

The **GSE** REPORT™

The American Enterprise Institute (AEI) held a conference on September 8 entitled “*Fannie Mae and Freddie Mac: Public Purposes and Private Interests.*” Noted speakers at the conference included Congressman Richard Baker (R-LA), Chairman of the House Banking Committee’s Capital Markets Subcommittee and consumer advocate Ralph Nader. A more detailed summary of the conference will be provided in the September issue of the *GSE Report Special Supplement*.

Contents of GSE Report™

Major Events

- Federal Reserve Bank of New York temporarily expands collateral accepted in repurchase transactions to include pass-through mortgage securities of Fannie & Freddie (*p. 6*)
 - Previously, the Fed has limited collateral to Treasury securities
 - The Fed’s purchase of GSE debt would further strengthen the value of the GSEs’ implied government guarantee and would put the Fed in the position where it would pay for potential shortfalls in GSEs’ financial safety and soundness
 - Cong. Ron Paul (R-TX) says the announcement is “risky,” “bolsters the value of the implied government guarantee,” and raises “troubling questions.”
 - Cong. Paul asks the Chairman of the Domestic and International Subcommittee of the House Banking Committee, Cong. Spencer Bachus (R-AL), to hold hearings on the issue
- Chairman of the Senate Banking Committee Phil Gramm (R-TX) supports 22% budget increase for Fannie & Freddie’s safety and soundness regulator, OFHEO (*p. 8*)
 - Senator Gramm cites Fannie & Freddie’s \$2 trillion of assets and mortgage-backed securities outstanding and notes that “As Government Sponsored Enterprises, these organizations present risk to the American taxpayer through the implied guaranty of the obligations by the United States Treasury”
 - Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker (R-LA) and consumer advocate Ralph Nader also support full funding of OFHEO’s budget request
- Coalition of consumer groups sends joint letter to the Chairman of Freddie noting that they are disappointed that the company has not stepped forward in the public discussion of HUD’s proposed increase of Fannie & Freddie’s affordable housing goals and has not publicly supported raising them (*p. 8*)
 - ACORN, Center for Community Change, Housing Assistance Council, McAuley Institute, National Congress for Community Economic Development, National Low Income Housing Coalition, National Neighborhood Coalition, National Peoples Action signed the letter
- Senior health care aides in the US House of Representatives are considering establishing a new GSE – “Rexxie Mae to provide health insurance coverage for drug benefits for low- to moderate-income seniors. (*p. 9*)

All GSEs

- US agencies’ debt issuance topped \$3 trillion for the first half of 1999, up 0.8% from the first half of last year – the majority of which was short-term debt (*p. 9*)

Fannie Mae and Freddie Mac

- *New York Times* reports that stock prices of Fannie & Freddie are down this year – Fannie is down 10.3% and Freddie is down 14% (p. 10)
 - Article cites the following as reasons for the poor stock performance: (1) rising interest rates; (2) the huge size of Fannie & Freddie has become an impediment to growth; (3) they have been forced to compete more intensely with each other and the FHLBanks; and (4) counterattacks by Fannie/Freddie watchdog group, FM WATCH
 - Goldman Sachs analyst says, “Fannie and Freddie have been so successful that people are taking seriously the notion that they’ve become too big.” The crucial question is: “Should these things continue to be considered growth stocks, given their size?”
 - Portfolio Manager of the Safeco Equity fund, says he did not see Fannie or Freddie’s profits being hurt by FM WATCH in the next five years, however, he said the group’s existence “will keep a lid somewhat on the P/E’s of both of them” because of the risk that a political backlash will result in attempts to alter Fannie & Freddie’s special status
- Freddie purchases its largest multifamily deal in history and Fannie makes its largest equity investment in Florida to date – both aimed at the luxury apartment market. (p. 11)
 - Freddie and Bankers Mutual close on a \$170 million transaction for a 3,482-unit luxury apartment community in San Francisco located on 144 acres near the Pacific Ocean
 - Amenities include a 47,000 square foot retail center with a grocery store and recreational facilities including tennis courts, basketball courts and a baseball field. Consumers have a choice of 35 different floor plans.
 - Financing competition for this high-profile complex was reportedly “very keen.” [GSE participation was not needed to make the transactions work; GSE participation displaced private sector financiers.]
 - Fannie makes a \$5.6 million equity investment in a 303-unit luxury apartment community
 - Amenities include interior courtyards, a four-story parking garage, nine-foot ceilings, computer desks, interior air-conditioning corridors, controlled access parking, and a choice of 17 different floor plans
 - [Fannie & Freddie should be using their government-granted subsidies to invest in affordable housing projects, rather than posh luxury apartment communities.]
 - As William Apgar, Assistant Secretary of HUD for Housing is quoted as saying, “there are two clear and indisputable facts...One, the number of Americans in need of affordable housing stands at an all-time record high of 5.3 million families. Two, Fannie and Freddie are making record profits.” (*Washington Post*, Kathleen Day, 8/8/99)
- Department of Justice official recommends Fannie & Freddie’s entrance into subprime market (p. 12)
- Fannie/Freddie watchdog group, FM WATCH, says its coalition is already making progress in its campaign against Fannie & Freddie (p. 12)
 - FM WATCH claims success in two areas – (1) a 22% budget increase for Fannie & Freddie’s safety and soundness regulator, OFHEO and (2) HUD’s proposal to increase Fannie & Freddie’s affordable housing goals
 - Fannie & Freddie deny that FM WATCH had any impact, claiming that they did not oppose the increase in OFHEO’s budget; Fannie says it also never opposed HUD’s proposal to increase its affordable housing goals
- Fannie & Freddie prompt suspicion by primary market (p. 13)
 - FM WATCH Executive Director Mike House says the membership of FM WATCH shows that it’s not just the mortgage industry that is concerned about the GSEs but that the broader financial services industry is also concerned
- Asset-backed securities market players say a pending \$263 million home equity deal is likely targeted for purchase by Fannie or Freddie (p. 14)
 - [Purchases of home equity loans do not further Fannie & Freddie’s mission of providing liquidity to the secondary mortgage market since the majority of home equity loans are used to consolidate consumer debt and are made to consumers who already own their homes.]
- Pilots by Fannie & Freddie offer brokers and in Fannie’s case, consumers – an automated underwriting “portability.” The pilots allow brokers and consumers to use the GSEs’ automated underwriting systems to receive an underwriting decision prior to a lender bidding and winning the deal. (p. 15)
 - [This conflicts with the Mortgage Bankers Association (MBA)’s recent policy statement on the GSEs - “The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including, but not limited to consumers,

- owners/developers of housing, mortgage brokers, and other real estate professionals.”]
- Fannie has denied that it has ever attempted to provide portability on its website in defending its iQualify and openclose.com web ventures, yet sources close to iQualify maintain that the site still offers portability and that Fannie is aware that portability is still being offered on the website.
 - In another venture by Fannie into portability, Priceline.com just announces that it has teamed up with Alliance Capital Partners to allow consumers direct access to Fannie’s automated underwriting system allowing consumers “to name their price for mortgage loans on-line”
 - Freddie’s pilot is with IMX Exchange which allows brokers to receive an automated underwriting decision from Freddie’s automated underwriting system, Loan Prospector, over Freddie’s Internet site - IMX says there is a 100% chance that it will expand the pilot
 - A MBA editorial notes that Freddie’s Best Practices handbook for lenders says “Whenever you allow someone outside of your organization to perform services for which you have ultimate responsibility you increase the risk that mistakes and negligent omissions will occur.” However, “When you sell home loan mortgages to us, you have full responsibility for their quality. The quality could be affected by the process used in their origination.”
 - MBA editorial argues that Fannie & Freddie should not use their automated underwriting systems on auction sites, because these auctions diminish the relationship between the lender and the loan originators, resulting in erosion of loan quality [which Freddie states is ultimately the responsibility of the lenders because their capital is on the line.]
- Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors, and consumers (p. 19)
 - [Despite Fannie’s repeated pronouncements that lenders are their “only customers,” Fannie & Freddie continue to build their technology brand name and market directly to brokers, realtors and consumers.]
 - [Fannie & Freddie are using their technology to control the origination process and expand into

new lines of

business.]

- Michael Williams, Senior Vice President for Customer Technology Services at Fannie, stated during a recent Morgan Stanley Internet conference about its technology goals: “In business-to-business e-commerce, Fannie Mae will establish the standards, the connections and the marketplace.”
- Real estate and mortgage finance attorney description of “GSE mentality”: “If there’s a problem with the loan, it’s your [the lender’s] problem.” (p. 24)
- Second largest mortgage insurer, Radian Guaranty, appoints a company liaison to Fannie & Freddie (p. 24)

Fannie Mae

- Fannie strikes alliance agreements with Washington Mutual and Waterfield Mortgage (p. 25)
 - As part of the agreement, both companies will sell most of their conforming mortgage loans to Fannie
 - Washington Mutual will use its own underwriting system but will expand its product line by developing more products with Fannie
 - Washington Mutual and Fannie will also explore Fannie’s possible purchase of Washington Mutual’s fixed rate Advantage 90 mortgage product, which lets customers eliminate private mortgage insurance payments
 - Waterfield Mortgage will test Fannie’s automated underwriting system improvements (Desktop Underwriter) and Fannie pilot programs. Waterfield and Fannie will also work on initiatives to combine Waterfield’s paperless technologies with Fannie’s technology initiatives
- Orange County Community Housing Corp. Executive Director, Allen Baldwin, says Fannie’s \$6 billion “House Orange County” investment plan will do nothing for housing affordability in Orange County (p. 26)
 - Baldwin claims Fannie “clouds and confuses the issue of affordable housing by wagging about \$6 billion numbers and superlatives about its efforts to making housing more affordable.”
- Fannie is moving further into subprime mortgages (p. 26)
 - *Boston Globe* explains Fannie’s subprime lending standards
- Fannie begins “Working Mortgage” pilot in Ohio (p. 26)
 - Pilot allows borrowers to have their mortgage payments automatically deducted from their paychecks
 - Fannie expects to expand the program in the Year 2000
 - Aegis Mortgage Corp. has been designated the Automated Clearing House transaction processor for the project

- Fannie invests in more “fledgling” depository institutions (p. 27)
 - Fannie makes a \$250,000 equity investment in the newly formed Legacy Bank and purchases a \$100,000 certificate of deposit
 - Fannie purchases 4.49% of the voting shares of Greater Buffalo Savings Bank
 - Fannie’s ownership of 4.99% of Greater Buffalo Savings Bank will range from \$330,000 to \$900,000, depending on how many shares Greater Buffalo sells in its public offering
 - Without Fannie’s investment, it was questionable whether Greater Buffalo would have been able to meet the capital requirements necessary to open its office. With Fannie’s investment, the company is now set to open in October and plans to aggressively challenge market leaders, M&T Bank and HSBC Bank USA, for retail customers in Buffalo.
 - Fannie said it had already invested more than \$54 million in more than 90 institutions and plans to invest \$75 million in community lending institutions through the year 2000
 - [It is questionable how an investment in a depository lending institution fulfills Fannie’s charter of providing liquidity to the secondary mortgage market, particularly when these institutions are using the money to provide traditional “hometown banking” services that are already being competitively served by private financial institutions.]
- Fannie starts \$1 million underwriting pilot program to help consumers refinance their debt into one loan (p. 28)
 - [Consolidating consumers’ credit card debt does not further Fannie Mae’s core purpose of providing liquidity to the secondary mortgage market.]
- Fannie’s CEO Franklin Raines writes Letter to the Editor in the *Washington Post* in response to the newspaper’s article entitled “*Fear of What Fannie May Do*” by Kathleen Day which reported on the recent criticisms being expressed by the private industry and government about Fannie & Freddie (p. 29)
 - Raines uses his letter to disparage those who criticize Fannie
- Fannie’s net mortgage portfolio increases \$7.2 billion in July (p. 30)
 - Fannie’s total MBS outstanding increased to \$920.4 billion
 - Fannie reported portfolio purchases of Fannie MBS as \$8.5 billion in July
- Fannie announces that it intends to appoint Ann Marie Wheelock, who is currently the Fannie Mae Foundation President and CEO, to the post of Senior Vice President of Fannie Mae’s Western Regional Office (p. 30)
 - Stacey Davis Steed, who is currently a Vice President at Fannie Mae, will be the new President and CEO of the Fannie Mae Foundation
- Lucrative employee perks at Fannie (p. 30)
 - Fannie employees are eligible for a forgivable loan of up to \$11,000 to cover the cost of a down payment on a house and associated closing costs
- Mid-America Apartment Corp. (an apartment-only REIT) is negotiating to cut costs by refinancing its borrowing with Fannie (p. 30)
- Further strengthening its hold over the academic community, Fannie grants Miami-Dade College \$595,000 (p. 31)
- Fannie executive will speak at Annual Apartment Outlook conference (p. 31)
- Fannie announces that the National Association of Investors Corp. has named Fannie among “the top 100 Companies that Investment Clubs Love to Own.” (p. 31)
 - Fannie ranks as #66
- Fannie ranks in top ten of the “100 best companies for working mothers” (p. 31)
 - A number of other private financial services providers were also ranked in the top ten
- 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 in press events (currently 34 offices are officially open and operating and nine more are in the process of being organized) (p. 32)
 - Fannie said it plans to have 45 partnership offices opened by the end of the year

Freddie Mac

- Freddie writes a letter-to-the-editor to the *Wall Street Journal* to say that it is not “irked” by HUD’s proposal to raise Fannie & Freddie’s affordable housing goals (p. 35)
- Freddie changes its marketing strategy and for the first time Freddie announces its upcoming benchmark sale (Reference Notes) well in advance of the sale (p. 35)
 - The move by Freddie is a deliberate attempt to help make its debt sell more like Treasuries

- Tactic will likely help blur the lines between various types of bonds
- Some traders complained that Freddie's early announcement only added pressure to an already shaky environment
- Freddie promotes Senior Vice President of Servicing, Paul Peterson, to Senior Vice President of Strategy (p. 36)
 - Freddie names Margaret Colon as the new Senior Vice President of Servicing

Federal Home Loan Banks

- FHLBank of New York receives approval from the Federal Housing Finance Board (FHFB) to offer a new single-family financing program for portfolio lenders called the Sequential Participation program (p. 37)
 - Sequential Participation is part of a pilot program – the Community Mortgage Asset Activities Program – that will split the credit and interest rate risk between private-sector mortgage lenders and the FHLBank of NY
 - The program qualifies as an acceptable investment by the FHLBanks under a July 28 proposal by the FHFB that restricts the FHLBanks' investments and purchases of mortgage-backed securities
 - Although the program has been approved, the FHFB requests comments on the program
- FHLBank of Boston assists in developing secondary market for commercial loans (p. 38)
- Agency dealers are complaining about the FHLBanks' Tap debt program (p. 38)
 - FHLBanks' Tap program is similar to Fannie & Freddie's Benchmark and Reference Note programs, marketed as alternatives to Treasuries
 - Debt analysts suggest the FHLBanks consider reducing the number of auctions during a given week and increasing the sizes of the reopenings
 - Way in which FHLBank Tap program issues its debt may make smaller regional dealer firms less competitive against major Wall Street firms for FHLBank dealer positions
- Status report of legislation containing FHLBank expansion provisions (p. 39)
 - Conference Committee will reconcile the House and Senate-passed versions of financial services modernization bills. Both versions contain FHLBank provisions.

