The totals were **5,201 in favor and 3,124 opposed** shortly before the *MortgageWire* deadline Friday. That means we've had nearly 7,000 responses in the past week after receiving less than 1,400 in the first eight weeks the survey was posted!”

Fannie Mae

Fannie Reportedly Spent more than \$31.8 Million in 1998 on Television (This does not count the considerable amount of money Fannie spends on print advertising)

Lenders are Concerned that Fannie’s Ads “Cut them out of the Picture,” and are designed to build Fannie Mae’s brand name

Fannie Agrees that their Advertisements are too “Fannie Mae-Centric” and will try to Incorporate Lenders into their Advertisements

- According to an *American Banker* article by Joshua Brockman, lenders are becoming concerned about the recent ad campaigns by Fannie. “A lot of our members take exception to what appears to

be an outreach to consumers without any reference to the lender,” said Paul Reid, Executive Vice President of the Mortgage Bankers Association. “We want the lender to be mentioned more up-front.”

- As noted in the April 2 *GSE Report*, the newest ad campaign by Fannie features a neighborhood, Portland’s King neighborhood, that has been transformed by homeownership. This commercial and others that the Foundation ran last year advertise a toll-free number offering the viewer a guide to homeownership from Fannie. (As noted in previous reports, although Fannie’s name was advertised prominently throughout the ad, the ads seem somewhat disingenuous. Fannie’s contribution to the King neighborhood appeared only to be a \$150,000 grant to the HOST Development Corp., which managed the rehabilitation of seven houses as part of Fannie’s HomeTeam partnership with the Portland Trailblazers. And, Fannie’s contribution to another spotlighted neighborhood last year, San Antonio’s Coliseum Oaks, was only a contribution to a neighborhood playground.)
- John Buckley, Senior Vice President of Communication at Fannie, noted that lenders should not be afraid of Fannie’s ads because they are “a public service educational effort meant to educate potential homebuyers about what they need to do to become a homeowner.”
- However, Richard Beidl, an analyst at the Tower Group in Needham, MA, noted that Fannie is “making more of an effort to increase their brand awareness with the end customer.” The company, he noted is trying to get the customer to go to a broker or lender to get a “Fannie Mae loan, rather than just saying, “I want a 30-year, fixed-rate loan.”
- According to Competitive Media Reporting, Fannie and its Foundation spent more than \$31.8 million in 1998 on television. (*American Banker*, Joshua Brockman, 4/14/99)
- In related news, Fannie ran another expensive print ad in the *Washington Post* that was at least ¾ of the page. The ad featured a father and son with the headline by Fannie that “Every time we cut the cost of homeownership, more Americans get one step closer to the American Dream.” (*Washington Post*, 4/15/99)

Fannie “Changes its Tune”

- According to the *National Mortgage News website*, in response to criticism, Fannie will try to incorporate lenders into their print and radio advertising. “One of the messages we’ve heard from lenders is that our public position is too Fannie Mae-centric, and frankly, we think they had a point,” stated Senior Vice President John Buckley. “So you will be noticing a greater effort to put our lender-partners in the mix.” Fannie also claims that primary lenders will be included in more of Fannie’s press conferences and public activities, however, reportedly due to cost it will be awhile before they are mentioned in Fannie’s television commercials. “It’s not something you should expect any time soon,” said a spokesman for the Fannie Mae Foundation. (*National Mortgage News website*, posted 4/26/99)

Editorial Note: The funds spent on Fannie Mae’s advertising budget, which is designed to build their brand name, would be put to better use if those monies were directed at lower consumers’ costs.

<p style="text-align: center;">AFL-CIO Alleges that Fannie has Conflicts of Interest on the Committee that Determines Executive Compensation</p>

- According to a recent study by the AFL-CIO, 126 of the S&P 500 companies, including Fannie, have conflicts of interest on the committees that determine executive compensation. According to the report, one out of every five companies listed on the S&P 500 Index have “conflicted” directors on their compensation committees, with nepotism, friendships and business relationships interfering with independent decision-making, according to the AFL-CIO’s review of regulatory filings. The AFL-CIO reportedly reviewed all of the proxy statements issued by the S&P’s 500-stock index in 1998 and all that have been issued so far this year. According to the *Washington Post*, the AFL-CIO study specifically mentioned former Fannie Chairman and CEO Jim Johnson as an example of having a conflict of interest with someone on the committee determining their compensation. The article noted that Johnson’s 1998 total compensation was \$5.5 million and that Thomas A. Leonard was designated by Johnson to be on his compensation committee. The *Bergen Record* noted further that Chubb’s compensation committee chairman, Lawrence Small, is the President of Fannie, which guarantees securities purchase by Chubb. Gail Devlin, a Chubb spokeswoman, said Small’s relationship to Chubb does not constitute a conflict of interest, adding that Fannie Mae-backed securities represent a small part of Chubb’s \$15 billion investment portfolio. (*Bergen Record Online*, 4/8/99; *Bloomberg News*, 4/7/99; *Washington Post*, 4/7/99)

Fannie Expands into Home Improvement Loans

- Southern California Gas Co. and Fannie announced on April 6 that they have expanded their low-interest financing program to help consumers make “energy-efficiency” improvements to their homes. The program, “Home Energy-Upgrade Finance Program,” first introduced in April 1998, will be expanded to include fixed-rate financing for roofing, siding, built-in gas barbecues, evaporative coolers, insulated plantation shutters and pool and spa heaters. From \$1,000 to \$5,000 in financing is available, according to gas company officials, for these and other improvements, such as new central air-conditioning, window and door replacements, and insulation. The financing can be taken for up to 10 years. According to Lance DeLaura, Products and Service Manager for the Southern California Gas Co, “This program provides unsecured financing, which simplifies the finance process and preserves the customer’s potential borrowing power for loans secured by property.” Congressman George Radanovich (R-CA) reportedly commended Southern California Gas, Fannie Mae, and Volt VIEWtech Inc.- the Fannie Mae specialty lender and program administrator – for their involvement in the program. (*Business Wire*, 4/6/99)

Fannie would like the Financial Accounting Standards Board’s (FASB) new Derivative and Hedging Rule to be Delayed – Reportedly the Rule would Inhibit Companies like Fannie from Selling Bonds Overseas

- According to *National Mortgage News’ website*, Fannie wants FASB to delay implementation of its new derivative and hedging rule (FAS 133) for one year. Fannie’s Chief Financial Officer, Timothy Howard, wrote a letter to FASB Chairman Edmund Jenkins explaining that with a combination of working on a “mammoth Year 2000 remediation project” coupled with the adoption of FAS 133 “has placed a substantial burden on technology resources and raises concerns whether all objectives can be successfully met.” Because Fannie reports on a calendar year basis, it would not need to comply with FAS 133 until Jan. 1, 2000. However, for companies that report on a fiscal year basis, the effective date for compliance of FAS 133 is June 15. The letter also notes that Fannie has over \$150 billion in notional derivative contracts and has identified over 50 distinct types of transactional structures that must be addressed by a new accounting system. FDIC Chief

