

The **GSE** REPORT TM

Contents of GSE Report TM

Major Events

- HUD Secretary Andrew Cuomo says HUD will work to resolve the conflict between the primary and secondary mortgage market – notes that lines are blurring between the two markets (*p. 4*)
 - Cuomo pushes to fully open “black box” automated underwriting systems and calls for “transparency” in automated underwriting systems
 - Cuomo announces that FHA will lead by example and will be the first to bring “transparency” to automated underwriting – FHA’s new underwriting system will be “fully open and understandable”
 - Cuomo says he will make FHA’s automated underwriting system a “glass box” in contrast to the “black box” automated underwriting systems used today [Editorial note: Fannie & Freddie control 95% of automated underwriting market share.]
 - Mortgage Bankers Association, the America’s Community Bankers, and consumer groups applaud the announcement
 - [Editorial note: Will Fannie & Freddie be forced to make their automated underwriting systems “transparent?”]
- Martin Luther King III writes an editorial accusing Fannie & Freddie of perpetuating a minority housing gap (*p. 6*)
 - King supports HUD’s proposal to raise Fannie & Freddie’s affordable housing goals
 - King believes HUD’s proposal is an excellent opportunity to let people in Washington know that there should be meaningful affordable goals placed on Fannie & Freddie. HUD’s goals should mean more than an increase in the overall percentage goals for Fannie & Freddie – the goals should actually make a real difference in the number of black and minority families that own their own homes.
 - King notes that despite Fannie & Freddie’s special exemptions and more than sufficient resources, the GSEs are lagging the primary market in serving borrowers that are low income, minority, and in underserved areas
- The GSEs receive exemption from privacy requirements imposed on other fully private financial institutions in the Financial Services Modernization Act (Gramm-Leach-Bliley Act – S. 900) that was signed into law by President Clinton on November 12 (*p. 7*)
 - Language was inserted, however, into the Statement of Managers that narrowed the intent of the privacy exemption. That language will allow the regulator (the Federal Trade Commission) to blunt any potential benefits the GSEs may have received from the additional exemption language.
 - Fannie/Freddie watchdog group, FM Watch, calls the GSE privacy exemption “anti-consumer,” providing the GSEs with a competitive advantage over the rest of the financial services industry at consumers’ expense
 - FM Watch says it’s another “midnight raid by the government subsidized enterprises”
- FHFB withdraws its anti-arbitrage proposal until the newly enacted FHLBank capital reforms in the financial services modernization bill (S. 900) are fully implemented (FHFB estimates this could take up to two years) (*p. 10*)
 - The anti-arbitrage proposal was an attempt by the FHFB to end the FHLBank System’s controversial arbitrage practices. The proposal was made in response to criticism by the Treasury Department and Congress that the FHLBank System was using its implied government guarantee from its GSE status to borrow heavily at preferential rates and then investing the proceeds in higher yielding instruments that are often unrelated to its housing mission.
 - FHFB will resubmit a portion of the proposal that defines and authorizes new “member mortgage assets” which the FHFB says will encourage the FHLBanks to compete against Fannie & Freddie and give the FHLBanks alternatives to arbitrage-driven investments.
- American Bankers Association (ABA) releases a report calling for privatization of the Farm Credit System (*p. 12*)
 - ABA believes Congress could do more to help struggling farmers by privatizing the Farm Credit System and using the Farm Credit System’s \$1 billion of annual subsidies to fund a tax credit to all farmers – not just the wealthy and the hobbyists
 - Independent banking consultant, Bert Ely – who delivered the report at the annual ABA conference earlier this

month – stated that “The Farm Credit System increasingly serves America’s larger, wealthier farmers, older farmers as well as hobbyist farmers...the ‘wealthy weekenders’...These are not the types of borrowers the FCS was chartered to serve.”

Fannie Mae and Freddie Mac

- Moving outside their mission of providing liquidity to the secondary mortgage market, Fannie & Freddie are both expanding into the home equity market (*p. 13*)
 - Morgan Stanley analysts report that Fannie’s total home equity/home improvement loans are up \$1.3 billion year-to-date and will likely double last year’s volume. Analysts note that if Fannie expands its home equity pilot with Home Depot into Home Depot’s 1200 stores, Fannie could likely reach \$144 million in annual volume
 - [Editorial note: The majority of home equity loans are made to middle- to higher-income, non-minority homeowners for debt consolidation. Home equity borrowers already own their own homes. Home equity loans are a consumer loan product, not a product that helps homebuyers purchase a home.]
- Fannie begins selling short-term securities (Benchmark Bills) over weekly Internet-based Dutch auctions to its authorized dealer group (*p. 14*)
 - Two weeks later, Freddie announces that it will begin selling its short-term securities (Reference Bills) over weekly Internet-based Dutch auction
 - Dealers say Fannie’s new program gives Fannie a higher return by cutting the dealers’ commissions [Freddie’s dealer commission is similar to Fannie’s]
 - Chicago Board of Trade is exploring the possibility of offering futures on Fannie’s new Benchmark Bills
- The conforming loan limit for Fannie & Freddie could increase by nearly \$20,000 (8%) next year (*p. 16*)
 - Fannie & Freddie may be able to purchase homes as high as \$259,440 (currently their ceiling is \$240,000)
- The Mortgage Bankers Association (MBA) and the National Association of Mortgage Brokers (NAMB) are working on a proposal to register every brokerage company and every broker in the US (and ultimately, possibly others involved in origination, such as appraisers) as a means to control fraud (*p. 17*)
 - The MBA and NAMB cannot force broker companies and individual brokers to register, but the plan under discussion would encourage brokers to register by having Fannie, Freddie, and HUD refuse to do business with any brokerage company or broker that does not have a registration number
 - Some worry that Fannie & Freddie would use registration as a tool to help them enter the mortgage origination business, dealing directly with brokers
- Fannie & Freddie both rank in *Washingtonian* Magazine’s “Great Places to Work” (*p. 17*)

