

The **GSE** REPORT

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ALL GSEs

- ***-- OMB Has Reportedly Dropped the Proposal to Impose User Fees on Fannie & Freddie in President Clinton’s FY 2000 Budget, But Is Still Considering Imposing an Increase in the Ginnie Mae Guaranty Fee***

-- Fannie Successfully Killed the User Fee Proposal on Fannie & Freddie by Referring to it as a “Tax on Homeownership.” Will Fannie Keep Its Promise to Work on Killing Other “Homeownership Taxes” Like the Ginnie Mae Guaranty Fee Increase?

-- OMB Has Reportedly Dropped the Proposal to Privatize Ginnie Mae in President Clinton’s FY 2000 Budget

-- Since a Privatized Ginnie Mae Would No Longer Carry the Full Faith and Credit of the US Government, Or Have the Implied Backing Provided Other GSEs, There Was a Question as to Whether a Privatized Ginnie Mae Would Actually be able to Compete with Existing GSEs

-- MBA and HUD Opposed Ginnie Mae Privatization Proposal

Background

- As we stated in the January 8th *GSE Report*, the OMB considered including the following in the President’s FY 2000 Budget to help offset the costs of new spending programs: (1) a \$250 million user fee on both Fannie and Freddie; (2) a three-point increase in the Ginnie Mae guaranty fee from 6 basis points to 9 basis points; and (3) a proposal to privatize and sell Ginnie Mae. Reportedly, the OMB has now dropped the proposal to impose user fees on Fannie and Freddie and the proposal to privatize Ginnie Mae. However, reports are that the increase in the Ginnie Mae guaranty fee is still included in the President’s budget.

Proposal to Impose User Fees on Fannie and Freddie has Reportedly Been Dropped from President’s Year 2000 Budget:

- Reports continue to circulate that the user fee proposal on Fannie and Freddie has been “killed.” The original, now “killed” proposal, reportedly included a \$250 million annual

user fee on both Fannie and Freddie - raising a total of \$500 million – that would compensate the government for Fannie and Freddie’s exemption from SEC registrations by virtue of their GSE status. Fannie and Freddie were able to elicit support from housing trade groups, consumer groups, Congressmen and big-city Mayors, in opposition to the user fee, which they referred to as a “tax on homeownership.”

- The *Washington Post* reported as early as January 6th that heavy lobbying by Fannie had resulted in Fannie successfully “killing” the fee proposal and eliminating the Fannie/Freddie fees from the President’s budget. The article cited Fannie’s tremendous political connections and the fact that Fannie’s current Chairman, Franklin Raines, was President Clinton’s past Director of the OMB as reasons why the proposal was “killed.” Recent news reports have not changed since the last *GSE Report*. The *Associated Press* reported on January 15th that Fannie’s Spokesman stated that the user fee proposal had been dropped after drawing strong opposition from those “who did not want to see a tax on homeownership.” (*Associated Press*, 1/18/99; *Washington Post*, 1/6/99)

Ginnie Mae Guaranty Fee Increase Still Being Considered as a Revenue Raiser – Will Fannie Keep Its Promise to Work on Killing Other Homeownership Taxes Like Ginnie Mae Guaranty Fee Increase?

- (Fannie’s successful lobbying to kill the user fee “tax on homeownership,” must not have worked to kill the Ginnie Mae guaranty fee increase, considered as another “tax on homeownership.”) Reports are circulating that the Ginnie Mae guaranty fee increase is still being considered as a potential revenue raiser in the President’s budget. As we noted in the last *GSE Report*, Fannie successfully requested that housing trade groups join with them in opposition to the user fee as well as the Ginnie Mae increase. A joint letter was submitted to OMB Director Jacob Lew opposing any “fee” increases, labeling them a “homeownership tax.” “We have agreed to oppose any ‘homeownership tax’ – no matter what the source – that would make housing finance more costly or establish other obstacles to expand homeownership,” the coalition said in the letter. “Hopefully, these ideas will die before the new budget is submitted,” the letter stated. The letter was co-signed by the Mortgage Bankers Association, the National Association of Home Builders, the National Association of Realtors, Fannie Mae and Freddie Mac. Fannie was also able to elicit support from two dozen congressmen and big-city mayors who complained to OMB Director Lew.
- Raines’ Promise - Fannie’s new Chairman Franklin Raines has stated his commitment to work with its partners to fight these “taxes on homeownership.” The following is a summary of Raines’ remarks at the recent Mortgage Bankers Association Executive Meeting on January 14th:

“Just recently, we saw the power of our partnership in action. Together, in the middle of the holiday week, we stopped an onerous tax on home buyers from sneaking into the federal budget... So let me take this opportunity to thank the MBA once again for stepping up and coming through for home-buying consumers. But these things are like Hydra, the beast from Greek mythology, where you cut off one head and another grows back in its place. ***Homeownership taxes and penalties certainly will come into play again this year. And I know we’ll be able to count on you, just as you can count on us.***”

- (The MBA still considers the Ginnie Mae guaranty fee increase as falling under the category of a “tax on homeownership.”) According to *National Mortgage News*, MBA Executive Vice President Paul Reid stated that “We feel strongly that any consideration of future Ginnie Mae fee increases should be abandoned because of the negative impact such a fee would have on homeownership.” According to *Real Estate Finance Today*, Christopher Sumner, President and Chief Executive Officer of CrossLand Mortgage Corp. in Salt Lake City and MBA President-Elect believed that the SEC user fee proposal on Fannie and Freddie as well as the Ginnie Mae guaranty fee increase as ways to fund additional federal spending would have severe consequences on American housing policy. “The value of homeownership and what that means far outweighs any piddling amount that might be raised by the user fee,” Sumner said.

Ginnie Mae Privatization Proposal was Dropped

- Reports are that the OMB dropped its proposal to privatize and sell Ginnie Mae. The OMB had considered selling off the exclusive right to package and guarantee timely payments on pools of mortgage loans that already carry the backing of FHA and VA. Privatizing Ginnie Mae, which finances more than 12% of all US mortgages, would have reportedly raised \$2.5 billion though it would have meant foregoing more than \$400 million a year in revenue from the agency, according to OMB estimates. If the OMB had decided to privatize Ginnie Mae, and Congress had approved, it would have been the largest sale ever of a US government agency and the fifth largest US IPO (initial public offering).

Since a Privatized Ginnie Mae Would No Longer Carry the Full Faith and Credit of the US Government, Or Have the Implied Backing Provided Other GSEs, There Was a Question as to Whether a Privatized Ginnie Mae Would Actually be able to Compete with Existing GSEs:

- It was speculated that one of the outcomes of a privatized Ginnie Mae would have been the introduction of a third big GSE that might have eventually competed with Fannie and Freddie. According to *Bloomberg*, the proposal that was being considered would have allowed Ginnie Mae’s charter to be broadened some time in the future so it could compete with Fannie and Freddie for home loans not backed by the federal government. “Initially, the government’s intent seems to be to provide competition” for Fannie and Freddie, said Raymond James & Associates Analyst Richard Bove in a research report.
- However, the likely structure for a privatized Ginnie Mae would have left the agency in a competitive disadvantage to the other GSEs. No one believes that a private entity can provide an equivalent to the full-faith-and-credit guaranty that Ginnie Mae currently enjoys. According to Wall Street sources, without the guaranty, Ginnie Mae’s MBS, instead of trading at a higher price than Fannie or Freddie, would likely trade at a worse price. “There is no way to privatize a program that carries a full-faith-and-credit guaranty,” said Laurie Goodman, Managing Director at PaineWebber. Goodman stated that when a servicer defaults, the government steps in and makes the payments. Without the guaranty, “these securities are likely to trade behind those from other securities, and hence mortgage rates may well rise for the voting borrower market,” Goodman said, adding that would be a politically unacceptable outcome.

- According to *Mortgage Marketplace*, there are other potential pitfalls in a privatized structure that would strip Ginnie Mae's full-faith-and-credit guaranty. For example, Ginnie Mae MBS currently gets a zero risk weighting for bank capital, which helps it trade favorably and provides enhanced market acceptance and liquidity. Sources agreed that the government guarantee for existing Ginnie Mae MBS would not be affected if privatization occurred, and a government-backed Ginnie Mae would still be around to take care of already existing securities programs. However, if a new and different Ginnie Mae MBS be issued as the outstanding MBS matured, the liquidity and value of old Ginnie Mae MBS could be adversely affected.

Despite Reports that the Ginnie Mae Privatization Proposal (Now Killed) Barred Fannie from Purchasing a Privatized Ginnie Mae, There Were Rumors that Fannie was Considering Buying Ginnie Mae

- Industry officials speculated that either Fannie or Freddie would be interested in buying Ginnie Mae. Despite reports that the OMB is considered banning Fannie or Freddie from purchasing Ginnie Mae, the most speculated buyer of Ginnie Mae was Fannie Mae. Raines, however, told reporters that Fannie was not interested in purchasing a privatized Ginnie Mae. "We haven't the slightest idea what's in the President's budget with regard to GNMA, and, for that reason, we have nothing to say about it," said Fannie's Senior Spokesman John Buckley. "The rumor that Fannie Mae is the likely purchaser of GNMA has no basis in fact."

