

The **GSE** REPORT TM

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 - Support market competition that results in affordable housing for consumers;
 - Promote Federal policies that do not allow the GSEs to move beyond their unique charters into markets and services already provided by the private sector, and;
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- *Wall Street Journal* article notes that behind the exclusive lender deals with the GSEs – is technology (p. 17)
 - Lenders are increasingly concerned with pressure to use Fannie & Freddie's automated underwriting technology rather than their own systems
- Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors, and consumers (p. 18)
 - Despite Fannie's repeated pronouncements that lenders are their "only customers," Fannie & Freddie continue to market and build their technology brand name directly to brokers, realtors and consumers
 - (Announcements illustrate further that these two GSEs are using their duopoly status with technology as their tool to vertically integrate the mortgage industry and horizontally expand into new lines of business. The combination of their taxpayer subsidized status as a duopoly with technology will allow them to eliminate entire industries.)

• Fannie's recent developments

- (1) Fannie plays a major role (4% equity interest) in HomeStore.com – Since HomeStore.com's IPO, the website has changed its focus from a business focus to a consumer focus

HomeStore.com owns Realtor.com (the largest home-listing site on the Internet and official site of the National Association of Realtors), HomeBuilder.com, SpringStreet.com (rental properties) and CommericalSource.com (commercial real estate)

Article questions whether HomeStore.com will be the leading real estate portal for all types of property?
[Fannie will then own 4% interest in major real estate portal]

- (2) Finet – Fannie’s private sector technology partner – raises an additional \$13 million of equity capital for technology improvements

[Could Fannie have purchased shares in the company to help raise capital for the company’s technology improvements?]

• Freddie’s Recent Developments

- (1) Cybertek Corp. will add Freddie’s automated underwriting system through its website
- (2) REO Manager and Workout Prospector II – Freddie makes enhancements to its Internet-based real-estate owned properties’ database – Freddie allows lenders to access non-Freddie loans online

Fannie Mae

- Fannie criticizes HUD for doing its job (p. 20)
 - HUD steps up its enforcement of Fannie & Freddie
 - Fannie complains about being regulated
- Fannie Hires Veteran Capitol Hill House Banking Committee Senior Staff Member (p. 20)
- Fannie begins “Working Mortgage” pilot – a pilot that provides borrowers with direct deposit of their paychecks timed to the borrower’s pay schedule (p. 21)
 - Financial services companies have been marketing this program for over 10 years
- Fannie partners with a CRA mutual fund (p. 21)
- 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 38 offices are officially opened and three more are in the process of being formed) (p. 21)

Freddie Mac

- Freddie purchases over half of a 125% loan-to-value securitization for its portfolio (p. 22)
- United Guaranty introduces a product for lenders who are unsure whether they are selling the loan to Freddie or holding it in portfolio (p. 22)
- Freddie hires former counsel to Senate Republic Conference as a lobbyist (p. 23)
- Freddie hires House Democratic Housing Subcommittee counsel (p. 23)

Federal Home Loan Banks

- FHLBank of Seattle is considering offering the FHLBank System’s Mortgage Partnership Finance (MPF) program to its members – a program that is competing with Fannie & Freddie in the secondary mortgage market (p. 23)
 - The MPF program is becoming a real competitor to Fannie & Freddie – half of the FHLBanks are now offering or planning to offer the program
- Status Report of Legislation Containing FHLBank Expansion Provisions (p. 24)
 - House bills containing FHLBank expansion provisions advance to Rules Committee

Private Sector Items to Note

- Private sector starts an investment fund to provide a secondary market for low-income mortgages (p. 24)
- Private sector issues first securitization of reverse mortgages in the United States (p. 25)

Farmer Mac

- Farmer Mac common stock begins trading on the New York Stock Exchange (p. 25)
- Farmer Mac releases a letter from Senator Richard Lugar (R-IN) praising Farmer Mac and urging Congress to continue its support (p. 25)
 - Letter released days after the GAO released a study indicating that Farmer Mac is largely ineffective and the Chairman of the House Banking Committee Jim Leach (R-IA) and Chairman of the House Banking Subcommittee on Capital Markets and GSEs, Richard Baker (R-LA) Criticized Farmer Mac

Farm Credit Administration/Farm Credit Banks

- Commercial banks and even a few Farm Credit System lenders oppose a controversial Farm Credit Administration proposal that would let Farm Credit System lenders compete in the same geographic area (*p. 26*)
 - Proposed rule increases the worries of commercial banks about unfair competition from the Farm Credit banks due to their GSE status

Major Events

“FM WATCH” - The Flashlight is on...

FM WATCH is a coalition of financial services trade groups formed to monitor the activities of Fannie & Freddie, working in conjunction with consumer advocates and taxpayer groups

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FM WATCH also supports the National Taxpayers Union request for proposed risk-based capital standards for Fannie & Freddie

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FM WATCH Executive Director Michael House told reporters that Fannie has an army of 82 lobbyists and “If they got rid of some of their lobbyists, they could probably lower interest rates.”

FM WATCH’s mission statement:

“Recognizing the critical importance of Fannie Mae and Freddie Mac’s unique charters, FM Watch will monitor the activities of these government-subsidized enterprises and:

- Alert the public to Fannie Mae and Freddie Mac actions which benefit the interests of investors at the expense of homebuyers and taxpayers;**
- Support market competition that results in affordable housing for consumers;**
- Promote Federal policies that do not allow the GSEs to move beyond their unique charters into markets and services already provided by the private sector, and;**
- Support Federal policies that prevent exposure to unnecessary risks that could require a massive bailout by the American taxpayer.”**

- A coalition of financial services trade associations officially announced the debut of a newly formed coalition – FM WATCH - to monitor the activities of Fannie and Freddie. Working with consumer advocates and taxpayer groups, FM WATCH, held a press conference on June 17, releasing its mission statement, goals and membership. *Passing out flashlights, FM WATCH said it would put a spotlight on Fannie Mae and Freddie Mac and “alert the public to...[Fannie & Freddie] actions that benefit the interests of their investors at the expense of home buyers and taxpayers.”* Michael William House, Executive Director of FM WATCH, stated that “No group has ever come together to shine a light on Fannie Mae and Freddie Mac that cuts through their**

rhetoric and clever commercials. We're not bomb throwers," House added. "We're in it for the long haul." (*Wall Street Journal*, Michael Schroeder, 6/17/99)

- FM WATCH argues that consumers will receive the most benefits from a truly competitive market. "They [Fannie and Freddie] can underprice any financial good and service," stated Gerald L. Friedman, Chairman of FM WATCH. "That's in the short-term interest of the consumer, but in the very short term. Initially prices go down, but once competition is reduced, as in any monopoly or duopoly, prices go up, shareholder profits prevail, and the consumer loses." Friedman stated that "Banks have realized they [Fannie and Freddie] may try to become giant financial services companies and with their tremendous leverage are capable of putting people out of business." (*American Banker*, Marc Hochstein, 6/21/99; *Real Estate Finance Today*, 6/18/99)
- FM WATCH's membership includes:
 - Appraisal Institute
 - Association of Financial Guaranty Insurers (AFGI)
 - Consumer Bankers Association (CBA)
 - Consumer Mortgage Coalition (CMC)
 - Financial Services Roundtable
 - Home Equity Lender Leadership Organization (HELLO)
 - Mortgage Insurance Companies of America (MICA)
 - National Home Equity Mortgage Association (NHEMA)
- Ralph Nader, the most prominent consumer advocate, earlier expressed support for a coalition to address concerns about Fannie and Freddie. (*American Banker*, Marc Hochstein, 6/21/99)
- Reportedly, Bruce Marks, Executive Director of the Neighborhood Assistance Corporation of America, said his housing advocacy group hopes to join FM WATCH. (*American Banker*, Marc Hochstein, 6/21/99)

