

The **GSE** REPORT TM

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All GSEs

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between Fannie and the government. "Investments are being affected by a close relationship between the enterprise and the government, and the money flows back to the government patrons in many forms - political donations, the hiring of government officials, distribution of grants in every congressional district. Everyone is getting paid out of that big trough," according to Wallison.

- Wallison also sees parallels with the Savings & Loan collapse in the 80's. "They [Fannie & Freddie] have very low capital margins (less than 2 percent of assets versus 8 percent for commercial banks), and they've been looking for high-risk investments to improve their profitability. It's a prescription for financial disaster if interest rates go up. And Congress is ignoring it."
- Reporter notes that Fannie cannot prove that the current system would keep rates lower. The reporter states, "The private secondary market for mortgages has ballooned over the past two decades, and it's quite possible that real competition would result in rates just as low or even lower than Fannie makes possible. But Congress does not have the courage to take the risk to find out... So Fannie Mae will continue to thrive. It's not fair to the competition, and it's certainly not how the game of American capitalism is normally played. But in Washington you never argue with success - especially when it's the work of your cronies."

Fannie Mae and Freddie Mac

- Sources agree that it is likely that under both the Basel proposal and the US regulatory proposal, the risk-weighting for top-rated mortgage-backed securities (MBS) and asset-backed securities (ABS) will be lowered to 20% (same as for Fannie's & Freddie's MBS) (p. 12)
- Analyst downgrades Household International and Associates First Capital Corp.'s stock because of encroachment into the subprime home equity business by Fannie & Freddie (p. 13)
 - Subprime home equity lending is beyond Fannie's mission of providing liquidity for the mortgage market
 - FM WATCH - "Let's Follow the Money" - GSEs' programs for subprime borrowers - "Consumers pay more and the GSEs pocket it"
- Article notes that Fannie & Freddie have a credibility problem when they continually deny that they are not trying to expand into the private sector mortgage industry's business - "Let's Be Frank...or Freddie" (p. 14)
 - "The possibility remains that even if Fannie does not go after consumers, they are certainly paving the way to go after brokers and other originators. If this happens, where does that leave Fannie's 'only customers?'"
 - "Despite GSE denials and acerbic PR salvos, the fact remains that a week doesn't go by in which another story, advertisement, statement, or news item involving Freddie and Fannie's alleged trespasses. It's the mortgage industry equivalent of Lewinsky-gate: the story that just won't go away."
- The California Association of Realtors (CAR) decide to monitor the activities of Fannie & Freddie (p. 16)
 - Group of realtor activists would like CAR to do more than just monitor - activists form Government Sponsored Enterprise Containment Coalition
 - Article notes that the National Association of Realtors (NAR) is discouraging its members from joining the Fannie/Freddie watchdog group, FM WATCH. However, officials at NAR said that the association is neutral on the issue
- Reporter notes that charges by Fannie that the Fannie/Freddie watchdog group, FM WATCH, is simply a front for the mortgage insurance industry is undermined by the fact that the Mortgage Bankers Association will be issuing a policy statement that is similar to the positions held by FM WATCH (p. 16)
- Fannie & Freddie are becoming larger forces in credit enhancement in the tax-exempt housing bond market (p. 17)
- Fannie/Freddie watchdog group, FM WATCH, could have some impact on Fannie & Freddie's stock (p. 18)
- 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
- Fannie's recent developments
 - Fidelity National Credit Services and Fannie launch credit reporting services on Fannie's automated underwriting systems
- Freddie's Recent Developments
 - (1) Freddie will offer brokers instant access to its automated underwriting system through CrossLand Mortgage's website
 - (2) Freddie may put its automated underwriting systems into local NAACP offices

Fannie Mae

- Fannie invests in another national commercial bank (p. 20)

- *Fortune Magazine* ranks Fannie as the #2 firm for minority diversity (p. 20)
- Fannie Chairman Franklin Raines is part of investor group that is interested in purchasing a major league baseball team for Washington, DC (p. 20)
- *USA Today* asks CEOs of major companies to submit the websites they use on their job and leisure sites (p. 20)
 - CEOs were not allowed to submit the sites of their own companies
 - Fannie Chairman Franklin Raines submits AOL.com and Realtor.com (Franklin Raines sits on the Board of AOL.com and Fannie owns 4% of HomeStore.com, the owner of Realtor.com)
- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (currently 34 offices are officially open and operating and seven more are in the process of being organized) (p. 20)
 - Fannie said it plans to have 45 partnership offices opened by the end of the year

Freddie Mac

- Freddie hires former Speaker Newt Gingrich as a consultant (p. 22)
- Freddie names Adrian Corbiere as Senior Vice President, Multifamily (p. 22)
- Freddie purchases \$22 million mortgage loan for a 21-building apartment community (p. 23)

Federal Home Loan Banks

- FHLBank of New York purchases \$788,000 participation in New Jersey multifamily and single-family mortgages under Community Mortgage Asset (CMA) program (p. 23)
- Status report of legislation containing FHLBank expansion provisions (p. 23)
 - Financial services modernization bill containing FHLBank expansion provisions passes the House
 - Bill will now go to Conference Committee to be reconciled with Senate-passed version of financial services modernization bill
- FHLBank System prices two debt issues under its new "Tap" program (p. 24)

Private Sector Items to Note

- President Clinton requests housing and job assistance on Indian reservations as part of his Administration's "New Markets Initiatives" (p. 24)
 - Lenders and mortgage insurers respond with new programs and initiatives

Farmer Mac

- "Dear Colleague" letter praises Farmer Mac and urges members of the House Banking and Agriculture Committees to continue its support (p. 26)
 - 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

- Farm Credit Administration issues Final Rule on leasing activities (p. 27)

Major Events

HUD Secretary Andrew Cuomo is reportedly in favor of increasing Fannie & Freddie's affordable housing goals

- According to an article by Ed Staples with *Mortgage-Backed Securities Letter*, HUD Secretary Andrew Cuomo is in favor of increasing Fannie and Freddie's affordable housing goals and is planning to issue a proposed rule on Fannie and Freddie's affordable housing goals within the next few months. The article reports that currently Fannie and Freddie are required to have 42% of the units they finance serve families at or below the area median income. Staples notes that one report stated that under HUD's new proposal, the figure goes up as high as 50%. According to an article in *Housing Affairs Letter*, the increase will be between five and eight percentage points. The article notes that HUD may issue a notice of proposed rulemaking on increasing Fannie and Freddie's affordable housing goals, however, HUD does not have to do this, since federal law authorizes the Secretary to set the goals.
- Recently, the US Conference of Mayors and FM WATCH (the new Fannie/Freddie watchdog group) have requested that HUD increase and strengthen Fannie and Freddie's affordable housing goals. These actions have reportedly reinforced HUD's position to increase Fannie and Freddie's affordable housing goals. According to the *Housing Affairs Letter* article, HUD's increasing of Fannie and Freddie's affordable housing goals "became a virtual *fait accompli* after it was endorsed by the US Conference of Mayors and a new watchdog group composed of a substantial portion of the real estate industry." (*Housing Affairs Letter*, 6/18/99; *Mortgage-Backed Securities Letter-American Banker*, 6/28/99)

Consumer advocate Ralph Nader urges House Budget Committee to end Fannie & Freddie's corporate welfare

Nader suggests a full examination of the GSEs

Nader states that "it is obvious that some of the subsidy derived from their GSE status is being used, not for home buyers, but to increase corporate power and control over all facets of the mortgage business"

Nader questions, "Will this growing duopoly enjoyed by Fannie and Freddie stifle competition by private companies-competition that might reduce costs and encourage innovation in a variety of mortgage products?"