Fannie Mae

- Fannie is charging a higher guaranty fee for its subprime (alt-A, A-) and niche products (home equity, home improvement, and reverse mortgages) (*p. 18*)
 - Fannie says its new products save consumers money, yet Fannie may be eating up the potential consumer savings by charging higher guaranty fees that are passed along to borrowers
 - Analysts says that Fannie is pushing its automated underwriting to the point-of-sale so that Fannie will have the “first look” at evaluating these “niche products” before pushing them aside to consumer finance companies or alt-A securitizers that have historically dominated these sectors
- Congress is asked to investigate problems with an apartment housing complex – Longwood Estates – owned by the Finch Group in partnership with Fannie (*p. 19*)
 - Finch Group defaulted on its mortgage and Longwood may be in jeopardy of demolition
- Fannie’s borrowing crowds smaller corporate issuers, making it difficult for smaller issuers to compete (*p. 19*)
- Texas votes to make reverse mortgage lending – a version of home equity lending – easier in the state (*p. 20*)
 - Fannie is one of the earliest and most vocal proponents of reverse mortgages – Two major types of reverse mortgages available today are the federally insured reverse mortgage, called the FHA Home Equity Conversion Mortgage and the Fannie Mae Home Keeper loan
 - Reverse mortgage borrowers can use their funds anyway they wish – to pay for home improvements, health care, prescriptions, travel, etc.
 - Consumer advocates and housing officials warn that the reverse mortgage loans carry high costs and may not be right for everyone – Consumers Union issued a report warning consumers that the loans can be expensive and are more complicated than traditional mortgages
 - [Editorial note: Congress never intended the GSEs to assist homeowners with financing travel costs, etc. Fannie’s mission is to provide liquidity to the secondary mortgage market.]
- Fannie invests in another shopping mall (*p. 21*)
 - [Editorial note: Investing in shopping malls is outside Fannie’s mission of providing liquidity to the secondary

mortgage market.]

- Fannie begins commercial real estate pilot that allows borrowers to purchase rental properties – Fannie will purchase the loans (p. 21)
- Fannie moves outside its mission and invests again in construction lending (p. 22)
- An undisclosed dispute with Fannie caused Bay View to delay its purchase of Franchise Mortgage Acceptance Corp. thus causing Bay View to struggle on Wall Street (p. 22)
- Fannie says it will begin purchasing newly originated CRA loans (p. 23)
 - Previously, Fannie would only purchase seasoned CRA loans, because they wanted to see at least 12 months of behavior (leaving lenders with the risk)
- Fannie drops Deutsche Bank from its list of preferred dealers – no reason given for dropping the Bank (p. 23)
- Countrywide and Bear Stearns have teamed up to offer a new first-of-its-kind residential mortgage-backed securities (MBS) deal – a derivative-style interest-only (IO) strip deal, made up of Fannie Mae collateral (p. 23)
 - The transaction is the first time an IO deal has been done in the agency sector
- *Buffalo News* says Fannie’s Buffalo Partnership office financed \$737 million in mortgages in first year? (p. 24)
 - Fannie’s press release says Fannie provided \$737 million in affordable housing financing?
 - [Editorial note: Fannie creates the false impression that consumers can go to Fannie to get loans. Fannie does not provide loans to consumers, fully private financial institutions such as mortgage companies, banks and thrifts provide mortgages to consumers. Although Fannie says it has no interest in going direct to consumers, it does not appear that Fannie provided a clarification of its proper role to the *Buffalo News* nor does Fannie provide clarification in its press release that its “lender partners” actually provide the loans.]
- The youthful-age and recent arrival of Fannie CEO Franklin Raines complicate Fannie’s search for a new President and Chief Operating Officer to replace departing Lawrence Small (p. 24)
 - Fannie’s Managing Director of International Housing Finance Services, Martin Levine, will also be leaving the firm in January
- Former Fannie Chairman optimistically claims that the US homeownership rate will surpass 70% by 2010 (p. 25)
- Only after officials intervene, Fannie and Alliance Mortgage decide not to evict a woman who paid 28 years on her 30-year mortgage (woman had less than \$1,000 left on her mortgage) (p. 25)
- Fannie is part of US/China Housing cooperation initiative (p. 26)
- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (currently 34 offices are officially open and operating and nine more are in the process of being organized) (p. 26)
 - Fannie says it plans to have 45 partnership offices opened by the end of the year