Private Sector Items to Note

- MGIC Investment Corporation, Marshall and Ilsley Corp., and a management team have agreed to become partners in an Internet mortgage services company – Customers Forever - designed to help large residential mortgage servicers retain and enhance their customer relationship (p. 40)
 - Customers Forever is described as a revolution that “uses the Internet to shift power back to the [mortgage] customers who pay all the bills.”

Farm Credit Administration

- Farm Credit Administration (FCA) delays vote on controversial plan to allow the Farm Credit System lenders to compete in the same geographic area (p. 41)
 - FCA puts proposal “on hold” after Senator Thad Cochran (R-MS) requested that the proposal be reviewed further
 - FCA does not plan to revisit the issue until 2000 at the earliest
 - Commercial banks and even a few Farm Credit lenders themselves are opposed to the proposal
 - A recent American Bankers Association Task Force report criticized the proposal stating that “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions.”

Ginnie Mae

- *Fannie Mae purchased \$8.8 billion of government-insured mortgages in the first six months in 1999, and made a commitment for an additional \$6 billion in the early summer. Industry representatives surmise that Fannie Mae is increasing its government purchases in order to lay the foundation for a Ginnie Mae privatization legislative initiative next year. By buying sizable purchases of government-insured mortgages, industry representatives speculate that the GSEs will make the case that Ginnie Mae is no longer needed. Ginnie Mae privatization would strengthen significantly the GSEs monopoly grip over the housing finance system.* (p. 42)*
- Various proposals are being considered as alternatives to Ginnie Mae privatization (p. 42)
- *National Mortgage News* surveys its website users about proposal for Ginnie Mae to purchase its own MBS (p. 44)

Major Events

Federal Reserve Bank of New York temporarily expands collateral accepted in repurchase transactions to include pass-through mortgage securities of Fannie & Freddie

Previously, the Fed has limited collateral to Treasury securities

The Fed's purchase of GSE debt would further strengthen the value of the GSEs' implied government guarantee and would put the Fed in the position where it would pay for potential shortfalls in GSEs' financial safety and soundness

Cong. Ron Paul (R-TX) says the announcement is "risky," "bolsters the value of the implied government guarantee," and raises "troubling questions"

Cong. Paul asks the Chairman of the Domestic and International Subcommittee of the House Banking Committee, Cong. Spencer Bachus (R-AL), to hold hearings on the issue

- The Federal Reserve Bank of New York announced that it has approved a temporary expansion of eligible collateral for repurchase transactions to include pass-through securities of Ginnie Mae, Fannie Mae, Freddie Mac, STRIP securities of the US Treasury and "stripped" securities of other government agencies. Strips are Treasury bonds whose principal and interest components have been split into separate payment streams. Previously, the Fed has limited collateral to Treasury securities.
- The move was one of a number of measures that the Federal Reserve Bank of New York said was intended to provide greater assurance that the Fed will be able to manage banking system reserves throughout the Year 2000 date change in anticipation of any computer complications. The Federal Reserve Bank said it expects to begin accepting the expanded collateral in early October and to continue to do so only through April 2000. The Federal Open Market Committee, which approved the changes at its August 24 meeting, will review the new collateral arrangements before the current plan ends in April.

Background

- The Federal Reserve Bank of New York is responsible for keeping overnight interest rates close to the target set by the central bank's policymakers as part of their effort to keep the US economy stable. The Federal Reserve Bank of New York tries to come close to the chosen target for the federal funds rate (the interest rate financial institutions charge one another on overnight loans) by adding and subtracting cash from the US banking system on virtually a daily basis. Most frequently, it adds cash by lending money to 30 large financial firms known as primary dealers. As collateral, the companies typically deliver US Treasury securities to the Federal Reserve Bank of New York to hold until the loan has been repaid. With the Federal Reserve Bank of New York's temporary change of policy, the Federal Reserve Bank of New York has expanded its eligible list of collateral to include mortgage-backed securities of Fannie, Freddie, Ginnie Mae, STRIP securities of the US Treasury and "stripped" securities of other government agencies.
(*Washington Post*, 9/9/99)

Cong. Paul calls the FRBNY's move "risky" and requests hearings on issue

- Cong. Ron Paul (R-TX) issued a press release stating that the Federal Reserve Bank of New York's decision "raises troubling questions." He further stated, **"I have contacted the office of Rep. Spencer Bachus, the chairman of the Subcommittee on Domestic and International Monetary Policy of the House Committee on Banking and Financial Services, to call for hearings on this important question. Hopefully, hearings would put to rest serious questions raised by this announcement."** Finally, Paul stated that **"This decision, though approved only through April 2000, bolsters the value of the implied government guarantee – this action is highly risky when viewed from the perspective of potential taxpayer liability. These highly-leveraged institutions are already leveraged off the Treasury balance sheet. A further expansion of collateral with mortgage securities, which the Fed can use as collateral for monetary expansion, must be closely scrutinized."**
- Paul also added that **"I commend Rep. Richard Baker's call for greater oversight of the GSE's and to eliminate their line of credit to the Treasury."**

Bond Market Association supports the change

- According to *National Mortgage News*, the Bond Market Association supports the move stating that "On preliminary review, it appears that the Fed's action will enable securities firms to augment funding alternatives during the millenium date change." As we've noted in previous *GSE Reports*, the Bond Market Association has met in the past with the Federal Reserve Bank of New York to recommend that the Federal Reserve Bank of NY purchase additional GSE debt as part of its open-market operations. The Bond Market told 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.
- Thomas Stanton, a Washington lawyer who has written extensively on 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.**
- **A Barron's Online article notes the following: "Fed purchases of Fannie or Freddie securities arguably would be only a step away from the Hong Kong Monetary Authority's buying of stocks a few months ago with the express intent of pushing up the Hang Seng. Fannie and Freddie's common shares both trade on the New York Stock Exchange. State capitalism, anybody?"** (*Barron's Online*, 11/9/98; *Dow Jones Newswire*, 9/9/99, 10/30/98; *Cong. Ron Paul press release*, 9/9/99; *Federal Reserve Bank of New York press release*, 9/8/99; *National Mortgage News website*, posted 9/9/99)

Chairman of the Senate Banking Committee Phil Gramm (R-TX) supports 22% budget increase for Fannie & Freddie's safety and soundness regulator, OFHEO

Senator Gramm cites Fannie & Freddie's \$2 trillion of assets and mortgage-backed securities outstanding and notes that "As Government Sponsored Enterprises, these organizations present risk to the American taxpayer through the implied guaranty of the obligations by the United States Treasury"

Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker (R-LA) and consumer advocate Ralph Nader also support full funding of OFHEO's budget request

- Chairman of the Senate Banking Committee Phil Gramm (R-TX) wrote a letter to Senator Christopher "Kit" Bond (R-MO), Chairman of the Subcommittee on VA-HUD Appropriations Committee, to approve the full \$19.5 million requested by OFHEO for Fiscal Year 2000 operations -- a 22% budget increase from Fiscal Year 1999.
- **Gramm writes, "At the end of June 1999, Fannie Mae and Freddie Mac together had assets and mortgage-backed securities outstanding in excess of \$2 trillion - double the level of just six years ago. As Government Sponsored Enterprises, these organizations present risk to the American taxpayer through the implied guaranty of their obligations by the United States Treasury. OFHEO requires specialized expertise and technology in order to fulfill its mandate to monitor the risks associated with the complex business operations of Fannie Mae and Freddie Mac. The Congress should approve OFHEO's full funding request in the interest of containing these risks."** (*Senator Phil Gramm letter to Senator Kit Bond, 9/8/99*)
- As reported in the August 20th *GSE Report*, Chairman of the House Banking Capital Markets Subcommittee Richard Baker (R-LA) and consumer advocate Ralph Nader both support full funding of OFHEO's budget request.

Coalition of consumer groups sends joint letter to the Chairman of Freddie noting that they are disappointed that the company has not stepped forward in the public discussion of HUD's proposed increase of Fannie & Freddie's affordable housing goals and has not publicly supported raising them

ACORN, Center for Community Change, Housing Assistance Council, McAuley Institute, National Congress for Community Economic Development, National Low Income Housing Coalition, National Neighborhood Coalition, National Peoples Action signed the letter

- A coalition of consumer groups wrote a joint letter on August 20, 1999 to Freddie Chairman Leland Brendsel on HUD's recent proposal to increase the affordable housing goals of Fannie and Freddie. The coalition writes, "We appreciate the important role Freddie Mac plays in mortgage markets, and how that can benefit low and moderate income people and their communities. Given that role, we are disappointed that Freddie Mac has not stepped forward in the public discussion of the goals and has not publicly supported raising them." The letter concludes that "It is our hope that Freddie Mac will enter this vital public discussion, participate in the effort to raise affordable housing goals, and work to fulfill and surpass the higher goals." The following consumer groups signed the letter: ACORN, Center for Community Change, Housing Assistance Council, McAuley

Institute, National Congress for Community Economic Development, National Low Income Housing Coalition, National Neighborhood Coalition, and the National Peoples Action.
(Consumer group letter to Freddie Chairman Leland Brendsel, 8/20/99)

Senior health care aides in the U.S. House of Representatives are considering establishing a new GSE – “Rexxie Mae” – to provide insurance coverage for drug benefits for low- to moderate-income seniors. (No further details are available at this time.)

All GSEs

US agencies’ debt issuance topped \$3 trillion for the first half of 1999, up 0.8% from the first half of last year – the majority of which was short-term debt

- According to John Connor with *Dow Jones Newswire*, the Bond Market Association reported that US agencies issued \$3.073 trillion of debt during the first half of 1999, an increase of 0.8% over the first half of 1998. Short-term debt accounted for what Connor calls the “lion’s share” of the six-month total, however, there was a 23.4% increase in long-term debt as the agencies issued \$344 billion of long-term debt during the first half of 1999, compared to \$279 billion in the first half of 1998.
- The FHLBank System issued the most debt of the agencies with \$1.296 trillion of debt in the first half of 1999, an increase of 8.8% over the first-half of 1998 when it issued \$1.191 trillion. The FHLBank System issued \$1.140 trillion of short-term debt, an increase of 7.6% from the \$1.060 trillion issued during the first half of 1998. Fannie increased its debt issuance to nearly \$464 billion in the first half of this year, compared to almost \$437 billion in the first half-of 1998, an increase of 6.2%. Fannie’s long-term debt issuance for the first half of 1999 increased 16.8% over the first-half of last year, to \$89 billion from \$76 billion. Freddie issued \$874 billion during the first half of 1999, compared to \$1.051 trillion during the first half of 1998, a decline of 17%. Freddie had a 20% decline in short-term borrowing from nearly \$1 trillion during the first half of 1998, compared to last year’s \$796 billion during the first half of this year. Long-term debt issuance by Freddie increased 48% over the first half of last year. Sallie Mae, which is in the process of privatization, issued \$272 billion in debt for the first half of 1999, an increase of 21.9% over the first half of last year. The Tennessee Valley Authority issued \$14 billion of debt during the first half of 1999, an increase of 18.5%. (*Dow Jones Newswire*, John Connor, 8/13/99)

Fannie Mae and Freddie Mac

***New York Times* reports that stock prices of Fannie & Freddie are down this year – Fannie is down 10.3% and Freddie is down 14%**

Article cites the following as reasons for the poor stock performance: (1) rising interest rates; (2) the huge size of Fannie & Freddie has become an impediment to growth; (3) they have been forced to compete more intensely with each other and the FHLBanks; and (4) counterattacks by Fannie/Freddie watchdog group, FM WATCH

Goldman Sachs analyst says, “Fannie and Freddie have been so successful that people are taking seriously the notion that they’ve become too big.” The crucial question is: “Should these things continue to be considered growth stocks, given their size?”

Portfolio Manager of the Safeco Equity fund, says he did not see Fannie or Freddie’s profits being hurt by FM WATCH in the next five years, however, he said the group’s existence “will keep a lid somewhat on the P/E’s of both of them” because of the risk that a political backlash will result in attempts to alter Fannie & Freddie’s special status.

- The *New York Times* ran an article by Robert Hershey Jr. reporting on the depressed stock prices of Fannie and Freddie this year. The article, entitled “*The Clouds over Freddie and Fannie*,” noted that Fannie’s stock is down 10.3% this year while Freddie is down 14% - at the same time that major indexes are up 10.4% to 29.7%. Hershey notes that analysts cited the following as reasons for the poor stock performance: (1) rising interest rates; (2) the huge size of Fannie and Freddie has become an impediment to growth; (3) they have been forced to compete more intensely with each other and the FHLBanks; and (4) counterattacks by Fannie/Freddie watchdog group, FM WATCH

Rising Interest Rates

- Interest rates have climbed and pushed the 30-year conventional mortgages from just under 7% at the beginning of the year to more than 8% during part of August. “They’re [Fannie and Freddie] are perceived to be the most rate-sensitive financial stocks,” said Thomas Hanley, a Managing Director at Warburg Dillon Read.

Size an impediment to growth

- There is a notion that Fannie and Freddie’s tremendous size is an impediment to growth, which suggests a structural decline in profitability and has prompted the two companies to expand into other lines of business. “Fannie and Freddie have been so successful that people are taking seriously the notion that they’ve become too big,” said Michael Hodes, a Mortgage Finance analyst at Goldman Sachs. The crucial question, Mr. Hodes said, is: “Should these things continue to be considered growth stocks, given their size.”

More competition

- Hershey notes that Fannie and Freddie have been forced to compete more intensely with each other and recently with the FHLBanks.