Accountant Robert Storch said it might support a delay of FAS 133 if affected institutions can make a good case. Storch noted that during the comment period on FAS 133, the regulators requested a delay of the effective date until after Year 2000 computer issues were resolved, however, FASB rejected that argument. Storch recommends that affected institutions are going to have to make a good case to FASB that goes beyond just Year 2000 issues. (*National Mortgage News website*, posted 4/15/99, 4/16/99)

- According to Jonathan Tower of *Bloomberg News*, the FAS 133 would have the effect of inhibiting overseas bond sales. FAS 133 would reportedly require companies to report losses on derivatives in their earnings statements and include derivatives held to hedge a company's currency risk on foreign bond sales. Companies that sell bonds denominated in a foreign currency often use derivatives such as currency swaps to guard against a rise in the currency that could make it costlier to repay the debt. Tower reports that under FAS 133, the accounting treatment of foreign currency derivatives would be out of sync with the treatment of bonds, which could cause companies' earnings to swing more from one quarter to the next. Rather than taking the risk, many companies have decided to keep their borrowing in the US. A Fannie spokesman noted that "there are parts of FAS 133 that could have an impact on our ability to issue non-dollar securities." Fannie reportedly has 24 issues of non-dollar bonds outstanding and 1,960 denominated in dollars. Tower's article noted that FAS 133 would "make companies report the current value of derivative positions, from interest rate swaps to futures contracts, giving investors a fuller view of their finances. Earlier, derivative losses managed to go unreported for months or even years." FASB has reportedly received 10 letters from companies asking for more time to comply with the new rule. (*The Journal Record*, Jonathan Tower, *Bloomberg News*, 4/15/99; *Capital Markets Report – Dow Jones Newswire*, 4/20/99, 4/27/99)

Top 40 Lender Expresses Concerns about Fannie's Entrance into the Servicing of Loans

- According to the *National Mortgage News* website, a top 40 lender stated the following about his view on Fannie's goals: "I think what they're really after, eventually, is the servicing side of the business." (*National Mortgage News website*, posted 4/20/99)

Barron's Online Ran an Extensive Piece on Fannie entitled "Fannie's Foes: Mortgage Giant Faces a New Challenge from a Surprising Source"

- A recent *Barron's* article focused on several potential challenges to Fannie's domination of the mortgage market. While Fannie may seem to have "a winning streak going that might amaze even Cal Ripkin," with 45 straight quarters of record profits, there may be trouble on the horizon. This may be evident, according to the author Jim McTague, in Fannie Mae's stock price, "Fannie's uninspiring stock performances stems from signs that the company's long-standing political clout may be weakening, undermining the federally sanctioned duopoly it shares with its younger cousin, Freddie Mac."
- While some Wall Street analysts call such fears overblown, McTague notes that there is "one wild card" – a "threat of genuine competition" from the FHLBank System – notably the FHLBank System's Mortgage Partnership Finance Program. He also notes that key lawmakers like Senate Banking Committee Chair Phil Gramm (R-TX) and House Banking Chair Jim Leach (R-IA) have expressed their dislike of GSEs, and a new private sector coalition, called the Competitive Consumer Lending Coalition, which has reportedly been formed to address the GSEs' charter

creep. The coalition reportedly formed after Freddie in 1998 persuaded the House to amend its charter so it could insure mortgage risk. The House reversed itself after the private sector opposed the charter revision. It was reportedly a “wake-up call” for mortgage insurers and mortgage lenders on Fannie and Freddie’s “charter creep.”

- The FHLBank’s Mortgage Partnership Finance program, still only in the pilot stages, has the potential for “explosive growth,” and may reach the \$9 billion mark in under two years (it has currently purchased over \$1.5 billion in mortgages), at which time the program will be reviewed by the Federal Housing Finance Board to determine if it can continue. McTague notes that Fannie is putting much effort into fighting this program -- by lobbying bank regulators that the program is too risky, especially in terms of secondary-loss prevention. McTague surmises, “so far the Federal Deposit Insurance Corp. hasn’t been swayed.”
- McTague speculates that Fannie may try to stack the Federal Housing Finance Board or lobby Congress that it should make it harder for FHLBanks to offer such loans, but predicts that neither will be successful. In a last-ditch attempt to fight the MPF program, Fannie could try to offer a similar program, but McTague notes that this would come at a great loss for Fannie, cutting into MBS guaranty fees. As McTague concludes, “Fannie Mae’s ace in the hole has always been its ability to convince Congress that it’s doing a good job for the American consumer by lowering the costs of buying a home. The argument might be less effective this time around. The Federal Home Loan Banks are claiming that their new product does the exact same thing.” (*Barron’s*, Jim McTague, 4/26/99)

Fannie’s CEO Claims Most Predatory Lending Practices Occur in the Subprime Market and the Goal Should be to Make B,C, and D Credit Borrowers into A Credits and Borrow from the Conventional Market

The National Home Equity Mortgage Association (NHEMA) Notes that Predatory Lending Practices Don’t Just Exist in the Subprime Market but also in the Conventional Market – Counsel for NHEMA states that Most Abuses Occur in the “Lower End of the Market...where Fannie and Freddie are Looking Hardest is the Upper End of the Market. They’d Like to Cream-Skim”

- Fannie Mae CEO Frank Raines recently gave the Moran Weston Lecture at Columbia University’s School of International and Public Affairs. (According to Josh Brockman of the *American Banker*, Weston was a community banker and advocate for affordable housing). Not surprisingly, Raines compared Fannie Mae to Weston, and noted that 68% of Fannie Mae’s loans last year were for low- and moderate-income families, and minorities.
- The crux of Raines’ speech focused on the dangers of predatory lending, which he said occurs primarily in the subprime market. Raines called predatory lending a “countertrend” to the housing boom of the 90’s. He acknowledged that subprime lending is an important part of the lending market for some that cannot qualify for conventional loans. But, according to Raines, the lower rates of the conventional market are more beneficial to the consumer -- and their equity. “Clearly, it is much better to help families move from the B, C, and D credit ratings into an A rating and borrow from the conventional mortgage market.” Raines mentioned Fannie’s “making A’s” practice, by including outreach to make consumers aware of the importance of having good credit or correcting credit problems. According to a Fannie survey, said Raines, more than 70 percent of

African Americans would put off a home purchase until they could qualify for the conventional market loans.