First Official Action of FM WATCH – Strengthen the Affordable Housing Requirements for Fannie & Freddie

- In the interest of providing more homeownership to the low- and moderate-income community, FM WATCH's first official action was the release of a letter to HUD Secretary Andrew Cuomo, supporting HUD's efforts to strengthen the affordable housing goals for Fannie and Freddie. "Only by setting meaningful housing goals and establishing strict definitions for delivering affordable housing to underserved communities will Fannie Mae and Freddie Mac have the appropriate incentive to use their substantial resources, financial know how, creativity and skill in developing programs and tools to get the job done."
- ***"It is our understanding that Fannie Mae and Freddie Mac have been talking to administration officials, to Congress, and to private entities, saying they did not want to change any affordable housing goals," stated FM WATCH Executive Director House. "We believe that because Fannie Mae and Freddie Mac get substantial government subsidy, they should be leading the fight to raise affordable housing goals," not railing against them.*** (*American Banker*, Marc Hochstein, 6/21/99; *National Mortgage News*, Lew Sichelman, 6/21/99))

FM WATCH Also Supports the National Taxpayers Union Request for Proposed Risk-Based Capital Standards for Fannie & Freddie

- In the interest of taxpayers, FM WATCH also endorsed an open letter by the National Taxpayers Union to House Banking Committee Chairman Jim Leach (R-IA) expressing support for proposed risk-based capital standards for Fannie and Freddie. (*American Banker*, Marc Hochstein, 6/21/99)
- FM WATCH Chairman Friedman noted that FM WATCH is about “containment.” “And by containment, I mean staying out of the primary mortgage market and staying out of financial products and services in which the consumer is being served by private enterprise.” (*Inman News Feature*, 6/18/99) Friedman pointed out that Congress could contain the GSEs by reexamining their charters. “They could be limited by charter to providing liquidity to the secondary market,” he stated. (*Real Estate Finance Today*, 6/18/99) *The Wall Street Journal* noted that critics of Fannie and Freddie are concerned that the GSEs, in their search for new sources of revenue, as more families have come to own homes, will enter markets currently served by the private sector. Executives say this would be an unfair fight because government backing gives Fannie and Freddie an unfair competitive advantage by allowing Fannie and Freddie to borrow more cheaply than competitors and giving them a pass on some taxes. (*Wall Street Journal*, Michael Schroeder, 6/17/99)
- Friedman also noted that the GSEs are trying to require lenders to use their automated underwriting systems, to make those systems “the dominant gateways to the consumer” (*American Banker*, Marc Hochstein, 6/21/99)

Fannie & Freddie Waste Money on Advertising and Hiring Lobbyists Away from FM WATCH

- According to *National Mortgage News*, FM WATCH Executive Director House accused Fannie and Freddie of doing “everything in the world to stop” the coalition. (*National Mortgage News*, 6/21/99)
- According to an article in the *Real Estate Finance Today*, “Fannie Mae and Freddie Mac spinmeisters lurked in the lobby of the Washington Press Club outside the news conference announcing the formation of *FM WATCH*, ready with press packets in hand.” (*Real Estate Finance Today*, 6/18/99) Fannie also ran full page ads in *Roll Call* (a Capitol Hill newspaper) and a very expensive 2/3 page ad in the *Washington Post*. [The ads were obviously written prior to Fannie even knowing the mission and goals of FM WATCH since the ads could not even identify the name of the group.]
- According to a *Wall Street Journal* article by Michael Schroeder, Fannie was pressuring lobbying firms and trade groups not to join FM WATCH. “We’re not causal about managing our political risk,” said Fannie Spokesman John Buckley. “We said to a number of our friends, ‘You don’t want to be on the side of the bad guys.’”
- Schroeder also noted that within a day after being approached by FM WATCH organizers, two-well known Washington lobbying firms – Williams & Jensen and Griffin, Johnson, Dover & Stewart –were hired by Fannie. In an oddly candid disclosure, Williams & Jensen said in a recent lobbying report that it was hired to provide “opposition to efforts of a coalition formed to pursue unspecified legislative or regulatory issues that may be opposed by Fannie Mae.”

- However, as Schroeder noted some high-profile consultants decided to stay on despite being approached by Fannie such as Former Republican National Committee Chairman Haley Barbour. *“After we were approached by the coalition, Fannie Mae then tried to hire us. They offered us more money and said they’d pay us even more, if that’s what it took,” Mr. Barbour said.* Ed Gillespie, head of Policy Impact Communications, said he was called three times by Fannie Mae allies, but refused to give in. (*Wall Street Journal*, Michael Schroeder, 6/17/99)
- According to a *National Mortgage News* and *Real Estate Finance Today* article, ***FM WATCH Chairman Friedman confirmed that that every time he spoke to a lobbying firm, Fannie officials would hire the company at a much higher price than the Coalition could afford. “Firms were recruited right out from underneath me. I got to be known as the \$200,000 a year man” because whenever I walked into the office they recruited him out from under me with the promise of a \$200,000 salary” Friedman stated. There’s been a lot of intimidation going on. People—lawyers, consultants—are advised that they better not participate with us. It isn’t paranoia, we know what we’re in for.*” (*National Mortgage News*, 6/21/99; *Real Estate Finance Today*, 6/18/99)**
- ***FM WATCH Executive Director House told reporters that Fannie had an army of 82 lobbyists and “If they got rid of some of their lobbyists, they could probably lower interest rates.”*** (*Real Estate Finance Today*, 6/18/99)
- FM WATCH also announced the creation of its own website at www.fmwatch.org. (FM WATCH press releases, 6/17/99)

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| <p>Mortgage Bankers Association (MBA) considers a strong policy statement against charter expansion activities of Fannie & Freddie</p> |
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- According to the *American Banker* and *National Mortgage News*, the Mortgage Bankers Association (MBA) is considering a new policy statement against the charter expansion activities of Fannie and Freddie. Still in draft form, the policy statement reportedly advocates curtailment of Fannie and Freddie’s activities outside of purchasing loans. The draft has been approved by the MBA’s Board of Governors for Residential Lending and would become official if it is endorsed by the its Board of Directors. Paul Reid, Executive Vice President of the MBA said the draft is “a work in progress” and subject to amendment.
- The articles noted that the draft policy statement also raises concerns about Fannie and Freddie’s technology developments. Reportedly the draft says these systems were “developed in a subsidized environment, yet have served to discourage development of competing systems from the private sector, thereby limiting competition and innovation.” The draft calls for Fannie and Freddie to “refrain” from further development or sale of technology other than for their own internal uses and not for outside users. The draft further states that Fannie and Freddie “should be encouraged to approve automated underwriting systems developed by the private sector.” Fannie and Freddie should also publicly release data they collect on loans “to enable primary market participants to improve the efficiency of the mortgage market,” it says.
- The draft also states that “Guarantee fees and other charges should be set at levels appropriate to protect the GSEs against the risks posed by the types of mortgages purchased, as well as guarantees and services provided, and to provide reasonable but not excessive returns to shareholders.”