Fannie/Freddie watchdog group, FM WATCH

- Hershey notes that FM WATCH was recently formed by an alliance of banking and mortgage trade groups to head off what it contends is an effort by Fannie and Freddie to encroach on its members' markets in search of new revenue sources. FM WATCH expresses particular concern about Fannie's advertising campaigns that seem to be aimed at establishing a consumer brand name. "Fannie Mae and Freddie Mac's actions over the past few years have moved them beyond their unique charters in a way that is more beneficial to their investors than home buyers and taxpayers," FM WATCH said in a statement. Richard Meagley, Portfolio Manager of the Safeco Equity fund, says he did not see Fannie or Freddie's profits being hurt by FM WATCH in the next five years, however, he said the group's existence "will keep a lid somewhat on the P/E's of both of them" because of the risk that a political backlash will result in attempts to alter their special status. (*New York Times*, 9/5/99)

Freddie purchases its largest multifamily deal in history and Fannie makes its largest equity investment in Florida to date – both aimed at the luxury apartment market

Freddie and Bankers Mutual close on a \$170 million transaction for a 3,482-unit luxury apartment community in San Francisco located on 144 acres near the Pacific Ocean

Amenities include a 47,000 square foot retail center with a grocery store and recreational facilities including tennis courts, basketball courts and a baseball field. Consumers have a choice of 35 different floor plans

Financing competition for the high-profile complex was reportedly "very keen." [GSE participation was not needed to make the transactions work; GSE participation displaced private sector financiers.]

Fannie makes a \$5.6 million equity investment in a 303-unit luxury apartment community

Amenities include interior courtyards, a four-story parking garage, nine-foot ceilings, computer desks, interior air-conditioned corridors, controlled access parking, and a choice of 17 different floor plans

[Fannie & Freddie should be using their government-granted subsidies to invest in affordable housing rather than posh luxury apartment communities]

As William Apgar, Assistant Secretary of HUD for Housing is quoted as saying, "there are two clear and indisputable facts...One, the number of Americans in need of affordable housing stands at an all-time record high of 5.3 million families. Two, Fannie and Freddie are making record profits." (*Washington Post*, Kathleen Day, 8/8/99)

Freddie

- Bankers Mutual, a division of Franchise Mortgage Acceptance Company and Freddie announced the funding of the Parkmerced Apartments located in San Francisco. The \$170 million first mortgage represents the largest single multifamily mortgage purchase in Freddie's history. The loan helped finance the acquisition of the property by Olympic View Realty, LLC. According to Freddie, Parkmerced Apartments provides 3,482 rental housing units. Located on 144 acres near the Pacific Ocean, the housing unit offers 35 different floor plans. The surrounding Parkmerced development includes a 47,000 square foot retail center with a grocery store and a variety of tenant

services. Recreational facilities available to tenants include tennis courts, basketball courts and a baseball field. (*Freddie press release, 8/23/99; National Mortgage News website, posted 8/24/99*)

- According to *National Mortgage News*, a Bankers Mutual official said that since the Parkmerced Apartments was such a high-profile property, the competition for financing Parkmerced was “very keen.” Last year, Bankers Mutual and Freddie teamed up to finance another San Francisco multifamily complex, Golden Gateway, for \$140 million. (*National Mortgage News, 9/6/99*)

Fannie

- Fannie issued a press release to announce its largest equity investment in Florida to date. Fannie’s American Communities Fund made a \$5.6 million equity investment in Echelon at Cheney Place, a 303-unit apartment in downtown Orlando. The \$28 million revitalization effort, under construction at a four-acre site on North Orange Avenue, is led by a development and finance team that includes Echelon International, Fannie, the city of Orlando Community Redevelopment Agency, Wachovia Bank, Beers Construction of Orlando, and Looney Ricks Kiss Architects. Echelon at Cheney Place is an apartment community consisting of one-, two, and three-bedroom apartments in a four-story building with interior courtyards and an adjacent four-story, 460-space parking garage. The apartments include nine-foot ceilings, computer desks, interior air-conditioned corridors, and controlled access parking. Residents can select from among 17 different floor plans ranging in size from 600 square feet to 1,500 square feet. (*Fannie press release, 9/7/99*)

Department of Justice official recommends Fannie & Freddie’s entrance into subprime market

- According to *National Mortgage News* and *BNA Daily Report for Executives* articles, Department of Justice special litigation counsel Alexander Ross recommended that one way to bring standards into the subprime market was to bring Fannie and Freddie into the subprime market. Ross made his statement during the 10th annual conference of the American Association of Residential Mortgage Regulators. Ross stated, “Fannie and Freddie will drive the bad guys out and make it safe for the good guys to come in and make that loan,” he stated. Ross reportedly stated that subprime mortgage market is in chaos, without any real standards on what loans should cost or what customers should pay. “In my view, there’s only one solution to that,” said Ross, “and that’s for Fannie and Freddie to get all the way into the subprime market and to establish those standards so that brokers, lenders, borrowers can know what it takes to get a mortgage with certain creditworthiness standards.” (*BNA Daily Report for Executives, R. Christian Bruce, 8/13/99; National Mortgage News website, posted 9/1/99*)

Fannie/Freddie watchdog group, FM WATCH, says its coalition is already making progress

FM WATCH claims success in two areas – (1) a 22% budget increase for Fannie & Freddie’s safety and soundness regulator, OFHEO and (2) HUD’s proposal to increase Fannie & Freddie’s affordable housing goals

Fannie & Freddie deny that that FM WATCH had any impact, claiming that they did not oppose the increase in OFHEO’s budget; Fannie also says it never opposed HUD’s proposal to increase its affordable housing goals

- According to a *Legal Times* article by Sam Lowenberg, Fannie/Freddie Watchdog group, FM WATCH, is already claiming progress in its campaign against Fannie and Freddie.

Budget increase for OFHEO

- The first success claimed by the group was getting the House Appropriations Committee in late July to increase the budget of Fannie and Freddie's safety and soundness regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), from \$16 million to \$19.5 million. FM WATCH Executive Director Mike House of Hogan & Hartson said FM WATCH's lobbying of key committee members played an important role in moving the bill. Fannie and Freddie, however, deny that FM WATCH had a role, and argue that the increase was routine and they did not oppose it. Freddie Mac spokeswoman Sharon McHale said the company did not lobby on the issue. A spokesman for Fannie said the company has a policy of not lobbying on the oversight agency's budget, because of the appearance of impropriety. House counters that Fannie and Freddie, knowing that they could not win in the House, decided to take the issue up in the Senate where they have powerful allies.

Increase in Fannie & Freddie's affordable housing goals

- HUD Secretary Andrew Cuomo recently proposed increasing Fannie and Freddie's affordable housing goals. While House says that Cuomo's decision to increase the affordable housing goals was his own, FM WATCH's backing was important if Fannie Mae decided to attack it in Congress. Fannie spokesman David Jeffers says it never opposed raising the standards, so it could not be counted as a win for FM WATCH. Jeffers said the company is satisfied with the way the new regulations came out. (*Legal Times*, Sam Lowenberg, Weeks of August 23 and 30, 1999)

Fannie & Freddie prompt suspicion by primary market

FM WATCH Executive Director Mike House says the membership of FM WATCH shows that it's not just the mortgage industry that is concerned about the GSEs but that the broader financial services industry is also concerned

- A recent report by Dale Dorr in the *Credit Risk Management Report* focused on FM WATCH. **The GSEs claim that they will remain within their charters, and Dorr notes that "some speculate the allegations [by FM WATCH] are simply sour grapes from primary market players if their charters were changed." However, Dorr notes, "several financial powerhouses have joined the ranks of the new group ... leading many to believe the threat is real."**
- Dorr cited Freddie Mac's attempt last October to amend their charter to allow them to insure mortgages as the impetus for the formation of FM WATCH. He quotes Mike House, executive director of FM WATCH, as saying Freddie's move was "a wake-up call for the industry. They way overstepped their bounds." House also voiced objections to Fannie Mae's advertisements in print and on television that praise their commitment to American homeowners. Dorr also noted that "many believe the campaigns inaccurately depict Fannie as a direct source of home loans in the minds of consumers."
- Technology -- especially the GSEs' control of the automated underwriting market -- is also a matter of concern to those in opposition to the GSEs, said Dorr. Dorr quoted Don Lange, president of the Mortgage Bankers Association, as saying, "we have no problem with them investing in and improving technology for managing secondary market risk, but they're going beyond the secondary market and effectively circumventing the seller-servicer." Dorr also noted that the MBA

is not a part of FM WATCH and does not intend to join. However, their recent GSE policy statement addresses many concerns similar to those of FM WATCH.

- The views of FM WATCH and the MBA are not shared by everyone, according to Dorr. He quotes Jim Fowler, an analyst with the investment firm Banc of America Securities as stating, “in small pockets of the industry, they’re worried because they didn’t keep up with technological advances. Others have taken the lion’s share and left them to clamor with two easily recognizable names.” Mike House disagreed with Fowler’s assessment. “I think many of these organizations are ahead of the curve . . . **The membership of FM WATCH shows it’s not just the mortgage industry or technologically challenged firms, but a financial services issue.**” Dorr further noted that the GSEs’ strongly disagree with everything the FM WATCH contends. Freddie Mac spokesperson Sharon McHale said, “it’s a pocketbook issue. FM WATCH is trying to protect the industry from changes that would limit mortgage insurers’ business . . . We’re not seeking to enter the primary market. We have no intention of origination. We have no plans to change our charter.” Fannie officials did not respond to Dorr’s repeated requests for an interview.
- Dorr concluded by first quoting Fowler as saying, “complaints from FM WATCH and others ultimately will result in no change.” He further noted, “if Fowler is right, and if Fannie and Freddie were to venture into the primary market, no one could compete with their consumer recognition.” **“There’s a risk for everybody in the food chain, says House. If you establish a brand name [like Fannie and Freddie] there’s no reason to bring in the marketing director for Taco Bell to establish yourself with consumers. You can control the chain.”** (*Credit Risk Management Report*, Dale Dorr, 8/23/99)

Asset-backed securities market players say a pending \$263 million home equity deal is likely targeted for purchase by Fannie or Freddie

[Purchases of home equity loans do not further Fannie & Freddie’s mission of providing liquidity to the secondary mortgage market since the majority of home equity loans are used to consolidate consumer debt and are made to consumers who already own their homes.]

- According to *Reuters*, some asset-backed securities market players said a pending \$263 million home equity deal from Oakwood Homes Corp. includes one senior pass-through class - \$226.7 million five-year paper – “that was likely pegged for one of the agencies.” “The deal seems to have been structured for a large agency buyer,” wrote ABS analysts at Banc of America Securities in their daily ABS report. Other market participants also speculated that the pass-through tranche was being pre-sold to one of the agencies. No pricing guidance was available on the tranche. The agencies would not comment on their portfolio purchases. (*Reuters*, 8/30/99)

Pilots by Fannie & Freddie offer brokers and in Fannie's case, consumers - an automated underwriting "portability." The pilots allow brokers and consumers to use the GSEs' automated underwriting systems to receive an underwriting decision prior to a lender bidding and winning the deal.

[This conflicts with the Mortgage Bankers Association (MBA)'s recent policy statement on the GSEs – "The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including, but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals." (MBA GSE Policy Statement, 8/10/99)]

Fannie has denied that it has ever attempted to provide portability on its website in defending its iQualify and openclose.com web ventures, yet sources close to iQualify maintain that the site still offers portability on its website and that Fannie is aware that portability is still being offered on the website.

In another venture by Fannie into portability, Priceline.com just announces that it has teamed up with Alliance Capital Partners to allow consumers direct access to Fannie's automated underwriting system allowing consumers "to name their price for mortgage loans on-line"

Freddie's pilot is with IMX Exchange which allows brokers to receive an automated underwriting decision from Freddie's automated underwriting system, Loan Prospector, over Freddie's Internet site – IMX says there is a 100% chance that it will expand the pilot

A MBA editorial notes that Freddie's Best Practices handbook for lenders says "Whenever you allow someone outside of your organization to perform services for which you have ultimate responsibility you increase the risk that mistakes and negligent omissions will occur." However, "When you sell home loan mortgages to us, you have full responsibility for their quality. The quality could be affected by the process used in their origination."

MBA editorial argues that Fannie & Freddie should not use their automated underwriting systems on auction sites, because these auctions diminish the relationship between the lender and the loan originators, resulting in erosion of loan quality [which Freddie states is ultimately the responsibility of the lenders because their capital is on the line]

Freddie's IMX pilot

- According to a *National Mortgage News* article by Matt Strickberger, lenders are concerned that an automated underwriting pilot by Freddie with IMX Exchange will give brokers "portability." The pilot allows brokers to run borrower information through Freddie's automated underwriting system, Loan Prospector, prior to a lender bidding and winning a deal. According to an editorial in *National Mortgage News*, 2,500 brokers and 100 wholesalers have signed onto the new product.
- Strickberger points out that this pilot is controversial as lenders fear that with automated underwriting portability, lenders would lose control of the process. That is very sensitive to the rank and file of mortgage lenders, though not necessarily the largest lenders. "This deal amounts to a direct relationship with the broker," said one lender. "It's a fungible automated underwriting

decision among those lenders involved in the pilot. No lender is involved in the process, until they bid and win the bid. That disenfranchises the seller-servicer.”

- **In the *National Mortgage News* editorial, Freddie’s Director of Marketing, Sharon McClung told editors that mortgage bankers were “worrying for nothing.” She noted that “Freddie Mac is ill-equipped for dealing with the consumer,” and said the agency relied on its seller-servicers for risk management. McClung told editors she did not foresee Freddie ever working directly with brokers, however when pressed to rule it out she deferred the question to higher management.** During a recent Internet and Financial Services Conference by Morgan Stanley Dean Witter in August, Richard Wilkes, President and CEO of IMX Exchange (also a Director of Finet.com) noted that five lenders were participating in the project and that there was a 100% chance that the pilot would be expanded. During his presentation, Wilkes noted that IMX Exchange was built to maintain all types of consumer financial products (e.g., auto loans). According to *National Mortgage News*, IMX plans to develop relationships with five additional automated underwriting services, and has a verbal agreement with pmiAura. (*National Mortgage News*, Matt Strickberger, 7/19/99; *Morgan Stanley Dean Witter Internet and Financial Services Conference*, August 5, 1999, New York, NY; *National Mortgage News Editorial*, 9/6/99)

Fannie’s pilots - iQualify, openclose.com and now the partnership with priceline.com

- According to a *National Mortgage News* article by Matt Strickberger, many were surprised at Freddie’s introduction of the IMX pilot, considering Fannie’s iQualify and openclose.com’s inability to attract lenders until it eliminated portability from the site. [iQualify, owned by Finet.com, was the first website that allowed consumers direct access to Fannie’s automated underwriting system; openclose.com was a website owned by mortgage.com that did allow brokers direct access to Fannie’s automated underwriting system but after criticism by lenders, the site was modified. The site now requires brokers to choose a “premier lender” every time they use the site to get a loan approved by Fannie’s automated underwriting system to ensure that there was no “auctioning” of Fannie’s automated underwriting system-approved loans by brokers.] **Freddie had at first taken the high road and said it would not offer portability unless competitive pressures forced it to offer it, while Fannie was forced to defend its position and deny that it ever planned to participate with openclose.com’s plans to provide portability on its website.**
- **Despite Fannie’s denial that it never planned to offer portability of Fannie-automated underwriting approved-loans, according to Strickberger’s article, a source close to iQualify, which is no longer a standalone site, but part of Finet’s Interloan website, confirms that it still offers portable automated underwriting decisions on the site [using Fannie’s automated underwriting system]. Fannie, is according to the source, aware that a portable automated underwriting decision is still offered on the site and that Finet plans to add other automated decision-makers to the site to camouflage Fannie’s effort to maintain a portable site.**
- Further, according to a recent *Mortgage Technology* article excerpted from Faulkner & Gray’s “*Mortgage Technology Directory*,” Finet.com announced a new auction service, rolling out primarily on HomeSeekers.com, that would let buyers receive competitive bids for their purchase-mortgage business once they find a house they like and get an offer under contract. The auction service would qualify borrowers upfront through iQualify [uses Fannie’s automated underwriting system]. Finet reportedly proposes to eliminate lender “wobble room” once lenders make aggressive bids. When the lender makes a bid on Finet, said L. Daniel Rawitch, Vice Chairman of Finet, the notion is that “there is no turning back” from honoring the bid.