Nader notes that some of the GSEs' government subsidies - intended to lower the costs for home buyers - are being diverted to build political and lobbying efforts "designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market."

- During a House Budget Committee hearing on June 30, consumer advocate Ralph Nader proposed sweeping reforms to end the practice of corporate welfare, which he said includes corporate tax breaks, federal giveaways, and other provisions that are estimated to cost taxpayers over \$100 billion a year. Nader proposed 25 bills to combat various aspects of the corporate welfare problem.

One of the problems he specifically highlighted in his oral and written testimony were the GSEs -- mainly Fannie and Freddie.

- Nader testified that the GSEs are “stealth recipients of corporate welfare” because they do not receive cash or other outward federal subsidies, instead they receive their benefits through credit enhancements and their implied federal guarantee. **He states, however, much of the risk of Fannie and Freddie (like other GSEs) remains with the federal government and taxpayers, while the profits flow to the private corporation executives and shareholders.**
- Nader did note that the GSEs do provide an important service to the secondary mortgage market by stabilizing and adding liquidity to the market. But he asked, **“could these functions be carried out without government subsidy? Could private corporations -- without links to the government and without corporate welfare -- perform the same functions? These are questions meriting close Congressional scrutiny.”**
- **Nader states that the “key to Fannie and Freddie’s phenomenal profits and soaring stock values is the financial market’s perception that there is an implied government guarantee behind the obligations of these corporations.”**
- Nader listed some of the reasons why the GSEs are perceived to be so closely linked to the federal government and that the taxpayers and the US Treasury would bail them out if there was a problem:
 - they have a \$2.25 billion contingency fund with the Treasury;
 - their securities are government securities for the purposes of the Securities Exchange Act of 1934;
 - their securities serve as eligible collateral for Federal Reserve banks’ discount loans;
 - the securities are exempt from SEC registration;
 - the Secretary of Treasury approves the issues;
 - the Federal Reserve acts as their fiscal agent for the issues; and
 - their obligations are eligible for unlimited investments by national banks and state bank members of the Federal Reserve as well as by federally insured thrifts.
- Nader also stated that Fannie and Freddie are exempt from state and local taxes – “another benefit that clearly falls under the rubric of corporate welfare.” Nader further criticized Fannie on the tax issue, noting that Fannie did not “cough up a dollar” even when the District of Columbia [the company’s headquarters] was on the edge of bankruptcy.
- While the GSEs may acknowledge that they receive “benefits” from their government ties, they have not assigned a dollar figure to the benefit. Nader references a study by CBO that estimated that the dollar value of credit enhancement stemming from the government links was at least \$6.5 billion in 1995. According to CBO, Fannie and Freddie, however, only pass along part of that subsidy on to home buyers (about \$4.4 billion) – with the remainder pocketed by shareholders. “In other words, for every \$2 delivered to home buyers, Fannie and Freddie take \$1 of that subsidy for themselves.” The CBO also estimated in 1995 that approximately 40% of the earnings of Fannie and Freddie could be traced back to their government-sponsored status. Their government sponsorship has made them very profitable companies and the dominant force in the housing finance market. Nader also highlighted the lucrative salaries, stock options, and executive compensation enjoyed by the officials of Fannie and Freddie from their government subsidies. **“It**

is obvious that some of the subsidy derived from their GSE status is being used, not for home buyers, but to increase corporate power and control over all facets of the mortgage business,” noted Nader.

- **Nader questions, “Will this growing duopoly enjoyed by Fannie and Freddie stifle competition by private companies-competition that might reduce costs and encourage innovation in a variety of mortgage products?”**
- Nader also expressed concern over the large amounts of debt issued by the GSEs, their arbitrage, and non-mission related investments. Farmer Mac especially troubled Nader, since the GSE is said to have \$1.18 billion in non-mission investments (61%). He quoted Congressman James Leach as calling it “unconscionable.”
- Nader suggests that Congress undertake a top-to-bottom review of all the GSEs to answer the following:
 - **“Are these hybrid half government, half-private entities needed to meet credit needs?**
 - **How well do they meet their statutory missions in specific sectors?**
 - **And how much of their operations are devoted, not to their missions, but to playing the market in outlandish and unneeded arbitrage games?**
 - **How much of their subsidy is used to benefit consumers, and how much is siphoned into shareholder profits and bloated executive compensation agreements?**
 - **Are existing capital standards adequate?”**
- **Nader concluded by noting that some of the GSEs’ government subsidies - intended to lower the costs for home buyers - are being diverted to build political and lobbying efforts “designed to make it difficult, if not impossible, for the Congress to provide (or the public to demand) proper oversight or regulatory improvements which would protect the public, increase support for affordable housing or ensure open competition in the mortgage market.”**

(Testimony of Ralph Nader before the House Committee on the Budget, 6/30/99; *BNA Daily Report for Executives*, 7/1/99)

HUD sends letter to Appropriations Committees requesting that Fannie & Freddie pay for their mission oversight

House Appropriators are reportedly “seriously considering” the proposal, however, Senate Appropriators have reportedly rejected the idea

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 proposed \$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

- 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 annually 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 closed by writing that ***HUD "strongly believes that the GSEs, not the taxpayers, should bear the cost for HUD's mission regulation."***
- According to *National Mortgage News*, sources have indicated that Senate Appropriators have rejected the request, while House Appropriators are "seriously considering it" but have not made a decision. The article notes that VA-HUD Appropriations Committee Chairman, Senator Christopher Bond (R-MO) is concerned that HUD Secretary Andrew Cuomo will only use the funds to hire more "community builders" who haven't been authorized by Congress. (*Hal C. DeCell III Letter to Subcommittee on VA, HUD and Independent Agencies Appropriations Committee; National Mortgage News website, posted 7/7/99*)

Fannie provides servicing fee up-front to Countrywide – this is the first arrangement of its kind

This arrangement increases Fannie's risk

Separately, Countrywide also announces that it has agreed to sell a substantial portion of its loans to Fannie

As part of the agreement, Fannie will be partnering with Countrywide to distribute products such as credit reports, appraisals, title insurance, flood determination and home inspection through Fannie's technology system

Fannie will also "explore strategies" related to Countrywide's newly acquired Balboa Insurance group and Countrywide Securities Corp.

- According to an article by Marc Hochstein of the *American Banker*, Countrywide Credit Industries reached an agreement with Fannie that "could fundamentally alter the economics of the mortgage industry." The *American Banker* article noted that before the arrangement, when Countrywide made a 7.5% loan, it placed the loan into a pool backing a Fannie security that pays holders a 7% coupon. Each year, Countrywide would collect a fee of 25 basis points to service the loan and Fannie would get 25 basis points to guarantee the security. Under the new agreement, Countrywide would now place the same 7.5% loan into a 7.25% Fannie security. Fannie would still collect the 25 basis point guarantee fee but the prevailing market rate for mortgage-backed bonds would still be 7%. The key difference under the new arrangement is that Countrywide would be getting its servicing fee as cash up-front rather than having to collect it over the life of the

loan. According to a *National Mortgage News* article by Paul Muolo and Brian Collins, “Instead of Countrywide collecting the cash flow on servicing over five to six years (a normal amortization schedule) it will receive cash ‘immediately’ by taking its Fannie Mae servicing and putting it into a mortgage-backed security. In other words, it will receive the servicing risk on the investor and takes it out of Countrywide.” **Jonathan E. Gray, an analyst at Sanford C. Bernstein & Co., said the transaction may create some risks for Fannie. Should something happen to Countrywide, Fannie would want to transfer the servicing on those loans to another company. “If there’s no recurring income [for the servicer], that increases business risk,” Gray stated.** Gray stated that Fannie would need to get “some kind of collateral” to protect itself from such an event. Countrywide’s spokesman reportedly would not comment on whether Countrywide was posting any kind of collateral to Fannie, but said that Fannie “recognizes that Countrywide is not going to go anywhere.”