- Finally, the draft calls for the banning of Fannie and Freddie in “any primary market activities.”
- MBA President Donald Lange told *National Mortgage News* that the Board is purposely moving slowly on the policy statement. “We are all trying to understand the implications of the policy statement,” he said. “The last thing we want do right now is move too fast.” While some wording may change, the policy statement has been approved in principle and should be cleared within 30 days, said Lange. (*American Banker*, 6/23/99; *National Mortgage News website*, posted 6/23/99)

US Conference of Mayors support strengthening the affordable housing goals for Fannie & Freddie despite heavy lobbying against the proposal by Fannie & Freddie

HUD supports the Resolution passed by the US Conference of Mayors and expects to finish its review of affordable housing goals for Fannie & Freddie by the end of the summer

- According to an article by Jerry Guidera in the *Wall Street Journal*, the US Conference of Mayors passed a resolution during their meeting in New Orleans pushing for higher lending goals for Fannie and Freddie, “despite a determined lobbying effort by the two GSEs to quash any statement of principle on the issue of lending to poorer families.”
- The resolution stated that, “The US Conference of Mayors strongly supports Administration efforts to increase homeownership,” by “increasing the affordable housing lending goals for GSEs to effectively expand lending to low, moderate- and middle-income borrowers and underserved neighborhoods.”
- Guidera reported that the resolution immediately received the support of HUD. “America’s mayors have spoken up for a genuine, measurable commitment to increase mortgage lending for cities and minorities,” said Howard Glaser, Counselor to HUD Secretary Cuomo. HUD indicated that it would finish its review of Fannie and Freddie’s affordable housing goals by the end of this summer. Glaser reportedly said that the US Conference of Mayors Resolution would provide the momentum to push for higher homeownership rates. (*Dow Jones Newswire*, Jerry Guidera, 6/17/99)

All GSEs

Financial Consultant predicts that the proposed Basel Rule would put Fannie, Freddie, and the FHLBanks under price pressure

- Karen Shaw Petrou, President of ISD/Shaw Inc., a Washington-based consulting firm wrote a commentary for the *American Banker* on the Basel Committee for Banking Supervision’s risk-based capital proposal. Shaw predicted that the GSEs would be affected by the rule once the framework was implemented. Shaw wrote, “Another winner in the new proposal would be nonbank issuers or guarantors of debt. The current systems favors government and bank obligations over even the highest-rated corporate ones. The new system would put highly rated corporate claims on the same footing as bank and government-sponsored-enterprise obligations. This should level the proverbial playing field for the financial guarantee industry, while putting

Fannie Mae, Freddie Mac, and the Federal Home Loan banks under price pressure.” (*American Banker*, 6/18/99)

Fannie Mae and Freddie Mac

HUD sends Letter to Capitol Hill justifying the Administration’s budget request that Fannie & Freddie pay for their mission oversight

HUD believes that Fannie & Freddie, not the taxpayers, should bear the cost of HUD’s regulation of Fannie & Freddie - Letter notes that it is standard practice for the Federal government to charge the financial institution it regulates for the cost of the regulation

The \$10 million per year assessment on Fannie & Freddie is only a tiny percentage of Fannie & Freddie’s combined annual net income of \$5.1 billion

HUD said it plans to concentrate its mission regulation of Fannie & Freddie on:

- **Fannie & Freddie’s affordable housing goals;**
- **Fair lending;**
- **Mortgage finance and housing market research and analysis;**
- **Non-mortgage investments; and**
- **New business activity and program reviews**

- Hal C. DeCell III, Assistant Secretary for Congressional and Intergovernmental Relations at HUD sent a recent letter to Capitol Hill justifying the proposal contained in the Administration’s FY 2000 Budget that would allow HUD to assess Fannie and Freddie for the costs of mission regulation. The Administration’s budget requests that the GSEs pay an aggregate of \$10 million a year regulatory fee. *DeCell notes that the \$10 million assessment is “a tiny percentage of the GSEs’ combined annual net income of \$5.1 billion in 1998.”*
- DeCell writes that it is “standard practice for the Federal government to charge the financial institutions it regulates for the costs of that regulation, rather than have the taxpayers bear the cost.” HUD notes that the OCC, OTS, and NCUA all assess the financial institutions within their purview for the costs of regulation. “Similar arrangements exist with respect to the GSE regulatory work of the Federal Housing Finance Board and the Farm Credit Administration. Even within HUD, the Office of Federal Housing Enterprise Oversight was granted the authority in the 1992 Act to assess Fannie Mae and Freddie Mac for costs of ensuring safety and soundness, but the law did not apply the same principle to HUD’s mission regulation of the GSEs. It is time to eliminate that anomaly.”
- DeCell writes that HUD intends to focus on the following key areas in its regulation of Fannie and Freddie:
 - (1) Affordable Housing Goals – HUD plans to propose new affordable housing goals for Fannie and Freddie shortly. HUD would like to greatly increase the monitoring of Fannie and Freddie in meeting their goals “to ensure that the transactions properly qualify for goal counting purposes, as well as verification of the loan level data provided to HUD by the GSEs.”

- (2) Fair Lending – HUD plans to increase enforcement in this area to “ensure that the GSEs are not discriminating in their mortgage purchases” and “ensure that GSE business practices including automated underwriting do not discriminate on any unlawful basis.”
 - (3) Mortgage Finance and Housing Market Research – HUD plans to expand its research to effectively target the GSE housing goals.
 - (4) Non-Mortgage Investments – HUD plans to enhance its monitoring of “GSE’s non-mortgage investments and activities to ensure that they are consistent with the public purposes stated in the GSEs’ Congressional Charters.”
 - (5) New Business Activity and Program Reviews – HUD would like additional funds to strengthen its monitoring of GSEs’ business activities “to ensure that they are in the public interest and consistent with the GSEs’ Congressional charters.”
- DeCell closed by writing that **HUD “strongly believes that the GSEs, not the taxpayers, should bear the cost for HUD’s mission regulation.”** (*Hal C. DeCell III Letter to Subcommittee on VA, HUD and Independent Agencies Appropriations Committee*)

An investment research and management company details Fannie & Freddie’s corporate welfare on its website

- An investment research and management company, Creative Investment Research, published a section on its website raising questions about Fannie and Freddie’s corporate welfare. The minority-owned company stated on its website that it researches and creates socially responsible investments and provides information on minority and women-owned financial institutions.
- The website noted that “the popular perception is that Fannie and Freddie have greatly increased home mortgage opportunities for Americans in general and for minority and low-to-moderate income Americans in particular. Homeownership statistics suggest otherwise.” The website notes that homeownership rates for the majority of Americans have not increased greatly under Fannie and Freddie and minority homeownership rates have actually fallen, since its peak in 1980. “So, despite having paid billions in government subsidized profits to Fannie Mae shareholders, home ownership rates in the US have increased, but increased slightly.”
- The website listed a series of compelling questions:
 - “How is it that homeownership rates have not increased significantly given the mission and assistance provided by Fannie Mae and Freddie Mac, and given the billions in government-subsidized profits paid to date to shareholders of Fannie and Freddie stock?”
 - “Since Freddie and Fannie claim that any change in GSE status will increase the cost of homeownership for all Americans, shouldn’t they be held responsible for not more significantly increasing these homeownership rates?”
 - “Minority homeownership rates have fallen from their peak 1980 level. Aren’t Freddie Mac and Fannie Mae charged with making home mortgage credit more broadly available?”
 - “Aren’t these statistics an indication that they have failed in this part of their mission, given the high percentage of mortgage loans originated in the U.S. under Freddie/Fannie guidelines and

given the specific mandate under which these organization operate and use to justify receiving government subsidies ?”