MBA and HUD Opposed Ginnie Mae Privatization Proposal

- *National Mortgage News* and *Bloomberg* reported that the Administration dropped the Ginnie Mae privatization proposal in the face of concerns raised by HUD and the MBA on the details. HUD Secretary Andrew Cuomo reportedly strenuously opposed any plans to privatize Ginnie Mae and MBA's Executive Vice President Paul Reid stated that lenders were concerned that "the loss of the full faith and credit of the US government would increase the cost of homeownership." Reid reportedly stated that "The MBA is pleased to have played a role in reversing the Ginnie Mae proposal." Reid noted that the "Details of the Ginnie Mae sale were sketchy," and "Concerns existed that any change to Ginnie Mae's highly successful program of securitizing (Federal Housing Administration) and (Veterans Administration) loans would be jeopardized because the loss of the full-faith and credit of the US government would increase the cost of homeownership." (***Other rumors circulated that the Ginnie Mae proposal was dropped because the revenue that the Ginnie Mae privatization proposal was estimated to raise was no longer needed to balance the President's budget. The Administration decided to tap the tobacco industry for more money instead.***)
- Robert O'Toole, Senior Staff Vice President for Residential Finance at the MBA stated that for the MBA to support privation "it would have to be something that doesn't take anything away from the existing advantages that the homebuyer has because of the Ginnie Mae guarantee." O'Toole further stated that "We're intrigued by the concept, particularly if it can result in an entity that will securitize conventional loans." However, the strength of the current Ginnie Mae program, apart from its efficiency, is that its securities are backed by the full faith and credit of the US government. This guarantee tells investors that they "will not lose principal on this product," O'Toole said.

“Anything that looks different than that would have an impact on the future FHA and VA buyers,” O’Toole stated.

(American Banker, 1/5/99, 1/19/99, 1/21/99; Associated Press, 1/16/99; Bloomberg News, 1/5/99, 1/20/99; Capital Markets Report-Dow Jones, 1/20/99; Wall Street Journal - Dow Jones Newswire, 12/30/98, 1/5/99, 1/6/99, 1/11/99; Dow Jones Newswire, 1/20/99; Mortgage-Backed Securities Letter-American Banker, 1/18/99; Mortgage Marketplace-American Banker, 1/18/99; National Mortgage News, 1/4/99; National Mortgage News website, posted 12/30/98, 1/5/99, 1/20/99; Real Estate Finance Today – Electronic Edition, 1/15/99; Joint Trade Association Letter to OMB, 12/30/98; Regulatory Compliance Watch-American Banker, 1/18/99; Washington Post, 1/6/99; Fannie’s Chairman Franklin Raines speech before MBA Executive Comm. in New York, 1/14/99)

- ***For the First Time Ever, GSE Debt Issuance Exceeded Treasury Security Sales:***
 - According to *Barron’s*, for the first time ever, issuance of long-term debt by the GSEs exceeded Treasury security sales last year - at roughly \$440 billion of long-term debt sales in 1998, versus Treasury’s \$405 billion. One of the major factors for this increase was Fannie and Freddie’s new benchmark global note offerings, which began in the early part of 1998. The offerings by Fannie and Freddie received considerable attention and solid demand from institutional and foreign investors mostly due to the emerging scarcity of Treasuries. “People are realizing that agencies are a factor in the market and that they have to be involved,” says Andrew Brenner of FIMAT USA. “Besides, they’re cheap.”
 - There are fewer Treasuries going around right now, however, there is an increasing demand for obligations backed with the full faith and credit of the US government. The GSEs are filling this need. The government does not guarantee the GSEs, however, as *Barron’s* points out, the GSEs “are widely perceived as having an implied guarantee based on their federal connections and the widespread view that the US wouldn’t allow a GSE to fail.” The article notes that the Bond Market Association is lobbying the New York Fed to resume including agencies in its open-market operations. (As we noted in the November 20th *GSE Report*, despite pleas from the Bond Market Association, the New York Federal Reserve does not plan to purchase additional GSE debt because the action would put the Fed in the position of bailing out the GSEs and would make the Fed a major creditor of GSEs.)
 - GSE issuances now account for 7.7% of the taxable bond market, as measured by Salomon Smith Barney Broad Investment Grade Bond Index, up from 5.9% a year ago. In comparison, the Treasuries share fell 10% during the same period, while corporate securities increased by 8% and mortgage-backed debt rose 3%. Analysts expect the GSE share to be as much as 8.5% by the end of 1999. (*Barron’s Online*, 1/18/99)
- ***Fannie and Freddie’s Regulator, OFHEO, Issues a Final Rule Regarding Freedom of Information (FOIA) Disclosures – Freddie Argued that the Agencies, Not OFHEO, Should Determine FOIA Requests (OFHEO Disagreed):***

- The Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie and Freddie, issued a final rule establishing the basic policies of OFHEO regarding disclosure of information to the public. The rule implements the Freedom of Information Act (FOIA) by establishing procedures by which the public may inspect OFHEO records, request and obtain copies of materials, and appeal denial of such requests under the FOIA. Comments were received by Fannie and Freddie and were considered when OFHEO developed the final rule. According to OFHEO's final rule in the *Federal Register*, many of Fannie and Freddie's comments related to their request that the proposed rule be expanded to include provisions specifying how OFHEO will process a request for information which is not required to be disclosed under the FOIA because it is covered by a FOIA exemption. The agencies believed that OFHEO's current review of requests for nonpublic information on a case-by-case basis was burdensome on OFHEO and would lead to uncertainty and unpredictability in the disclosure policies. OFHEO disagreed and found that its current procedure for case-by-case review is appropriate and effective and does not pose an undue burden on the agency.

Freddie Believes the Agencies Should Determine FOIA Requests – OFHEO Disagreed

- Freddie Mac commented that “the 1992 Act did not specifically delegate to OFHEO the function of public release of information about the Enterprises.” Therefore, Freddie believed that “OFHEO should exercise its discretion considering the release of information about the Enterprises in a manner whereby the Enterprises, not OFHEO, decide whether to release such information.” Further, Freddie commented that “to the extent that such nonpublic information originates with the Enterprises, it is the Enterprise's property, not OFHEO's. Therefore, Freddie Mac believes that OFHEO's determination to release information should only be made after the Enterprises have had the opportunity to comment on the effect of any disclosure of such information to the public.” OFHEO disagreed with Freddie's arguments and noted that there are certain circumstances when OFHEO must notify and consider input from submitters prior to releasing records, however, the OFHEO is subject to the legal requirements of the FOIA which requires OFHEO to make the final decision as to whether any information may be released. The effective date for the rule is January 22, 1999. (*Federal Register*, pages 70998-71014, 12/23/98)
- ***Senate Banking Committee Chairman Announces the Senate Banking Subcommittees with Jurisdiction Over GSEs:***
 - Senate Banking Committee Chairman Phil Gramm (R-TX) announced on January 12th the Subcommittee on Financial Institutions would have jurisdiction over the FHLBank System, while the Subcommittee on Economic Policy will have jurisdiction over Fannie and Freddie. (*Senate Banking Committee press release*, 1/12/99)

Fannie Mae and Freddie Mac

- -- ***Coalition of Trade Associations Petition Federal Banking Regulators for Risk-Based Capital Rule, Covering Commercial Mortgage Backed Securities (CMBS) that are More Reflective of Risk***

-- Groups Would like AAA-Rated Tranches of CMBS to Receive Same Capital Treatment as Fannie & Freddie Mortgage-Backed Securities (MBS)

-- Fannie Opposes the Change

- A coalition of trade associations, called the Capital Consortium, urged the federal banking regulators to finalize proposed revisions to their risk-based capital rules that would make it easier for banks and thrifts to engage in a wider range of commercial real estate origination and asset securitization activities. The Capital Consortium, formed in 1992, consists of the Mortgage Bankers Association, the National Realty Committee, the National Association of Realtors, the Bond Market Association, and the Commercial Real Estate Secondary Market and Securitization Association. The Consortium sent a joint letter to the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision on January 12th.
- The Capital Consortium proposal, if adopted, would lower the amount of capital institutions would be required to hold against top-rated commercial mortgage-backed securities. Among other things, the proposal would lower from 100% to 20%, the risk-weight for AAA-rated CMBS. Such risk weighting would give AAA-rated CMBS the same favorable treatment as Fannie and Freddie MBS. Right now, only Fannie and Freddie MBS receive a 20% risk-weighting, while Ginnie Mae MBS receives a zero risk-weighting. "Because AAA-rated CMBS have demonstrated a long and successful performance record, they should be given similar capital treatment as securities issued by federal government-sponsored enterprises," the Consortium stated in a separate Jan. 12 release. According to *National Mortgage News*, a source noted that "We are only asking what the regulators proposed," further stating that "It is considered non-controversial." The Capital Consortium would like regulators to separate the 20% risk-weighting for CMBS and finalize it.