- Raines noted that Acting Assistant Attorney General for Civil Rights Bill Lann Lee asked Fannie’s affordable housing coalition to help fight the predatory practices of lenders who, according to Raines, prey on cash-starved and equity-rich widows. Predatory lenders, warned Raines, also prey on homeowners who are experiencing credit problems. Lenders will “flip” loans that may lower the monthly payments, but then extend the term of the loan. Raines also warned of the dangers of equity debt -- noting that this type of debt is much more serious than credit debt. He strongly warned, “the mortgage finance industry has a responsibility to police the bad actors, protect consumers and establish standards for what constitutes appropriate lending. We can’t just say caveat emperor and walk away.”
- Wright Andrews, counsel for the National Home Equity Mortgage Association (NHEMA), in an *American Banker* article covering Raines’ speech, stated that typical home equity lenders are “middle class folks with some ding on their credit,” and noted that only 10% are senior citizens. Andrews also spoke out against loan flipping, calling it the number one abusive practice. But, Andrews stated, “it isn’t just the subprime where people are getting hit.” The conventional markets also see predatory practices in the form of “junk fees” like inflated credit reports. He also said that most abuses occur in “the lower end of the market ... where Fannie and Freddie are looking hardest is the upper end of the market. They’d like to cream-skim.”
- NHEMA is planing to address concerns with predatory lending on Capitol Hill, according to Andrews. He noted that “We don’t think that the few bad actors out there should be allowed to rip off consumers and give the industry a bad name.” Raines suggested that information and education are key. “Within a few weeks, Fannie Mae, as a corporation, is going to release a guide in English and Spanish that specifically deals with the predatory lending problem.” He also suggested several ways the mortgage industry can limit predatory lending: by always offering the lowest rate for which a consumer qualifies; by considering a consumer’s ability to repay the loan, not just their equity; and by offering full cost disclosure at least 3 days prior to a loan closing. (*Franklin Raines speech, Colombia University, 4/22/99; American Banker, Joshua Brockman, 4/29/99*)

Fannie Continues to Argue that it is a Private Company with No Implied Government Guarantee – Just Like Depository Institutions; Claims that Fannie’s Charter is Similar to National Banks’ Charters

- In a recent speech to reporters, Fannie’s Chairman Franklin Raines claimed that Fannie was a private company with no implied federal government guarantee. Raines notes that every one of their debt securities clearly states that it is not backed by the full faith and credit of the government and that their cost of funds is significantly higher than the US Treasury’s. According to Raines, “Any advantage we may have in the market pales in comparison to the financial advantages of some of our customers. National banks earn far more from the funds they lend than we do. Their net interest margin – the spread between cost of funds and interest and fees earned – is 411 basis points. Our is only 117 basis points.” (Speech by Fannie’s Chairman Franklin Raines, “Money, Markets, and the News”, 3/19/99)
- As noted in the April *GSE Special Supplement*, at a recent AEI Conference on Fannie and Freddie, Andrew Marzol with Fannie stated: “It’s too late to debate privatizing Fannie Mae.” “We’re

already private, with \$70 billion in private capital. We have a government charter, but so does Norwest and Chase Manhattan.” Vern McKinley, a policy contributor to Cato, disputed Marzol’s statement at the conference. McKinley countered by pointing out that Marzol’s definition of privatization is narrow and noted that if the discussion of privatizing Fannie and Freddie was such a “fruitless exercise,” then why would Congress have passed a law in 1992 to direct the Treasury, GAO, HUD and CBO to prepare studies on the impact of privatizing the GSEs? The 1992 legislation defined privatization as “repealing the Federal charters of [Fannie Mae and Freddie Mac], eliminating any Federal sponsorship of the enterprises, and allowing the enterprises to continue to operate as fully private entities.” McKinley noted that Marzol’s comparison of Fannie and Freddie to national banks is a good comparison but he reminded Marzol that there are differences between national banks and Fannie and Freddie. National banks do have government charters and are backed by the credit standing of the federal government in the form of government deposit insurance. However, he noted that while Fannie has a government charter and is implicitly backed by the federal government – there is a major difference – Fannie doesn’t pay for its government sponsorship, which gives them a competitive advantage over those institutions that pay for their government backing. “If Mr. Marzol’s analogy to national banks is meant as an admission that Fannie Mae should be charged a ‘capitalization fee’ to recover some of the benefits retained by the government sponsored enterprises (GSEs), then progress has been made today.”

Editorial Note: By the “dueling charters” line of reasoning, the GSEs are attempting to advance an argument that a level playing field exists between insured depository institutions and the GSEs. The GSEs’ definition of a level playing field is lopsided.

- First, banks and GSEs do not operate in the same competitive environments. A new bank receives a federal charter with a satisfactory application and adequate capital. A GSE charter requires an Act of Congress; consequently the GSEs have little competition in their primary markets.
- Second, the economic benefit of federal deposit insurance flows, for the most part, to depositors versus depositories. The GSEs, on the other hand, derive billions of dollars of benefits annually from their implied federal guarantee. Insured depository institutions pay for their deposit insurance, which benefits their customers. Further, the federal benefit of deposit insurance protects the “depositors” (i.e. the consumers) should a bank fail, and not the institution, while the government granted benefits provided to Fannie and Freddie protect the institution and shareholders of these entities. The GSEs do not pay for their implied federal guarantee, and it generously benefits shareholders as well as borrowers.
- Third, capital standards, even when adjusted for asset differences, are hardly equivalent. The GSEs are permitted to operate at capital levels that would be considered unsound by the regulators who oversee depository institutions.
- Finally, only the GSEs are granted a variety of exemptions that have substantial economic benefit, from not paying local taxes to avoiding the cost of SEC reporting and registration.

There are major differences between the GSEs and depository institutions that would make Fannie and Freddie’s newest argument appear moot, if not unsound.

Despite Fannie’s False Insistence that it is a Private Company just like any other Depository Institution, Investors, Reporters, and Consumers View the Company as a Government Agency Backed by the Government – Newspaper Corrections Setting the Record Straight that Fannie and Freddie are “Private” Companies Not Backed by the Government are Virtually Non-Existent

Reporters Mistakenly Refer to Fannie’s Bond Issues as Backed by the Federal Government

- A *Reuters* reporter noted the following about a recent Fannie bond issue, “Fannie Mae’s debt carries top triple AAA ratings and is guaranteed by the U.S. government.” (*Reuters*, Deepthi Wickremasinghe, 4/8/99)
- A *Bloomberg News* article noted the following, “FHLB’s new bonds will be priced the same day that Fannie Mae, another triple-A rated U.S. government agency...prices its new callable jumbo global or “benchmark” bonds...” (*Bloomberg News*, 4/19/99)
- Note: Not only are there articles that state that Fannie’s debt is government guaranteed, there are numerous articles each week reporting that Fannie enjoys an implied government guarantee due to its GSE status.
- As noted in the April 2 issue of the *GSE Report*, Fannie donated a six-bedroom, 5,384 square foot house to the family of the seven surviving Houston, TX octuplets. A few letters to the editor were sent by consumers who were upset that the “federal government” (i.e., Fannie Mae) would be providing homes free of charge to the family. See quotes below:

Letter-to-the-Editor – Orlando Sentinel

“Having just finished the weekly ritual of spending Sunday morning reading the morning paper from front to back, I found myself seriously disturbed by an article I noticed about a house in Texas. It seems that Rep. Sheila Jackson Lee, D-Houston, deemed it necessary to approach the Federal National Mortgage Association (Fannie Mae) about providing a home for the Nigerian couple who recently become the parents of octuplets.

“Now, this in itself is rather unusual, as it seems increasingly more difficult to attract the attention of a politician over issues of public concern. To see this kind of intervention in a circumstance that involves only one family and has already been of considerable cost to the taxpayers of Texas must, I’m sure, attract the ire of many. Now we have an elected official seeing fit to arrange for this family to receive at no cost a home valued at \$274,000, which belonged to a federal agency. Hence it belonged to the taxpayers of America, many of whom are working very hard to meet their own mortgage payments.