- “Given that Freddie Mac was found by the EEOC to be discriminating against Black employees, can we expect Freddie to fairly distribute housing credit to African Americans?”
- “Do Freddie and Fannie receive any other special benefits from their GSE status not explicitly recognized so far. What rates do employees of these companies pay when traveling on business - government or corporate? If they pay the government rate for hotels, airfare and other business travel expenses, aren't we further subsidizing private shareholder gains using public funds?”
- “What is the role of the Foundations sponsored by Fannie Mae and Freddie Mac? What, exactly, do they do? How much do they spend, on an annual basis, on print and electronic advertising? Do these advertising expenditures have a direct, measurable impact? If so, how, exactly, do these expenditures help these institutions carry out their congressionally mandated missions? Does the Federal government subsidize these expenditures twice - once, given the reduced borrowing costs Fannie and Freddie receive and again through tax exemptions granted to foundations?” (*Creative Investment Research*, www.creativeinvest.com, posted 6/22/99)

Fannie & Freddie’s involvement in the subprime market is unnecessary and would not benefit consumers

FM WATCH – “Let’s Follow the Money” – GSEs’ programs for subprime and low downpayment borrowers - “Consumers pay more and the GSEs pocket it”

Article notes that small lenders feel squeezed by GSEs in the subprime and home equity market

A research company analyst worries that C and D borrowers may be cut of the market because it would be too expensive for lenders to afford to do C and D loans with Fannie & Freddie skimming the cream of the A- market

Subprime home equity lending is beyond Fannie’s mission of providing liquidity for the mortgage market – Chart shows that most home equity borrowers are using their loans for debt consolidation

- Senator John Kerry (D-MA) recently sent letters to Fannie and Freddie urging the companies to explore ways to bring standardization and competitive pricing to the subprime market. The National Home Equity Mortgage Association Outside Counsel Wright Andrews stated that “We believe his [Senator Kerry] concerns about the subprime market and the approach are misplaced.” He further stated that “*We look forward to explaining that the GSEs should not be involved in the subprime market. Their involvement is unnecessary and could hurt the very people he wants to help.*” (*National Mortgage News*, 6/14/99)

FM WATCH – “Let’s Follow the Money” – GSEs’ programs for low downpayment and subprime borrowers - “Consumers pay more and the GSEs pocket it”

- FM WATCH sent a press release stating that Fannie and Freddie’s involvement in the low downpayment and subprime areas cost consumers more while the GSEs pocket it.

Low Downpayment:

- FM WATCH gave an example of Fannie and Freddie's delivery fees on their low downpayment programs:
 - "Fannie Mae and Freddie Mac claim their delivery fee programs for low downpayment borrowers cut homebuyers' costs. The truth is they cost consumers more, not less.
 - Fannie Mae and Freddie Mac claim their programs are designed to cut the amount homebuyers would pay for private mortgage insurance. The truth is the homebuyer pays a fee in the form of a higher interest rate for the reduction in mortgage insurance coverage. One way or the other that fee goes straight into Fannie Mae and Freddie Mac's pockets.
 - Not only do homebuyers pay a higher interest rate; they pay it for the life of the loan. In contrast, the private insurance Fannie Mae and Freddie Mac are replacing with their delivery fees is cancelled once the homeowner builds up enough equity."

Subprime:

- FM WATCH gave an example of Freddie's delivery fees on their subprime program:
 - "Freddie Mac's subprime program targets homebuyers with blemished credit records and other risk factors that would not qualify them for a standard mortgage. Freddie Mac charges lenders delivery fees up to 5.35 percent to purchase these mortgages and these fees are passed on to consumers, typically in the form of higher interest rates. These fees go directly into Freddie Mac's pocket.
 - The overall cost of these mortgages is often higher than the cost of comparable subprime mortgages offered by lenders, which either keep the mortgages or sell them to other secondary market investors.
 - **The bottom line:** Despite its government-subsidies, Freddie Mac is not lowering consumer costs and increasing affordability, rather it's passing the benefits back to its investors." (*FM WATCH press release, 6/22/99*)
- During FM WATCH's recent press conference, FM WATCH Chairman Gerald Friedman noted that Fannie and Freddie by using their 33-to-1 debt-to-equity leverage, in the short term can underprice the competition in subprime and home equity lending. This underpricing is in the short-term interest of the consumer, he stated, but in the long term the price will rise. He cited a January 1999 report by Barbara Miles with Congressional Research Service and stated that according to the CRS Report, "initially prices go down, but once prices are reduced, as in any duopoly or monopoly, shareholder profit prevails, and the consumer loses." (*Mortgage-Backed Securities Letter – American Banker, 6/21/99*)

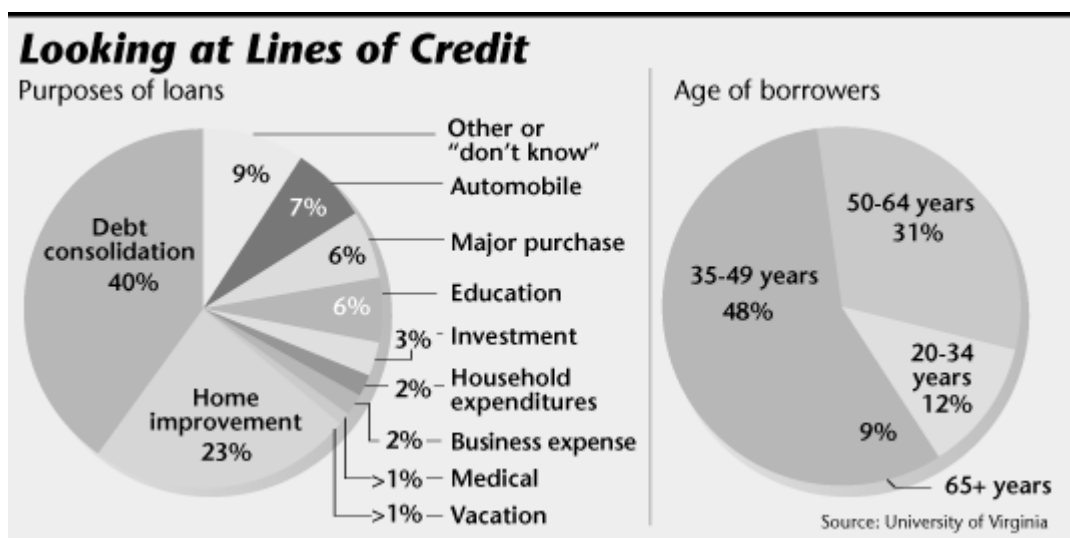
Article notes that small lenders feel squeezed by GSEs in the subprime and home equity market

A research company analyst worries that C and D borrowers may be cut of the market because it would be too expensive for lenders to afford to do C and D loans with Fannie & Freddie skimming the cream of the A- Market

- According to a *Real Estate Finance Today* article by Gwendolyn Glenn, a new report released by David Olson Research found that the entrance of Fannie and Freddie and banks into the subprime mortgage market is making it more difficult for smaller mortgage firms that concentrate on subprime and home equity loans to do business. Christine Clifford, a Vice President at Olson Research, predicted that Fannie and Freddie will play an increasingly significant role in the subprime market and that the GSEs have already captured 8% of the total subprime market since they began purchasing alternative-A and A- mortgages. The Olson report noted that the area Fannie and Freddie are targeting is a sizable loan group as 50% of subprime loans fall into the category of being just below conforming status. Some industry watchers have criticized Fannie and Freddie for skimming the cream off of the subprime loan business and making the cost of doing C and D loans more expensive. “Usually, lenders who do both conforming and subprime loans have only about 5 percent of their business in C and D loans. Most of their business is marginally A-, which is where you make money to pay for and cover the losses of defaults. As these companies are forced to deal with more bad credit, it will be harder for them to do business because as you go down the credit spectrum, it costs more to keep C and D loans from defaulting,” Clifford stated. **“When lenders can’t afford to deal with C and D loans, will those borrowers be cut out of the housing market?”** (*Real Estate Finance Today – Electronic Edition*, Gwendolyn Glenn, 6/18/99)

Subprime home equity lending is beyond Fannie’s mission of providing liquidity for the mortgage market – Chart shows that most home equity borrowers are using their loans for debt consolidation

- According to an *American Banker* article by Hala Habal, the reasons borrowers take home equity loans are as “diverse as the borrowers.” The National Home Equity Mortgage Association stated that 30% of borrowers use home equity loans for debt consolidation, 20% for home improvements, 25% for medical or educational uses, and 25% for home purchases. Consumers obtain home equity loans and use the proceeds to pay off existing credit card, auto, and other personal debts. The following chart by the University of Virginia was printed in the *American Banker* article:



(*American Banker*, Hala Habal, 6/15/99)

[Editorial Note: The single largest use of home equity and subprime loan proceeds is to pay off other debts. Home equity and subprime mortgages do not encourage homeownership. Instead, they give existing homeowners expanded opportunities to have the federal government subsidize their personal consumption expenditures.]