Fannie Opposes Capital Consortium's Proposal

- Fannie Mae, however, objects to the proposal in a letter objecting to giving AAA-rated ABS the same risk weighting as Fannie MBS. "We recommend that the agencies revise the proposal to place AAA-rated private securities...between the 20% risk weight now assigned to GSEs and the 50% risk class," Fannie said. Reportedly, Fannie and Freddie have opposed lowering the risk weighting to 20% for triple-A rated ABS tranches, arguing that a triple-A rating is not equal to the GSEs' low levels of risk.
- Reportedly, according to *National Mortgage News*, all the regulators agreed to a 20% risk-weighting for AAA-rating asset-backed securities when they issued the proposed rule on recourse and direct credit substitutes in November 1997 for public comment. However, the regulators have not been able to agree on the appropriate risk-based capital

treatment for lower-rated tranches. (*BNA Daily Report for Executives*, 1/13/99; *Mortgage-Backed Securities Letter-American Banker*, 12/7/98; *National Mortgage News website*, posted 1/11/99)

- ***Fannie & Freddie's Stock Drops – Political (OFHEO Risk-Based Capital Rule and Ginnie Mae Privatization) and Interest Rate Risk Cited for Stock Decline:***
 - Analysts in an *American Banker* article by Joshua Brockman noted that Fannie and Freddie's stock had plunged in a two-day period as a result of fears of growing political and interest rate risk for the GSEs. Salomon Smith Barney analyst Thomas O'Donnell believes that Fannie and Freddie "are getting a hit that's not commensurate with the rest of the sector," and believes that interest rate risk rather than political uncertainty is mostly the cause of the stock decline. Sources in Washington, however, noted that political uncertainties surrounding the GSEs recently contributed to the stock decline. Political uncertainties include the privatization of Ginnie Mae being considered as a potential revenue raiser in the President's FY 2000 budget with the potential for Ginnie Mae to compete with Fannie and Freddie, and the upcoming release of OFHEO risk-based capital proposal on Fannie and Freddie (which according to some reports, could reveal a capital shortfall at Fannie Mae).
 - Jonathan Gray, a Principal at Sanford C. Bernstein & Co. noted that there is "a higher level of political risk than we've seen in a couple of years." Gray added the political risk is coming from "deterioration in the relationship between Fannie and Freddie and mortgage insurers." Gray called the situation "potentially dangerous" and stated that even if Fannie and Freddie succeed in deflecting the challenge, the company's valuation could be hurt. Shareholder relations staff at Fannie and Freddie do not believe the political risk to the GSEs is greater than previous years. When questioned about the recent investor uneasiness over political issues surrounding the GSEs, Cindy Gertz, Vice President of Shareholder Relations at Freddie stated that "Political risk will always introduce some level of volatility into our stock price performance." Jayne Shontell, Senior Vice President for Investor Relations at Fannie, dismissed political risk noting that every year the budget process introduces issues involving Fannie. "There's nothing fundamental that has changed about the Fannie Mae story." (*American Banker*, 1/13/99)
- ***Fannie & Freddie to Oversee a New CRA Program for Insurance Companies?:***
 - According to an article in *The Insurance Accountant*, Massachusetts-based insurers have found a way to satisfy their obligations under Massachusetts's new "pay or play" (CRA-like) investment law, packaging low cost mortgages and selling them as mortgage backed securities to investors. According to life insurance sources, the plan was developed by the large mutual and stock domestic insurers domiciled in Massachusetts, including John Hancock, Massachusetts Mutual and Liberty Life Insurance Co. prior to the Massachusetts's laws enactment last August. Other companies expected to participate include All America Financial, Savings Bank Life Insurance, Berkshire Life, Paul Revere Life Insurance Co., Boston Mutual Insurance Co. and New England Financial. Under the new plan, companies would provide low-cost mortgages to low-income families and then package them for sale to investors as mortgage-backed securities. The program, referred to as a "soft second program," will help finance up to 97% of the

purchase price of the dwelling. Reportedly, *life insurers will set up their own board to administer the loans while Fannie and Freddie will supervise the actual deals.*

- Reportedly, the plan is similar to that used by large banks to satisfy CRA requirements, however, insurers can take advantage of certain tax breaks offered under the new Massachusetts law. The tax breaks under the new law are expected to save Massachusetts domestic life insurers as much as \$25 million a year, according to the Massachusetts Department of Revenue. Property/Casualty insurers are expected to save approximately \$20 million a year after the phase out of the taxes. (*Insurance Accountant-American Banker*, 1/4/99)
- ***Fannie and Freddie Report Record Profits - Fannie Has 12th Straight Year of Record Profits – Freddie’s Income up 22%:***

Fannie Mae

- On January 14th, Fannie reported higher earnings per share for the 1998 fourth quarter and full year – its 12th straight year of record profits. Fannie posted net income for the 1998 fourth quarter of \$888.5 million, or 84 cents per diluted share, up from \$794 million, or 74 cents, in the 1997 fourth quarter. Fourth quarter net interest income was \$976.5 million, against 1.03 billion in 1997. For the full year, Fannie reported earnings of \$3.418 billion, or \$3.23 per share, up 14.1% from 1997. Fannie also announced a 31% growth in the company’s mortgage portfolio between December 31, 1997 and December 31, 1998, a \$161.1 million increase in fee and other income, and a \$90.0 million decline in credit-related losses. According to Lawrence Small, Fannie’s President and Chief Operating Officer, “The growth in Fannie Mae’s mortgage portfolio in 1998 was simply phenomenal. During the year, the portfolio grew by nearly \$100 billion. That is more portfolio growth, in dollar terms, than the company achieved in the first fifty years of its existence.” Small also said that commitments to purchase mortgages totaled \$191.9 billion in 1998 compared with \$68.7 billion in 1997. At December 31, 1998, Fannie’s mortgage portfolio was \$415 billion, compared with \$316 billion at December 31, 1997. Small said that fee and other income rose to \$274.6 million in 1998 from \$124.6 million in 1997. Small noted that this increase resulted primarily from significant increases in fee income related to technology products and from fees on multifamily activities. Technology fees were driven by usage of Fannie’s automated underwriting system, Desktop Underwriter and Desktop Originator systems and rose to \$57.6 million in 1998, over five times the amount recorded in 1997. The company paid \$1.19 billion in federal income taxes in 1998, down from \$1.63 billion in 1997. Fannie said its use of low-income housing credits was a factor in the decline. Fannie does not pay state and local income taxes. (*Business Wire*, 1/14/99; *Fannie press release*, 1/14/99; *Reuters*, 1/18/99; *Wall Street Journal*, 1/15/99; *Washington Post*, 1/15/99)

Freddie Mac

- Freddie announced record diluted earnings per common share of \$2.31 for 1998, a 23% increase over 1997 diluted earnings per share of \$1.88. Freddie announced record net income/earnings of \$1.7 billion or \$2.31 a diluted share, up 22% from \$1.395 billion or \$1.88 a diluted share for 1997. Fourth-quarter net income totaled \$468 million or 62 cents a diluted share, versus \$372 million or 51 cents a year earlier and \$425 million in the third quarter. Total revenues rose from \$3.029 billion in 1997 to \$3.337 billion in

1998. Net interest income on earning assets totaled \$1.927 billion in 1998, up 18% from \$1.631 billion in 1997. The growth was spurred by a \$52 billion increase in the average retained portfolio balance. The actual balance was \$255 billion at the end of the year, up a record \$91 billion. (*Freddie press release, 1/15/99; National Mortgage News website, posted 1/20/99; Reuters, 1/19/99*)

- ***Analyst Recommends Fannie and Freddie Stock as a “Buy” Based on its “Duopoly” Status in the Secondary Market that Allows the Companies to Dominate an Industry that is Growing 6% to 8% a Year:***

- Sean Aurigemma, an analyst with BT Alex. Brown has recommended Fannie and Freddie’s stock as a “buy.” One of the reasons for his recommendation was that in his opinion, the secondary marketing “duopoly” of Fannie and Freddie allows the agencies to dominate an industry that is growing 6% to 8% each year. (*American Banker, 1/20/99*)

- ***-- Fannie and Freddie Form Partnerships with NAACP***

-- Freddie Will Use NAACP Community Offices to Encourage the Use of Freddie Mac Programs and Freddie Mac Technology onto Consumers

-- Freddie is Providing Grants to NAACP Community Offices for Outreach Efforts and Helping Borrowers Qualify for their Loans to be Sold to Freddie Mac

-- Freddie Will Also Increase Its Automated Underwriting Market Share By Placing Its Automated Underwriting Systems in NAACP Community Offices:

Fannie Hosts Press Conference with Cong. James Clyburn (D-SC), Chairman of the Congressional Black Caucus to Announce Five-Year Partnership