- Mike Koch, a Director of Technical Marketing for Fannie, denies that it is a participant in providing portability on the site. “Desktop Underwriting decisions are not transferable between lenders. Period. If Monument as a seller/servicer chooses to transfer a loan to another lender, that lender can accept Monument’s decision without a waiver of reps and warranties,” said Koch. “Desktop Underwriting decisions are just not portable,” Koch stated. (*National Mortgage News*, Matt Strickberger, 7/19/99; *Mortgage Technology*, article excerpted from Faulkner & Gray’s “*Mortgage Technology Directory*,” September/October 1999)
- **[However, emphatic Fannie’s denials that the company is not trying to make Desktop Underwriting decisions portable, the statements when compared to the evidence ring hollow.] Priceline.com just announces that it will provide consumers the ability to access Fannie’s automated underwriting system, Desktop Underwriter, to “name their price for mortgage loans on-line”]**

Priceline.com offers Fannie automated underwriting portability

- Priceline.com announced a new mortgage lending partnership with Alliance Capital Partners (a unitary thrift holding company) that expands the firm’s “name your price” mortgage loans, offered online. The partnership will provide consumers direct access to Fannie’s automated underwriting system, Desktop Underwriter. The new venture, called Pricelinemortgage, will allow consumers to find out if their bid for a mortgage has been approved in as little as a few minutes. Alliance Mortgage, Alliance Capital’s mortgage subsidiary will provide loan decisions rendered by Fannie’s system on the Priceline.com mortgage site. LendingTree, a multilender site that formed an alliance with Priceline.com will also participate in the new partnership. Ben Ness, Senior Vice President of Financial Services at Priceline.com noted that by partnering with the subsidiary of a thrift, Priceline is automatically licensed to operate in all 50 states.
- Under the partnership, borrowers would also receive a guaranteed maximum loan closing cost quote and an on-line rate lock-in if their bid was accepted. The new venture is reportedly expected to roll out a pilot program in Florida by the end of the month. Home equity loans will not initially be offered through the partnership. Priceline will have a 49% stake in Pricelinemortgage and Alliance Capital will have a 51% stake. [This is contrary to the Mortgage Bankers Association (MBA)’s recent policy statement on the GSEs – “The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including, but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals.”] (*National Mortgage News website*, posted 9/2/99; *American Banker*, 9/3/99; *Wall Street Journal Interactive*, 9/1/99; *Business Wire*, 9/1/99)

Mortgage Bankers Association editorial – Fannie & Freddie should not allow the use of their automated underwriting systems on these auction sites

- A *Real Estate Finance Today* editorial (published by the Mortgage Bankers Association of America (MBA)) stated that Fannie and Freddie should not allow the use of their automated underwriting systems on Internet auction sites because these auctions diminish the relationship between the lender and the loan originators, resulting in erosion of loan quality [which as Freddie states is ultimately the responsibility of the lenders, who bear the financial liability for the loan.]
- The editorial notes that “Ensuring the quality of third-party originations has been a mantra in the secondary market.” The portability auction pilots eliminate the quality management that lenders bring to the mortgage origination process. The following are excerpts taken from Freddie’s Best Practices Handbook:

“It is important to take the time to learn about mortgage brokers and correspondents to control the risks inherent in wholesale operations.”

“Whenever you allow someone outside of your organization to perform services for which you have ultimate responsibility, you increase the risk that mistakes and negligent omissions will occur.”

“Managing your mortgage brokers and correspondents includes more than gathering information. You must take action, such as ongoing communication of information and expectations.”

“When you sell home loan mortgages to us, you have full responsibility for their quality. The quality could be affected by the process used in their origination.”

- The editorial agrees with Freddie’s statements. “Many aspects of credit quality can only be evaluated by the person at the point of sale. As a result, lenders have discovered that designing the controls that allow them to push technology to the point of sale is a complicated process.” As Freddie points out, the process in the wholesale arena is especially complicated since the originator is not an employee of the company that bears the financial liability for the loan. Yet that originator makes critical decisions about loan quality and many of these critical decisions cannot be validated by automated underwriting technology.
- “Internet auctions substitute an electronic price exchange for the personal relationship between the originator and the wholesaler. Service and quality can get lost in the shuffle. Auction sponsors advertise that they perform certain broker approval functions, but they make clear that they assume no liability for loan fraud.” Yet, as the editorial notes, Freddie is providing its automated underwriting system, Loan Prospector to IMX Exchange. Automated underwriting technology does not turn underwriting from an art into a science, thus electronic commerce must include safeguards such as building strong relationships between the originator and funding source for the protection of the lender, the consumer and the secondary market.
- The editorial concluded with the following, **“Fannie Mae and Freddie Mac should not allow their AU systems to be used in internet mortgage auctions, because these auctions diminish the relationship between their seller/servicers and the loan originators. The seller/servicers have the primary responsibility and incentive for maintaining loan quality, because their capital and their standing as approved seller/servicers are on the line. Loan quality will be eroded if technology is used to move control over third-party originations further away from the lenders funding the loans.”** (*Real Estate Finance Today*, editorial, “Quality Matters, 8/20/99)

Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors and consumers

[Despite Fannie's repeated pronouncements that lenders are their "only customers," Fannie & Freddie continue to build their technology brand name and market directly to brokers, realtors, and consumers]

[Fannie & Freddie are using their technology to control the origination process and expand into new lines of business]

Michael Williams, Senior Vice President for Customer Technology Services at Fannie, stated during a recent Morgan Stanley Internet conference about its technology goals: "In business-to-business e-commerce, Fannie Mae will establish the standards, the connections and the marketplace."

Fannie's recent technology announcements:

- (1) Fannie eliminates automated underwriting (Desktop Originator) fees for brokers and lenders to attract more lenders and brokers to its systems. Fannie will now only charge lenders one fee per loan [to Fannie] for unlimited access to any automated underwriting system on Fannie's MORNETPlus system [final decision on which of the competing automated underwriting systems are on the system is controlled by Fannie]. Fannie also waives its surcharge for running FHA loans through its system. [Fannie calls this system "OpenAccess," however, Fannie is in charge of access and fees to the pipeline and still requires products like Flex 97 to be run through its automated underwriting system only. This is contrary to the MBA's recent policy statement on the GSEs that states that the GSEs should not tie their technology to products. (*MBA GSE Policy Statement, 8/10/99*)]
- (2) Fannie adds four new credit agencies to its MORNETPlus Network technology pipeline – 13 credit agencies are now on its pipeline. One of the credit agencies, LandSafe (subsidiary of Countrywide), says it will provide its LandSafe Appraisal products and services on MORNETPlus [products and services offered by LandSafe include closing services, credit reports, title insurance, flood determination, home inspection and appraisals]. Fannie said it will also add flood and title companies to its pipeline
- (3) Fannie is chosen by *Computerworld Magazine* as the 26th best place for Information Technology professionals to work
 - Approximately 1,200 of its 3,500 employees work in technology, which accounts for 20% of Fannie's spending
- (4) Express Financial Corporation, a subsidiary of Interactive Technologies introduces WEBAPP software to enable consumers to complete a mortgage application on-line, and receive a response through Fannie's MORNET system – Express Financial Services will then send the complete WEBAPP to a branch office near the user's home
[This is contrary to the MBA's recent policy statement on the GSEs – "The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals."]

- (5) HUD approves Fannie's Desktop Underwriter and pmiAura products for automated underwriting of FHA loans
- (6) Fannie announces it has added new web-based applications for multifamily delegated underwriting servicing lenders and investors to its website – Fannie wants to expand access for business-to-business e-commerce
- (7) Finet, the owner of the first website that allows consumers direct access to Fannie's automated underwriting system, announced a marketing agreement with RealEstate.com to provide online mortgage services to consumers on the Real Estate.com website. Finet also announced a partnership with HomeFair.com to provide relocation services at its Mortgage Centers

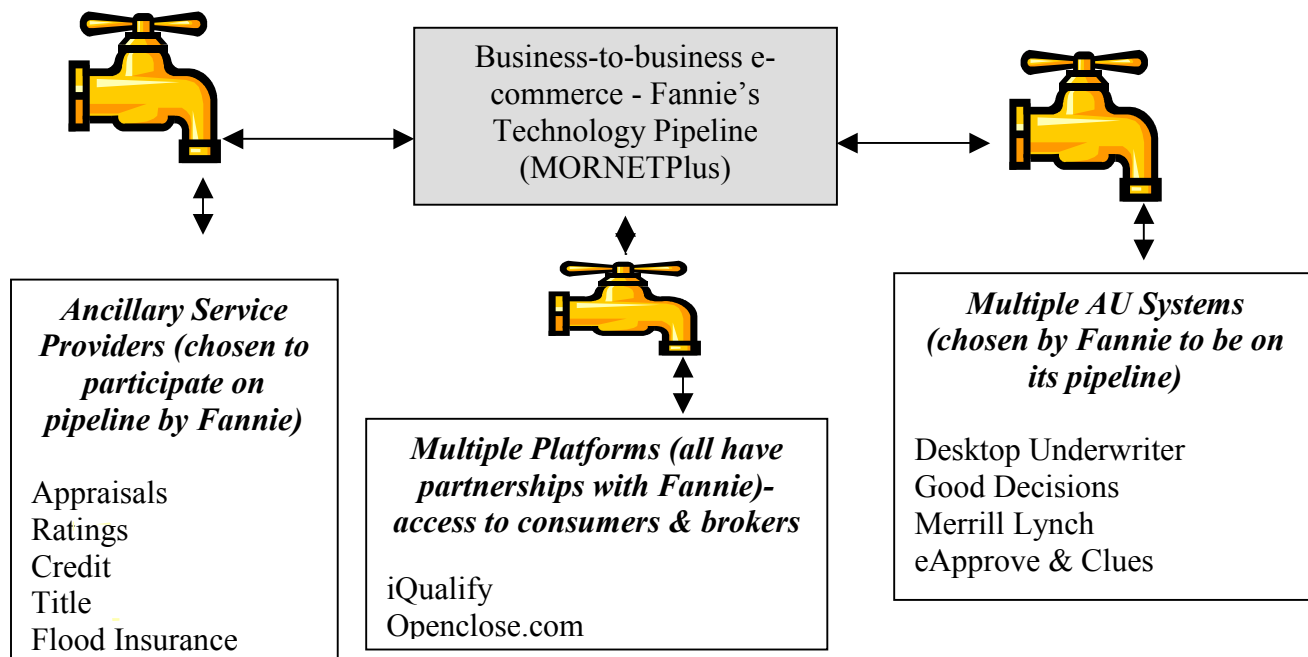
Freddie's recent technology announcements:

- (1) Freddie has custom-built a client/server-based computer software system for originating franchise loans
- (2) Freddie puts its automated underwriting second generation user guide on AllRegs ® CD-ROM

Fannie tells analyst it will control business-to-business e-commerce

- During a Morgan Stanley Dean Witter Internet and Financial Services Conference on August 5, Michael Williams, Senior Vice President for Customer Technology Services, stated the following about Fannie's technology goals: **"In business-to-business e-commerce, Fannie Mae will establish the standards, the connections and the marketplace."** Williams notes that since all lenders need the secondary market, Fannie believes that it is uniquely positioned to provide technology business for lenders. Williams further believes that technology: (1) will help Fannie's business partners; (2) provide a critical tool for expanding market; (3) will cut costs and remove bias; and (4) will help Fannie to double its earnings growth over next five years. Fannie says that lenders may use any technology method they choose but the technology "must be secure." (*Morgan Stanley Dean Witter conference, "The Internet and Financial Services Conference,"* New York, NY, 9/5/99)

- Coming from the Internet conference, it appears that Fannie visualizes controlling the business-to-business e-commerce something like this---



Fannie's recent technology announcements:

- (1) Fannie eliminates automated underwriting (Desktop Originator) fees for brokers and lenders to attract more lenders and brokers to use its systems – Fannie also waives its surcharge for running FHA loans through its system [Fannie calls this system “OpenAccess,” however, Fannie is in charge of access and fees to the pipeline and still requires products like Flex 97 to be run through its automated underwriting system only. This is contrary to the MBA’s recent policy statement on the GSEs that states that the GSEs should not tie their technology to products.]
- Fannie announced that beginning September 1, it will eliminate the \$40-a-month subscription fee it charges brokers to use Fannie’s Desktop Originator and the \$1,000 monthly subscription fee lenders have been paying to use the system. Fannie recently announced that lenders will pay just one fee [to Fannie] per-loan charge for unlimited access to any automated underwriting engine [chosen by Fannie] on Fannie’s MORNETPlus network, and that it is dropping the \$20 surcharge [to Fannie] for running FHA loans through Fannie’s Desktop Underwriter. As part of its “OpenAccess” system, Fannie says it will provide refunds of underwriting charges on mortgage products that require Fannie’s Desktop Underwriter use, such as Flex 97, and are delivered on June 1, 1999. (*Fannie press release, 8/19/99; Credit Risk Management Report, 8/23/99; Inman News Feature, 8/18/99*) [Regardless of a refund, Fannie is still tying its products to its automated underwriting technology. Only those lenders that have Fannie’s automated underwriting system in its offices will be able to provide this Flex 97 product to consumers.]