Despite increased mortgage risk and doing little for housing, Fannie & Freddie are increasingly big holders of their own mortgage-backed securities

- In its Annual Report to Congress, Fannie and Freddie's safety and soundness regulator, the Office of Federal Housing Enterprise Oversight (OFHEO) reported that Fannie and Freddie are increasingly holding their own MBSs in their portfolios. In a Question and Answer period during a recent House Banking Committee hearing on OFHEO's proposed risk-based capital rule, OFHEO's Acting Director Mark Kinsey noted that this was the fastest growing part of Fannie and Freddie's business, stating that 62% of Fannie's portfolio was its own MBS and Freddie's percentage was 77%. Kinsey estimated that Fannie and Freddie hold approximately ¼ of their original issues. In its annual report to Congress, it was reported that Fannie's holdings of its own MBS grew to \$197 billion by the end of 1998, up 51% from 1997. Freddie held \$168 billion of its own MBS at the end of 1998, up 63% from 1997. The report further noted that Fannie holds 24% of its total MBS outstanding, while Freddie holds 26%. In his testimony, Kinsey stated that MBS really does not "put anybody in a house." The act of holding more of their MBS in portfolio does not change GSEs' *credit* risk exposure but it does increase the GSEs' *interest* rate risk. (*OFHEO Acting Director Market written and oral testimony before House Capital Markets Subcommittee, 5/12/99; OFHEO's Annual Report to Congress, June 1999; Dow Jones Newswire, John Connor, 6/15/99*)
- On a related note, Fannie announced that its net mortgage portfolio grew by \$18.3 billion in May to \$464.8 billion, an annualized growth rate of 49.2%, up sharply from 15.8% in April. The year-to-date annualized net mortgage portfolio growth rate was 28.7%. (*Reuters, 6/10/99*)
- In its Annual Report, OFHEO also announced that, under the current statutory requirements, Fannie and Freddie exceeded current safety and soundness standards in all of the areas in which they were examined including categories such as credit risk, interest rate risk, liquidity management, information technology, internal controls, audit programs, management information, management process, and board governance. OFHEO highlighted the work it had done in 1998 on its creation of a risk-based capital proposal for Fannie and Freddie. As reported in previous *GSE Reports*, if OFHEO's proposed risk-based capital rule were in effect on specific test dates in 1996 and 1997, Fannie would have had sizable capital shortfalls (\$3.5 billion in 1996 and \$3.68 billion in 1997) and Freddie would have had adequate capital. In addition, OFHEO suggested that Fannie, which earned more than \$3.4 billion in 1998, could have met the June 1997 requirement by adjusting its debt structure at a cost of less than \$200 million a year. (*OFHEO's Annual Report to Congress, June 1999; Dow Jones Newswire, John Connor, 6/15/99*)
- OFHEO also reported that the combined earnings for Fannie and Freddie grew to \$5.1 billion. Freddie's income grew 22% while Fannie's increased 12%. "Net interest income drove revenues for both enterprises as combined net interest income rose to \$6.3 billion in 1998, from \$5.8 billion in 1997," it said. The report also stated that the total combined debt outstanding for the two GSEs

reached \$747 billion in 1998, an increase of 38% from 1997. (*OFHEO's Annual Report to Congress*, June 1999; *Dow Jones Newswire*, John Connor, 6/15/99)

Prudential Securities analyst notes that when examining Fannie & Freddie's market share – One should look past the recent exclusive deals with lenders and consider the technology impact that Fannie & Freddie are using to increase their market share

Analyst titles his report, "It's the Technology, Stupid! Investors of FRE (Freddie) and FNM (Fannie) Need to Look Beyond Short-Term Changes in Market Share."

- Jonathan Adams, an analyst for Prudential Securities, wrote a investor report on the recent exclusive deals between the GSEs and big lenders, where the lenders agree to sell the bulk of their basic loans to one GSE, like the Norwest Mortgage / Freddie Mac deal. Adams notes that much of the attention in these new agreements has gone to the change in market share -- where it appears that Freddie Mac has recently gained a great deal of the market since making agreements with Norwest and Bank of America. However, Adams notes that Prudential feels "the attention given to initial shift in market share between the GSEs may miss the bigger picture, which is a strengthening of the role of the GSEs in the broader secondary market."
- In fact, Adams noted that the recent flurry of activity by the GSEs might represent "the first round in a radical restructuring of loan origination and pricing technology. If we are correct, the position of the GSEs should be improving in the capital markets rather than eroding due to poor pricing."
- Adams and other analysts made their predictions based on the GSEs' interests in making the automated underwriting process easier and more efficient. As he noted, "for some time, the need to navigate through multiple layers of underwriting technology has been at odds with the promised efficiencies this technology was designed to deliver to the mortgage business." Now the GSEs have deals where they allow their partners to use their own automated technology or the technology of the GSEs. He quotes the Freddie Mac press release announcing their deal with Norwest as, "one of the keys to understanding this arrangement ... the commitment by both parties to 'share their credit expertise to find ways to use their respective technologies in an effort to further streamline the approval process for borrowers.' In the same press release from Freddie Mac, the company spoke of the need to 'align our underwriting process.'"
- According to Adams, Fannie Mae expressed similar goals to streamline the underwriting process. In their agreements with Fleet Mortgage and Dime Bancorp, Fannie agreed to waive underwriting fees for Desktop Originator as long as the loans were run through the MORNETPlus system of underwriters.
- Adams concludes by echoing his earlier statements that the GSEs could gain market share through these agreements. It is not the balance of market share between Fannie and Freddie that should be watched; instead it is the market share between the GSEs and the rest of the mortgage market. "Once a seamless process has been established between the large lenders and the GSEs (either Fannie Mae or Freddie Mac) market share is likely to be ceded by other secondary market competitors to the GSEs." (Jonathan Adams, Prudential Securities Investor Report, "It's the Technology, Stupid! Investors of FRE and FNM Need to Look Beyond Short-Term Changes in Market Share, 6/4/99)

***Wall Street Journal* article notes that behind the exclusive lender deals with the GSEs
– is Technology**

Lenders are increasingly concerned with pressure to use Fannie & Freddie's automated underwriting technology rather than their own systems