- According to the *American Banker*, Countrywide executives told analysts during an investor call that it would use the new structure in 30% to 40% of its conventional-loan securitizations in its second fiscal quarter. (*American Banker*, 6/25/99; *National Mortgage News*, 7/5/99)
- In a separate announcement, Countrywide reached an agreement with Fannie to allocate a “substantial portion of Countrywide’s agency-eligible production to Fannie.” As part of the agreement, Countrywide will receive greater use of its CLUES proprietary underwriting technology, greater usage of short-form appraisals, expansion of streamlined loan products, flow sales for expanded-criteria loans, and guideline waivers.
- Fannie will also be partnering with Countrywide to distribute products such as credit reports, appraisals, title insurance, flood determination and home inspection through Fannie’s MORNETPlus technology system and network. (*National Mortgage News website*, posted 7/12/99; *American Banker*, 7/12/99; *PR Newswire*, 7/9/99)
- Fannie said it also had agreed to “explore strategies” related to Countrywide’s newly acquired Balboa Insurance group and Countrywide Securities Corporation, a broker-dealer subsidiary, which will now have a position in the Fannie medium-term note dealer group. (*PR Newswire*, 7/9/99)

All GSEs

Nominee for Deputy Treasury Secretary said the Fed may use corporate securities such as GSE securities as a substitute for Treasuries to conduct open market operations and to increase the size of its portfolio

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

- According to an article by John Connor with *Dow Jones Newswire*, the nominee to be deputy Treasury secretary, Stuart Eizenstat said the Federal Reserve, which currently uses Treasury securities to conduct open-market operations, would adapt to the dwindling supply of Treasury securities by substituting other debt securities for Treasuries. Eizenstat reportedly made his comments in a written answer to a question posted by Senate Finance Committee Chairman William Roth (R-DE) about the consequences of eliminating the public debt by 2015. “As the

supply of Treasuries dwindles in the future, as we gradually reduce the debt held by the public, there would be a ready supply of securities of other issuers, including high-quality corporations and government-sponsored enterprises, that would likely become benchmarks for the broader market,” Eizenstat stated. Connor notes that Fannie, Freddie, and the FHLBank System have become increasingly larger players in the capital markets and are issuing more debt collectively than the Treasury. (*Dow Jones Newswire*, John Connor, 7/8/99)

- As reported in the November 6th and November 20th, 1998 *GSE Reports*, the Bond Market Association reportedly met with the Federal Reserve of New York to recommend that the Federal Reserve of New York purchase additional GSE debt as part of its open-market operations. “They were in to see us,” said Peter Bakstansky, Spokesman for the New York Fed. “We heard them. We appreciate their input. We have no current plans to change our operations.” Thomas Stanton, a Washington lawyer who has written extensively about the GSEs, noted that **there is already an implied, or mistakenly inferred, federal guarantee on the GSEs. By having the Fed actively use GSE securities in open market operations, the implied federal guarantee would be strengthened and would put the Fed in the position where it would pay for potential shortfalls in GSEs’ financial safety and soundness rather than be free to make decisions on the good of the financial system. Stanton noted that “The Fed then becomes a major creditor of GSEs.”** (*Barron’s Online*, 11/9/98; *Dow Jones Newswire*, 10/30/98)
- The Fed began buying agency debt back in 1971, but hasn’t added to its permanent holdings of agency securities since the early 1980s and has allowed its holdings to mature without replacement. The Fed, which now holds only about \$387 million of these securities, announced in 1997 that it would allow its remaining holdings to mature without replacements. (*Barron’s Online*, 11/9/98; *Dow Jones Newswire*, 10/30/98)

Reporter notes that US officials piously lecture the world about the economic problems caused by “crony capitalism” – Yet, “What about Fannie Mae and other cozy arrangements right under their noses?”

GSEs are crony capitalism: American style

Peter Wallison, American Enterprise Institute Fellow, agreed that there is evidence of crony capitalism at work between Fannie and the government. “Investments are being affected by a close relationship between the enterprise and the government, and the money flows back to the government patrons in many forms -- political donations, the hiring of government officials, distribution of grants in every congressional district. Everyone is getting paid out of that big trough,” according to Wallison.

Wallison also sees parallels with the Savings & Loan collapse in the 80’s. “They [Fannie/Freddie] have very low capital margins (less than 2 percent of assets versus 8 percent for commercial banks), and they’ve been looking for higher-risk investments to improve their profitability. It’s a prescription for financial disaster if interest rates go up. And Congress is ignoring it.”

Reporter notes that Fannie cannot prove that the current system would keep rates lower. The reporter states, “The private secondary market for mortgages has ballooned over the past two decades, and it’s quite possible that real competition would result in rates just as low or even lower than Fannie makes possible. But Congress does not have the courage to take the risk to find out. . . So Fannie Mae will continue to thrive. It’s not fair to the competition, and it’s

certainly not how the game of American capitalism is normally played. But in Washington you never argue with success -- especially when it's the work of your cronies."

- Owen Ullmann, a reporter for *USA Today*, recently wrote an article in *The International Economy* magazine that focused on the "crony capitalism" that exists between government officials and corporate executives at the GSEs (particularly at Fannie Mae). Ullmann refers to their close relationship as "crony capitalism," defined as "the cozy relationship between government officials and corporate execs that encouraged bad investment decisions." Ullmann references a 1998 speech by former Treasury Secretary Robert Rubin in which he cited "close links between governments, banks and corporations [that] led to fundamentally unsound investments" as reason for the Asian crisis. He believes that the criticism is "right on point," yet in Washington, DC, Ullmann states that a form of crony capitalism exists right under Treasury's nose – and with its blessing. **Ullmann highlights the hypocrisy that exists when US government officials "piously lecture the world" about the economic problems caused by "crony capitalism" when the US has Fannie Mae and "other cozy arrangements right under their noses."**
- Ullmann focuses his article on Fannie since it is the largest of the GSEs. He notes that Fannie has close ties with the Washington establishment -- mainly with the White House and Members of Congress. Ullmann notes that Fannie's greatest advantage is its implied federal guarantee. **Ullmann admits that there is no actual federal guarantee, however, Fannie nonetheless can borrow at rates close to those for Treasury securities. The advantage over private competitors has been estimated by various studies at 25 to 75 basis points. Citing the 1996 Treasury and Congressional Budget Office studies, Ullmann notes that Fannie and Freddie's federal guarantee was valued at over \$6 billion a year. While 2/3 of that amount is returned to homeowners, the remaining \$2 billion is divided between shareholders and the executives who run Fannie and Freddie. "As a means of funneling federal subsidies to home buyers, the GSEs are a spongy conduit – soaking up nearly \$1 for every \$2 delivered," the CBO report concluded. "As a result, Fannie's bottom line had been nothing short of sensational."** Last year the company earned \$3.4 billion, up 14 percent from 1997, and is continuing that pace this year. Fannie Mae's mortgage portfolio now tops \$1 trillion, making Fannie Mae the largest financial company in the US. In addition, Fannie's market valuation is up 50 percent from two years ago to \$70 billion, according to Ullmann, and the company is aiming to double earnings per share over the next five years.
- Since Fannie does not deal directly with consumers, Ullmann notes, the company saves billions on office space and employees. In addition, the company operates on a 100 basis-point spread, with only about 7 basis points accounting for expenses. Banks on the other hand, operate on a 400 basis-point scale, with expenses accounting for about 100 basis points. **According to Ullmann, Fannie Mae's net income is about \$900,000 per employee.**
- According to their critics, Fannie doesn't play by the usual free-market rules. "Its federal charter guarantees that it will make enormous profits on risk-free investments at the expense of wholly private competitors. Fannie should go completely private or become a government agency again so taxpayers could reap all the benefits," argue the opponents. **Peter Wallison, American Enterprise Institute Fellow, agreed that there is evidence of crony capitalism at work between Fannie and the government. "Investments are being affected by a close relationship between the enterprise and the government, and the money flows back to the government patrons in many forms -- political donations, the hiring of government officials, distribution of grants in every congressional district. Everyone is getting paid out of that big trough,"** according to

Wallison. Wallison also sees parallels with the Savings & Loan collapse in the 80's. "They [Fannie/Freddie] have very low capital margins (less than 2 percent of assets versus 8 percent for commercial banks), and they've been looking for higher-risk investments to improve their profitability. It's a prescription for financial disaster if interest rates go up. And Congress is ignoring it."