- (2) Fannie adds four new credit agencies to its MORNETPlus Network technology pipeline – One of the credit agencies, LandSafe (subsidiary of Countrywide), will provide closing services, credit reports, title insurance, flood determination, home inspection and appraisals through the MORNETPlus system
- Fannie announced that it added four additional credit agencies over its MORNETPlus network: CBA Information Services, Factual Data Corporation, LandSafe, and The Credit Network. According to Fannie, 13 credit agencies are now offered on its pipeline and the company plans to add flood and title companies to the pipeline. According to LandSafe (subsidiary of Countrywide), the company will provide its LandSafe Appraisal products and services on MORNETPlus. (*Fannie press release, 8/30/99; PR Newswire, 8/30/99*)
- (3) Fannie is chosen by *Computerworld Magazine* as the 26th best place for Information Technology professionals to work
- Approximately 1,200 of its 3,500 employees work in technology, which accounts for 20% of Fannie's spending
 - According to Fannie Mae, *Computerworld Magazine* ranked Fannie as the 26th best place for Information Technology professionals to work. The criteria for the ranking included access to training opportunities, average salary increases, the percent of staff promoted, benefits, and the percentage of women and minority staff in management positions. The magazine noted that approximately 1,200 of its 3,500 employees work in technology, which accounts for 20% of the company's spending. According to the article, Fannie employees are also eligible for a forgivable loan of up to \$11,000 to cover the cost of the down payment of a house and associated closing costs. (*Fannie website, Computerworld Magazine, 6/28/99*)
- (4) Express Financial Corporation, a subsidiary of Interactive Technologies introduces WEBAPP software to enable consumers to complete a mortgage application on-line, and receive a response through Fannie's MORNET system
- Express Financial Corporation, a subsidiary of Interactive Technologies.com, announced the formation of its new on-line WEBAPP Software that will enable consumers to complete a mortgage application on-line, and receive a response in minutes via the MORNET systems (which Express defines as Fannie's automated underwriting system. Express Financial Corp. will send the complete WEBAPP to a branch office near the user's home where originators will finish the mortgage transaction. (*Business Wire, 8/18/99*) [This appears to be against the Mortgage Bankers Association (MBA)'s recent policy statement on the GSEs – “The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including, but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals.” (*MBA GSE Policy Statement, 8/10/99*)]
- (5) HUD approves Fannie's Desktop Underwriter and pmiAura products for automated underwriting of FHA loans.
- The Department of Housing and Urban Development (HUD) announced its approval of Fannie's Desktop Underwriter and pmiAura products for automated underwriting of FHA loans. In February 1998, HUD approved Freddie's automated underwriting system, Loan Prospector, to perform automated underwriting of FHA loans. Freddie announced that Loan

Prospector had processed nearly 1.8 million government loan submissions since the serve was approved last year. Freddie also has the approval to underwrite VA loans (approval received in October of 1997). Fannie, however, has started a pilot program to perform automated underwriting of VA loans and expects final approval by the end of the year. (*Real Estate Finance Today*, 8/27/99; *National Mortgage News*, 8/23/99; *American Banker*, 8/20/99; *Freddie press release*, 8/20/99)

(6) Fannie adds new web-based applications for multifamily DUS lenders and investors

- Fannie announced the addition of two new applications to its website, which Fannie said it will further expand lenders and investor access to Fannie for multifamily business-to-business e-commerce. One application, known as the Electronic Submission process will provide Fannie's Delegated Underwriting and Servicing lenders the ability to submit loan underwriting and property inspection information via the Internet. The second application expands the scope of data available to investors in multifamily securities, and provides "user-friendly" accessibility. Investors will have website access to monthly updated information on Multifamily DUS and Prior Approval MBS and on REMIC securities. Fannie said its website provides a single point of entry for multifamily business-to-business e-commerce. (*Fannie press release*, 8/23/99)

(7) Finet announces marketing arrangement with RealEstate.com and HomeFair.com

- Finet, the owner of the first website that allows consumers direct access to Fannie's automated underwriting system, announced a marketing agreement with Real Estate.com to provide online mortgage services to consumers on the Real Estate.com website. Finet.com loan counselors will reportedly assist consumers in evaluating and selecting loan products from more than 60 lenders. (*Real Estate Finance Today*, 8/27/99) Finet.com also announced a partnership with HomeFair.com to provide relocation services at its Mortgage Centers. HomeFair, launched in 1994, reportedly was one of the first 1000 commercial websites. It provides relocation information such as school reports, calculators, and other relocation-related resources. (*Inman News Feature*, 9/7/99)
- In related news, the *American Banker* reported that after Finet shut some units and took other cost-cutting measures, the company had a slight revenue increase in its fiscal first quarter after reporting revenue declines the previous two quarters. The company had revenues of \$2.04 million in the first three months that ended July 31, compared to \$2.03 million in the last quarter of 1999. The company had an operating loss of \$6.3 million, more than half the \$1.2 million loss in the previous quarter. Finet.com reportedly bought most of the assets of Lowestrade.com recently and said it reduced costs by 41% by discontinuing unprofitable lines of business. The company closed nine branch offices in the past six months, reducing staff, and got out of the servicing business. (*American Banker*, Hala Habal, 8/31/99)

Freddie's recent technology announcements:

- (1) Freddie has custom-built a client/server-based computer software system for originating franchise loans
- According to a *Real Estate Finance Today* article, Freddie has custom-built a client/server-based computer software system to help reduce turnaround time for originating franchise loans. The FMAC Loan Origination and Information System, or LOIS, automates the loan process

from inception to funding. “This system will shorten the loan originating and closing process and substantially impact the processing of new loans for repeat borrowers,” according to Mohan Chabra, Director of Information Technology for FMAC and the creator of LOIS. (*Real Estate Finance Today*, 8/20/99)

(2) Freddie puts its automated underwriting second generation user guide on AllRegs ® CD-ROM

- Freddie announced that its Loan Prospector ® Second Generation User Guide and the 1999 Loan Prospector Enhancement Guide are now available on CD-ROM. (*Freddie press release*, 9/1/99)

Real estate and mortgage finance attorney description of “GSE mentality”: “if there’s a problem with the loan, it’s your [lender] problem.”

- According to a *National Mortgage News* article, a legal specialist in real estate and mortgage finance, Phillip Schulman, stated that recent actions by the Department of Housing and Urban Development (HUD), led him to believe that HUD had adopted “somewhat of a GSE mentality.” Schulman, a partner in the local office of Kirkpatrick & Lockhart and general counsel to the Title One Home Improvement Lenders Association, said that HUD, like Fannie Mae and Freddie Mac, is now of the view that “if there’s a problem with the loan, it’s your problem, not theirs.” (*National Mortgage News website*, posted 9/8/99)

Second largest mortgage insurer, Radian Guaranty, appoints a company liaison to Fannie & Freddie

- According to an *American Banker* article by Marc Hochstein, Radian Guaranty, the second-largest mortgage insurer, appointed Sam King, Senior Vice President and National Account Manager to be its point person with Fannie and Freddie. Fannie and Freddie are “the largest beneficiaries of private mortgage insurance,” stated Frank Filippis, Chairman and Chief Executive of Radian, so it is natural, even overdue, that the company appoints an executive to work with the agencies full time. Filippis downplayed the tension that has emerged between the mortgage industry and the GSEs. “We disagree with them on a couple of points,” he said, adding that by appointing a liaison his company will increase dialogue with Fannie and Freddie. “The more appropriate discussions you have with people, the more opportunities you have to avoid areas of major disagreement,” he said. The article noted that PMI Mortgage Insurance Co. has had an official liaison with Fannie and Freddie for two years. (*American Banker*, Marc Hochstein, 8/20/99)

Fannie Mae

Fannie strikes alliance agreements with Washington Mutual and Waterfield Mortgage

As part of the agreement, both companies will sell most of their conforming mortgage loans to Fannie

Washington Mutual will use its own underwriting system but will expand its product line by developing more products with Fannie

Washington Mutual and Fannie will also explore Fannie's possible purchase of Washington Mutual's fixed rate Advantage 90 mortgage product, which lets customers eliminate private mortgage insurance payments

Waterfield Mortgage will test Fannie's automated underwriting system improvements (Desktop Underwriter) and Fannie pilot programs. Waterfield and Fannie will also work on initiatives to combine Waterfield's paperless technologies with Fannie's technology initiatives

Washington Mutual

- Washington Mutual and Fannie entered into a strategic alliance, under which Washington Mutual will sell most of its fixed-rate conforming mortgage loans to Fannie. Under the agreement, Washington Mutual will use its own underwriting system, while working closely with Fannie in sharing credit risk management. The agreement also allows Washington Mutual the opportunity to expand its product line by working with Fannie to develop additional conforming products in the future, including single-family, multi-family and manufactured home loans.
- Subject to Fannie's charter requirements, Washington Mutual and Fannie have also agreed to explore Fannie's possible purchase of Washington Mutual's fixed-rate Advantage 90™ mortgage product. The Advantage 90 enables consumers to eliminate private mortgage insurance payments and provides an option to lower the interest rate on their loans once certain conditions are met. (*Business Wire*, 9/2/99; *National Mortgage News website*, posted 9/2/99; *Dow Jones Newswire*, 9/2/99)

Waterfield Mortgage

- Fannie and Waterfield Mortgage struck an agreement in which Waterfield Mortgage will sell virtually all of its conforming loans to Fannie. The agreement also means that Waterfield will be included in testing Fannie's automated underwriting system improvements (Desktop Underwriter) and Fannie pilot programs. Waterfield and Fannie will also work on initiatives to combine Waterfield's paperless technologies with Fannie's technology initiatives. According to *National Mortgage News*, Waterfield had over \$2 billion in total production during the first half of the year. Waterfield's Senior Vice President of Product Risk Management, Dan Cutaia, said the agreement "will give us the opportunity to combine our own laptop origination systems with Fannie Mae's Desktop Underwriter to provide the next generation in point-of-sale approval functionality." (*Business Wire*, 9/8/99; *National Mortgage News website*, posted 9/8/99)

Orange County Community Housing Corp. Executive Director, Allen Baldwin, says Fannie's \$6 billion "House Orange County" investment plan will do nothing for housing affordability in Orange County

Baldwin claims Fannie "clouds and confuses the issue of affordable housing by wagging about \$6 billion numbers and superlatives about its efforts to making housing more affordable"

- Fannie held a press conference with Cong. Ed Royce (R-CA) and Cong. Gary Miller (R-CA) on August 25 to announce a \$6 billion "House Orange County" investment plan. (*Fannie press release, 8/25/99*)
- Allen Baldwin, the Executive Director of the Orange County Community Housing Corp. of Santa Ana wrote a letter to the *Los Angeles Times* criticizing the paper for running an article on Fannie's announcement on its front page because it was a "story that had no news."
- Baldwin writes:

"Please understand that the Fannie Mae billion-dollar program will do nothing for housing affordability in Orange County. The Times is wrong and Fannie Mae clouds and confuses the issue of affordable housing by wagging about \$6 billion numbers and superlatives about its efforts to making housing more affordable. Housing finance does not have a major role to play in making housing affordable. The production of housing units at lost cost does... To hear us, our elected officials or our staffers talk, there is no housing problem. By gosh, didn't we just see a story about a \$6-billion commitment? Problem solved. No, the emperor is quite naked.") (*Los Angeles Times Orange County Commentary, 8/29/99*)

Fannie is moving further into subprime mortgages

***Boston Globe* article explains Fannie's subprime lending standards**

- A *Boston Globe* article by Kathleen Howley reported that Fannie is "leading the way" when it comes to reaching out to subprime borrowers. "Non-traditional" loans are good businesses, said Julie Gould, a Vice President of Fannie Mae. Gould stated that it was not a matter of lowering the goal posts but a change in perception about who is a good risk. "We believe that buying a home shouldn't be like climbing Mt. Everest. The processes should not be difficult or death-defying or hard to get through," she stated. Gould noted that while Fannie's standards are expansive enough to include a blemished credit history, there cannot be too many strikes against a borrower. "We have avoided the trap of layering too many of these flexibilities all in one loan. If you do that, you are opening yourself up for failure," she said. Gould remarked that of the four components of the loan – down payment, debt-to-income ratio, credit history, and level of savings – only one or two can be substituted. "You don't want to max all four of those out in one loan. It's not a good recipe. But, the loan is flexible enough so you could pick one and maybe two of those and still get somebody into a home," Gould said. (*Boston Globe, Kathleen Howley, 9/2/99*)

Fannie begins "Working Mortgage" pilot in Ohio

Pilot allows borrowers to have their mortgage payments automatically deducted from their paychecks

Fannie expects to expand the program in the Year 2000

Aegis Mortgage Corp. has been designated the Automated Clearing House transaction processor for the product

- Fannie launched its “Working Mortgage” pilot in Ohio by Bank One Mortgage. The pilot is expected to last six months. The pilot sets up an automatic deduction of a mortgage payment that matches the timing of the borrower’s weekly or biweekly paycheck. Withdrawing funds for the mortgage payment with each period results in faster amortization of the mortgage, allowing the borrower to build up equity at an accelerated rate. The “Working Mortgage” is available only to those who use the direct deposit option. After setting up a direct deposit account, the borrower applies for a “Working Mortgage” through one of the pilot lenders, such as Bank One mortgage. The borrower agrees to have their mortgage payments deducted on the same day their pay is deposited. Aegis Mortgage Acceleration Corporation of San Francisco, CA was selected by Fannie to be the Automated Clearing House transaction processor for the “Working Mortgage.” Fannie said it expects to expand the program during the year 2000. As part of the pilot, Fannie has committed to purchasing \$25 million in new mortgages from Bank One Mortgage. Fannie previously announced that the “Working Mortgage” will also be available from Citicorp Mortgage, FT Mortgage, and Old Kent Mortgage during the pilot period. (*National Mortgage News website*, posted 8/31/99; *PR Newswire*, 8/30/99)

Fannie invests in more “fledgling” depository institutions

Fannie makes a \$250,000 equity investment in the newly formed Legacy Bank and purchases a \$100,000 certificate of deposit

Legacy Bank says Fannie’s contribution will allow it to provide “hometown banking”

Fannie purchases 4.49% of the voting shares of Greater Buffalo Savings Bank

Fannie’s ownership of 4.99% of Greater Buffalo Savings Bank will range from \$330,000 to \$900,000, depending on how many shares Greater Buffalo sells in its public offering

Without Fannie’s investment, it is questionable whether Greater Buffalo would have been able to meet the capital requirements necessary to open its office, but with Fannie’s investment, the company is now set to open in October and plans to aggressively challenge market leaders M&T Bank and HSBC Bank USA for retail customers in Buffalo]

Fannie said it has already invested more than \$54 million in more than 90 institutions and plans to invest \$75 million in community lending institutions through the year 2000

[It is questionable how an investment in a depository lending institution fulfills Fannie’s charter of providing liquidity to the secondary mortgage market, particularly when these institutions are using the money to provide traditional “hometown banking” services that are already being competitively served by private financial institutions.]