- Carlos Tejada of the *Wall Street Journal* wrote an article on the GSEs' recent deals with big mortgage lenders such as Norwest Mortgage and Resource Bancshares Mortgage Group, where the lenders have agreed to sell almost all their basic mortgages to one GSE. According to the *Wall Street Journal*, the \$109.45 billion deal that Freddie Mac and Norwest made this past March was the initial deal in now a series of exclusive deals between big lenders and the GSEs.
- Tejada noted that the traditional, informal method of selling single mortgages to the GSE offering the better deal has become increasingly difficult for mortgage lenders who felt forced to use both Fannie and Freddie's automated technology, and possibly their own developed systems, to run each loan through. According to Tejada, that is why Norwest approached both Fannie Mae and Freddie Mac early this year, looking for an exclusive deal. The lender had quite a lot of money invested in their own automated system, but felt increased pressure to use the automated systems from Fannie and Freddie. *Norwest Mortgage's chief executive Mark Oman is quoted as saying, "It's like if you live in a house where the electricity works perfectly well, and I said, 'Let me tear out your white wires and put in red ones, and we'll charge you every time you turn on the lights.' Why would you do that?"*
- In addition to the Norwest / Freddie Mac agreement, Freddie has also made a \$62.23 billion deal with Bank of America. Fannie Mae has made three similar deals, a \$35.86 billion deal with Fleet Mortgage, a \$30.81 billion deal North American Mortgage, and a deal with Resource Bancshares for \$15.43 billion. Tejada noted that the exact details of each deal have not been disclosed, but insiders have said that the agreements include reduced fees to use Fannie and Freddie's automated underwriting systems, and allows lenders to sell a loan even if the loan application was accepted by another computer system.
- The deals also include pricing agreements on guarantee fees, and agreements on eliminating duplicate steps such as credit checks and loan-quality monitoring. As Tejada notes, "Such efficiencies could accelerate the drop in the cost of taking out a mortgage. Already, thanks in part to competition and computerized underwriting, the initial fees and charges on a mortgage have dropped to 0.76% of the loan amount in April from 0.84% in April 1998, according to the Federal Housing Finance Board."
- Tejada also noted, "The agreements also come as investors have increasingly turned a critical eye on Fannie and Freddie. Shares of the two companies have fallen as investors wondered whether they would be able to continue big profit gains in the midst of a slowing mortgage market. Investors are also concerned that a coalition of industry groups, FM Watch, has been formed to keep the two from moving into other businesses. (*Wall Street Journal*, Carlos Tejada, 6/22/99)

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 market and build their technology brand name directly to brokers, realtors, and consumers

(Announcements illustrate further that these two GSEs are using their duopoly status with technology as their tool to vertically integrate the mortgage industry and horizontally expand into new lines of business. The combination of their taxpayer subsidized status as a duopoly with technology will allow them to eliminate entire industries.)

Fannie Recent Developments:

(1) Fannie plays a major role (4% Equity Interest) in HomeStore.com - Since HomeStore.com's IPO, the site has changed its focus from a business focus to a consumer focus

HomeStore.com owns Realtor.com (the largest home-listing site on the Internet and official site of the National Association of Realtors), HomeBuilder.com, SpringStreet.com (rental properties) and Commercial Source.com (commercial real estate)

Article questions whether HomeStore.com will be the leading real estate portal for all types of property? [Fannie will then own 4% interest in major real estate portal]

(2) Finet – Fannie's private sector technology partner – raises an additional \$13 million of equity capital for technology improvements

[Could Fannie have purchased shares in the company to help raise capital for the company's technology *improvements*?]

Freddie's Recent Developments:

(1) Cybertek Corp. will add Freddie's automated underwriting system through its website

(2) REO Manager and Workout Prospector II– Freddie makes enhancements to its Internet-based real-estate owned properties' database – Freddie Allows Lenders to Access Non-Freddie Loans Online

Background:

- According to *Web Finance*, **Fannie is "using the Internet to strengthen its already dominant position in the mortgage industry."** The article cites Fannie's Openclose.com website through which mortgage brokers and lenders can use Fannie's automated underwriting system as one example. Another example is Fannie's recent announcement to let four mortgage lenders offer designated mortgage brokers access to its Desktop Originator software through the Lenders Interactive Online Network (LION), a mortgage industry website providing products and rate information to mortgage brokers. **The article notes that the announcements are significant because companies like Fannie and Freddie have traditionally played the role of mortgage buyers in the industry, while banks and consumer finance companies have dominated the area of origination, working with mortgage brokers to secure and complete mortgage loan**

applications. However, now that Fannie is trying to establish itself as a source of Internet-based underwriting technology for mortgage brokers, the company can exert more control over the origination process. The article references Morgan Stanley Dean Witter analyst Kenneth Posner's report, "The Internet Mortgage Report: New Models, New Opportunities," that notes that "as the Internet grows as a sales channel for mortgages, Fannie has the potential to create a growing class of brokers who depend on the company for technology." As a result, Fannie will have more bargaining power over banks and consumer finance companies because its software will be widely used, wrote Posner. Fannie will therefore have more power to dictate prices at which the company buys loans, he wrote. (Web Finance, 4/26/99)

Fannie's Recent Developments:

- (1) **HomeStore.com** - As we reported in the June 11 *GSE Report*, when HomeStore.com filed its official papers on May 28 to announce a public offering of the company, it was revealed that Fannie owned 833,354 shares or 4.5% of the company. The National Association of Realtors, for which Realtor.com is its official website (and major part of HomeStore.com), only owns 9% of the company. HomeStore.com owns the following websites:

Realtor.com – the largest home listing site on the Internet and official site of the National Association of Realtors

HomeBuilder.com – the web's leading provider information on newly built homes, with listings for more than 100,000 new homes and planned developments throughout the US;

SpringStreet.com – listing more than 6 million rental units in 6,000 cities nationwide; and

CommercialSource.com – the official commercial real estate site of the National Association of Realtors.

An *Inman News Feature* article notes that when HomeStore.com debuted on the web several weeks ago, its site offered mostly company information regarding its consumer real estate sites, however, after the IPO the company tinkered with its website that "clearly targets consumers." The article asks "Could HomeStore.com become the leading online real estate portal for all types of property?" (*Inman News Feature*, 6/16/99)

- (2) **Finet** – Fannie's technology partner - Finet Holdings Corp. – owner of the iQualify.com website (a website that links consumers directly to Fannie's automated underwriting system) – raised an additional \$13 million of equity capital in late May. The company plans to use the funds for technology improvements to its website. The company raised the funds through the private placement of 2,170,000 shares of common stock. Except for Cumberland Associates, LLC, the list of stockholders was not reported. Finet plans to distribute website templates that can be outfitted with graphics and logos for brokers to use and allow brokers to get onto an underwriting server, access various underwriting engines, and get a mortgage loan approval. Finet says it is also adding underwriting engines to its connecting server to route consumers to underwriting engines that fit their borrowing (*Mortgage Marketplace – American Banker*, 5/31/99)

[Editorial Note: As reported in previous *GSE Reports*, Fannie and Finet have an historically close technology relationship with each other. It is unclear whether Fannie is an equity investor in Finet,

however, it would not be out of the realm of possibility. Fannie does have an equity investment in HomeStore.com (previous story), which Fannie never acknowledged until HomeStore.com filed the official papers making the information public.]

Freddie's Recent Developments

- (1) **Cybertek Corp.** – Cybertek Corp, a subsidiary of Policy Management Systems Corp., said it has an agreement to deliver Freddie's automated underwriting system, Loan Prospector, through its website. Lenders will have the option to route loans through Freddie's system either through Freddie's electronic network, GoldWorks, or through Cybertek Internet connection. (*American Banker*, 6/22/99)
- (2) **REO Manager and Workout Prospector II**– Freddie released REO Manager, a new application available on its GoldWorks network that will have deep information on Freddie's real estate owned properties. Freddie stated that REOM should give customers faster answers to questions about their Freddie REO portfolios and reduce the time needed to submit expense reimbursement forms. The REOM will also provide a constantly updated database of real estate brokers and eviction attorneys and their contact information, property occupancy status, mortgage insurance information, claim-filing dates and dates for when property condition certificates were sent out. (*Mortgage Marketplace-American Banker*, 6/21/99) Freddie also announced that it introduced an online version of Workout Prospector that would enable servicers to use Freddie data to process workout decisions while logged onto Freddie's GoldWorks network. Freddie also created the ability for servicers to process non-Freddie loans on the secure network. (*Real Estate Finance Today-Electronic Edition*, 6/18/99)