- Fannie held a press conference at the National Press Club on January 21st to announce a multi-million dollar, five-year partnership with NAACP to put more African-Americans on the path to homeownership. Under the partnership, Fannie pledged to purchase an unlimited number of NAACP-referred mortgages, including the “Fannie 97” mortgage, which only requires a 3% downpayment. Fannie is also offering \$100 million in special financings for mortgages requiring as little as 1% to 3% down. Fifty of the \$100 million will be earmarked to help families whose credit histories have been marred by emergency medical bills. Congressman James Clyburn, Chairman of the Congressional Black Caucus, participated in the press conference. Former Congressman Kweisi Mfume, President and CEO of the NAACP, Fannie Chairman Franklin Raines, and Joel Smith, President of NationsBank’s East Region also participated. Fannie expects to launch the program in the next 60 to 90 days. The principal lender in the program is NationsBank Corp. that also has a partnership with the NAACP. (*Associated Press, 1/21/99; Business Wire, 1/13/99, 1/20/99; Fannie press release, 1/21/99; National Mortgage News website, posted 1/21/99; Reuters, 1/21/99*)

Freddie Will Use NAACP Community Offices to Encourage Freddie Mac Programs and Technology onto Consumers - Freddie is Providing Grants to NAACP Community Offices for Outreach Efforts and Helping Borrowers Qualify for their Loans to be Sold to Freddie Mac – Freddie Will Also Increase Its Automated Underwriting Market Share By Placing Its Automated Underwriting Systems in NAACP Community Offices

- Freddie announced an alliance with the NAACP to increase minority homeownership by expanding credit counseling, outreach and marketing efforts, and the availability of low downpayment mortgage products with flexible underwriting guidelines. Under the initiative, Freddie has agreed to purchase up to \$500 million in mortgage loans. The alliance will be managed through local NAACP Community Development Resource Centers. The alliance will be launched in the seven states where NAACP Community Resource Centers are located: Florida, Georgia, Maryland, North Carolina, South Carolina, Texas, and Virginia. The NAACP Community Offices will work with lenders to qualify borrowers for loans, originate mortgages, and sell qualifying loans to Freddie. According to Craig Nickerson, Vice President for Community Development Lending at Freddie, the agency plans to increase the capacity of the NAACP Community offices through grants from Freddie Mac; enhance the office's ability to reach out to potential homebuyers through marketing and advertising support; provide the latest in automated technology (Freddie Mac) to each office; and work cooperatively on new affordable housing mortgage products. (*Freddie press release, 1/15/99; National Mortgage News website, posted 1/20/99*)
- ***Fannie & Freddie Believe that the Introduction of the Euro Will Increase the Popularity of Fannie & Freddie Mortgage-Backed Securities (MBS) and Agency Debt:***
 - According to *Mortgage Marketplace*, Fannie and Freddie believe that the European monetary union will increase the investor interest in Fannie and Freddie MBS and agency debt by removing the possibility of an arbitrage between different currencies. The introduction of Euro gives Fannie and Freddie an opportunity to fill an investment vacuum left by the switch to a single currency. With the introduction of the Euro, Robert Burns, Director of Securities Marketing at Freddie, believes that European fixed-income investors lost a valuable yield-curve arbitrage because fixed-income investors on the Continent typically arbitrated among the interest rates of different countries and their respective currencies. Burns gave the following example of an arbitrage (pre-Euro): France had an interest rate of 4% and Germany a 5% rate; then the fixed income investor would buy in the French currency and sell in the German, betting that the yield spreads, or the difference in interest rates would converge. Now, with the introduction of the Euro, the arbitrage has been eliminated and investors will be looking outside the Continent for other spread products. Burns believes that Freddie can fill this need since Freddie Mac Gold pass-throughs and agency debt yields more than Treasuries with comparable maturities and both offer virtually no credit risk and high liquidity. Burns is noticing more interest from European investors in Freddie's products in the last year. (*Mortgage Marketplace-American Banker, 1/11/99*)

Fannie Mae

- -- ***Fannie Encroaches into Mortgage Insurance Business by Announcing that it is Cutting the Cost of Mortgage Insurance for its New Low Down Payment Program***
- ***Fannie States that this is “Just the Beginning” of the Mortgage Insurance Options Fannie Plans to Provide***
- ***Fannie Further Increases Automated Underwriting Market Share – Only High LTV Loans that are Run Through Fannie’s Automated Underwriting System (Not Competing Underwriting Systems) Will Receive Lower Mortgage Insurance Benefits***
- ***Fannie’s Initiative Causes Mortgage Insurers’ Shares to Drop - S&P Announced that Fannie’s Initiative Could Mean Lower Premiums and Lower Earnings for Mortgage Insurance Industry***
- ***Merrill Lynch Analyst Reports that the “Likely Winners” from Fannie’s New Program are Borrowers and Fannie. The Report Expects Fannie to Pocket an Arbitrage Profit. The “Likely Losers” are Mortgage Lenders***

- Fannie announced that they are cutting the cost of mortgage insurance with a new program beginning in March of this year. The program will enable high LTV loans (those with low down payments) ***underwritten through Fannie’s automated underwriting system***, Desktop Underwriter, to have lower mortgage insurance costs. The new Chairman and CEO of Fannie Franklin Raines made the announcement during the National Association of Home Builders convention in Dallas. Raines claimed that approximately 150,000 Fannie borrowers would benefit from the change in the first year it takes effect and estimated that the total savings to borrowers would be \$16.5 million. Raines announced that this initiative was “just the beginning” of the mortgage insurance options Fannie plans to provide.

Details of the MI Program

- Under one option of the new program, Fannie said it would reduce the percent of loan amounts that have to be backed by insurance, back to levels in place in 1994. Currently, Fannie requires that loans with only a 5% down payment (95% LTV) have 30% of the mortgage loan covered by insurance. This will be reduced to 25% under the new initiative. Required coverage for a loan with a 10% down payment (90% LTV) will be reduced from 25% to 17%. Fannie claims that a homebuyer selecting this reduced mortgage insurance coverage would save at least \$110 per year or \$1,100 over the first 10 years of the mortgage. With a 90% LTV on a \$100,000 mortgage, Fannie claims the borrower will save at least \$130 a year or \$1,200 over the duration of the mortgage insurance coverage (which in this case would be approximately 9.5 years).
- Another option allows borrowers to further reduce the amount of the mortgage that must be insured by paying up-front fees or higher interest rates ***and Fannie would purchase additional insurance coverage on loans using this option***. Under this option, for a loan with a 5% down payment (95% LTV), the minimum mortgage insurance coverage would be 18% of the mortgage loan; for a loan with 10% down (90% LTV), the minimum coverage would be 12% of the loan. To obtain mortgage insurance coverage at these

levels, the homebuyer would be required to make a payment at closing or pay a higher note rate.

- Both programs are for purchases and refinancings of owner-occupied properties. In addition, Fannie is expanding its Flexible 97 low down-payment program by buying additional coverage for these loans from Commonwealth Mortgage Assurance Corp. (CMAC) and Mortgage Guaranty Insurance Corp (MGIC). Fannie claims that this risk-sharing arrangement with the mortgage insurers will allow Fannie to originate Flexible 97 loans through its automated underwriting system, Desktop Underwriter, to more homebuyers with weaker credit histories.
- Fannie will also purchase mortgage insurance for 90% LTV loans that are on investor-owned properties when combined with higher note rates – normally the buyer purchases mortgage insurance. Fannie has a commitment from CMAC to provide coverage at the time of purchase by Fannie.

Must Use Fannie's Automated Underwriting System to Receive Lower Mortgage Insurance Benefits

- Fannie claims that it can offer this mortgage insurance reduction program because Fannie's automated underwriting system does a better job measuring a borrower's credit risk. Starting in March, ***only loans approved by Fannie Mae's automated underwriting system***, including refinancings, ***will qualify for lower mortgage insurance in its new low down payment program.***

Fannie's Initiative Causes Mortgage Insurers' Shares to Drop – S&P Announced that Fannie's Initiative Could Mean Lower Premiums and Lower Earnings for Mortgage Insurance Industry

- As further evidence that Fannie's new programs are encroaching into the mortgage insurance business, reports of Fannie's new program caused mortgage insurance companies' stock to decline – including those mortgage insurance companies participating in Fannie's new program. MGIC Investment Corp. and CMAC Investment Corp. (both companies are participating in the new Fannie program) and other mortgage insurers stock fell as much as 16% in the past few days. According to *Bloomberg*, on January 15th, MGIC's stock dropped to 36 ½ representing a 5 13/16 decline from just two days earlier (Wednesday, January 13th). CMAC Investment Corp. and PMI Group Inc. fell by 16% and 12% respectively in the two-day period. CMAC fell 3 ½ to 42 7/16 on January 15th and PMI fell 2 7/16. "This is all in response to a new uncertainty that exists because of Fannie Mae's mortgage insurance initiatives," said Steven Schwartz, an analyst at ABN Amro Inc. in Chicago. Even so, he added: "It's very, very unclear what kind of dent this makes in the industry."
- S&P Rating Agency announced that Fannie's new initiative reduces its coverage requirements for mortgage insurance could mean lower premiums and lower earnings for the mortgage insurance industry. S&P stated that the short-term effect of the reductions would be modest, however there will be "growing long-term effect on the mortgage insurance industry." S&P noted, however, that if credit conditions deteriorate significantly, the reductions would mitigate losses. In S&P's opinion, Fannie's initiative could force Freddie to follow Fannie's lead, offering similar reductions for loans

processed through Freddie's automated underwriting system, Loan Prospector. Fannie's initiative could also result in the elimination of GSE pool insurance – a layer of insurance which a mortgage insurer puts on a block of business of business produced by one lender and sold to a GSE or investors with a GSE guarantee. The new requirements cause a narrowing of the range of possible earnings outcome for the industry," said S&P, "resulting in lower potential earnings on the high end and lower potential operating losses on the low end." (*American Banker*, 1/15/99; *Associated Press*, 1/15/99; *Bloomberg*, 1/15/99; *Capital Markets Report – Dow Jones Newswire*, 1/15/99; *Fannie press release*, 1/15/99; *National Mortgage News website*, posted 1/18/99; *Reuters*, 1/21/99; *USA Today*, 1/15/99; *Washington Post*, 1/16/99)