- Fannie made a \$250,000 equity investment in the newly formed Legacy Bancorp to increase the capacity of Legacy Bank’s subsidiary to offer affordable housing products. In addition, Fannie

purchased a \$100,000 certificate of deposit at Legacy Bank. Legacy Bank said it will provide Milwaukee residents the opportunity to assess traditional banking services, such as checking accounts, savings accounts, ATMs, and more. Initially, the Bank will focus on the Fond Du Lac Avenue Corridor, a low-to-moderate income African American community. Legacy Bank's President Margaret Henningsen stated that "Thanks to Fannie Mae's financial support and resources, we will be able to provide 'hometown' banking and can begin to offer the products and services that all Milwaukee residents want and need." According to Fannie, the company has committed to invest \$75 million in community lending institutions nationwide through the year 2000, and has already committed more than \$54 million in more than 90 institutions. (*Fannie press release, 9/8/99; National Mortgage News website, posted 9/8/99*)

- As reported in the August 20 *GSE Report*, Fannie also recently announced that it would purchase 4.99% of the voting shares of a savings bank in Buffalo, NY to assist the savings bank in opening for business. According to an article in the *Buffalo News*, the bank raised \$6 million with help from Fannie. The article noted that an investment from Fannie of at least \$300,000 helped the bank reach its regulatory capital requirement. Fannie's ownership of up to 4.99% of Greater Buffalo Savings means that the investment will range from \$300,000 to \$900,000 depending on how many shares Greater Buffalo Savings Bank sells in its public offering which closes October 9. The Fannie Mae investment was arranged through its partnership office. According to the article, the bank has begun a \$300,000 renovation on its leased space and the bank plans to spend another \$300,000 on a vault, computers, and equipment. The bank says it plans to aggressively compete against market leaders M&T Bank and HSBC Bank USA for retail customers in Buffalo with free checking and other discount products. (*Buffalo News, 8/17/99*)

Fannie starts \$1 million underwriting pilot program to help consumers refinance their debt into one loan

[Consolidating consumers' credit card debt does not further Fannie's core purpose of providing liquidity to the secondary mortgage market.]

- The *Omaha World-Herald* article profiled a consumer who "saved her house and her credit rating" through a pilot program offered by the Consumer Credit Counseling Service of Nebraska, Fannie, and the First National Bank of Omaha. According to the article, the program, which has had six of its 11 nationwide loan closings in Nebraska, allowed the consumer to refinance her debt and lower her monthly bills without meeting normal debt-to-income ratios. The consumer has since gotten rid of her credit cards. (*Omaha World-Herald, 8/28/99*)
- According to a Fannie press release, Fannie started this \$1 million underwriting pilot as part of its "HouseNebraska" initiative. The program, Consumer Credit Counseling Service (CCCS) Underwriting Pilot, is for "consumers who have had credit hardships" and have participated in CCCS's debt management program. Fannie, CCCS, and First National Bank of Omaha are participants in the pilot. (*Fannie press release, 4/19/99*)

Fannie's CEO Franklin Raines writes Letter to the Editor in the *Washington Post* in response to the newspaper's article entitled "*Fear of What Fannie May Do*" by Kathleen Day which reported on the recent criticisms being expressed by the private industry and government about Fannie & Freddie

Raines uses his letter to disparage those who criticize Fannie

- Franklin Raines, CEO of Fannie Mae, wrote a letter-to-the-editor to the *Washington Post* on August 31, 1999 in response to reporter Kathleen Day's August 9, 1999 *Post* article entitled "*Fear of What Fannie May Do*." Raines began his piece by stating "there is a dispute going on in the mortgage industry. It's over money." After noting that Fannie is committed to lowering homeownership costs, illustrated by their lowering of mortgage insurance requirements, Raines turned his attention to the mortgage insurance industry.
- "Naturally, mortgage insurers want to keep coverage requirements and premiums as high as possible. Since they can't make this happen in the business realm, they are hiring lobbyists and fighting it out in Washington. Don't be fooled. The issue is not about public policy. It's about whether mortgage insurers and their allies can use the Washington lobbying process to make more money for themselves. That's why we call them the Coalition for Higher Mortgage Costs."
- Raines then noted that the August 9 article revealed a second issue: that Fannie raises private capital to finance mortgages, rather than the taxpayer's money. He stated that Fannie needed \$2.6 billion dollars of new capital to finance \$400 billion in affordable mortgages for over 4 million families. "We got it from profits," said Raines. He noted that Fannie's pretax profits were distributed the following way: 29 percent for income taxes, 49 percent for capital and 22 percent for shareholder dividends. Raines then said that Fannie's capital keeps "mortgage rates low, finances our pledge to invest \$1 trillion to meet the housing needs of 10 million underserved families and finances \$300 billion in community development plans with dozens of cities across the country, including \$1 billion here in the District. Anybody who suggests that Fannie Mae can serve more families by earning less profit has it upside down. Our profits create the capital that allows us to serve more families."
- Raines also found fault with the article's mention of Fannie's potential use of technology. He refuted that Fannie will ever attempt to originate mortgages. "Most of the industry knows of my pledge that Fannie Mae will not originate mortgages. And Fannie Mae has embraced the new housing goals set by HUD Secretary Andrew Cuomo as part of our affordable housing mission."
- Raines then suggested that the difference Fannie makes for consumers can be judged in the *Post's* Mortgage Rate Chart in the Real Estate Section, where the interest rate in the first column (the mortgages that Fannie buys) is lower than the second column by a fraction of a percentage point. It "may not seem like much, but right now, a mortgage in the Fannie Mae column saves home buyers as much as \$20,000 over the life of their loans."
- In his conclusion, Raines states, "Fannie Mae's efforts to cut home-buying costs will not always please those who benefit financially from high costs of the status quo. But for us, we have one mission: helping more families become homeowners or obtain decent rental housing. If that is controversial, so be it." (Franklin Raines, *The Washington Post*, August 31, 1999)

Fannie's net mortgage portfolio increases \$7.2 billion in July

Fannie's total MBS outstanding increased to \$920.4 billion

Fannie reported portfolio purchases of Fannie MBS as \$8.5 billion in July

- Fannie announced that its net mortgage portfolio increased \$7.2 billion in July to \$480.7 billion. This reflects an 18.3% annual growth rate for July, down from a 22.3% rate in June. Mortgage purchases were \$14 billion in July, compared with \$15.9 billion in June, while portfolio liquidations were \$6.7 billion in July, down from \$7.0 billion in June. Fannie issued \$23.8 billion of MBS in July, down from \$24.9 billion in June. Fannie's total MBS outstanding increased by \$9.0 billion in July to \$920.4 billion, an 11.8% annualized growth rate, down from 14.2% in June. According to *Reuters*, Fannie reported for the first time portfolio purchases of Fannie MBS, which were \$8.5 billion in July, compared to \$10.1 billion in June. (*Dow Jones Newswire*, 8/11/99; *American Banker*, 8/12/99; *Reuters*, 8/11/99)

Fannie announces that it intends to appoint Ann Marie Wheelock, who is currently the Fannie Mae Foundation President and CEO, to the post of Senior Vice President of Fannie Mae's Western Regional Office

Stacey Davis Steed, who is currently a Vice President at Fannie Mae, will be the new President and CEO of the Fannie Mae Foundation

- Fannie announced that it intends to appoint Ann Marie Wheelock, who is currently serving as the Fannie Mae Foundation's President and CEO, to the post of Senior Vice President of Fannie Mae's Western Regional Office. Wheelock was previously Executive Vice President and Chief Operating Officer of the Foundation and before that, was Executive Assistant to former Fannie Chairman Jim Johnson. Wheelock's appointment is subject to approval of Fannie's Board of Directors. Stacey Davis Steed, has been Vice President for Housing and Community Development for Fannie's Southern Regional Office in Atlanta and was prior to that position, a director in Fannie's public affairs department. Steeds' appointment is effective September 16. (*National Mortgage News website*, posted 9/8/99; *Business Wire*, 9/7/99; *PR Newswire*, 9/7/99)

Lucrative employee perks at Fannie

Fannie employees are eligible for a forgivable loan of up to \$11,000 to cover the cost of a down payment on a house and associated closing costs

- According to *Computerworld Magazine*, Fannie employees are eligible for a forgivable loan of up to \$11,000 to cover the cost of the down payment and associated closing costs. (*Computerworld Magazine*, 6/28/99)

Mid-America Apartment Corp. (an apartment-only REIT) is negotiating to cut costs by refinancing its borrowing with Fannie

- Mid-America Apartment Corp. is in negotiations to replace \$120 million of its current borrowing with financing from Fannie at a significantly reduced cost. Mid-America Apartment Corp. is an apartment-only real estate investment trust. The company is hoping to cut costs by replacing

financing at a present blended cost of 7.3% with a line of credit it expects will reduce its cost to below 6.2%. “The Fannie Mae program offers us the ability to switch from short term to fixed rate debt, and also to sell properties and substitute collateral with minimal transaction costs,” said Simon Wadsworth, the Chief Financial Officer of Mid-America. Wadsworth said that \$82 million of the replacement will be from existing variable-rate short-term debt and the \$38 million balance will be to refinance term debt that matures in December. The company is expected to close the loan in October. (*Inman News Feature*, 8/20/99; *Dow Jones Newswire*, 8/18/99; *Business Wire*, 8/18/99)

Further strengthening its hold over the academic community, Fannie grants Miami-Dade College \$595,000

- The Fannie Mae Foundation has granted Miami-Dade Community College \$595,000 as part of its Community Colleges Initiative. The college has a Mortgage Finance Program – a 12-month certificate program within the Associate in Science degree in Financial Services. The new program uses state-of-the-art technology to provide hands-on training, professional development opportunities through internships, job shadowing and lectures by industry experts, as well as Fannie Mae Foundation-sponsored scholarships and laptops. Many of the students in the first class of the college’s program were already working in the mortgage industry. (*PR Newswire*, 9/3/99)

Fannie executive will speak at Annual Apartment Outlook conference

- According to the *Los Angeles Times*, Heidi McKibben, Vice President of Fannie will be one of the featured speakers at the Annual Apartment Outlook conference on September 29. The event, organized by the Real Estate Conference Group, will feature more than 40 speakers and cover a broad range of areas, including apartment financing and development, real estate technology, apartments in downtown Los Angeles and economics. (*Los Angeles Times*, 8/31/99)

Fannie announces that the National Association of Investors Corp. has named Fannie among the “top 100 Companies that Investment Clubs Love to Own”

Fannie ranks as #66

- In a Feature Story on its website, Fannie announced that in a compilation by the National Association of Investors Corporation, Fannie ranked among the “Top 100 companies that Investment Clubs Love to Own.” Fannie stated that the ranking was published in the July issue of *Money Magazine*. Fannie ranked 66th overall. (*Fannie website*, posted 8/31/99)

Fannie ranks in top ten of the “100 best companies for working mothers”

A number of other private financial services providers were also ranked in the top ten

- *Working Mother* magazine announced its list of the “100 Best Companies for Working Mothers.” Working Mother magazine did not rank the 100 companies, but named the following 10 companies as exceptionally progressive: Bank of America, Cigna, Deutsche Bank, Fannie Mae, First Tennessee Bank, IBM, Eli Lilly, Lincoln Financial, Lotus Development, and Prudential Financial Services. (*CBS MarketWatch*, 9/1/99; *Fannie press release*, 9/1/99)

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 in press events (currently 34 offices are officially open and operating and nine more are in the process of being organized)

Fannie said it plans to have 45 partnership offices opened by the end of the year

- Fannie currently has 34 partnership offices “officially” operating. Fannie has announced plans to open or commitments to open partnership offices in the following areas: Columbia, SC; South Dakota; Milwaukee, WI; Bismarck, ND; Pittsburgh, PA; Newark, NJ; Nashville, TN; Salt Lake City, UT and Cheyenne, WY. In a speech before the Long Island Housing Partnership’s Annual Meeting, Fannie Chairman Franklin Raines stated that Fannie hopes to expand to 45 partnership offices around the country by the end of the year. (*Fannie Chairman Franklin Raines speech before the Long Island Housing Partnership Annual Meeting, 6/18/99*)
- According to the *Salt Lake City Tribune*, Fannie said it plans to open a partnership office in Salt Lake City, UT later this year to educate low- to moderate-income families about loan programs]. (*Salt Lake City Tribune, 8/26/99*)
- According to the *Milwaukee Journal Sentinel*, Fannie plans to open its Milwaukee partnership office in September and is in its final round of interviews for the Milwaukee partnership office director position. (*Milwaukee Journal Sentinel, 8/27/99*)

Fannie participates in National Republican Senatorial golf fundraiser in Scotland

- According to *National Journal’s Congress Daily*, more than 50 lobbyists spent a few days in late August playing golf in St. Andrews, Scotland, with a half-dozen Senators – all as part of the National Republican Senatorial Committee’s “Tartan Invitational.” *National Journal* reports that representatives of Fannie Mae were on the duffer/donor invite list. Among the Republican Senators at the event: Majority Whip Don Nickles, NRSC Chairman Mitch McConnell, Energy and Natural Resources Chairman Murkowski and Senators John Ashcroft and Judd Gregg. (*Congress Daily, 9/9/99*)

Fannie names director for its new South Carolina partnership office

- Fannie announced that it has named Heyward Bannister, director of its new South Carolina partnership office. Bannister previously worked for the US Department of Veterans Affairs, where he served as Special Assistant to Secretary Togo West, Jr. and liaison to the White House. Prior to that position, he worked as owner and president of the Bannister Company, a South Carolina firm specializing in outreach and marketing strategies for business and nonprofit organizations. (*Fannie press release, 9/1/99*)

Senator Orrin Hatch (R-UT), Senator Robert Bennett (R-UT), Governor Mike Leavitt, Cong. James Hansen (R-UT) and Cong. Merrill Cook (R-UT) – Press Conference held at Utah State Capitol

- Fannie held a press conference with the above officials at the Utah State Capitol to announce a \$7 billion “House Utah” investment plan. Fannie’s President and COO Lawrence Small participated in the press conference. As part of the initiative, Fannie said it had worked with the State of Utah Library System to create hyperlinks from its “Pioneer” web page to Fannie’s HomePath.com website. Fannie said a total of 70 libraries in 29 counties throughout the state have access to Fannie’s website. Fannie said it also installed Desktop Home Counselor, an tool that provides

affordability analyses and offers on-the-spot guidance to first-time homebuyers, for the Ute Indian Tribe, NHS, and Salt Lake Community Action group. According to the *Salt Lake City Tribune*, Fannie announced during its press conference that it planned to open a partnership office in Salt Lake City, UT later this year to educate low- to moderate-income families about loan programs. (*Fannie press release*, 8/25/99; *Salt Lake City Tribune*, 8/26/99)

Congressional Whip Tom DeLay (R-TX)

- Fannie held a press conference with Congressman DeLay (R-TX) to present the Greater Fort Bend Economic Development Council with a \$50,000 grant for the “Excellence at Fifth Street” Redevelopment Initiative. Also participating at the press conference were Reverend Robert Childress, County Judge Jim Adolphus and Mrs. Christine DeLay, the co-chairs of the “Excellence at Fifth Street” redevelopment initiative. Fannie’s \$50,000 grant will reportedly fund a census study to assess the needs and desires that best serve this community. (*Fannie press release*, 8/27/99)

Senator Pete Domenici (R-NM), Congresswoman Heather Wilson (R-NM) and Albuquerque Mayor Jim Baca and Don Martin (Past President of the National Association of Homebuilders)

- Fannie held a press conference with the above officials for a “wall-raising” for Tres Placitas, a mixed-income development under construction in Albuquerque. Lawrence Small, President and COO of Fannie attended the press conference. Fannie provided \$2.5 million in debt financing for the development of Tres Placitas and has committed to purchase \$5 million in affordable, energy and location efficient mortgage loans, known as Albuquerque DREEM Mortgages. (*Fannie press release*, 8/26/99)

Senator Richard Bryan (D-NV) and Reno Nevada Mayor Jeff Griffin

- Fannie held a press conference with the above officials to celebrate the grand opening of an 85 new unit affordable housing development – Park Manor Apartments. Fannie made a \$2.5 million equity investment in Park Manor Apartments. (*Fannie press release*, 8/25/99)

Senator Mike Crapo (R-ID), Lieutenant Governor Butch Otter, Boise Mayor Brent Coles

- Fannie held a press conference with the above officials to announce Fannie’s \$2 billion “House Idaho” investment plan. During the press conference, Fannie presented Mayor Coles with a \$12,000 check. As part of the program, Fannie it will purchase more than \$4.3 million in multi-family tax-exempt bonds from the Idaho Housing and Finance Association to help finance construction of the Mallard Point Apartments, a 158-unit development for seniors.