“I’m sure many other hard-working Americans are wondering how the, too, can get a six-bedroom, 5,400-square-foot, two-story home for free.” Brian Wilmott, Orlando (*Orlando Sentinel*, 4/2/99)

Letter-to-the-Editor –Dallas Morning News

“Tell me, where do I go to get on the list? Rep. Sheila Jackson Lee, D-Houston ‘reached out’ to parents Nkem Chukwu and Lyke Louis Udobi and gave them a 5,384-square-foot home, appraised at \$274,000 courtesy of the Federal National Mortgage Association known as Fannie Mae. Rep.

Jackson Lee said she is now handing them over to Rep. Nick Lampson, D-Beaumont. She said, 'They'll be in good hands.'

Shucks, if the U.S. government (U.S. taxpayers) is giving away houses, I'd be plum happy to get one. Just tell me whom do I have to contact to see up?" Jess Gordon, Highland Village (*Dallas Morning News*, 4/2/99)

Fannie Partners with an Electronic Commerce Network to Provide Automated Title Insurance and Flood Information through Fannie's Automated Underwriting Technology System Network

(Fannie Moves a Step Closer Towards Vertically Integrating the Mortgage Market by Combining the Use of the Federal Subsidies with Technology)

- Fannie and Realec have agreed to provide electronic access to title insurance, flood insurance, and existing credit and appraisal transactions on Fannie's MornetPlus Network. Beginning later this year, lenders will be able to order the products and services from Realec, a multi-vendor electronic commerce network launched by Stewart Information Services and Fidelity National Financial Inc. This is the first time Fannie has made flood certificates and title services available to lenders over the MORNETPlus network. Lenders will also be able to send orders for multiple services without having to re-key data, and check the status of services online. Pat Stone, President of Fidelity National Title said the Fannie/Realec alliance "allows lenders to leverage a single connection to access [Fannie Mae's] Desktop Underwriter and the other products and services required to close the loan." Financial terms of the alliance weren't disclosed. (*National Mortgage News website*, posted 4/12/99; *Business Wire*, 4/12/99; *Inman News Feature*, 4/12/99; *Fannie press release*, 4/12/99; *Dow Jones Newswire*, 4/14/99)

As reported in the March 5 GSE Report, Morgan Stanley Dean Witter Analyst Kenneth Posner wrote that "Fannie Mae and Freddie Mac will use the Internet to accelerate the use of their automated underwriting systems. In so doing, they will create a growing class of originators who are dependent on agency technology and thus less likely to negotiate pricing or hold back from selling loans." (Morgan Stanley Dean Witter- US and the Americas Investment Research, US Savings & Loans/GSEs & Mortgage Finance, The Internet Mortgage Report: New Models, New Opportunities, Kenneth Posner, 2/4/99)

Using its Technology and Foundation to Promote the Company's "Brand Name" and Reach to Consumers, Fannie Unveils a New "Consumer Friendly" Website for its Foundation

- The Fannie Mae Foundation announced that it has redesigned its website (fanniemaefoundation.org) to be a more comprehensive, user-friendly, customer-focused tool for interactive communications. The site includes new content and the ability for visitors to obtain and submit information on the grant-making process, register for the company's annual Help the Homeless Walkathon and receive homebuyer information. The website is organized into six sections that provide information on buying a home and housing policy issues as well as the foundation, its recent activities, its grant-making and community initiatives, and the partnerships and programs in which it is involved. (*PR Newswire*, 4/22/99; *National Mortgage News website*, posted 4/22/99)

**Columnist Notes that Threat of User Fees on Fannie & Freddie Causes
Fannie to “Reach Out” to Republicans**

- Robert Novak, a Columnist with the *Chicago Sun-Times*, noted that Fannie, “which long as shown a pronounced liberal and Democratic tilt, is reaching out to Republicans now that it is threatened by the Clinton administration with a user fee on home mortgages.” Novak cites Fannie’s hiring of Arne Christenson, the former Chief of Staff to former House Speaker Newt Gingrich to its company to lobby against the tax, and cites recently arranged Fannie Mae photo opps with Sen. Rod Grams of Minnesota, “the most endangered Republican senator seeking re-election in 2000,” and a soon to be scheduled session with Republican Senator Rick Santorum of Pennsylvania, “who also faces tough going next year.”
- Novak notes that Fannie’s political contributions traditionally have been biased toward Democratic candidates and he reports that “the conservative Capital Research Center has ranked the company over the last several years among the 10 worst corporate ‘misgivers’ to liberal causes, ranking it second from the bottom in 1994.” Novak also notes that the current Chairman of Fannie Franklin Raines was the Clinton Administration’s Budget Director and the former Fannie Mae Chairman Jim Johnson (who is currently chairman of the Executive Committee) is a former Democratic operative who managed Walter Mondale’s 1984 presidential campaign. (*Chicago Sun-Times*, 4/4/99)

Fannie is Majority Owner (84%) of a New Mixed-Use “Environmentally Friendly” Community in Arizona which Includes Retail Shops, a Copying Center, and an Art Gallery – Since the Development is So Far Away from Downtown Tucson, Some Critics believe the Community will Contribute to Traffic and Air Problems - Only 20% of the Community is Dedicated to “Affordable Housing” (House Prices begin at \$90,000) and the House Prices in the Community are Approximately 10% Above a Typical Tucson Subdivision

- Fannie held a press conference to announce the completion of a mixed-use environmentally friendly community called Civano. Arizona Governor Jane Hull, Cong. Jim Kolbe (R-AZ), Tucson Mayor George Miller and US Department of Energy Assistant Secretary for Energy Efficiency and Renewable Energy Dan Reicher all participated in the Fannie press conference. Fannie is the majority owner (84%) of Civano. Only 20% of the 2,600 homes in the 1,100 -acre community will be “affordable” for low- and moderate-income families. The homes in the neighborhood will range from \$90,000 to \$200,000. Custom homes will be available for \$150,000 to \$300,000. Fannie provided more than \$5 million in equity from Fannie’s American Communities Fund. Some buildings will reportedly have a mix of uses, including retail downstairs, residential upstairs, and a cluster of shops including a café, a copying center, and an art gallery.
- Critics state that the Civano project is giving short shrift to its original goal of being a solar village and they question putting taxpayer money into the community. The city of Tucson gave \$3 million to extend sewer and water lines and build the project’s main road. The city will also include a park near the community in an upcoming municipal bond election and the state chipped in a \$300,000 solar grant. And critics note that’s it so far on the fringes of Tucson that it’s part of the urban sprawl and will only add to traffic and air problems. “This project lost its radiance,” said Molly McKasson, a former City Council member who is running for Mayor. (*Arizona Republic*, 4/17/99; *Business Wire*, 4/16/99; *Fannie press release*, 4/16/99)

Fannie Begins New Program that would Allow Homebuyers to Purchase a Home without Buying the Land Underneath the Home