Merrill Lynch Analyst Reports that the "Likely Winners" from Fannie's New Program are Borrowers and Fannie. The Report Expects Fannie to Pocket an Arbitrage Profit. The "Likely Losers" are Mortgage Lenders

- According to a Merrill Lynch Industry Report, the "potential winners," under Fannie's new initiative will be "borrowers who will enjoy lower MI premiums (if they can find a lender who will give them one of these loans at a comparable rate), and the Agencies who will undoubtedly pocket an arbitrage profit when all is said and done." The "likely losers" were identified as mortgage lenders. The Report states that "Assuming the enhanced borrower education programs and market competition eventually force lenders to offer these 'shallow coverage' insured loans, we anticipate that the biggest losers in Fannie Mae's new world will ultimately be mortgage lenders...Although this change is unlikely to materially impact the profitability of major lenders (at least not for the foreseeable future), we do not expect mortgage industry trade groups to take this initiative lightly." In addition, the Report notes that this program will negatively affect pool insurance, captive insurance arrangements, and lenders' bargaining power with the mortgage insurers, and will not allow lenders to use their own underwriting systems to participate in the program. (*Merrill Lynch Industry Report on Mortgage Insurance*, Mark Constant, Vice President and Michael Hughes, CFA, First Vice President, 1/15/99)

ACB Applauds Fannie's Efforts to Lower Mortgage Insurance

- The America's Community Bankers, a trade group representing the thrift industry, stated that it welcomed Fannie's move to reduce mortgage insurance costs for borrowers. In a statement on January 19th, the ACB stated, "Though the changes are currently limited to loans sold to Fannie Mae using its Desktop Underwriter software, the changes indicate that Fannie Mae, together with both portfolio lenders and lenders originating loans for sale to investors, never have any interest in requiring more mortgage insurance than necessary to protect the lender or investor." ACB said it hopes a similar spirit of cooperation can be achieved in implementing legislation enacted last year that requires private mortgage insurance to be eliminated automatically when the home owner's equity reaches 22%. (Note: There is some question as to whether Fannie's new program will allow borrowers to cancel at 22%.) (*America's Community Bankers Statement*, 1/19/99)

- ***Fannie Pledges Partnership with Lenders and Vows that Fannie Never Intends to Originate Mortgages:***

- During a recent speech before the Mortgage Bankers Association, Fannie’s new Chairman and CEO Franklin Raines pledged that Fannie would always be a partner with mortgage lenders and never a competitor, stating that “Let me say in plain words, as the new Chairman of Fannie Mae, we will never originate mortgages. I would tattoo this statement on my forehead if it would help drive the point home.” Raines pledged that Fannie would work with lenders to reach out to consumers “at the margins” of homeownership. Further, Raines vowed to work in partnership with the MBA on political issues such as fighting budgetary proposals that would add any tax or undue expenses to homeowners. Fannie vowed that the Mortgage Bankers Association could count on Fannie for support and vice versa to tackle homeownership taxes and penalties. (*Reuters*, 1/14/99; *Franklin Raines speech to the MBA in New York*, 1/14/99)
- (Industry analysts, however, suggested that Raines’ statement should not provide any comfort to lenders or other real estate settlement service providers, such as title insurers, and appraisers. Raines didn’t say that Fannie Mae wouldn’t fund loans or monopolize services provided by other real estate settlement service providers, such as title insurers and appraisers. Raines only stated that Fannie would not originate loans. “In the short run, that’s probably good news for mortgage brokers, but over time, their compensation will be squeezed by the duopsony power of the GSEs.”)
- -- ***Fannie Mae CEO Raines Believes that Using Fannie’s Technology to “Custom Tailor” Loans is the Future for Fannie – New Details from Raines on How Such a Program Would Work***
- -- ***(Does Fannie Envision that its “Black Box” Technology Will Provide Personal Financial/Investment Advice to Consumers?):***
- Fannie’s new CEO Franklin Raines has made numerous statements in recent speeches about the direction he would like to steer Fannie. Raines envisions that the future for mortgage finance and Fannie is providing “mass customization” of mortgages to consumers. Raines has stated that Fannie and its seller/servicers, must be in a position to “custom tailor” and price a mortgage to meet the consumer’s desire for changing liquidity needs, risk and term by using technology, specifically Fannie’s technology. At a recent speech at the MBA in New York, Raines gave further details on how such a program would work. “Finally, the day is coming when consumers will be able to custom-tailor their mortgage payments to suit their individual lives and needs. Do they want to time their mortgage payments to the year they retire? No problem. Do they want to take a few months off to cover other costs, or not have to pay in the months when college tuition is due? No problem. Do they want to change courses in mid-stream, say, switch, from fixed-rate to ARM? Again, no problem. Fannie Mae’s products –from Desktop Underwriter and Desktop Originator, to Flexible 97 – are just the beginning. With new technology and techniques, from advanced software to risk management strategies, we can help lenders offer consumers the best product at the best price. In all of this, the day is coming when the credit market will bend to suit consumer’s needs, rather than vice versa. The question is how we get there in a smooth, orderly manner. The answer goes to the heart of Fannie Mae’s orientation toward customer service. And as the new initiatives come along, we’ll pursue them in partnership with you [MBA].” (*Raines Speech to the MBA in New York*, 1/14/99)

- ***GSEs Expanding into Personal Finance? - M&T Bank Launches “Personal Banking Advocates” to First-Time Home Buyers Through Fannie’s Buffalo Partnership Program:***
 - M&T Bank in Buffalo, NY launched a program to reach low and moderate-income customers by offering “personal banking advocates” to first-time homebuyers. The banking advocate is for customers of the bank’s new “Get Started” mortgage. According to an article in the *Buffalo News*, the adviser will help customers keep good credit status by making prompt mortgage payments, counsel new homeowners on maintenance expenses and other financial responsibilities, and encourage savings growth. According to the article, ***M&T launched the personal banking advocate program through Buffalo’s new Fannie Mae partnership office.*** (*Buffalo News*, 1/2/99)

- ***-- Fannie Claims that It Saved the Housing Market During a “Credit Crunch” Last Year By Tapping World Markets***

-- Fannie Claims it Can Keep World Market Upheavals from Affecting Homebuyers and Homebuilders:

 - Fannie’s new Chairman Franklin Raines stated during a Mortgage Bankers Association Senior Executives Meeting that mortgage borrowers were not affected by last year’s “credit crunch” because Fannie had tapped world markets. Raines stated that Fannie managed to immunize the home mortgage market from global credit turmoil by raising \$40 billion in overseas investment capital and injecting some \$400 billion of liquidity into the market. Raines stated that “Fannie can help keep upheaval in London or Tokyo from hurting home buyers and home builders from Dallas to Dubuque. When it comes to mortgage financing in America, we’re a force for stability in an unstable world. That means home buyers and lenders don’t have to worry about every spasm in the global economy.” (*Franklin Raines Speech Before the MBA in New York*, 1/14/99)

- ***Leading Candidate for CBO Director Job Has Lobbied for Fannie Mae:***
 - Dan Crippen is considered the leading candidate for the next director of the Congressional Budget Office. According to the *BNA Daily Report for Executives*, Crippen served as President Reagan’s Domestic Policy Adviser and also served as Chief Counsel and Economic Policy Adviser to former Senate Majority Leader Howard Baker (R-TN). More recently, in the private sector, Crippen had been Executive Director of the Merrill Lynch International Council and a Senior Vice President of the Duberstein Group, a consulting firm. Crippen currently works for the law firm of Washington Counsel, P.C., which represents clients on a variety of federal issues. (According to the Center for Responsive Politics lobbyist database, in (late) 1997, Crippen was listed as a lobbyist for Fannie Mae, while at Washington Counsel, on the issues of taxation/internal revenue code/budget/appropriations/and housing. According to the database, Crippen was not listed as a lobbyist for Fannie Mae in (early) 1997 while he was employed at the Duberstein Group; however, Fannie has the Duberstein Group on retainer for lobbying services. Kenneth Duberstein, Chairman and CEO of the Duberstein Group, also serves on Fannie’s Board of Directors (nominated in 1998.)) (*BNA Daily Report for Executives*,

1/13/99,1/14/99;*Center for Responsive Politics Lobbyist Database-CRP Website*; *Dow Jones Newswire*, 4/16/98;*PR Newswire*, 4/16/98;*White House press release*, 12/16/98)