- Why does Congress ignore these warning signs? According to Ullmann it is due to many factors -- the first that Fannie tends to fill its high ranks with former government officials. Current CEO Franklin Raines was President Clinton's budget director, while former CEO James Johnson was a close Mondale advisor. Others in Fannie Mae's high levels include former Clinton Deputy Attorney General Jamie Gorelick, now a Vice Chair; Arne Christenson, formerly Newt Gingrich's Chief of Staff and now a Senior VP at Fannie Mae; Jack Quinn, Vice President Gore's former Chief of Staff, and now a director. Plus, he writes that the pay is great: former Chairman and CEO of Fannie Jim Johnson collected \$9.5 million last year, while current Chairman Franklin Raines will make approximately half that amount this year.
- In addition, Fannie Mae keeps nearly 20 "top-drawer" law firms on retainer for lobbying purposes, notes Ullmann. John Buckley, another former government insider who worked on the Reagan and Dole campaigns and who is now a Senior VP at Fannie Mae, acknowledges that Fannie spends about \$4 million a year for lobbying, but contends that is on par with other large corporations. But Ullmann notes, "there's nothing typical about Fannie's lobbying clout, however, for those on the receiving end. [Congressman James] Leach says Fannie alone has more clout with Congress than all the private banks in the United States put together."
- Fannie is also prone to playing hardball, Ullmann reports. **"It will hire key government critics to buy their silence, and it will intimidate lawyers, consultants and financiers who go up against it by pressuring clients of the opponents to withdraw their business."** A congressional source is quoted as saying, **"Fannie has this grandmotherly image . . . but they'll castrate you, decapitate you, tie you up and throw you in the Potomac. They're absolutely ruthless."** Ullmann notes that Buckley does not deny that Fannie can be tough with their opponents. But he denies that the GSE is brutish. Instead, Buckley said that Fannie's critics aren't intimidated by their means, instead, they are intimidated by their "spectacular accomplishments."
- As for Fannie's critics, Ullmann mentions the formation of a coalition to fight the GSEs' expansion into areas beyond their charter, noting that the critics are gearing up for a fight in Congress. Concluding his article, Ullmann quotes John Buckley, Fannie's Senior VP as saying, **"The critics have never been able to prove that consumers won't suffer (by paying higher mortgage rates) if we give up our charter."** Ullmann notes that "[h]e's right. But neither can Fannie prove that the current system would keep rates lower. The private secondary market for mortgages has ballooned over the past two decades, and it's quite possible that real competition would result in rates just as low or even lower than Fannie makes possible. But Congress does not have the courage to take the risk to find out. . . So Fannie Mae will continue to thrive. It's not fair to the competition, and it's certainly not how the game of American capitalism is normally played. But in Washington you never argue with success -- especially when it's the work of your cronies." (*The International Economy*, Owen Ullmann, July/August 1999)

Fannie Mae and Freddie Mac

Sources agree that it is likely that under both the Basel proposal and the US regulatory proposal, the risk-weighting for top-rated mortgage-backed securities (MBS) and asset-backed securities (ABS) will be lowered to 20% (same as for Fannie's & Freddie's MBS)

- According to a *Mortgage-Backed Securities Letter* article by Ed Staples, US bank regulators are currently preparing a new proposed recourse rule that, similar to the June proposal from the Basel Committee, will feature a ratings-driven approach to mortgage- and asset-backed securities and commercial MBS. Sources believe that the US proposal could become final earlier than the Basel proposal because of the extended comment period involved in the Basel process. Sources also agree that it appears likely under both the US regulatory proposal and the Basel proposal that top-rated MBS, CMBS and ABS will likely be accorded the same risk weighting as Fannie and Freddie. The article notes that officials at Fannie and Freddie refused to comment on the issue but have opposed a similar ratings-driven approach when it appeared as part of the November 1997 recourse rule. (*Mortgage-Backed Securities Letter-American Banker*, Ed Staples, 7/5/99)

Financial services trade associations support lowering risk-weighting for AAA and AA rated securities for private-label MBS to 20% - same as Fannie & Freddie

- As reported in the May 14th *GSE Report*, a joint financial services trade letter was sent to the Federal Reserve Board on May 11 requesting that the Federal Reserve and other bank regulators revise the risk-weightings so that all investment grade MBS be given a 20% risk-weighting to ensure that Fannie and Freddie MBS would not be treated more favorably under bank risk-based capital guidelines than private-label MBS with AAA and AA ratings. The letter notes that currently Fannie and Freddie's MBS have "support from an array of government-granted benefits" that provide preferential treatment to GSE-supported MBS over other private sector MBS. "In addition to being among the limited class of securities insured depositories may hold, the risk based capital regulations afford their MBS [Fannie and Freddie's] a favorable 20 percent risk weight, resulting in a 1.6 percent capital charge." On the other hand, "MBS guaranteed by private institutions are assigned a risk weight of either 50 percent (equal to a 4 percent capital charge) or 100 percent, depending on the 'prudential' nature of the underlying mortgages."
- The letter further notes that, "Since banks and thrifts need to hold less capital against government sponsored enterprise (GSE) securities than other comparable investments, their required hurdle is lower, thereby making investments in Fannie Mae or Freddie Mac MBS preferred over other investment alternatives, even when they have identical investment ratings." The letter concluded by stating that "We urge the Federal Reserve and other bank regulators to revise the risk-weightings so that all investment grade mortgage backed securities should be given a 20 percent risk weighting. This would further the process of reform of the risk-based capital system to more closely align ratings with real risk." The letter was signed by the Financial Services Roundtable, America's Community Bankers, American Bankers Association, Consumer Mortgage Coalition, Mortgage Insurance Companies of America, and the National Home Equity Mortgage Association. (*Joint Bank Trade Letter to Federal Reserve Board*, 5/11/99)
- The Mortgage Bankers Association also sent a letter to the Fed on the issue. Paul Reid, Executive Vice President of the Mortgage Bankers Association, sent a letter to Federal Reserve Board Chairman Alan Greenspan requesting that a reduction be given for the risk-weighting for highly rated (AAA and AA) private label mortgage- and asset-backed securities (MBS/ABS) from 50

percent to 20 percent. Reid wrote that the “MBA feels strongly that by reducing the capital requirement for these types of securities, the agencies will have taken an important step toward meeting the goal stated in the rule’s preamble of adopting ‘capital requirements that more closely reflect a banking organization’s relative exposure to credit risk.’” Reid urged the regulatory agencies to carve out this section and rule on it separately “without waiting to include it in the final rule.” Reid wrote that “the current risk-based capital rule discourages a large number of potential investors (banks and thrifts) from investing in highly rated private label MBS. These investor groups face a significantly higher capital charge for investing in private label MBS than they do for other MBS of comparable credit quality which enjoy a 20 percent risk weighting.” Reid closed his letter by writing that “The MBA believes that remedial action *now* would clearly demonstrate that the Fed and the other regulators are truly committed to the goal of aligning risk ratings more closely to actual risk.” (*MBA Executive Vice President Paul Reid letter to the Federal Reserve Board, 5/24/99*)