- Fannie held a press conference with Senator Gordon Smith (R-OR) to announce a new initiative called the Sabin Community Land Trust. The program enables homebuyers to purchase a home without buying the land beneath their home. Under the initiative, homebuyers agree on a purchase price for the home itself and sign a long-term ground lease for the land beneath the home for \$25 per month. The Sabin Community Land Trust owns the land on which the homes sit. The initiative also includes a lease-purchase component under which the homebuyer makes monthly payments, with a portion of the payment going into an escrow account. The escrow account funds will be used toward the downpayment when the homebuyer is ready to assume the mortgage. Sabin Community Land Trust will develop ten homes ranging in price from \$67,000 to \$77,000 in Northeast Portland. (*Fannie press releases, 4/8/99; Portland Oregonian, 4/9/99*)

Former Fannie Chairman Jim Johnson Details the Chairman Transition at Fannie

- In the April 1999 edition of “*Across the Board*” magazine, former Fannie Mae CEO James A. Johnson wrote a lengthy article on his views on how a successful executive transition should take place. According to Johnson, Fannie Mae’s unique “overlap” method worked well in the seven-month transition between Johnson and Frank Raines. Johnson cites seven successful benefits of an overlap transition, including “Promoting a Succession Culture,” time for a “Hello / Goodbye tour;” time for the existing CEO to “Take the Heat” for bad decisions made during the CEO’s tenure, and the “Need for Public Scorekeeping.” According to Johnson, the most important factor in the Fannie Mae transition was that their “core values and fundamental mission remained constant.” According to the article, during his tenure at Fannie, Johnson’s vision for Fannie’s expansion was “an emphasis on our doing more for those with lower incomes, for minorities, and for those whom the mortgage industry has not served well. On the other hand, Frank’s [New Chairman Franklin Raines] complementary vision has been articulated, over time, by an emphasis on technological solutions to individual needs.” (*Across the Board, April 1999*)

Fannie Announces a Grant to Fund Fellowship at National American Indian Housing Council

- Fannie announced that it has awarded a \$50,000 fellowship to the National American Indian Housing Council, a national organization that assists Native American tribes and tribal housing agencies provide affordable housing for Native people in Indian Communities and Alaskan native villages. (*Fannie press release, 4/12/99*)

Fannie Announces New Members of its Housing Impact Advisory Council

- Fannie announced the following 20 people as new members to the company’s 1999 Housing Impact Advisory Council. The Council meets three times a year with Fannie’s Senior Management. The Council has 41 members. The Council will be co-chaired by Glenda Hood, the Mayor of Orlando, FL and Agnes Bundy Scanlan, Senior Vice President and Director of Corporate Community Development for Fleet Financial Group. The following are the new members:
 - (1) Herb Appel, Jr.- President of the Greater Fort Bend Economic Development Council
 - (2) Gale Cincotta-Co-Founder and Executive Director of the National Training and Information Council
 - (3) Steve Cramer-President and Executive Director of Project for Pride in Living, Inc.
 - (4) Rick Davis - Owner of Davis Homes and R.E. Davis Construction

- (5) Bill Faith – Executive Director of the Coalition on Homelessness and Housing in Ohio
- (6) Daniel Fauske – Chief Executive Officer and Executive Director for the Alaska Housing Finance Corporation
- (7) Helen Feinberg-Manager of Housing Finance for William Hough & Company
- (8) The Honorable Betty Flores – Mayor of Laredo, TX
- (9) Ron Garcia – Vice President for Loan Production & Manager of the Retail Banking Division at Quaker City Federal Savings & Loan in Whittier, CA
- (10) R. Charles Gaston – Senior Development Specialist for Community Builders in Kansas City, MO
- (11) George Hamblin, Jr. – Vice President & Residential Lending Manager for Commercial Federal Mortgage Corp.
- (12) John Heagy – Vice President of Investment for Dollar Bank
- (13) K. Kirke Kickingbird – Director of the Native American Legal Resource Center at Oklahoma City University School of Law
- (14) Wil Nabors – Program Director of the Local Initiatives Support Corporation Office in Baton Rouge
- (15) Abdul Sm Rasheed-Staff and Program Manager at the North Carolina Community Development Initiative in Raleigh, NC
- (16) Richard Rienstra- Executive Director of Trinity Village Non-Profit Housing Corporation
- (17) Agnes Bundy Scanlan-Fleet Financial Group
- (18) Beatriz Olvera Stotzer – Founder and President of New Economics for Women in Los Angeles
- (19) Robert Strickland – Alabama Housing Finance Agency
- (20) Bruce Toll- Co-Founder of Toll Brothers, Inc. (*Fannie press release, 4/13/99*)

Fannie Further Expands its Political Reach by Including Federal and State Officeholders in its Press Conferences and Press Releases and Increasingly Using its Partnership Offices (currently 36 offices - another reportedly will be added in Newark, NJ) in Press Events

Senators Thomas and Enzi are also Urging Fannie to Open a Partnership Office in Wyoming

- It appears that Fannie might be opening local offices at the rate of practically one a month. Just last month, Fannie opened its 35th Fannie Mae Partnership Office. According to *Bloomberg News*, the *Star Ledger of Newark* is reporting that Fannie is planning to open another Partnership Office in downtown Newark, NJ- making it the 36th Partnership Office. The *Associated Press* is reporting that Senators Craig Thomas (R-WY) and Michael Enzi (R-WY) are urging Fannie to open a Partnership Office in Wyoming. (*Associated Press, 4/28/99; Bloomberg News, 4/20/99*)

Senator Gordon Smith (R-OR) – New Program will Allow Homebuyers to Purchase a Home without Buying the Land Underneath the Home

- Fannie issued a press release to announce the first-year results of “HouseOregon.” A statement by Senator Smith was included in Fannie’s press release. Fannie then issued another press release announcing that Senator Smith “unveiled” a “one of a kind homeownership initiative.” The initiative called the Sabin Community Land Trust, enables homebuyers to purchase a home without having to buy the land beneath their home. (More details of the program were included in this *GSE Report*.) (*Fannie press releases, 4/8/99; Portland Oregonian, 4/9/99*)

Cong. Tom Coburn (R-OK)

- Fannie announced a partnership with the Rogers County Housing Finance Authority, wherein Fannie will purchase \$7.4 million of single-family, tax-exempt mortgage revenue bonds issued by the Rogers County HFA. The bond proceeds will provide financing for 30-year, fixed-rate mortgages with a reduced interest rate. A statement by Cong. Coburn was included in Fannie’s press release. (*Fannie press release, 4/8/99*)

Arizona Governor Jane Hull, Cong. Jim Kolbe (R-AZ), Tucson Mayor George Miller and US Department of Energy Assistant Secretary for Energy Efficiency and Renewable Energy

- Fannie issued a press release to announce the completion of a mixed-use environmentally friendly community called Civano. All of the above mentioned people participated in the Fannie press conference. Only 20% of the 2,600 homes in the 1,100-acre community will be “affordable” for low- and moderate-income families. Fannie is the majority owner (84%) of Civano. The homes in the neighborhood will range from \$90,000 to \$200,000. Custom homes will be available for \$150,000 to \$300,000. Fannie provided more than \$5 million in equity from Fannie’s American Communities Fund. (More details on this initiative are included in this *GSE Report*.) (*Business Wire*, 4/16/99; *Fannie press release*, 4/16/99)