Fannie Mae

Fannie criticizes HUD for doing its job

HUD steps up its enforcement of Fannie & Freddie Fannie complains about being regulated

- In an Open Forum for *National Mortgage News*, Fannie's Chairman Franklin Raines wrote that HUD's "revival of regulation" is an area of concern and "is not healthy from the standpoint of the real estate industry." Directly criticizing HUD, Raines stated that "the record at HUD for wise regulation is not strong." HUD has currently announced a number of items they are considering examining at Fannie and Freddie. Raines calls this a "bad turn of events." Raines stated that he hoped Fannie could work with realtors, mortgage bankers, and homebuilders as "allies" while HUD is making efforts "to reach into the conventional mortgage and attempt to bring to that market the kind of bureaucratic over-reaching that they have overlaid in the government market over so many years." [HUD is responsible for the mission regulation of Fannie and Freddie.] (*National Mortgage News*, 6/14/99)

Fannie Hires Veteran Capitol Hill House Banking Committee Senior Staff Member

- Fannie hires Richard Maurano, Democratic Deputy Staff Director to the House Banking Committee. Rick is a well-respected Capitol Hill veteran who will add value to Fannie's large, but rapidly growing stable of politically savvy employees and outside lobbyists. *(Not yet reported.)*

Fannie begins "Working Mortgage" Pilot – a Pilot that provides borrowers with direct deposit of their paychecks timed to the borrower's pay schedule

Private financial services companies have been marketing this program for over ten years

- Fannie announced a \$250 million "working mortgage" pilot that allows borrowers to have their mortgage payments automatically withdrawn from their paychecks to allow borrowers to build up equity in their homes by providing a faster amortization of the mortgage. The product will initially be available from Bank One Mortgage, Citicorp Mortgage, FT Mortgage, and Old Kent Mortgage. The product offers borrowers a mortgage loan with special benefits including lower down payments. To apply, a borrower must set up a direct deposit account and agree to have payments deducted the same day the check is deposited. *(Fannie press release, 6/14/99)*

Fannie partners with a CRA mutual fund

- Fannie announced at a US Conference of Mayors conference that Fannie was partnering with the US Conference of Mayors and Access Capital Strategies to produce CRA mortgage-backed securities. Fannie Chairman Franklin Raines stated in a speech that "Access Capital will provide the funds that purchase Community Reinvestment Act (CRA) loans made by lenders, and Fannie Mae will guarantee the loans." Access Capital will now be working directly with participating mayors and with Fannie on a community by community basis. Through the partnership, Fannie will create mortgage-backed securities for the Access Capital Strategies Community Investment Fund, a mutual fund established to make CRA-related investments. According to Ronald Homer, CEO of Access Capital Strategies, the first deals, with Dallas, Denver, and New Orleans are expected to produce about \$50 million in CRA MBS by August. *(Fannie press release, 6/13/99; Mortgage-Backed Securities Letter-American Banker, 6/21/99)*

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 38 offices are officially opened and three more are in the process of being formed)

(Although Fannie claimed recently that its advertisements were too "Fannie Mae-Centric" and did not incorporate the crucial contribution of its lender partners in its successful projects - Fannie continues to only incidentally mention its lender partners in its numerous press releases and advertising)

- Fannie announced during a press conference with Cong. Kleczka (D-WI), Cong. Tom Barrett (D-WI), and Milwaukee Mayor John Norquist that it would be opening its 37th Partnership Office in Milwaukee later this summer "staffed and running within 90 days." According to the *Milwaukee Journal*, Cong. Barrett reportedly broached the idea of a Fannie office in Milwaukee five years ago. The *Associated Press* reported that Fannie would hire a three-person staff for the partnership office. *(Fannie press release, 6/2/99; Milwaukee Journal, 6/3/99; Associated Press, 6/3/99)*

- Fannie also announced during a press conference that it would open its 38th official Partnership Office in Bismarck, North Dakota within 90 days. North Dakota Governor Edward Schafer, Senator Kent Conrad (D-ND), and Cong. Earl Pomeroy (D-ND) participated in the press conference. (*Fannie press release*, 6/3/99)
- As reported in previous *GSE Reports*, Fannie is also in the process of opening up at least three more partnership offices. According to a *Pittsburgh Post-Gazette* article, Fannie will be opening a Fannie Mae partnership office in Pittsburgh. The article further noted that Fannie officials were not sure when or in what neighborhood the Pittsburgh office would open. (*Pittsburgh Post-Gazette*, 5/8/99). According to *Bloomberg News*, the *Star Ledger of Newark* reported that Fannie is planning to open a Partnership Office in downtown Newark, NJ and the *Associated Press* is reporting that Senators Craig Thomas (R-WY) and Michael Enzi (R-WY) were urging Fannie to open a Partnership Office in Wyoming. (*Associated Press*, 4/28/99; *Bloomberg News*, 4/20/99)

Governor Jim Hunt, Senator John Edwards (D-NC), Cong. David Price (D-NC), Cong. Eva Clayton (D-NC), and Cong. Bob Etheridge (D-NC)

- Fannie held a press conference with the above officials to announce the results of Fannie's "HouseCharlotte" program during an affordable housing forum. (*Fannie press release*, 6/14/99)

Cong. Karen McCarthy (D-MO), Kansas City Mayor Pro Tem Alvin Brooks

- Fannie held a press conference with the above officials to announce the opening of Park Gate Apartments and Townhomes in Kansas City. The complex consists of 16 two-story buildings comprising 104 units. Fannie purchased \$600,000 of a \$1.9 million loan that was originated by the Missouri Housing Development Commission. Mercantile Bank provided construction financing. (*Fannie press release*, 6/1/99)

Cong. John Hostettler (R-IN)

- Fannie held a press conference with Cong. Hostettler to introduce a family who moved into a home using the "First Home/One Down" program. (*Fannie press release*, 6/21/99)

Freddie Mac

Freddie purchases over half of a 125% loan-to-value securitization for its portfolio

- According to *National Mortgage News' website*, Freddie purchased the senior piece of Goleta National Bank's recently completed \$122 million high loan-to-value securitization. Goleta NB reportedly did its first high LTV securitization – a \$81 million pool in December of last year. Freddie reportedly purchased a \$57 million piece of the first deal (\$81 million pool) and purchased a \$66 million piece of this recent \$122 million deal. A Freddie spokesman would not comment on the purchase, citing a Freddie policy "not to comment on purchases for its portfolio." (*National Mortgage News website*, posted 6/22/99)

United Guaranty introduces a product for lenders who are unsure whether they are selling the loan to Freddie or holding it in portfolio

- According to *National Mortgage News*' website, United Guaranty Residential Insurance Co. introduced a new product, Co-Primary, for lenders who are undecided whether they are selling the loan to Freddie or holding it in portfolio. A loan insured with Co-Primary reportedly has traditional mortgage insurance throughout the loan origination process. The lender then has the option of placing the loan in portfolio and still carry traditional coverage, or sell to Freddie on a negotiated basis. If the loan is sold to Freddie, the mortgage insurance automatically converts from traditional mortgage insurance coverage to dual-layer coverage. (*National Mortgage News website*, posted 6/16/99)

Freddie hires former counsel to Senate Republican Conference as an outside lobbyist

- Freddie hired Kimberly Kranys Cobb, former Counsel to the Republican Conference and Aide to Senator Connie Mack (R-FL) as a long-distance lobbyist. Cobb reportedly just moved to Charlotte. She is offering Freddie – her first client – advice on “how things work” in the GOP Senate. (*Washington Post*, 6/10/99)

Freddie hires House Democratic Housing Subcommittee Counsel

- Freddie hired Angela Garcia, counsel to the House Banking Housing Subcommittee. (*Not reported.*) Angela is a knowledgeable, well-respected staff member that will add to Freddie's Capitol Hill hires.