Fed Responds

- The Federal Reserve responded to the joint trade association letter in a June 2 letter, stating that if federal banking agencies revise their risk-based capital standards to assess a lower capital requirement against highly rated asset-backed and mortgage-backed securities, “then privately issued mortgage-backed securities based on whole mortgage loans could be assigned to the 20 percent risk weight if they are rated in the highest investment grade category.” The letter also noted that if proposals to revise the Basle Accord are implemented, “highly rated claims on sovereigns, banks, and corporations, as well as high quality mortgage- and asset-backed securities could be eligible for assignment to a lower risk category.” (*Richard Spillenkothen, Director of Banking Supervision and Regulation, Federal Reserve Letter, 6/2/99*)

Analyst downgrades Household International and Associates First Capital Corp.’s stock because of encroachment into the subprime home equity business by Fannie & Freddie

Subprime home equity lending is beyond Fannie’s mission of providing liquidity for the mortgage market

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

- Morgan Stanley Dean Witter analyst Ken Posner lowered the price target shares of strong buy-rated Household International Inc and on outperform-rated Associates First Capital Corp. Posner lowered his price targets because strong buy-rated Fannie and Freddie are penetrating the subprime home equity lending business, where Household and Associates compete. Posner said Fannie and Freddie’s technology, combined with its distribution channel, would allow them to penetrate much of the A- home equity lending. (*Reuters, 7/12/99*)

[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.]

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

FM WATCH – “Let’s Follow the Money” – GSEs’ programs for 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 subprime areas cost consumers more while the GSEs pocket it.
- 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)

Article notes that Fannie & Freddie have a credibility problem when they continually deny that they are not trying to expand into the private sector mortgage industry’s business – “Let’s Be Frank . . . or Freddie”

“The possibility remains that even if Fannie does not go after consumers, they are certainly paving the way to go after brokers and other originators. If this happens, where does that leave Fannie’s ‘only customers?’”

“Despite GSE denials and acerbic PR salvos, the fact remains that a week doesn’t go by in which another story, advertisement, statement, or news item involving Freddie and Fannie’s alleged trespasses. It’s the mortgage industry equivalent of Lewinsky-gate: the story that just won’t go away.”

- James Hennessy, Jr. a Senior Vice President of Sales and Marketing for Hansen Loan Quality Service, recently wrote an article in *MortgageOriginator.com* analyzing the continued denial by the GSEs that they are in competition with the rest of the mortgage industry. He noted that Franklin Raines, the CEO of Fannie Mae, has made many appearances in front of lenders and trade associations saying things like “our job is to support your business -- not to do your business.” “He [Raines] has even gone so far as to say he would tattoo that message on his forehead if he thought it would allay lenders’ fears.” Hennessy also reported on Raines’ recent full-page “letter” to lenders (actually an advertisement, according to Hennessy) that pledged to open Fannie’s automated underwriting system to all, even Freddie Mac. The letter concluded with “Fannie Mae will not originate mortgages. Period.” Hennessy compared these statements to those of former President George Bush when he famously said, “Read my lips. No new taxes.” Hennessy notes, **“The possibility remains that even if Fannie does not go after consumers, they are certainly**

paving the way to go after brokers and other originators. If this happens, where does that leave Fannie's 'only customers?'"

- Fannie and Freddie are fighting an uphill battle for their GSE credibility, with most of their wounds self-inflicted, according to Hennessy. He listed several examples of their credibility problems: such as Freddie's attempt to enter into the mortgage insurance business last fall; consumer advocate Ralph Nader calling for the revocation of the GSEs charters; and the GSEs continued push for public recognition, despite the fact that the ordinary citizen is not their customer. Hennessy also cited Freddie's advancement towards the subprime industry by hiring executives from the B/C industry; and Fannie Mae's extensive criticism of OFHEO's risk-based capital standards (which Fannie Mae failed to meet), as examples of the GSEs' self-infliction. In addition, Hennessy noted that Freddie Mac president Leland Brendsel may have given extra ammunition to his critics last spring when he said that Freddie's charter allowed the GSE to get involved in basically anything that reduces the cost of mortgage credit and increases the availability of mortgages. "Anything ... Presumably that includes eliminating those pesky, commission-gobbling brokers, those greedy lenders, those nagging loan servicers, and all their friends in escrow, title and mortgage insurance roles."
- Why do the GSEs make these gaffes? Hennessy was unsure -- it may be arrogance, or it may be that the GSEs are employing a different strategy to silence their critics -- by hiring as many talented people from the mortgage industry as possible. "It's like a 'Who's Who in Mortgage Lending, which strikes another strategy to take over the business by hiring talent away from its own clients. Do that long enough, and mathematically speaking, the criticism can't help but die out."
- As for critics of the GSEs, Hennessy noted that it's difficult to find critics that will speak out openly. "Few people in the lending community want to get stuck between two 8,000 pound gorillas. Trade press invariably quote unnamed sources and others who wish to keep their identities secret." Even the newly formed coalition to fight GSE expansion, the Competitive Consumer Lending Coalition [now FM WATCH], had not named any members as of press time. Hennessy did note that the coalition was rumored to include MI companies, title insurers, subprime and conforming mortgage bankers, and others in the industry.
- There has been little response from the GSEs on the new coalition, except for Fannie's continued mantra, "They should be called the Coalition for Higher Mortgage Rates." In addition, Hennessy noted that the "buzz" on the street was that Fannie Mae had hired several Washington lobbying firms, just to keep them away from the Coalition. Freddie Mac has been quieter; only asserting that the coalition is just a plot to keep mortgage insurance rates high for consumers. But Hennessy doesn't think this is a story that will stay quiet. **"Despite GSE denials and acerbic PR salvos, the fact remains that a week doesn't go by in which another story, advertisement, statement, or news item involving Freddie and Fannie's alleged trespasses. It's the mortgage industry equivalent of Lewinsky-gate: the story that just won't go away."** (*MortgageOriginator.com*, James L. Hennessy, Jr., July 1999)

The California Association of Realtors (CAR) decide to monitor the activities of Fannie & Freddie

Group of realtor activists would like CAR to do more than just monitor - activists form Government Sponsored Enterprise Containment Coalition

Article notes that the National Association of Realtors (NAR) is discouraging its members from joining the Fannie/Freddie Watchdog group, FM WATCH. However, officials at NAR said that the association is neutral on the issue

- According to a *National Mortgage News* article by Brian Collins, the California Association of Realtors (CAR) has decided to monitor Fannie and Freddie's real estate activities. CAR's Board of Directors reportedly approved a motion that states that "CAR continues to dialogue with and monitor the government-sponsored entities' business practices." The article reports that realtors seem particularly concerned about Fannie and Freddie selling REO (real-estate owned) properties, especially if it's not their servicing. Of concern to CAR is Fannie's contract with the US Marshals Service to sell seized and forfeited residential properties. Marcia Salkin, CAR's Director of Public Policy pointed out the US Marshals are not lenders and they do not provide mortgage capital. "We have a little problem with that activity." Fannie and Freddie also do not use the standard CAR sales contract, which creates "suspicion" on the part of agents representing buyers. "Some of the terms are not favorable to the buyers," she said.
- A group of realtor activists would like CAR to do more to address the GSEs. The activists have formed a group called the Government Sponsored Enterprise Containment Coalition. GSECC Spokesman Bruce Koklich believes CAR's decision to monitor the GSEs is "a good start." **Koklich, a California realtor who specializes in REO sales, stated, "I believe the monitoring will eventually make it clear to CAR that the agencies have lofty goals to expand further into the real estate brokerage market."** Koklich also pointed out that because of Fannie's tax-exempt status, it passes on municipal transfer taxes to the buyer. Normally the seller pays these taxes, which range from \$200-\$300. (*National Mortgage News*, Brian Collins, 6/28/99)
- According to an *Inman News* article, the National Association of Realtors (NAR) is urging its member associations not to join the Fannie/Freddie watchdog group, FM WATCH. According to the article, NAR said it generally supports the GSEs' activities and the GSEs' automated underwriting technology and risk management techniques believing that the GSEs lower the cost for homebuyers. (*Inman News Feature*, 7/5/99) [Editorial Note: According to various sources, officials at NAR stated that they have not discouraged members from joining FM WATCH, and are instead, neutral on the issue.]