Senator Bob Kerrey (D-NE), Omaha Mayor Hal Daub

- Fannie issued a press release to announce the grand opening of “Seven Oaks of Florence” Apartments for Seniors. Fannie was the sole equity investor in the project, investing \$1.4 million in the renovation of the project. The above listed persons participated in the Fannie press conference. (*Fannie press release*, 4/19/99)

Cong. John Conyers, Jr. (D-MI), Joseph Knollenberg (R-MI), Cong. Carolyn Kilpatrick (D-MI), Detroit Mayor Dennis Archer

- Fannie’s Chairman Franklin Raines held a press conference with the above listed officials to announce the results of Fannie’s “HouseDetroit” program. (*Fannie press release*, 4/26/99)

Cong. Solomon Ortiz (D-TX)

- Fannie issued a press release to announce a \$18 million mortgage revenue bond agreement with the Cameron County Housing Finance Corporation to provide downpayment assistance for homebuyers in Cameron County. A statement by Cong. Ortiz was included in the press release. (*Fannie press release*, 4/21/99)

Washington, DC Mayor Anthony Williams and Cong. Eleanor Holmes Norton (D-DC)

- Fannie held a press conference with Fannie’s CEO Franklin Raines to announce the launching of a \$1 billion House Washington initiative. DC Mayor Anthony Williams and Congresswoman Eleanor Holmes Norton participated in the press conference. The *Washington Business Journal* noted that the Fannie investment “should help blunt criticism that the company does not pay local income taxes.” (*PR Newswire*, 4/27/99; *Washington Business Journal*, 4/26/99)

Congressman Bob Schaffer (R-CO) and Sterling, CO Mayor Bill Finch

- Fannie issued a press release announcing the laying of the foundation for the Whitcomb Apartments to provide affordable housing for 90 low, moderate- and middle-income families. Fannie purchased nearly \$4.3 million of HUD-insured, tax-exempt and taxable multifamily mortgage revenue bonds from the city of Sterling to finance construction of the project. Half of the Apartments’ units will be reserved for low-income residents. The above persons participated in the Fannie press conference. (*Fannie press release*, 4/19/99)

Congressman Gene Green (D-TX)

- Fannie issued a press release announcing that it provided \$5,000 to the Latino Learning Center to assist with the operating costs associated with its “Home to Own” program. The program will use Fannie’s Desktop Home Counselor software as part of the program. Cong. Green participated in the Fannie press conference. (*Fannie press release*, 4/20/99)

Newport News, Virginia Mayor Joe Frank

- Fannie issued a press release announcing the opening for the Villages at Newport, a “Health-E Community” program that combines affordability and energy efficiency with high indoor air quality standards. The Villages of Newport subdivision contains 73 “affordable” homes priced from \$95,000 to approximately \$120,000. Newport News Mayor Joe Frank joined representatives for Fannie, Gabriel Enterprises, Bank of America, Wachovia Community Development Corporation and the Newport News Redevelopment Housing Authority for the announcement. (*Fannie press release, 4/8/99*)

Former Fannie Chairman & CEO Appointed as Outside Director of Goldman Sachs

- Goldman, Sachs & Co. named James Johnson, former head of Fannie Mae, as the first of three outside directors. Johnson’s appointment will become effective when Goldman Sachs sells shares publicly for the first time, requiring the appointment of external directors as it moves from private to public status. (*Bloomberg News, 4/11/99*)

Freddie Mac

Freddie Begins Selling “Estate Notes” which Add a Death Benefit to Retail Buyers of its Callable Debt - Making its Debt More Attractive to Individual Investors

- Freddie announced that it completed its first sale of a new series of bonds, referred to as Estate Notes that can be redeemed at face value if the holder dies. Under this program, Freddie has added a death benefit for retail buyers of its callable debt that would allow the bondholder’s estate to redeem the bonds at par. The new “put” option was developed with LaSalle National Bank, and was tailored toward investors concerned about estate planning. In the event an owner dies prior to the maturity of the security, the estate can put the bonds back to Freddie at 100% of par value. *Bloomberg* reported that the notes may be attractive for heirs who might not want to wait for the bonds to mature. Freddie also has the right to call the bonds, or buy them back, after two years. If the bonds are worth more than par when the holder dies, heirs may sell them at the market price and forego the optional redemption. The notes can be purchased in \$1,000 blocks. According to an article in the *National Mortgage News*, a Freddie spokesman said the new program “is one of at least two the GSE has made in the past month to serve retail investors, following the lowering of the minimum trading investment to \$1,000 from \$5,000 a few weeks ago.”
- LaSalle priced the \$20 million of 6.4% 15-year bonds at 99 cents per dollar face value. Freddie sold the bonds to LaSalle at 98.7 cents on the dollar. According to an agency debt trader at LaSalle, more than half of the issue was sold to firms that handle the accounts of individual investors.
- According to *Bloomberg*, the US issued similar bonds called “flower bonds” beginning in 1942 that were redeemable at par after death. Other companies have reportedly copied the idea. The Treasury securities were sold at a deep discount, and “flowered” to face value when the owner died and the funds would be used to pay the federal inheritance tax. The last of the Treasury issue reportedly matured in November. (*Bloomberg News, 4/7/99; 4/20/99; National Mortgage News, 4/12/99; National Mortgage News website, posted 4/7/99; Freddie press release, 4/6/99*)

Freddie Uses its Technology to Move Further into “A-” Market

- According to the *National Mortgage News website*, lenders can now sell A-minus loans to Freddie through Freddie’s Gold Cash Xtra Service on Freddie’s GoldWorks electronic network. The new service allows lenders to download rates, price and lock loans, and view their Gold Cash Xtra pipeline online. As part of the service, lenders will be able to choose among three commitment options: best efforts, servicing released; best efforts, servicing retained; and mandatory, servicing released. “By adding the A-minus offering to Gold Cash Xtra, Freddie Mac is providing lenders with an easy way to sell us their A-minus loans,” said Bob Ryan, Vice President of Marketing. “Lenders can now reach out to more borrowers and use Gold Cash Xtra’s servicing released option if they’re not prepared to service those loans. There’s no need to worry about hedging or originating enough loans and pooling them for a Guarantor transaction.” Lenders can also use Gold Cash Xtra to sell Freddie products such as balloon/reset loans with expanded loan-to-value (LTV) ratios and investor properties with LTVs of up to 90%. (*National Mortgage News website*, posted 4/20/99; *Freddie press release*, 4/19/99)

Federal Home Loan Banks

FHLBank of New York Joins the FHLBank System’s Mortgage Partnership Finance (MPF) Program

FHLBank of Pittsburgh is Expected to Join the MPF Program

The MPF Program is Becoming a Real Competitor to Fannie & Freddie – Four FHLBanks are Now Offering the Program

- The FHLBank of New York announced that it is now offering the MPF program – a program which gives savings institutions and commercial bank lenders a new alternative to holding home loans in portfolio or selling them to Fannie and Freddie. The program allows FHLBanks to purchase mortgage loans originated by member financial institutions. There are now four FHLBanks offering the program – the FHLBanks of Chicago (began the program), Dallas, Atlanta, and New York. According to Alfred DelliBovi, President of the FHLBank of New York, the MPF Program “gives our members a fresh alternative and builds our core competitive advantage, and that is providing the funding.” DelliBovi announced that the program has already funded two loans from a New York member – Elmira Savings and Loan. William McKenzie, President and CEO of Elmira Savings & Loan stated that “The MPF program gives us a new way to meet our customer’s needs. Any product which gives community lenders like Elmira Savings and Loan more choices is good for the neighborhood and good for American homebuyers.”
- Mortgage industry professionals have been noting the benefits of the MPF program in the press. “We’re very interested” in the MPF program, stated Paul Reid, Executive Vice President of the MBA. “It’s another outlet for our members. Competition always, we think, brings better efficiencies than a purely regulated market,” he stated. Terry Buhler, Vice President for the Secondary Market at Anchorbank in Madison, WI stated that the MPF program provides a “pricing advantage in the sale of the loan in the secondary market.” Further, another advantage, he stated is that the credit-enhancement fees that come to the local lender “are a portion of the guarantee fees that would normally go to the agencies [Fannie and Freddie].”