Cong. Randy “Duke” Cunningham (R-CA) and San Marcos Mayor Corky Smith

- Fannie held a press conference with the above officials and Washington Mutual and Community Interface Services to welcome a disabled resident into a new home. According to the press release, the resident became a homeowner through Fannie’s HomeChoice mortgage. (*Fannie press release*, 8/31/99)

Cong. Mel Watt (D-NC) and Charlotte, NC Mayor Pat McCrory

- Fannie held a press conference with the above officials to celebrate the grand opening of Marlborough Woods, a new 192-unit condominium conversion of existing duplex apartments located in Charlotte’s westside. In conjunction with the Marlborough conversion, Fannie has approved a \$2 million underwriting experiment, under which Wachovia Mortgage requires borrowers to pay only a 2% down payment. Fannie will purchase the first mortgage loans originated by Wachovia. (*Fannie press release*, 8/27/99)

Cong. Steny Hoyer (D-MD) and AARP

- Fannie held a reverse mortgage seminar with Cong. Hoyer, Unity Mortgage, and the American Association of Retired Persons (AARP) on August 30. Among other items, the seminar will answer questions such as how to qualify for a Fannie reverse mortgage. (*Fannie press release, 8/30/99*)

Cong. Wayne Gilchrest (R-MD) and Salisbury, MD Mayor Barrie Tilghman

- Fannie held a press conference with the above officials to celebrate the grand opening of “Gateway Village Phase II,” an affordable housing complex for seniors. Fannie made a \$1.3 million investment in Gateway Village Phase II. (*Fannie press release, 8/25/99*)

Cong. Ed Royce (R-CA) and Cong. Gary Miller (R-CA)

- Fannie held a press conference with the above officials to announce a \$6 billion “House Orange County” investment plan. (*Fannie press release, 8/25/99*)

Cong. Sonny Callahan (R-AL)

- Fannie held a affordable housing forum with Cong. Callahan and the Nonprofit Resource Center of Alabama, local lenders, Realtors, and developers and community leaders. Office of the Comptroller of the Currency’s Nancy Gresham-Jones provided the luncheon remarks; “*What is the OCC’s Community Development Perspective for the 21st Century?*” (*Fannie press release, 8/25/99*)

Cong. Baron Hill (D-IN)

- Fannie held a press conference with Cong. Hill and the Indiana Housing Finance Authority to welcome a new homeowner into his home. The homeowner received his home through the “First Home/One Down” initiative that allows qualified first-time homebuyers to obtain conventional mortgages with a down payment of as little as 1%. Under the initiative, applicants receive 5 or 10% down payment assistance in the form of a zero-interest loan. The balance of the home purchase, up to 95% of the price, is supported by the Indiana Housing Finance Authority First Home loan. Fannie has agreed to purchase the loans originated under the initiative. (*Fannie press release, 8/20/99*)

Cong. Mark Green (R-WI), Marinette Wisconsin Mayor Dog Oitzinger

- Fannie held a reverse mortgage seminar with the above officials and ComCor Mortgage, the Coalition for Wisconsin Aging Groups, the Wisconsin Housing and the Economic Development Authority. (*Fannie press release, 8/20/99*)

Cong. David Phelps (D-IL)

- Fannie held a press conference with Cong. Phelps to demonstrate First National Bank of Decatur’s use of Fannie’s automated underwriting system, Desktop Underwriter. (*Fannie press release, 9/1/99*)

Cong. Edward Pease (R-IN)

- Fannie held a press conference with Cong. Pease as a housewarming celebration for a new family that obtained their mortgage through the “First Home/One Down” initiative that allows qualified first-time homebuyers to obtain conventional mortgages with a down payment of as little as 1%. (*Fannie press release, 8/26/99*)

Cong. Tom Barrett (D-WI)

- Fannie issued a press release announcing its investment in Legacy Bancorp (see earlier story). A statement of support by Cong. Barrett was included in the press release. (*Fannie press release, 9/8/99*)

Cong. Bill McCollum (R-FL) and Orlando Mayor Glenda Hood

- Fannie held a press conference with Orlando Mayor Glenda Hood to announce the kick-off construction of a luxury rental property in Orlando. Fannie made a \$5.6 million equity investment in the project. A statement of support by Cong. Bill McCollum (R-FL) was included in the press release. (*Fannie press release, 9/7/99*)

Freddie Mac

Freddie writes a letter-to-the-editor to the *Wall Street Journal* to say that it is not “irked” by HUD’s proposal to raise Fannie and Freddie’s affordable housing goals

- Sharon McHale, Director of Public Relations at Freddie Mac, wrote a letter to the editor to the *Wall Street Journal* taking issue with the newspaper’s characterization of its views on HUD’s proposal to raise the affordable housing of Fannie and Freddie, as “irked.” McHale writes that “The attempts to tar Freddie Mac as ‘irked’ and critical of the department are off-base and inaccurate.” The company said it has entered into discussions with HUD to “work through the complex issues involved with a significant increase in our efforts.” (*Wall Street Journal, 8/26/99*)

Freddie changes its marketing strategy and for the first time Freddie announces its upcoming benchmark sale (Reference Notes) well in advance of the sale

The move by Freddie is a deliberate attempt to help make its debt sell more like Treasuries

Tactic will likely help blur the lines between various types of bonds

Some traders complained that Freddie’s early announcement only added pressure to an already shaky environment

- According to a *Wall Street Journal Interactive* article by Gregory Zuckerman, Freddie announced its coming sale of \$4 billion of 10-year notes well in advance of its sale. Usually, Fannie and Freddie wait just a few days after announcing their intention to sell securities before they begin selling the bonds. Many in the bond market were surprised by Freddie’s delay. Zuckerman explains the reason: “It marks the first time a US government agency will try to whet the appetite of investors by announcing a deal well in advance of the sale. The tactic, employed by both corporations and the Treasury Department, likely will help blur the lines between various types of bonds, encouraging more investors to jump in and out of different sectors.”
- The article notes that Freddie officials hope the move will allow them to sell the securities at a higher price and improve the popularity of the securities by convincing investors that Freddie’s

bonds will come at regular intervals, with enough warning to allow investors to free up space in their portfolios for the securities. “This is not a one-time strategy,” says Jerome Lienhard, Freddie’s Senior Vice President of Funding. The move is the latest to help make the debt-sales processes of agencies, corporations, and the Treasury Department more alike. “This is a deliberate attempt to commit to an issuance calendar to make our product more Treasury-like, while appealing to more corporate investors,” says Lienhard. (*Wall Street Journal Interactive*, Gregory Zuckerman, 9/7/99)

- Shella Calamba with *Dow Jones Newswire* compared Freddie’s new marketing process as similar to so-called “road shows” held for corporate bond deals, in which issuers make presentations for investors. Instead of traveling from city to city, Freddie has prepared a taped presentation for investors that will be accessible on Bloomberg L.P. terminals. Lienhard noted that Freddie aims to make investors more familiar with its new calendar, not to tell a credit story as corporate bond issuers must do in order to attract buyers. The lengthier waiting period between the announcement and the issuance has caused agency debt traders and analysts to speculate that the recently volatile markets prompted Freddie to use this new marketing strategy. The article noted that traders stress that agency bonds bear more of a resemblance to US Treasuries than to corporates. While investor presentations are not necessary for Treasuries, they are critical for corporate issuers. Calamba noted that some traders complained that Freddie’s early announcement only added pressure to an already shaky environment. Fannie said it is sticking with its formula for announcing, launching, and pricing its issuances within a three-day span. (*Dow Jones Newswire*, 9/7/99)

Freddie promotes Senior Vice President of Servicing, Paul Peterson, to Senior Vice President of Strategy

Freddie names Margaret Colon as the new Senior President of Servicing

- Freddie announced that it appointed Paul Peterson as Senior Vice President of Business Strategy. Peterson has been with Freddie since 1989 and served most recently as Senior Vice President of the Servicer Division. Peterson also directed Freddie’s corporate finance division, managing Freddie’s retained portfolio of mortgage loans, and concentrated on general funding issues. In his new position, Peterson will report to President David Glenn. (*American Banker*, 8/25/99; *National Mortgage News website*, posted 8/23/99)
- Succeeding Paul Peterson, Freddie appointed Margaret Colon as Senior Vice President of its Servicer Division. Colon will now be responsible for the overall management of Freddie’s mortgage loan servicing activities and business relationships. She will report directly to President David Glenn. Colon was most recently Freddie’s President of Corporate Finance Operations, where she managed the middle and back office functions for the investment business, and was responsible for all operational risk management, information management, strategic engineering, and portfolio administration processes. (*National Mortgage News website*, posted 8/27/99; *Freddie press release*, 8/26/99)

Federal Home Loan Banks

FHLBank of New York receives approval from the Federal Housing Finance Board (FHFB) to offer a new single-family financing program for portfolio lenders called the Sequential Participation program

Sequential Participation is part of a pilot program – the Community Mortgage Asset Activities Program - that will split the credit and interest rate risk between private-sector mortgage lenders and the FHLBank of New York

The program qualifies as an acceptable investment by the FHLBanks under a July 28 proposal by the FHFB that restricts the FHLBanks' investments and purchases of mortgage-backed securities

Although the program has been approved, the FHFB requests comments on the program

- The FHLBank of New received approval from the Federal Housing Finance Board (FHFB) to offer a new single-family product called Sequential Participation that is designed to assist community banks manage interest rate risk and relieve them of “onerous capital requirements,” said Alfred DelliBovi, President of the FHLBank of New York. However, the main advantage is that it allows a member institution to originate a 30-year mortgage and retain only a seven-year participation in a mortgage pool. “It is custom-designed for people who don’t want to deal with the secondary market, but still want to hold portions of the loan,” Mr. DelliBovi said.
- The program is different from the FHLBank System’s Mortgage Partnership Finance (MPF) program, which is a competitor to Fannie and Freddie in the secondary market. The MPF program provides an alternative to selling loans to Fannie and Freddie, while the Sequential Participation mitigates risk for portfolio lenders and does not compete with Fannie and Freddie. Unlike the MPF program, Mr. DelliBovi said that the FHLBank of New York did not have to fight Fannie and Freddie for the Sequential Participation program. He did, however, note that this new way of mortgage lending will “likely outperform some of the current practices of many lenders.”
- Under the program, pools of one-to-four family conforming fixed-rate mortgage loans are divided into three tranches. The lender retains Tranche A-1, which is the first and shorter cashflow position in the mortgage pool, and Tranche B, which is the credit support representing a 3% first-loss position. Tranche 2 represents a 48.5% interest in the pool, which has a longer cashflow position. By keeping Tranche A-1 and selling Tranche A-2, the members passes on the interest rate risk inherent in the longer cashflow to the FHLBank, according to the FHLBank of New York. In this example, the lenders collect their share of interest and principal for the first seven years of the loan pool and the FHLBank collects all principal and interest (except servicing fees) during the remaining life of the 30-year mortgage. FHFB Chairman Bruce Morrison said that the program is another example “of how to use the FHLBank system cooperative structure to create risk-sharing arrangements that bring competition to mortgage finance.” (*National Mortgage News*, 8/30/99; *National Mortgage News website*, posted 8/20/99)
- The FHFB provided notice in the *Federal Register* that although the FHFB had authorized modifications to the FHLBank of New York’s Community Mortgage Assets pilot Program which would authorize the FHLBank of New York to operate its Sequential Participation program, it is

allowing individuals to submit comments on the proposal on or before October 12, 1999. The FHFB noted that it was not obligated to publish notice for these modifications of the previously approved Community Mortgage Asset pilot program, but in the spirit of full disclosure, provided notice of the modifications. The FHFB further noted that the FHLBank of New York will not implement modifications to the program until the staff of the Office of Supervision conducts a preliminary examination of the modified program policies, procedures, and controls have been established. (*Federal Register*, 9/10/99, pages 49186-49187)

FHLBank of Boston assists in developing secondary market for commercial loans

- According to a *Portland Press Herald* article, the Finance Authority of Maine has helped to create the first state-sponsored secondary market for commercial loans. The article noted that under the new program, banks may sell portions of commercial loans to institutional purchasers. The Finance Authority of Maine worked with Legacy Securities Corp, Colson Services Corp. and the FHLBank of Boston to assist four Maine banks sell 36 commercial loans, totaling \$2.8 million, through a secondary market sale. (*Portland Press Herald*, 8/27/99)

Agency dealers are complaining about the FHLBanks' Tap debt program

FHLBanks' Tap program is similar to Fannie & Freddie's Benchmark and Reference Note programs, marketed as alternatives to Treasurys

Debt analysts suggest the FHLBanks consider reducing the number of auctions during a given week and increasing the sizes of the reopenings

Way in which FHLBank Tap program issues its debt may make smaller regional dealer firms less competitive against major Wall Street firms for FHLBank dealer positions

- According to a *Dow Jones Newswire* article by Shella Calamba, dealers and traders are reportedly complaining about aspects of the FHLBanks' Tap debt program. The program, operating for two months, fosters the issuance of bullet, or single-maturity, bonds almost twice daily in the agency debt market through competitive bidding among 20 pre-selected underwriters. The complaint by traders is that they aren't making any money. Calamba explains that mainly it is because spreads on the issues often widen once they hit the market in multiple reopenings each day but also stems from the small size of the frequent openings. "What happens is if they issue too much together back to back, certain issues can get ugly," said one trader. "If they can space it out evenly, the program will be successful." Market players also blame recent volatile conditions for the uneven performance of Taps. "The program was launched in a very difficult time in the market," the trader said. "Rates were rising, and spreads were widening simultaneously."
- Calamba also notes that unlike negotiated deals offering standard fees, winning firms in competitive bids hope to make money from the difference between the price they pay and the price at which they offer securities. Fannie and Freddie's debt programs reportedly utilize negotiated sales. "We're being asked to take risk on spreads and use our capital without the chance of having any stated fee structure," said another trader on the FHLBanks' Tap program. "For no fee, I'm not going to buy something with no liquidity and just hope that spreads tighten," he added.