- ***Fannie Plans to Expand its All-in-One Construction Pilot to More Lenders:***
 - Fannie announced at a recent National Association of Home Builders convention, that Fannie was promoting its all-in-one construction loan pilot program again. The program is designed for homeowners building their own homes. The loan rolls the construction costs into the mortgage, allowing homebuyers to operate under one loan. Under a pilot announced late last year with five lenders, including Continental Savings Bank, a borrower could lock-in the interest rate prior to the construction phase on loan amounts of up to \$227,150 and 90% of the finished value. Under the earlier pilot, the program allowed up to 11 months to complete the construction. According to *National Mortgage News*, only about \$5 million worth of the experimental loans under the first pilot have been written and Fannie now wants to open the pilot beyond the original five lender participants and two lenders which participated in an earlier but failed construction-to-term experiment. Fannie plans to expand the pilot to a half-dozen or more lenders within the next 45 days. (*National Mortgage News website*, posted 1/18/99)

- ***Washington Post Financial Reporter Names Fannie One of His Top 10 Stock Picks for 1999:***
 - James Glassman with the *Washington Post* named Fannie one of his top 10 stock picks for 1999. Glassman wrote “Fannie remains a phenomenon, increasing its earnings and dividend by 15 percent nearly every year. The price still hasn't caught up to the performance.” (*Washington Post*, 1/17/99)

- ***Former Freddie Official Appointed to CFO at Finet, the Holding Company for Fannie's iQualify Internet Mortgage Origination Site:***
 - Finet Holdings Corp. appointed Gary Palmer as acting chief finance officer. Palmer expects Finet's Board to make his status permanent in February. Palmer held financial posts at Freddie Mac, Imperial Savings and Southern Pacific Funding. (*American Banker*, 1/14/99)

- ***Fannie, Merrill Lynch, and The Enterprise Foundation Offer Free Affordable Housing Resource Guide for Orange County Residents:***
 - Fannie, Merrill Lynch, and The Enterprise Foundation announced that the groups had created a new free publication called the “Affordable Housing Options: An Orange County Resource Guide.” The publication is a collection of affordable housing programs and initiatives offered to residents throughout Orange County. (*Fannie press release*, 1/19/99)

- ***Fannie and FHLBank of Pittsburgh Hold Press Conference with Cong. William Coyne (D-PA) To Announce Partnership for Low- to Moderate-Income First Time Homebuyers in Southwestern Pennsylvania:***

- Fannie and the FHLBank of Pittsburgh joined Cong. William Coyne (D-PA) to describe how Fannie's low down payment program, Flex 97, and the FHLBank of Pittsburgh's Home Buyer Equity Fund could be used together to help more people buy homes. The press conference was held with a family who benefited from the new program. The program will provide up to \$5,000 in down payment and/or closing cost assistance and flexible mortgage terms for low and moderate-income families in Southwestern Pennsylvania who complete pre-home ownership counseling. (*Fannie press release, 1/15/99*)
- ***Fannie Holds Press Conference with Cong. Leonard Boswell (D-IA) to Announce Housing Assistance Plan for Papetti's Employees:***
 - Fannie held a press conference with Cong. Leonard Boswell (D-IA) to announce a program to help Papetti's of Iowa – an egg production company and the subsidiary of M.G. Waldbaum Company – to assist Papetti's employees to purchase homes in Lenox, IA. The "Papetti's of Iowa Home Purchase Assistance Program" allows an employee to receive a five-year forgivable loan from Papetti's for a portion of the closing costs or the down payment needed to purchase a home. Cong. Boswell stated that "Fannie Mae and Papetti's of Iowa are working together to make a long-term commitment to Lenox while helping their employees realize their dreams." He further stated that he commends "the efforts of these private partners, working together to make a difference in rural Iowa." (*Fannie press release, 1/12/99*)
- ***REIT Closes \$268.5 Million in Debt Financing with Fannie Mae:***
 - Archstone Communities Trust SBI (ASN), a real estate investment trust (REIT), completed \$268.5 million in debt financing with Fannie, backed by a pool of 16 assets. Archstone said the financing has a maturity of seven years. About \$150 million of the \$268.5 million in Fannie debt is fixed at an all-in interest rate of 6.3% until maturity. The remaining \$188.5 million is floating at a current all-in interest rate of 5.9%, which is capped at 6.9% for four years. The REIT says it intends to use the proceeds to pay down its existing line of credit. (*Dow Jones Newswire, 1/15/99; Wall Street Journal, 1/18/99*)
- ***Fannie Provides REITs with Credit Facilities:***
 - Fannie announced that a subsidiary of Walden Residential Properties, Inc., an equity real estate investment trust (REIT), arranged a \$250 million credit facility through WMF Washington Mortgage Corp. and Fannie. Fannie issued a multifamily mortgage-backed security on January 1, 1999 to fund the credit facility for the Walden/Drever Operating Partnership. The multifamily MBS is collateralized by more than 30 multifamily mortgages secured by properties in Texas, Arizona, and Florida which contain 10,287 units. (*Fannie press release, 1/5/99*)
 - Fannie also announced that Equity Residential Properties Trust recently arranged a \$226 million credit facility through Washington Capital Corporation and Fannie Mae for its REIT subsidiary, EQR Connor, LLC. The transaction consists of 15 properties located in eight states, with most of the units located in California, Colorado, and Kansas. More

than 95% of the 5,358 apartment units in this transaction are affordable to median income families. (*Fannie press release, 1/8/99*)

Freddie Mac

- -- (*Would You Like to Finance Some Building Materials with Your Mortgage Loan?*)

-- *Freddie Expands Its Reach into Consumer Retailers' Domain by Opening Interactive Mortgage Kiosks in a Regional Mall and a Unit of the Country's Largest Retailer – Wal-Mart*

-- *The New Kiosks Will Also Stress Home Maintenance and Improvement*

--*Congresswoman Cynthia McKinney (D-GA) Issues Statement of Support:*

- Freddie, a group of mortgage lenders, community organizations and retailers in DeKalb County, GA, launched a \$15 million minority partnership initiative. The initiative, “Expanding the Dream® DeKalb,” is the first of its kind in the nation to bring together the consumer marketing capabilities of a regional mall – South DeKalb Mall – and a unit of the country’s largest retailer – Wal-Mart --- with lenders, community organizations and Freddie. An important component of the initiative is the launching of the interactive mortgage kiosks – now available in the DeKalb regional mall and at a local Wal-Mart. Liane Levetan, DeKalb County’s Chief Executive Officer stated that, “One of the most exciting aspects of this program is its education component. ***It is going to provide first-time buyers with critical information about the loan application process and also stress home maintenance and improvement.*** We are happy to see these issues addressed in a lending program for new homeowners, similar to the current model that our community development department uses.” Congresswoman Cynthia McKinney (D-GA) stated that “Freddie Mac and their collaborative partners are to be commended for bringing education and information directly to the people through Expanding the Dream DeKalb.”
- The lenders involved in the program include Citizens Trust Bank Mortgage Services, Commonwealth United/National City Mortgage and Infinity Mortgage Corp. The lenders will be able to take applications at the South DeKalb mall kiosk locations on weekends and shoppers may register for homebuyer education classes at the Wal-Mart stand any day of the week. Eligible mortgage loans originated will be sold to Freddie Mac. (*Freddie press release, 12/16/98; National Mortgage News website, posted 1/17/99*)
- ***Freddie Priced a \$3 Billion Reference Note - Freddie anticipates issuing \$40 billion of Reference Notes in 1999:***
 - Freddie announced that it priced a \$3 billion, 5-year maturity Reference Note (marketed as alternatives to Treasuries) with a coupon of 5%. Coupon payments will be made semi-annually with the first payment due July 15, 1999. The sale increases the total outstanding balance of Reference Notes to \$23 billion. To date, Freddie has issued Reference Notes with maturities of three-, five- and ten-years and anticipates issuing bonds with maturities between two- and ten-years. Freddie anticipates issuing \$40 billion

of Reference Notes in 1999, depending on market conditions. (*Freddie press release, 1/13/99*)

- ***Freddie Makes Staffing Additions/Changes***

New Multifamily Finance Manager to Focus on Credit Enhancements of Public Finance/Tax-Exempt Bonds:

- Freddie recently hired Douglas Westfall to be the newly created position of director of multifamily public finance. Westfall will oversee development, marketing and operation of credit enhancements for public finance/tax-exempt bond activities of Freddie's multifamily division. Westfall was previously director for multifamily affordable housing products in Fannie's southeastern office. (*American Banker, 1/14/99; Freddie press release, 1/6/99*)

Freddie Hires Credit Risk Monitor for Hedging Portfolio:

- Freddie hired Steven Abrahams as Director of Portfolio Management and Credit Risk in its Single-Family Securitization Group. Abrahams, formerly a principal at Morgan Stanley Dean Witter & Co., will be responsible for monitoring credit risk and hedging opportunities within the portfolio management. (*American Banker, 1/14/99*)

Freddie Announces New Vice President of Shared Services:

- Freddie announced that it promoted Louise Capanale to the newly created position of Vice President of Shared Services in Human Resources. Prior to her promotion, Campanale had been an Internal Audit Director and before coming to Freddie Mac last June, she was a special assistant to the secretary of the US Senate. (*Freddie press release, 1/6/99*)

Freddie Appoints New Senior Vice President for Investor & Dealer Services:

- Freddie announced the appointment of Kevin Finnerty to the position of Senior Vice President, Investor and Dealer Services. Finnerty will be responsible for managing Freddie's mortgage securities marketing function, the REMIC process, the cash window process, and the sales and trading activity of Freddie's Securities Sales and Trading Group. (*Freddie press release, 1/19/99*)

- ***Freddie Mac Foundation Grants \$400,000 to Two Chicago Organizations to Serve At-Risk Children:***

- The Freddie Mac Foundation announced grants totaling \$400,000 to two Chicago-area organizations – I. A.M. A.B.L.E. Family Development Corporation (ABLE) and Lawndale Christian Development Corporation – both serving at-risk children in North Lawndale, Chicago. (*Freddie Mac Foundation press release, 1/6/99*)

Federal Home Loan Banks

- ***Financial Services Modernization Bill Containing FHLBank Expansion Provisions is Set to Move Quickly in the House and Senate:***
 - As we noted in the January 8th *GSE Report*, on the first day Congress was in session, House Banking Committee Chairman Jim Leach (R-IA) introduced a financial services modernization bill that would be his committee's "top priority." According to Chairman Leach, the bill, H.R. 10, is similar to a bill (H.R. 4870) that was introduced at the end of the last Congressional session and includes a provision that reforms the FHLBank System by changing membership rules and corporate governance of the FHLBanks and by increasing small bank access to funds for making agricultural and community development loans. According to *National Mortgage News*, the FHLBank provisions provide for voluntary membership for all thrifts, converts the annual \$300 million REFCorp. obligation to a percentage of FHLBank earnings, and makes access to FHLBank advances easier for small banks with less than \$500 million in assets. Chairman Leach stated that he hopes to move the bill of the House Banking Committee by the end of March. He hopes to have three hearings in the House Banking Committee on the bill (Feb. 10 and 11th and a date yet to be set). The bill then would likely have to go through the House Commerce Committee, which has jurisdiction over securities and insurance matters, on its way to the House floor. Senate Banking Committee Chairman Phil Gramm (R-TX) said he has scheduled a markup of a Senate financial services modernization bill even earlier than Chairman Leach's projected deadline – February 25th. (*American Banker*, 1/21/99; *BNA Daily Report for Executives*, 1/21/99; *House Banking Committee press release*, 1/6/99; *National Mortgage News website*, posted 1/6/99)
- ***FHLBank of Chicago's MPF Program Funds More than \$1 Billion of Residential Mortgages – MPF Program is Becoming a Real Competitor to Fannie and Freddie:***
 - The FHLBank of Chicago's Mortgage Partnership Finance (MPF) program, a competitor to Fannie and Freddie, passed a landmark by funding more than \$1 billion of residential mortgages – and \$800 million more is in the pipeline. (The FHLBank of Chicago was the first FHLBank to offer the mortgage purchase program and currently is the only FHLBank to offer member banks the opportunity to unload their loans. Under the Chicago plan, the FHLBank buys the loan outright, but the member bank is paid extra for providing a credit enhancement. The banks and thrifts that create and service the loan handle all aspects of the customer relationship. The risk is carved out in layers so that the FHLBank takes the first level of loss, the member bank takes the second level of loss up to the level of credit it has agreed to, and then the remaining loss is assumed by the FHLBank – leaving the member banks holding the credit risk and the FHLBank holding the funding, interest rate, liquidity and prepayment risks.) Alex Pollock, President and Chief Executive Officer of the FHLBank of Chicago, stated the MPF program is expected to grow and compete in the secondary market. Pollock stated that "We are delighted that MPF has grown so quickly. It is obviously popular among mortgage lenders." ***Pollock further noted that "MPF is already adding real competition in the secondary mortgage market and we expect it to grow much bigger." Pollock believes the MPF program is successful because "it gives mortgage lenders and their customers a better deal" (than***

Fannie and Freddie). According to Pollock, “Real competition in the secondary mortgage market is better for the mortgage finance system and American homebuyers. Everyone benefits from increased competition.”

- According to the FHLBank of Chicago, approximately 53% of the MPF loans have been made to low and moderate-income borrowers and the median loan is \$94,400. Fixed-rate, single-family residential mortgage loans are eligible for the program. According to a FHLBank of Chicago press release, under the MPF program, the banks and thrifts that create and service the loan handle all aspects of the customer relationship. According to the press release, the **MPF “structure allows lenders to fully retain their customer relationships without taking the interest rate risk of the loans or paying costly guarantee fees to a secondary mortgage agency.”**
- The MPF program is currently available to members in the FHLBanks of Chicago and Dallas. There are currently 44 thrifts and banks in the Chicago district of Illinois and Wisconsin participating, and more than 100 institutions are joining. The Dallas FHLBank has facilitated the funding of more than \$340 million of loans since joining the program in October 1998. In addition, three other FHLBanks are seeking to offer the MPF program to their members. (*FHLBank of Chicago press release, 1/12/99*)
- ***FHLBank of New York President Highlights the Benefits of FHLBank MPF Program Over Fannie and Freddie:***
 - According to *Real Estate Finance Today*, FHLBank of New York President Alfred DelliBovi recently touted the MPF program. Speaking at the 1999 Senior Executives Conference hosted by the Mortgage Bankers Association, DelliBovi noted that over the past two decades, the FHLBanks and their portfolio lending members have increasingly had difficulty competing with their private mortgage banking brethren who enjoy the efficiencies of Fannie and Freddie. DelliBovi believes that another handicap experienced by FHLBank members is the need to retain regulatory capital for mortgage loans held in portfolio. “Regulatory capital requirements discourage portfolio lending because lenders must hold twice as much capital for portfolio loans as they do against mortgage-backed securities,” he said. So FHLBank members have increasingly turned to selling fixed-rate loans into the secondary market, but at a cost. According to DelliBovi, when loans are sold into the secondary market (Fannie and Freddie), lenders pay a substantial credit enhancement fee and eliminate receiving profit from managing credit risk. The FHLBank of Chicago piloted the MPF program in an effort to capture some of the MBS guarantee fee income and lower the cost of extending mortgage credit through the FHLBank System. The MPF Program allows members to take on the marketing, credit and servicing risks while the FHLBanks take on the liquidity, duration and option risks. “We believe that this is the optimal sharing of the individual mortgage component risks and the maximum use of the home loan bank’s unique cooperative structure for the benefit of our members,” DelliBovi stated.
 - DelliBovi gave the following as benefits to using the MPF program:
 - (1) more competitive products in the mortgage market;
 - (2) members incurring only credit costs that are commensurate with actual credit management;

- (3) no material changes to current lending origination procedures;
- (4) participating members get to keep most of the fees involved in loan origination, such as origination fees and recurring fee income from servicing;
- (5) “And, in addition, members will receive a credit enhancement fee from a home loan bank. Instead of paying a fee to the GSE, the GSE pays a fee [to the lender],” DelliBovi said. (*Real Estate Finance Today, Electronic Edition*, 1/15/99)

- ***Small Banks Are Claiming the FHLBank’s MPF Program Helps Them Lower Loan Prices and Compete with Large Lenders – Small Banks Are Finding the Program Less Expensive than Selling to Fannie & Freddie – Community Bankers are Hoping the Competition will Drive Fannie & Freddie’s Pricing Down:***

- According to an article in the *American Banker*, community bankers are claiming that the FHLBank’s MPF program is helping them lower their loan prices and compete with large lenders. The MPF program provides community banks with another option for mortgages besides keeping the loans in their own portfolios or selling them to Fannie or Freddie. “This has given us a very competitive place in the market,” stated Lee Swanson, President and Chief Executive Officer of State Bank of Cross Plains, WI. “If there’s salvation for community banks down the road, this is the kind of program we need.” Banks claim that the MPF program allows them to match rates offered by their larger competitors, many of which can negotiate volume discounts with Fannie and Freddie. The *American Banker* reported that State Bank has financed \$74 million in mortgages through the FHLBank of Chicago since joining the program in an early state in the fall of 1997.
- Under the MPF program, banks pay a fee to the FHLBank, which funds the loans, and the community bank reportedly receives fee income from the customer for servicing the loan. Reportedly, community banks gain 80 to 100 basis points in servicing fees over the life of the loan – income it would forfeit if it sold the loans on the secondary market (Fannie and Freddie). “On a macro level, we’re changing the structure of the mortgage market,” said Alex Pollock, President and Chief Executive Officer of the FHLBank of Chicago.
- The FHLBank of Chicago may soon expand its program to members of the Pittsburgh and New York FHLBanks. In response, Pollock stated that he expected Fannie and Freddie to reduce their prices for community banks. A spokeswoman for Fannie said there were no plans to reduce their pricing structure.
- Community banks involved in the FHLBank of Chicago program, however, are still using Fannie and Freddie. Reportedly, Fox Valley Savings and Loan Association in Fond du Lac, Wisconsin plans to keep selling some loans even though more than half of their single-family mortgages has been funded through the MPF program since mid-1998. “Maybe Freddie will offer something more attractive some day,” said Richard Casper, a Vice President of Fox Valley Savings and Loan. (*American Banker*, 1/12/99)