Reporter notes that charges by Fannie that the Fannie/Freddie watchdog group, FM WATCH, is simply a front for the mortgage insurance industry is undermined by the fact that the Mortgage Bankers Association will be issuing a policy statement that is similar to the positions held by FM WATCH

- A recent article by real estate reporter and weekly consumer columnist, Lew Sichelman, focused on the similarity between the new Fannie/Freddie watchdog coalition's positions (FM WATCH) to that of a draft policy statement by the Mortgage Bankers Association. According to Sichelman, the GSEs have asserted that FM WATCH is simply a front for the private mortgage insurance industry.

However, the Mortgage Bankers Association (MBA) is going to challenge the GSEs' claim by issuing a policy statement that differs from their usual treatment of the GSEs. Instead of treating Fannie and Freddie with kid gloves, the MBA is in the final stages of readying a statement that calls on the GSEs to "cease and desist from, among other things, forcing their technology on primary lenders and charging exorbitant guaranty fees."

- The MBA members do certainly rely on the GSEs to buy their loans, noted Sichelman, but they also want to ensure that the GSEs do not encroach on their markets, and extend past their government charters. Therefore, the MBA paper "reads remarkably similar to the stance taken by the coalition of eight other trade associations [in FM WATCH]." While the MBA has not joined FM WATCH, their statement echoes FM WATCH's "watchdog" approach to monitoring the GSEs.
- The policy statement, which is in its final stages of approval, according to Sichelman, calls for independent and well-funded regulators of the GSEs; for prohibitions against Fannie and Freddie's participation in primary market activities; and limits the introduction of new products and services "only when they relate to the core functions of providing liquidity and stability in the secondary mortgage market." However, the "boldest" part of the statement is in terms of technology. According to MBA President Donald Lange, their statement on technology even surprised Fannie and Freddie. The technology section permits the GSEs to use technology for internal risk management operations, but prohibits the GSEs from "engaging in primary market activities that fall beyond their charters when they engage in outside distribution." The position paper says the agencies have already destroyed the equilibrium in housing finance with their technology, which is required with some affordable housing loans Fannie and Freddie purchase. Specifically, it says, "the technologies have been developed in a subsidized environment, yet have served to discourage development of competing systems from the private sector, thereby limiting competition and innovation." (Lew Sichelman, *realtimes.com*, 7/5/99)

<p style="text-align: center;">Fannie & Freddie are becoming larger forces in credit enhancement in the tax-exempt housing bond market</p>

- According to a *Dow Jones* article by Dena Aubin, Fannie and Freddie are becoming larger forces in credit enhancement for the tax-exempt housing bond market. According to Securities Data Corp, Fannie provided credit enhancement for about \$755 million in multifamily municipal housing bonds in 1998. The article noted that the only other provider with close to that volume was MBIA Insurance Corp. with \$699 million par value. Freddie, which launched its own credit enhancement product at the end of last year, closed on about \$480 million par value in 1998.
- Gail Sussman, a Director in the Public Finance group at Moody's Investors Service Inc. said she's seen a growing number of issuers replace letters of credit from relatively weakly rated banks with the Freddie credit enhancement product, often getting upgraded in the process. "They have an opportunity for what they consider reasonable fees to increase their ratings significantly," stated Sussman, sometimes moving to triple-A from Baa or single-A. The new product "is being pretty strongly marketed by Freddie Mac and well-embraced by a lot of housing borrowers," she stated. (*Dow Jones Newswire-Capital Markets Report*, Dena Aubin, 6/29/99)

**Fannie/Freddie watchdog group, FM WATCH, could have some impact
on Fannie & Freddie's stock**

- According to an article in *National Mortgage News*, a recent research report by Salomon Smith Barney Analyst Tom O'Donnell, noted that the formation of the watchdog group, FM WATCH, is another factor to consider when assessing the stock of the GSEs. However, O'Donnell asserts that Fannie and Freddie have certain advantages over the watchdog group. One advantage, O'Donnell believes is that Fannie and Freddie are "clearly" on the side of the consumer in their business activities and that Fannie is considered one of the most skilled lobbyists in Washington. (*National Mortgage News*, Eric Avidon, 6/28/99)

**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

Fannie's Recent Developments:

Fidelity National Credit Services and Fannie launch credit reporting services on Fannie's automated underwriting systems

Freddie's Recent Developments:

- (1) Freddie will offer brokers instant access to its automated underwriting system through CrossLand Mortgage's website
- (2) Freddie may put its automated underwriting systems into local NAACP offices

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:

Fidelity National Credit Services and Fannie launch credit reporting services on Fannie’s automated underwriting systems

Fidelity National Credit Services (FNCS) has partnered with nine mortgage credit reporting companies through the FNCS and Fannie Technical Affiliate Program. The affiliate program markets and delivers credit reporting services on Fannie’s automated underwriting system, Desktop Underwriter and Desktop Originator systems, while using technical affiliates’ existing hardware and software interfaces. The following technical affiliates have been rolled out on the new technical affiliate program: Capital Mortgage Reports, Rocklin CA; Credit Bureau Associates of No. California, Fairfield, CA; Credit Bureau of Santa Cruz, Capitola, CA; Credit Data Resources of Idaho, Inc., Boise, ID; Delta Credit Services, San Jose, CA; Federal Reporting Corporation, Austin, TX; Professional Credit Service, Eugene, OR; Residential Mortgage Credit Reports, Houston, TX; and Shasta Cascade Credit Bureau, Inc., Redding, CA. FCNS also said it has contracted with Bourne Software Systems to develop a technical affiliate software interface and it is developing three more credit reporting software interfaces for Fannie rollouts in July. (*PR Newswire, 7/7/99; National Mortgage News website, posted 7/7/99*)

Freddie’s Recent Developments

- (1) Freddie will offer brokers instant access to its automated underwriting system through CrossLand Mortgage’s website

Freddie announced that First Security Corp.’s CrossLand Mortgage Corp. unit will offer mortgage brokers instant loan approvals through CrossLand’s new website, <http://www.cmcbrokerline.com>. The site will provide brokers with direct access to Freddie’s automated underwriting system, Loan Prospector, on the internet. The service can be accessed by clicking the LoanRunner link on the CrossLand site. (*National Mortgage News website, posted 7/7/99*)