- The MPF program is becoming a real competitor to Fannie and Freddie. According to a joint press release by the FHLBanks of Chicago and New York, there are currently 55 savings institutions and commercial banks approved as participating customers and over 100 additional institutions are in various stages of joining the program. The program has over \$1.2 billion in outstanding loans, with master commitments for another billion dollars. (*American Banker*, Joshua Brockman, 4/21/99; *Bloomberg News*, 4/20/99; *FHLBanks of NY and Chicago press release*, 4/20/99)
- According to *National Mortgage News*, the FHLBank of Pittsburgh is expected to obtain FHFB approval soon to offer the MPF program.

Status Report of Legislation Containing FHLBank Expansion Provisions

- The House Commerce Subcommittee on Finance and Hazardous Materials held a hearing on the House's Financial Services Modernization bill (H.R. 10) on April 28, with plans to hold a second hearing on May 5. A reported third hearing has not been scheduled. As reported in previous *GSE Reports*, H.R. 10 contains the following FHLBank expansion provisions: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) changes financing from fee-based system to flat rate by converting the annual \$300 million REFCorp. obligation to 20.75% of earnings; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock. The House Banking Committee approved H.R. 10 on March 11 by a 51-8 bipartisan vote. The House Banking Committee version must also pass the Commerce Committee. According to *BNA*, House Commerce Committee Chairman Thomas Bliley (R-VA) said April 28 that his Committee would not take up the measure until the Senate can pass its own version of financial services modernization. The House leadership had previously given the Commerce Committee a May 14 deadline to vote on the measure. (*BNA Daily Report for Executives*, 4/0/99)
- The Senate Banking Committee passed its version of financial services modernization (S. 900) on a party-line vote of 11-9 on March 4. The Senate bill contains the following FHLBank language: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank earnings; and (4) reduces FHFB control of day-to-day operations; and (5) instructs the General Accounting Office (GAO) to conduct a study of the FHLBank System capital structure. *BNA* reported that Senate leaders agreed April 29 to begin floor debate on S. 900 May 3 but noted that the Democrats and Republicans have not resolved their policy differences. (*BNA Daily Report for Executives*, 4/0/99)
- Separate FHLBank bills have also been introduced in the House and Senate (H.R. 822 and S. 458). The bills were introduced in the Senate (S. 458) by Senator Chuck Hagel (R-NE) and Senator Evan Bayh (D-IN) and in the House (H.R. 822) by Congressman Richard Baker (R-LA) and Congressman Paul Kanjorski (D-PA). The bills would do the following: (1) ease small bank access to FHLBank advances; (2) make thrift membership voluntary; (3) convert the \$300 million REFCorp. obligation to 20.75% of FHLBank earnings; (4) reduce federal intrusion in day-to-day FHLBank operations; (5) and provide for permanent capital and a risk-based capital standard. (*National Mortgage News website*, posted 2/25/99) A "Memo to Members" from the National Low Income Housing Coalition noted that no community groups officially support or oppose H.R. 822 and S. 458, "although many would support the act if provisions were included that expressly targeted new resources and activities to underserved areas while also maintaining current targeted

activities.” The newsletter also noted that “Two specific provisions that community groups would strongly support are: an expanded membership of the Federal Home Loan Banks by allowing Community Development Financial Institutions to become non-member borrowers, and the creation of an economic development grant similar to the Affordable Housing Program to specifically target economic development activities.” (*Memo to Members*, National Low Income Housing Coalition, 4/9/99)

FHFB Issued Final Rules Expanding Eligible Collateral Requirements for FHLBank Advances

FHFB Issued Interim Final Rule Prohibiting FHLBanks from Imposing or Accepting a Fee in Lieu of Redeeming a Member Institution’s Excess Capital Stock in the Bank

- The FHFB issued a final rule expanding eligible collateral requirements for FHLBank advances. The rule, effective April 15, 1999, was published in the *Federal Register* on April 6. The FHFB also issued an interim final rule (published in the *Federal Register* on April 6) that would prohibit FHLBanks from imposing or accepting a fee in lieu of redeeming a Member’s institution’s excess capital stock in the Bank. The interim final rule is effective on April 6, 1999 and comments can be submitted by May 6, 1999. (*Federal Register*, 4/6/99, pages 16618-16621, and 16788-16795)

US Appeals Court Sets a Date for Oral Arguments in the FHFB Case Involving the Dismissal of FHFB Member Lawrence Costiglio

- According to John Connor with the *Dow Jones Newswire*, a US Federal Appeals Court has scheduled October 1 for oral arguments to review a lower court’s decision that upheld President Clinton’s March 1998 dismissal of FHFB Member Lawrence Costiglio, who was many times at odds with the views of FHFB Chairman Bruce Morrison. Costiglio filed a lawsuit challenging his firing, arguing that he legally should remain in office until a successor was appointed and confirmed. A US District Court Judge, however, upheld the firing. Costiglio then appealed to the federal appeals court. (*Dow Jones Newswire*, John Connor, 4/15/99) Costiglio’s firing left two vacancies on the five-member FHFB. Costiglio’s term as director expired in Feb. 1995, but he had been serving the agency in a holdover capacity until his March 1998 firing.

FHFB Demands a Refund for a FHLBank Study that was Supposed to Quantify the Value to the FHLBank System for its GSE Status

- According to a *Dow Jones Newswire* article by John Connor, the Federal Housing Finance Board (FHFB) is demanding nearly a \$400,000 refund from a firm it hired to conduct a study. The study was intended to address such questions as “the quantitative value to the Bank System of its GSE status,” and “how and to whom do Bank System members pass on the benefits they receive from Bank System membership?” The study was also to assess the extent to which members that borrow from the FHLBanks engage in housing and community development lending as well as the feasibility of privatizing the system.
- The FHFB hired the Washington, DC firm of Furash & Co. to complete the study. In an April 15 letter to Furash & Co, the FHFB cited “undelivered work” in demanding that Furash return \$397,999.87. Reportedly, the FHFB also sent an earlier “default letter” informing the company that its engagement was terminated “for failure to complete the required work by the date specified in the contract.” Connor notes in his article that the FHFB’s contract with Furash called for a

payment of \$754,155. The deadline for completing the study was reportedly extended several times with the last deadline as January 31, 1999. In the April 15th letter, the FHFB informed Furash that it paid \$542,999.87 to Furash to date and that it determined the value of Furash's work to be \$145,000. (*Dow Jones Newswire*, 4/16/99)