- The FHLBanks' Office of Finance said the agency has not received any complaints about the lack of selling commissions. "The dealers bid with that in mind, and that works well with them," said a spokesperson. "They've told us that they really like the program." Some players in the agency market, however, stressed that it may be too early to make a fair assessment of Taps. (*Dow Jones Newswire*, Shella Calamba, 9/1/99)

Regional firms face competition

- According to an article in the *Investment Dealers Digest* by Simon Boughey, the way in which the FHLBank System issues its debt has altered significantly in the last twelve months, with far reaching implications for both major Wall Street firms and regional dealers that underwrite this debt. The FHLBanks' new Tap program has stated that the "bottom five" of the 20-dealer group included in the Taps program will be dropped every quarter and replaced. The FHLBank System has not identified how the bottom five will be determined but ominously, FHLBank officials have admitted that a degree of subjectivity will enter into the process of determining which firms gets bumped. Boughey writes that the FHLBank System's plan may not sit well with the many regional dealers who have managed to carve out a niche for their company in the federal agency debt business during the past decade. Even though many of these firms place a large volume of agency paper, it is unlikely that they can match the larger Wall Street firms in terms of clout when it comes to trying to get one of the twenty Taps dealer slots. Reportedly these regional firms are already feeling some pressure from the FHLBanks' recent preference for bullet maturity structures over callable paper. For example, the small regional firms, Morgan Keegan Inc. and First Tennessee, have less experience with bullets as their franchise is based upon the need for callable paper among the local financial institutions, such as banks and thrifts. "They are definitely feeling the pinch. Their business is being ceded to the bullet market," said one dealer.
- However, the majority of dealers do not foresee a long-term danger for regional underwriters. A FHLBank spokesman, stated that there is no guarantee that the distribution will continue to be weighted in favor of bullet issuance and while the proportion of callable debt to the total has definitely declined, a great number of callable bonds are still sold. (*Investment Dealers Digest*, Simon Boughey, 8/23/99)

Status report of legislation containing FHLBank expansion provisions

Conference Committee will reconcile the House and Senate-passed versions of financial services modernization bills. Both versions contain FHLBank expansion provisions

House:

- The financial services modernization bill (H.R. 10) passed the full House on July 1 by a vote of 343-86. 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) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock.

Senate:

- The Senate passed its version of financial services modernization (S. 900) on May 6 by a mostly party-line vote of 55-44. The bill contains the following five FHLBank provisions: (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; (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. A provision was also included just minutes before the legislation passed the Senate on May 6 that would allow community development groups to tap directly into the FHLBank System, virtually free of charge.

- A Conference Committee is reconciling the House and Senate-passed versions of the financial services modernization bills. The Senate appointed all 20 Members of the Senate Banking Committee as its conferees. The House appointed 28 conferees, split evenly between the House Banking and House Commerce Committees. The reconciled bill will carry the S. 900 Senate designation.

Private Sector Items to Note

MGIC Investment Corporation, Marshall and Ilsley Corp., and a management team have agreed to become partners in an Internet mortgage services company – Customers Forever - designed to help large residential mortgage servicers retain and enhance their customer relationships

Customers Forever is described as a revolution that “uses the Internet to shift power back to the [mortgage] customers who pay all the bills.”

- MGIC Investment Corporation, Marshall and Ilsley Corp, and a management team led by long-time mortgage industry executive K. Terrence Wakefield have agreed to invest a total of \$21 million in Customers Forever, LLC, a leading-edge, Internet-focused transaction services company dedicated to helping large residential mortgage servicers retain and enhance relationships with their customers nationwide. Customers Forever will provide a private-label Internet site that a lenders’ most valued customers can access.
- The site enables lenders to provide consumers with online mortgage statements and payment capabilities, and can be accessed 24 hours a day, seven days a week. Borrowers are informed of refinancing opportunities and presented with pro-active cost-savings options. If the consumer chooses to refinance, a transaction can be approved over the Internet in a matter of seconds and fulfilled in a matter of days. Wakefield, President and CEO of the new venture, stated that the following, “We are in business to become a strategic ally of large residential mortgage servicers to help them increase their customer retention rates through a unique and powerful Internet application.”
- Wakefield also reportedly noted that in a few months, the Customers Forever site will also be able to originate second mortgages and home equity credit lines with the same ease and speed for refinancings of first mortgages. The company also plans to add a home purchase mortgage option that will available to a lender’s existing customers starting sometime next year. Because home purchases loans require more documentation, the company is building interfaces to support that type of lending.

- Customers Forever is not a lender and intends to stay in the background. Borrowers will never see its name on their own lenders' website, other than a reference to Equix, Customers Forever brand name for Internet-based loan services. The Customers Forever website hopes to do –relatively anonymously- is to lead what Wakefield describes as a revolution that “uses the Internet to shift power back to the [mortgage] customers who pay all the bills.” In an article for the *Washington Post*, Ken Harney writes the following about what Customers Forever means to borrowers, “The main change: You’re likely to be better informed about your mortgage and likely to feel at least slightly more valued as a customer. For many borrowers sick of long telephone waits to get questions answered about escrows, late charges, etc., that sort of feeling can’t come soon enough.” (*Internet Wire*, 9/2/99; *National Mortgage News website*, posted 9/2/99; *National Mortgage News*, 9/6/99; *American Banker*, 9/2/99; *Washington Post*, Kenneth Harney, 9/11/99)

Farm Credit Administration

Farm Credit Administration (FCA) delays vote on controversial plan to allow the Farm Credit System lenders to compete in the same geographic area

FCA puts proposal “on hold” after Senator Thad Cochran (R-MS) requested that the proposal be reviewed further

FCA does not plan to revisit the proposal until 2000 at the earliest

Commercial banks and even a few Farm Credit lenders themselves are opposed to the proposal

A recent American Bankers Association Task Force report criticized the proposal stating that “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions.”

- According to an *American Banker* article by Alan Kline, the Farm Credit Administration (FCA) has delayed voting on its controversial proposal to allow the Farm Credit System lenders to compete in the same geographic area. The proposal had strong opposition from its own members and did not even have unanimous support from the Farm Credit System members that are affected by the rule.
- Kline notes that the FCA decided to put the proposal “on hold” after Senator Thad Cochran (R-MS) requested that the proposal be reviewed further. According to a Farm Credit spokeswoman, the Board does not plan to revisit the issue until 2000 at the earliest.
- Opponents of the rule argue that the largest lenders will “cherry-pick” the best customers in other markets, leaving smaller, local lenders with the higher credit risks. They also argue that this would be the first step toward a mass consolidation of Farm Credit lenders. “In many ways, this would be analogous to First Union authorizing their branches and commercial loan officers to compete against one another for customers,” wrote Ronald Byrd, President and CEO with Central Maryland Farm Credit in Westminster. The most vocal opponent was reportedly the Farm Credit Bank of Texas, one of the nation’s six Farm Credit Banks that provide funds to smaller lenders. In an interview, Senior Vice President and General Counsel Bill Zimmerman stated that the FCA many

have overstepped its authority by proposing the rule. “If Congress feels the system is inappropriate, then Congress can change it,” Zimmerman stated. Zimmerman also was concerned that competition would weaken some of the smaller lenders and if any lender failed, he felt it would be up to the other Farm Credit institutions to bail them out. “It seems kind of silly to beat each other’s brains out,” he said.

- Commercial banks also reportedly oppose the rule and are concerned about the Farm Credit lenders expanding into faraway markets. Banks have accused the Farm Credit lenders of using their GSE status to undercut banks on interest rates charged to farmers. In the past, Mark Scanlan, agricultural lobbyist for the Independent Bankers Association of America, called the proposal “radical.” “There is potential for more competition from big Farm Credit System associations that want to skim off the best loans,” Mr. Scanlan said. “That brings up serious safety-and-soundness questions and may lead to interest rate wars.”
- As reported in the August 20 *GSE Report*, a recent ABA Task Force on Agricultural Banking criticized the FCA proposal. The report stated that “The Task Force believes that it is a waste of public resources and a serious safety and soundness issue for segments of a government sponsored enterprise to compete with itself and other private sector institutions.”
- The proposal was first published in the *Federal Register* last November. Currently, the FCA assigns geographic boundaries or restricts banks’ products to prevent internal competition. The proposed rule permits eligible farmers, ranchers, aquatic producers or harvesters, farm-related businesses, and rural homeowners to seek financing and related services from any association or Farm Credit Bank authorized to serve these customers. It also allows a Bank or association to extend credit, participate in loans, and provide related services to any eligible applicant. The *American Banker* article notes that there are currently 203 lenders in the current Farm Credit System. (*American Banker*, Alan Kline, 6/18/99, 8/26/99; *American Banker*, 8/11/98; *FCA News Release*, 12/10/98; *Federal Register*, 11/9/98, pages 60219-60222; *Federal Register*, 12/16/98, pages 69229-69230; “*Positioning Agriculture and Rural America for the 21st Century*,” American Bankers Association, 1999)

Ginnie Mae

- ***Fannie Mae purchased \$8.8 billion of government-insured mortgages in the first six months in 1999, and made a commitment for an additional \$6 billion in the early summer. Industry representatives surmise that Fannie Mae is increasing its government purchases in order to lay the foundation for a Ginnie Mae privatization legislative initiative next year. By buying sizable purchases of government-insured mortgages, industry representatives speculate that the GSEs will make the case that Ginnie Mae is no longer needed. Ginnie Mae privatization would strengthen significantly the GSEs monopoly grip over the housing finance system.****

Various proposals are being considered as alternatives to Ginnie Mae privatization

- According to a *National Mortgage News* column by Brian Collins, entitled “*Shake Your Money-Maker*,” the budget process is “the driver” behind proposals to expand Ginnie Mae. Last December, the Administration unsuccessfully floated a proposal to privatize Ginnie Mae – estimated to raise over \$2 billion. Collins reported that HUD is considering a proposal that would allow Ginnie Mae to purchase its own securities and build a \$60 billion investment portfolio. This

proposal would allow Ginnie Mae to support the market for its own guaranteed securities – like Fannie and Freddie. Collins writes that it could also lower interest rates for FHA and VA loans by a sliver of a percentage and allows Ginnie Mae to support innovative FHA loans programs, and generate arbitrage profits. A second proposal currently being considered would allow Ginnie Mae to securitize conventional loans, which would carry private mortgage insurance. The second proposal is reportedly being pushed by a few lenders and mortgage insurance executives who would like another secondary market outlet for conventional loans with loan-to-value ratios of 90% to 97%. Collins notes that if approved by Congress, it could create competition to Fannie and Freddie and allow FHA to enter into risk sharing agreements with large lenders. (*National Mortgage News website, Shake Your Money-Maker,*” Brian Collins, posted 9/10/99)

- According to a *National Mortgage News* article by Brian Collins, the Mortgage Bankers Association (MBA) supports the proposal that would allow Ginnie Mae to purchase its own mortgage-backed securities and build up a \$60 billion investment portfolio. According to sources, HUD Secretary Andrew Cuomo believes that Ginnie Mae already has the authority to “support the market” and purchase its own MBS. However, HUD needs Treasury Department approval and Collins notes that is a “major stumbling block.” Treasury officials could not be reached for comment. “We are supportive of the concept,” said MBA Senior Staff Vice President Robert O’Toole. “The concern is now whether the Treasury Department will (sign off on it),” he said. O’Toole explained that the proposal has lots of positives. “It lowers the cost of homeownership for FHA-VA borrowers. It enriches the value of the Ginnie Mae security in the market and it gives an outlet for special types of loan products that are difficult to place in the secondary market.” However, the MBA would like restrictions on whole loan purchases by Ginnie Mae where mortgage lenders have created an active market.
- As Collins points out, Fannie and Freddie are aggressive purchasers for their own securities and Fannie and Freddie MBS trade at higher prices than Ginnie Mae MBS. Ginnie Mae securities carry the full faith and credit of the US government, while Fannie and Freddie’s carry an implicit government guarantee.
- Collins notes that as of year-end 1998, Fannie and Freddie MBS outstanding totaled \$1.48 trillion. The GSEs currently hold roughly 25% of their own MBS as investments and their mortgage loan/MBS investment portfolios generate 75% of their profits. HUD Assistant Secretary William Apgar acknowledged that HUD is considering proposals for Ginnie Mae, but he would not comment on purchase plan. “Our main concern is that there are still persistent rumors that Ginnie Mae is on the block to be sold and we are foursquare against that,” Mr. Apgar said. “As a revenue gimmick, Ginnie Mae is too valuable.” (*National Mortgage News*, Brian Collins, 8/23/99)
- According to a *National Mortgage News* column by Terry Peters, Salomon Smith Barney analyst, Sharad Chaudhary, wrote that allowing Ginnie Mae to accumulate a mortgage investment portfolio could help fund the federal housing budget, but the proposal is likely to raise question about Ginnie Mae’s risk management capabilities. According to Chaudhary, the proposal would serve at least three purposes: supporting the price of Ginnie Mae MBS, generating net interest income for HUD and stimulating loans from lenders in those areas. The revenues that are generated by the fund he noted could also reduce political pressure to privatize Ginnie Mae. “However, concerns will likely be raising about Ginnie Mae’s ability to manage the interest-rate and credit risk on a portfolio of this size,” he concluded. “In addition, given recent trends, there may be a considerable amount of focus on defining the appropriate risk-based capital guidelines for Ginnie Mae, and determining whether it has the risk-management expertise to manage the portfolio by these guidelines.”

(*National Mortgage News website, "Ginnie Portfolio May Raise Risk Questions," Terry Peters, posted 9/7/99*)

National Mortgage News surveys its website users about proposal for Ginnie Mae to purchase its own MBS

- *National Mortgage News* included the following survey question on its website:

Should Ginnie Mae be allowed to buy its own securities to support the market for such securities and to build an investment portfolio? (*National Mortgage News website, posted 8/31/99*)

September 10, 1999

* **Item is an editorial comment.**

Canfield & Associates, Inc.
801 Pennsylvania Ave., NW, Suite 625
Washington, DC 20004
Phone: (202) 661-2100
Fax: (202) 661-2101
www.canfieldassoc.com