- (2) Freddie may put its underwriting systems into local NAACP offices

Freddie announced that it entered into a national alliance with the NAACP to increase minority homeownership. As part of the initiative, Freddie agreed to purchase up to \$500 million in mortgage loans. The alliance will be managed through local NAACP Community Development Resource Centers (CDRC), which will work with local financial institutions- to provide outreach and credit education to potential homebuyers. There are currently seven states where CDRCs are located – Maryland, Virginia, North Carolina, South Carolina, Georgia, Florida and Texas. As part of the initiative, Freddie said it would provide the latest in automated underwriting technology to each office (presumably Freddie’s system only). (*Freddie press release, 7/9/99*)

Fannie Mae

Fannie invests in another national commercial bank

- According to an article in the *Miami Herald*, Fannie provided an \$800,000 capital investment through its minority partnership investment program to Continental National Bank of Miami. The bank is Miami's first Cuban American-owned national bank. (*Miami Herald*, 6/28/99)

Fortune Magazine ranks Fannie as the # 2 firm for minority diversity

- *Fortune Magazine* and the Council on Economic Priorities compiled its annual list of America's best companies for minorities. Fannie was ranked #2 behind Union Bank of San Francisco. (*Fortune Magazine*, 7/19/99)

Fannie Chairman Franklin Raines is part of investor group that is interested in purchasing a major league baseball team for Washington, DC

- According to the *Washington Post*, Fannie Chairman Franklin Raines, Fred Malek, a Nixon White House advisor and former Texas Rangers part-owner, and James Kimsey, Founding CEO and Chairman Emeritus of America Online have joined forces to bring a major league baseball team to Washington, DC. According to the article, the group, known as Washington Baseball Club, might be interested in purchasing the Montreal Expos. According to *National Mortgage News*, Fannie has not commented on Raines' involvement. The *Washington Post* further noted that the investor group also plans to form a foundation to help inner city kids if the group is successful in purchasing the Expos. (*Washington Post*, 7/2/99; *National Mortgage News*' website, posted 7/7/99)

USA Today asks CEOs of major companies to submit the websites they use on their job and leisure sites

CEOs were not allowed to submit the sites of their own companies

Fannie Chairman Franklin Raines submits AOL.com and Realtor.com. (Franklin Raines sits on the Board of AOL.com and Fannie owns 4% of HomeStore.com, the owner of Realtor.com) (*USA Today*, 7/2/99)

Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (currently 34 offices are officially open and operating and seven more are in the process of being organized)

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

- Fannie currently has 34 partnership offices "officially" operating. Fannie has announced plans to open or commitments to open partnership offices in the following areas: Columbia, SC; South Dakota; Milwaukee, WI; Bismarck, ND; Pittsburgh, PA; Newark, NJ; and an office in Wyoming. In a speech before the Long Island Housing Partnership's Annual Meeting, Fannie Chairman Franklin Raines stated that Fannie hopes to expand to 45 partnership offices around the country by

the end of the year. (*Fannie Chairman Franklin Raines speech before the Long Island Housing Partnership Annual Meeting, 6/18/99*)

- Fannie held a press conference with South Carolina Governor Jim Hodges, Congressman Jim Clyburn (D-SC), and Columbia Mayor Robert Coble to announce as part of its “House South Carolina” plan, the opening of a partnership office in Columbia, SC. A spokeswoman noted that the office would be staffed by at least three employees. (*Fannie press conference, 7/8/99; The State - Knight Ridder, 7/3/99*)
- In a press conference with Senators Tom Daschle (D-SD) and Tim Johnson (D-SD), Fannie announced that that it had committed to opening up a South Dakota Partnership Office in the state.
- 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 a 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 a 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*)
- According to a *Pittsburgh Post-Gazette* article, Fannie will be opening a 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*)

Senator Richard Bryan (D-NV), North Las Vegas Mayor Michael Montandon

- Fannie held a press conference with the above officials and GMAC Mortgage to welcome the first new resident to receive relocation assistance under the city’s new Windsor Park Housing Revitalization bond. The \$4 million general obligation bond, purchased by Fannie in February, was used to provide the financing for the city of North Las Vegas to continue relocating residents of Windsor Park, a 241-unit housing subdivision that was considered uninhabitable due to excessive ground subsidence. (*Fannie press release, 7/6/99*)

Congressman Christopher Cox (R-CA)

- Fannie issued a press release with Cong. Cox to announce the unveiling of a \$4 million reverse mortgage pilot for Leisure World Co-Op owners. Representatives from GMAC Mortgage, Seattle Mortgage, Quaker City Federal Savings and Loan and Financial Freedom Senior Funding Corporation were also involved in the program. Fannie announced that it was expanding its reverse mortgage product to owners of Leisure World’s 6,500 co-ops. (*Fannie press release, 7/7/99*)

Congressman Mac Thornberry (R-TX)

- Fannie issued a press release announcing that Fannie had purchased a \$15 million tax-exempt mortgage revenue bond issued by the Nortex Housing Finance Corporation. Congressman Thornberry issued a statement of support. The bond proceeds, available through the participating lenders, will finance 6.95%, 30-year fixed rate mortgage loans and down payment and closing cost assistance grants equal to 4% of the loan amount. Norwest Mortgage, American National Bank, the Hering National Bank, and First National Bank in Burkburnett are participating lenders. (*Fannie press release, 7/8/99*)

Congressman Rick Hill (R-MT)

- Fannie issued a press release with Congressman Rick Hill (R-MT) to announce the convening of housing roundtable meetings with Montana housing leaders. (*Fannie press release, 7/6/99*)

Congressman Xavier Becerra (D-CA)

- Fannie announced with Congressman Becerra that the historic Los Altos Apartments was officially reopened thanks to a public-private partnership led by local non-profit developer Neighborhood Effort and Banc One, LISC, Wells Fargo Bank, City of Los Angeles Housing Department and Fannie. (*Fannie press release, 7/8/99*)

Congresswoman Lincoln Diaz-Balart (R-FL)

- Fannie issued a press release with Congresswoman Diaz-Balart to announce a homeownership partnership and a \$40,000 grant to San Juan Bosco Catholic Church for outreach efforts for immigrants and minority families. Fannie also announced the availability in Miami-Dade of its “New Immigrants Initiative,” a mortgage pilot for immigrants wishing to purchase a home. Participating lenders in the program are AIB Mortgage Company, Chase, Citibank, Countrywide Home Loans, Equity Financial Group, Sun Trust Bank, Miami, N.A., and Universal American Mortgage Company. (*Fannie press release, 6/25/99*)

Freddie Mac

Freddie hires former Speaker Newt Gingrich as a consultant

- According to *Hotline*, CNN’s Robert Novak stated the following about Former Speaker of the House Newt Gingrich’s “new gig as a government consultant”: “Freddie Mac, which is a government-backed outfit, has hired as a consultant Newt Gingrich. Now it means he doesn’t have to register as a lobbyist, but, you know, if it looks like a duck and walks like a duck, it is a duck. And I think Newt Gingrich is now going to be a high-paid lobbyist – I mean, consultant.” (*Hotline, 7/2/99 – “IP,” CNN, 7/1/99*)

Freddie names Adrian Corbiere as Senior Vice President, Multifamily

- Freddie announced the appointment of Adrian Corbiere to the position of Senior Vice President, Multifamily. Corbiere will report to David Glenn, President and COO of Freddie. Corbiere was Managing Director, Real Estate Investments at Allstate Insurance Company. (*Freddie press release, 6/28/99*)

Freddie purchases \$22 million mortgage loan for a 21-building apartment community

- Freddie announced the purchase of a \$22.2 million mortgage loan from Stockton, Luedemann, French/Jackson & West, a division of Northland/Marquette Capital Group. Trammell Crow Residential is the borrower and owner of the property securing the mortgage. The property, The Reserve at the Fountains Apartments, is a 21-building complex with 370 housing units located in Stafford, TX (outside of Houston). The apartment community, completed in 1998, features a fitness center, business center, resort-style swimming pool, oversized tubs, and numerous other amenities. (*Freddie press release, 6/25/99*)