Federal Home Loan Banks

FHLBank of Seattle is considering offering the FHLBank System's Mortgage Partnership Finance (MPF) program to its members – a Program that is competing with Fannie & Freddie in the secondary mortgage market

The MPF program is becoming a real competitor to Fannie & Freddie – Half of the FHLBanks are now offering or planning to offer the program

- According to *National Mortgage News*, the FHLBank of Seattle has applied to the Federal Housing Finance Board (FHFB) for approval to offer the FHLBank System's MPF program. Norman Rice, President and CEO of the FHLBank of Seattle said the proposal was “customer-driven” He reportedly stated that their members have “told us repeatedly that (they) want more alternatives in the secondary market” and “we are responding with an innovative program that will insulate members from interest rate risk.”
- The MPF program gives savings institutions and commercial bank lenders a new alternative to holding home loans in portfolio or selling them to Fannie and Freddie. The program allows FHLBanks to purchase mortgage loans originated by member financial institutions. The MPF program allows member institutions to originate and service single-family loans, while the FHLBank books the loans and manages the market risk. It is considered a profitable alternative to selling to Fannie and Freddie. Half of the FHLBanks are now offering or planning to offer the program - the FHLBanks of Chicago (which began the program), Dallas, Atlanta, New York, Pittsburgh, and now Seattle. Initially, the FHLBank of Pittsburgh will offer MPF on a limited basis before offering the program more broadly later this year.

Status report of legislation containing FHLBank expansion provisions

House bills containing FHLBank expansion provisions advance to Rules Committee

House:

- The House Commerce Committee passed HR 10 on June 10 by voice vote. The House Banking Committee passed its version of financial services modernization (H.R. 10) on March 11 by a 51-8 bipartisan vote.
- As reported in previous *GSE Reports*, both versions of H.R. 10 contain 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 FHFBS control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock.
- H.R. 10 will now proceed to the House Rules Committee so the Commerce Committee-version and the Banking Committee-version can be reconciled. The Chairman of the House Banking and House Commerce committees reportedly met on June 18 to begin work on the compromise. House Speaker Dennis Hastert (R-IL) urged both Chairmen to work out a deal in time for a vote on the House floor during the week of June 28 before the July 4 recess. Contentious issues such as privacy, op-subs, and CRA still need to be hammered out between the two versions. (*American Banker*, 6/21/99)

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 contained 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 FHFBS 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.

Private Sector Items to Note

Private Sector starts an investment fund to provide a secondary market for low-income mortgages

- A Florida investment company launched an investment fund – the CRA Qualified Investment Fund- designed to encourage banks to invest more money in low-income neighborhoods. The fund will purchase mortgage-backed securities and mortgages backed by properties in low-income neighborhoods. Banks that put money into the fund will earn returns on par with Treasuries and will be able to count their investments toward their CRA obligations. Fund spokesman Daniel Weinbach said most of the fund's purchases will be for mortgages with low-to-moderate income housing, but will also include small business loans and municipal bonds issued to build a

community center or fund an after-school program. The fund was created by a group of academics, bankers, and community organizers. Although the fund is targeted to bank investors, it is technically a mutual fund. Fund organizers have also promised that a community bank's investment will go back into its own community. For example, if a Harlem bank invests \$250,000, then the fund would allocate \$250,000 to buy mortgages in Harlem. (*Associated Press*, Patricia Lamiell, 6/17/99)

Private Sector issues first securitization of reverse mortgages in the United States

- According to *Mortgage Marketplace*, the first securitization of reverse mortgages from the United States is being developed by the private sector. TransAmerica First Inc. was said to be the issuer, Lehman Brothers is reportedly underwriting the transaction and Standard & Poor's is rating it. A source stated that this first securitization shows that the capital markets have discovered the product and are interested in it. The underlying loans are nonconforming. In early May, S&P rated a privately placed securitization of Canadian reverse mortgages. In the United States, most private reverse mortgages are originated within the conforming market. Fannie has a program for reverse mortgages and so far has held them in portfolio rather than securitize them. (*Mortgage Marketplace-American Banker*, 5/31/99)

Farmer Mac

Farmer Mac common stock begins trading on the New York Stock Exchange

- Farmer Mac announced that commencing Friday, June 18, 1999, its Class C and Class A common stocks began trading on the New York Stock Exchange, under the ticker symbols "AGM" and "AGM.A," respectively. Henry Edelman, President and CEO of Farmer Mac, who rang the opening bell at the exchange, said he was optimistic about the company's move from the NASDAQ market to the New York Stock Exchange. (*American Banker*, 6/21/99; *Farmer Mac press release*, 6/21/99)

Farmer Mac releases a letter from Senator Richard Lugar (R-IN) praising Farmer Mac and urging Congress to continue its support

Letter released days after the GAO released a study indicating that Farmer Mac is largely ineffective and the Chairman of the House Banking Committee Jim Leach (R-IA) and Chairman of the House Banking Subcommittee on Capital Markets and GSEs, Richard Baker (R-LA) criticized Farmer Mac

- Farmer Mac announced that Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry Richard Lugar (R-IN) sent a letter to Farmer Mac CEO Henry Edelman on June 15 complimenting Farmer Mac's progress since the charter reforms in 1996: "[s]ince the reforms, Farmer Mac has streamlined its loan purchase and security guarantee process and developed important new programs and products to serve rural America." The letter further stated that Congress "must continue to support institutions, like Farmer Mac, that are dedicated to rural America. Too often, agriculture and the rural economy are forgotten in organizations that have broader agendas." (*Farmer Mac press release*, 6/21/99)

- As reported in the June 11 *GSE Report*, the GAO released a study indicating that Farmer Mac is largely ineffective. Among its findings, the GAO found that: (1) Farmer Mac held \$1.18 billion in non-mission related investments, which accounted for 61% of Farmer Mac’s assets; (2) even if Farmer Mac continued to be economically viable, it was difficult to determine whether the public benefits created justify continued government sponsorship; and (3) Congress consider all the activities of Farmer Mac, the Farm Credit System, and the FHLBanks because of their overlapping missions. Chairman of the House Banking Committee Jim Leach (R-IA) stated that it was “unconscionable for a government-sponsored enterprise to have more than three-fifths of its assets in non-mission-related investments.” Leach further stated that “When a governmentally-privileged institution established to serve farmers abuses its status by investing disproportionately in arbitrated financial investments rather than agricultural loans, the Treasury and the Congress have an obligation to review its management practices.” Chairman of the House Banking Subcommittee on Capital Markets and GSEs Richard Baker (R-LA) said he planned to review the GAO Report and determine whether continued government sponsorship of Farmer Mac was needed.

Farm Credit Administration/Farm Credit Banks

Commercial banks and even a few Farm Credit System lenders oppose a controversial Farm Credit Administration proposal that would let Farm Credit System lenders compete in the same geographic area

Proposed rule increases the worries of commercial banks about unfair competition from the Farm Credit Banks due to their GSE status

- According to an *American Banker* article by Alan Kline, the Farm Credit Administration’s (FCA) controversial proposal to allow the Farm Credit System lenders to compete in the same geographic area does not even have unanimous support from the Farm Credit System lenders that are affected by the rule.
- 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 is 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.”

- 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.
- FCA Chairman Marsha Pyle Martin did not indicate in which direction the FCA would rule but stated that she is seriously considering the 228 comment letters they received on the proposal. She did, however, express disappointment at some of the criticism the FCA received. “I was surprised at some of the associations who were opposed,” she stated. “I considered them organizations that had no fear.” (*American Banker*, Alan Kline, 6/18/99; *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)

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