- ***Regulators are Considering the Issue of Capital Under the MPF Program:***
 - According to *National Mortgage News*, federal banking regulators are trying to decide how much capital a lender originating loans through the FHLBank's Mortgage Partnership Program (MPF) must hold against the "credit enhancement piece" that remains with the member institution (which places the FHLBank in a second-dollar position). According to a spokesman for the OTS, a determination could be made in a few weeks.
 - *National Mortgage News* reports that MPF loans receive favorable capital treatment – meaning that the FHLBank of Chicago must hold a 4% capital reserve against the entire mortgage amount in case of default. However, there is a debate right now over how the credit enhancement piece should be treated. Reportedly, three of the four federal banking regulators (including the OTS) give favorable capital treatment to the credit enhancement held by FHLBank system members. However, a source familiar with the MPF program notes that there is apparently one regulator who does not agree with this treatment and discussions are being held to create a uniform standard. (*National Mortgage News website*, posted 1/18/99)
- ***FHLBank System Does Not Believe It Has Sufficient Information to Determine its Vulnerability to the Year 2000 Problems from "Third Parties":***
 - According to the *Dow Jones Newswire* and the *Wall Street Journal*, the FHLBanks and the FHLBank System's Office of Finance is unsure of the extent to which they may be vulnerable to the Year 2000 problems of "third parties" (customers, vendors, and financial servicers). "Despite ongoing monitoring and communications with third parties, the FHLBanks and the Office of Finance [which borrows from the System] do not have sufficient information to estimate the likelihood of significant disruptions due to such parties," a new report on the System's finances said. Should a third party fail to address its Year 2000 problems, the business operations and financial conditions of the FHLBanks could be hurt.
 - The report noted that the FHLBank System has taken steps to identify and fix its own internal computer systems and their initial assessments, though incomplete, did not uncover any failures that would result in material loss of revenue. "However, significant disruption of business operations could occur if efforts by the FHLBanks and the Office of Finance to address Year 2000 issues prove inadequate," the report cautioned. (*Dow Jones Newswire*, 12/23/98; *Wall Street Journal*, 12/24/98)
- ***FHFB Selects FHLBank Members for Community Support Review:***
 - The Federal Housing Finance Board (FHFB) announced in the *Federal Register* the FHLBank members it has selected for the 1998-99 fourth quarter review cycle under the FHFB's community support requirement regulation. (*Federal Register*, 1/15/99, pages 2647-2652)

- ***FHFB Makes Technical Revisions to Affordable Housing Program Regulation:***
 - The FHFB published a correction to its interim final rule published in the *Federal Register* on May 20, 1998 that made technical revisions to the Affordable Housing Program regulation clarifying AHP requirements. The correction corrects amendatory instruction number 6 of the interim final rule. (*Federal Register*, 1/15/99, page 2550-2551)

Farm Credit System

- ***US Court of Appeals Rules that Two Farm Credit Administration Regulations Were Beyond Its Scope – Partial Victory for Banking Groups :***
 - The American Bankers Association (ABA) and Independent Bankers Association of America (IBAA) claimed a partial victory in their court case against the Farm Credit Administration. On January 19th, The US Court of Appeals for the District of Columbia ruled against two parts of regulations issued by the Farm Credit Administration (FCA) that the banking groups claimed let the farm credit system compete unfairly. The Court ruled that the provisions that loosened restrictions on which farm-related services could be financed through the System were not in keeping with what Congress had intended. According to a press release by the IBAA, the Court stated that “if Congress had wanted businesses providing farm-related services to receive loans from farm credit banks on the same basis as farmers,” it could have said so. The Court also struck down a provision that allowed financing of rural housing that was not owner-occupied. Under a rule issued two years ago, the FCA did not have a residency requirement. The banking groups argued the non-residency requirement would allow farm credit financing to “wealthy, big-city dwelling passive investors who wish to build or acquire rural housing for lease to residents.” According to the IBAA’s press release, the Court found that Congress clearly contemplated that eligible individuals must actually reside in the financed housing as a principal residence.

Background

- The Farm Credit Administration oversees the Farm Credit System, including the Federal Agricultural Mortgage Corp. or Farmer Mac. FCA issued regulations in 1997 (effective March 11, 1997) that expanded the scope of who could borrow from the System and for what purposes. The American Bankers Association (ABA) and the Independent Bankers Association (IBAA) filed a lawsuit on April 9, 1997 charging that some of the changes made by the FCA were beyond Congress’ intent for the FCA and would allow and put the FCA in direct competition with banks in rural areas. On November 24, 1997, the United States District Court for the District of Columbia issued a decision finding that the FCA “had acted well within its regulatory authority in each of the five sections in question.” The bankers filed an appeal on January 20, 1998. The January 19, 1999 US Court of Appeals ruling upheld two of the banking group’s objections

Parties Respond to the Ruling

- The IBAA hailed the decision but was “disappointed” that only two of the provisions were struck down. “Although it is always difficult to win against a federal agency, this shows that the FCA clearly went too far, despite its confident claims that it would win all counts of the lawsuit,” said IBAA President Bill McQuillan. He further stated that ***“Its interpretation of the law was clearly intended to give the Farm Credit System unfair advantages that Congress never intended to give a privileged tax-exempt government sponsored enterprise.”***
- The FCA, however, believe that the impact of the ruling would be minimal. “We’re very pleased with the ruling. They substantially upheld our regulations,” said Mark McBeth, Public Affairs Specialist with the FCA. “We don’t believe that the two exceptions are a great hindrance to the system going forward,” he said. (*American Banker*, 1/21/99; *Dow Jones Newswire*, 1/20/99; *FCA Press Release*, 1/20/99; *IBAA Press Release*, 1/19/99)
- ***Farmer Mac Earnings Rise – Farmer Mac Believes Its Reserves will Cover Economists’ Predictions of Increased Delinquencies:***
 - Farmer Mac announced net income of \$1.1 million for the fourth quarter of 1998 and \$5.7 million for the full year. Farmer Mac’s earnings per share for 1998 were 52 cents for Classes A and B common stock, and \$1.55 for Class C common stock. Farmer Mac President and CEO Henry Edelman stated that “Although continued low agricultural commodity prices during 1999 may, as some economists predict, result in increased delinquencies on agricultural mortgages, we believe Farmer Mac’s reserves are adequate to cover fully any losses that may arise from those increased delinquencies.” (*Farmer Mac press release*, 1/20/99; *National Mortgage News website*, posted 1/21/99)
- ***Farm Credit Administration Adopts Policy Statement on Providing Relief to Pork Producers as Pork Prices are Falling to Lowest Levels in 50 Years, and Approves Rule on Farm Credit Bank Assistance to Associations:***
 - The Farm Credit Administration adopted a policy statement that urges Farm Credit System institutions to work with pork producers affected by pork prices falling to their lowest level in nearly 50 years. “While the health of the Farm Credit System remains strong, the current situation may adversely impact the repayment capacity for some System borrowers. Providing borrowers the opportunity to restructure loans as soon as difficulties become apparent makes good business sense,” said FCA Board Chairman Marsha Pyle Martin, “and it benefits the borrower, too.” The FCA said that is it also encouraging System institutions to increase flexibility in certain situations by: (1) extending the terms of loan repayment; (2) reorganizing a borrowers’ debt obligations; (3) easing certain loan documentation or credit extension terms for new loans to borrowers; or (4) requesting the agency to grant relief from certain regulatory requirements.
 - The FCA also agreed to issue a proposed rule for comment that would repeal a requirement that a Farm Credit Bank or Agricultural Credit Bank have FCA prior approval before giving certain types of assistance to an affiliated association. Under the proposed rule, the institution must notify FCA, as well as the bank shareholders.

According to the FCA, by requiring that shareholders be notified of any financial assistance, the bank ensures that shareholders will be informed of the bank's actions. According to FCA, Congress will have a 30-day period to review the proposed rule, after which the proposed rule will be published in the *Federal Register* with a 30-day comment period. (*BNA Daily Report for Executives*, 1/22/99; *FCA press release*, 1/14/99)

- ***Farm Credit Administration Issues Policy Statement Encouraging More Credit Services to Young, Beginning, and Small Farmers and Ranchers:***
 - The Farm Credit Administration issued a policy statement in the *Federal Register* encouraging the Board of Directors of each Farm Credit System Institution to renew its commitment to providing credit and related services to young, beginning, and small farmers, ranchers, and producers or harvesters of aquatic borrowers (YBS borrowers). The policy statement encourages the System to examine existing statutory and regulatory authorities and develop innovative new programs to better serve YBS borrowers. The Farm Credit Administration defines a young farmer as 35 years or younger, a beginning farmer as having 10 years or fewer farming, ranching, or aquatic experience, and a small farmer as generating less than \$250,000 in annual gross agricultural or aquatic sales. (*Federal Register*, pages 70406-70407, 1/21/99)

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