Federal Home Loan Banks

FHLBank of New York purchases \$788,000 participation in New Jersey multifamily and single-family mortgages under Community Mortgage Asset (CMA) program

- According to *National Mortgage News*, the FHLBank of New York and Provident Savings Bank announced the funding of the first mortgages in New Jersey through the Community Mortgage Asset (CMA) program. The CMA program was launched in 1997. The FHLBank of New York purchased a \$788,421.42 participation in two mortgages on a multifamily apartment building and eight residential single-family homes. The article noted that the first mortgage was funded at an 80% participation interest in a pool consisting of two condominiums, three single-family homes and three two-family homes. The second mortgage was for a 51-unit multifamily apartment building, funded at 50% participation interest, which consists of three walk-up apartment buildings. (*National Mortgage News, Kim Renay Anderson, 6/28/99*)

Status report of legislation containing FHLBank expansion provisions

Financial services modernization bill containing FHLBank expansion provisions passes the House

Bill will now go to Conference Committee to be reconciled with Senate-passed version of financial services modernization bill
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House:

- The financial services modernization bill (H.R. 10) passed the full House on July 1 by a vote of 343-86. H.R. 10 contains the following FHLBank expansion provisions: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock.

Senate:

- The Senate passed its version of financial services modernization (S. 900) on May 6 by a mostly party-line vote of 55-44. The bill contains the following five FHLBank provisions: (1) makes thrift membership voluntary; (2) makes access to FHLBanks easier for small banks with less than \$500 million in assets; (3) converts the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank earnings; (4) reduces FHFB control of day-to-day operations; and (5) instructs the General Accounting Office (GAO) to conduct a study of the FHLBank System capital

structure. A provision was also included just minutes before the legislation passed the Senate on May 6 that would allow community development groups to tap directly into the FHLBank System, virtually free of charge.

- A Conference Committee will soon be appointed to reconcile the House and Senate-passed versions of the financial services modernization bills.

FHLBank System prices two debt issues under its new “Tap” program

- According to *National Mortgage News*, the FHLBank System priced two issues under its new “Tap” program. The first was a \$120 million bullet note, priced at 99.808453 and the second, a \$354 million bullet note, priced at 99.932684. The first noncallable issue carried a coupon of 6.25% with an August 13, 2004 maturity, slated to settle July 9. The second noncallable issue was priced to yield 5.875% with an August 15, 2001 maturity. The name “Taps” refers to the fact that the FHLBank System is using the issues to tap specific areas of the Treasury yield curve. Taps will follow three-month quarters, corresponding to the trading of on-the-run Treasuries and also have semiannual coupon payment dates that coincide with Treasuries. The coupons will be rounded down to the nearest 1/8th, and set during the first auction of the quarter. (*Dow Jones Newswire*, 7/2/99; *National Mortgage News website*, posted 7/8/99)

Private Sector Items to Note

President Clinton requests housing and job assistance on Indian reservations as part of his Administration’s “New Markets Initiatives”

Lenders and mortgage insurers respond with new programs and initiatives

- As part of his “New Markets Initiative,” President Clinton visited the Indian reservation of Pine Ridge on July 7. In his remarks, President Clinton gave a special thanks to Norwest Mortgage CEO Mark Oman, PMI Chairman and CEO Roger Houghton, MBA President Don Lange and Champions Homes CEO Walter Young, for their new program offerings.
- As part of the program, HUD has created a partnership with private lenders to issue enough new mortgages to create 1,000 additional Indian homeowners on reservations around the nation over the next three years, doubling the number of government-insured or guaranteed home mortgages issued in Indian Country during the period. An alliance between members of the Mortgage Insurance Companies of America and Indian tribes was announced that would promote Native American homeownership through new counseling, education and financing programs. The companies will insure \$37 million in mortgages on reservations.
- Mortgage Guaranty Insurance Co. will enter into a three-year alliance with the Oglala Sioux Tribe to: (1) Endow a full-time Director of Homeownership counseling; (2) create homeowner education courses for the Oglala Lakota College; (3) develop innovative lending criteria and new home financing mechanisms tailored to the specific needs of the Oglalas.

- PMI Mortgage Insurance Company is increasing its Native American mortgage insurance initiatives to \$55 million (from \$20 million) nationwide. PMI already insures mortgages of the Choctaw Nation, Chickasaw Nation, Citizen Potawatomi and Cherokee Nation in Oklahoma.
- GE Capital will implement a pilot program with its mortgage lender partners to insure \$2 million in mortgage loans in Indian Country. GE Capital is also working with the National Association of Indian American Housing Councils to develop an underwriting seminar to inform and help the conventional market meet the needs of Native Americans.
- Republic Mortgage Insurance Company will launch the Financial Independence pilot project with the Oglala Sioux Tribe on the Pine Ridge Reservation and later expand the project to other reservations. The project will give students the knowledge to manage their financial affairs wisely, covering such areas as getting a home mortgage, financing other large purchases, and using credit cards. The project will begin by offering the courses to 2,000 Pine Ridge students each year at the ninth grade and community college levels. RMIC will give \$100,000 over five years to make this project a reality.
- HUD will also work with the Mortgage Bankers Association and mortgage lenders including Norwest, Countrywide Mortgage, and Banc One Mortgage to increase the number of home mortgages issued on Indian reservations nationwide to create 1,000 new Indian homeowners over the next three years. According to the *Lincoln Journal Star*, Norwest Mortgage, a leader in lending on Indian reservations, will be offering home loans at 5.95% interest. Banc One Capital Markets and George K. Baum & Company – two of the nation’s largest municipal securities underwriters have made new commitments to underwrite \$300 million in bonds per year for five years to create a market for reservation mortgages. The new commitments make Banc One and Baum the largest firms to announce plans to do business in Indian country. (*HUD press release, 7/7/99; Lincoln Journal Star, 7/5/99*) Fannie issued a separate press release on July 7 to announce that it was also investing in the Pine Ridge reservation efforts.
- As part of the “New Markets Initiative,” Bank of America Corp. also announced plans to invest \$500 million in inner-city small businesses. Other banking companies involved in the “New Markets Initiative” are Bank One Corp, Deutsche Bank, and First Union Corp. First Union pledged at least \$5 million of small-business equity investments and loans this year and next year in the Appalachian region. (*American Banker, 7/7/99*)

Farmer Mac

“Dear Colleague” letter praises Farmer Mac and urges members of the House Banking and Agriculture Committees 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

- According to *National Mortgage News*, a “Dear Colleague” letter was sent to member of the House Agriculture and Banking Committees pointing out the positive aspects of GAO’s recent report on Farmer Mac and expressing support for its GSE status. “Farmer Mac is serving the needs of farm mortgage borrowers, is carrying out its Congressional mission as Congress intended it to do and is much serving of our continued support,” the letter states. The letter was signed by Representatives Frank Lucas (R-OK), Wes Watkins (R-OK), Doug Bereuter (R-NE), Rick Hill (R-MT), Leonard Boswell (D-ID), Charlie Stenholm (D-TX), Cal Dooley (D-CA), David Minge (D-MN), Bill Barrett (R-NE) and Jo Ann Emerson (R-MO). (*National Mortgage News*, 7/5/99)
- Separately, 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

Farm Credit Administration issues Final Rule on leasing activities

- The Farm Credit Administration issued its final rule clarifying existing regulations and providing guidance for institutions about leasing activities. (*Federal Register*, pages 34514-34519, 6/28/99)

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