Private Sector Items to Note

GE Capital Mortgage Insurance Begins New Program that Allows Homebuyers to Purchase a Home with No Downpayment – Fannie & Freddie will Not Purchase these Loans – Bear Stearns and GE Capital Mortgage Services will Provide the Secondary Market

- According to an article in the *American Banker*, GE Capital Mortgage Insurance has developed a new program that would allow homebuyers to purchase a home without a downpayment. The new program, CashSaver Advantage, is a privately insured mortgage option for which the lender makes a secured three-percent pledge in place of the borrower's downpayment. The pledge is released back to the lender when the loan amortizes below 97% or when 3% of the principle has been paid. The article noted that to date, Fannie and Freddie have not committed to purchasing these loans on the secondary market, however, GE has partnered with Bear Stearns for lenders selling loans in blocks of \$10 million or more. Also, those lenders using the program who need an immediate secondary market can use GE Capital Mortgage Services to price the loans to acquire on a loan-by-loan basis. (*American Banker*, 4/23/99)

PMI Mortgage Insurance Co. Moves its GSE Liaison to Washington to be Closer to Fannie & Freddie

- PMI Mortgage Insurance Co. has reportedly decided to move its liaison to Fannie and Freddie - Vice President James Wagner - to Washington, DC to facilitate closer interaction with Fannie and Freddie. According to PMI Chief Operating Officer Stephen Smith, "Jim's relocation to the Washington, DC area will permit us to manage these relationships as effectively and efficiently as possible and further enhance our quick response to industry and market developments." (*PMI Mortgage Insurance, Co. press release*, 4/5/99; *National Mortgage News* website, posted 4/7/99)

Bear Stearns Develops a New Model to Analyze Nonagency Loans

- According to an *American Banker* article by Joshua Brockman, Bear, Stearns & Co. has developed a new mortgage valuation model that provides investors with detailed loan-level information about securities backed by nonagency mortgages (those loans that do not qualify for sale to the agencies – including jumbo loans, alternative-A loans, A-minus loans, and credits with a 125% LTV ratio). According to Dale Westhoff, Senior Managing Director for Mortgage Research at Bear Stearns, the company believes that "the accuracy and analytics" in the new model "will surpass what's available in the agency sector." The Bears model according to Westhoff has a "very rich loan-level detail" that is not available in the agency sector. In comparison, Westhoff noted that "We don't get that much information on agency pools," which makes it more difficult to determine prepayment behavior. He added that Fannie and Freddie in the last few years "have widened their underwriting guidelines, and the pools have become more heterogeneous." According to Westhoff, the new Bear Stearns model will provide investors with property value, loan size, and coupon distribution

information that can be used for valuation or hedging. (*American Banker*, Joshua Brockman, 4/6/99)

Farmer Mac

Farmer Mac Reports a 50% Increase in its First Quarter Earnings

- Farmer Mac reported net income of \$1.6 million for the first quarter 1999, a 50% increase over first quarter 1998 net income of \$1.1 million on a fully taxable equivalent basis. The company also announced that it has filed an application to list its Class A and Class C common stock on the New York Stock Exchange and that its Board of Directors approved a 3-for-1 split of the Class C common stock, subject to Class C stockholder approval of a related by-law amendment. The company anticipates that the NYSE listing and the stock split will occur within 90 days. (*Farmer Mac press release*, 4/19/99; *National Mortgage News website*, posted 4/20/99)

Ginnie Mae

Senior Executive of Ginnie Mae States that the Privatization of Ginnie Mae May Still be Considered a Possibility as a Revenue Raiser in the Federal Budget

(Since a Privatized Ginnie Mae would No Longer Carry the Full Faith and Credit of the US Government, or Have the Implied Backing Provided other GSEs, there is a Question as to whether a Privatized Ginnie Mae would Actually be able to Compete with Existing GSEs)

- According to a *Bloomberg News* article, the Executive Vice President of Ginnie Mae George Anderson believes that the sale of Ginnie Mae is still a possibility and could happen soon. “It’s not safe to assume that we are still not in play,” he stated. “The money for the proposed sale is still in appropriation language.” The privatization of Ginnie Mae was kept in the Republican fiscal 2000 budget plan as a way to pay for increases in education spending and other domestic programs. According to Congressional estimates, the sale of Ginnie Mae could raise \$2.5 billion. As reported in previous *GSE Reports*, earlier this year, the OMB considered, but decided not to include, the privatization of Ginnie Mae, the imposition of user fees on Fannie and Freddie or an increase the Ginnie Mae guaranty fee in the President’s FY 2000 Budget.
- As to when Anderson estimated that a final decision on whether the issue of privatizing/selling Ginnie Mae would be made, he stated that “we are measuring it in days and weeks – before the end of the fiscal year.” [October 1, 1999]
- The article notes that if the sale of Ginnie Mae occurred, securities issued by Ginnie Mae following the sale would lose their full-faith-and-credit which would make its securities less appealing to investors who would demand more in yield to purchase them and thus raise mortgage rates for the people served by Ginnie Mae. “It’s done at the expense of those least able to afford it,” Anderson stated. “This is going to fall on first-time home buyers hard.” (*Bloomberg News*, 4/20/99)

Postal Service

House Subcommittee Approves a Postal Expansion Bill that would Allow the Post Office to Compete with Private Sector Financial Services Companies – Private Sector Banking Groups Argue that the Postal Services’ Implied Government Backing would give the Postal Service an Unfair Competitive Advantage over the Private Sector

- Despite opposition from private sector banking groups, the House Government Reform Postal Services Subcommittee approved a postal modernization bill (HR 22) on April 29 that has drawn criticism from several banking groups. On April 21, banking groups sent a letter to the author of the bill, Cong. John McHugh (R-NY) urging him to drop a provision (Section 204) that would give the Postal Service an “unfair competitive advantage” over private financial services providers. The American Bankers Association, the Bankers Roundtable, and the Independent Community Bankers of America signed the letter. The groups argued that Section 204 would allow the Postal Service to create a for-profit corporation to compete with the private sector “in any activity the Postal Services desires, including financial services provided by the private sector.” While Section 204 formally separates a for-profit subsidiary from any government support, the banking groups argued that the Postal Service would still enjoy the perception of government backing. “This is true of other government-related institutions that, in spite of legal realities and disclaimers, enjoy a market view of them as government-favored or – subsidized entities,” the letter stated. “Allowing the Postal Service to engage in businesses, such as electronic benefit transfer and transaction processing associated with online commerce and other financial services with implied government backing, would create an unfair competitive advantage,” the letter stated.
- According to *BNA*, several subcommittee members, including Rep. Henry Waxman (D-CA), ranking member on the full committee, stated that the subcommittee members plan to try and remove the objectionable language either before or during the full mark-up of the bill. A mark-up date has not yet been set. Cong. McHugh has also reportedly stated that he would work with his colleagues to resolve their concerns. (*American Banker*, 4/27/99; *BNA Daily Report for Executives*, Marc Selinger, 4/22/99; 4/30/99)

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