Freddie Mac

- Freddie is charging delivery fees (fees for using Freddie’s technology) for its subprime (A-), its flexible mortgage insurance loans and its 97% loan-to-value mortgage products (p. 28)
 - [Editorial note: Freddie says its new products save consumer’s money, yet Freddie may be eating up the potential consumer savings by charging delivery fees that are passed along to borrowers.]
- Freddie’s borrowing causes Treasury bond prices to tumble (p. 28)
- Freddie has former House Member Susan Molinari (R-NY) retained as a lobbyist (p. 28)
- Freddie’s Senior Vice President of Government Relations is on House Majority Whip Tom DeLay’s “Kitchen Cabinet” (p. 29)

Federal Home Loan Banks

- President Clinton announces his plans to renominate FHFB Chairman Bruce Morrison and FHFB Director J. Timothy O’Neill to the Federal Housing Finance Board (regulator of the FHLBank System) (p. 29)
 - Two other nominees, Franz Leichter and Douglas Miller, are still waiting for the Senate to vote on their nominations
 - Unclear when the Senate will take up the nominations
 - For the first time since the FHFB was created, the FHFB could have its first complete, full-time 5-member board (if the Senate confirms all nominations)

Farmer Mac

- Farm Credit Administration proposes risk based capital rule for Farmer Mac (p. 30)
- Farmer Mac is feeling the full effects of the economic problems currently facing US farmers (p. 31)

Major Events

HUD Secretary Andrew Cuomo says HUD will work to resolve the conflict between the primary and secondary mortgage market – notes that lines are blurring between the two markets

Cuomo pushes to fully open “black box” automated underwriting systems and calls for “transparency” in automated underwriting systems

Cuomo announces that FHA will lead by example and will be the first to bring “transparency” to automated underwriting – FHA’s new underwriting system will be “fully open and understandable”

Cuomo says he will make FHA’s automated underwriting system a “glass box” in contrast to the “black box” automated underwriting systems used today [Editorial note: Fannie & Freddie control 95% of automated underwriting market share.]

Mortgage Bankers Association, the America’s Community Bankers, and consumer groups applaud the announcement

[Editorial note: Will Fannie & Freddie be forced to make their automated underwriting systems “transparent?”]

- HUD Secretary Andrew Cuomo made references to the GSEs in a luncheon speech on November 3, commemorating the 50th anniversary of the Housing Act of 1949. Secretary Cuomo outlined HUD’s 10 priorities for the year 2000. One of HUD’s goals is to keep the housing industry strong and united. Cuomo predicted that new products and competition would cause friction between the primary and secondary mortgage markets. “New products will push productivity and cause fierce competition. As a result, it will be tough to determine where the primary and secondary market begin and end. You are going to see division and opposition in the housing industry.” However, Cuomo noted that HUD had a role to play in resolving the conflict. “HUD has to be an independent, but strong regulator, who will be fair to all parties to keep the housing industry unified.” (*BNA Daily Report for Executives*, Kenneth Talley, 11/4/99)
- Under HUD’s goal of increasing consumer confidence, Cuomo noted that a key area in improving consumer confidence is mortgage underwriting. “The formula for mortgage approval or disapproval must be clear and definable. We cannot, and should not, defend secret formulas or computer software programs which generate rejections or acceptances by unknown means. The FHA will lead by example again...FHA will be the first to bring transparency to automated underwriting. Our underwriting scorecard will be fully open and understandable. If a person is rejected, they will know why, on what basis, with no suspicion or fear.” (*Excerpted from HUD Secretary Cuomo speech on Housing Act of 1949*, 11/3/99)

Secretary Cuomo provides more details on making a “transparent” automated underwriting system

- During a speech before a Mortgage Bankers Association National Housing Summit in Charlottesville, VA on November 12, Secretary Cuomo provided more details on his plans to develop a “transparent” automated underwriting system. **Cuomo stated that HUD was creating a new “transparent” automated underwriting system scorecard for FHA loans as an alternative to the automated underwriting systems used by Fannie and Freddie.** Cuomo said FHA’s automated underwriting system “will produce an electronic score card of a prospective borrower’s qualifications for a mortgage that will be fully open, transparent and understandable.” According to Assistant Secretary for Housing and FHA Commissioner William Apgar, HUD plans to have the new FHA automated

scorecard available within six to eight months. (*Washington Post*, Sandra Fleishman, 11/12/99; *National Mortgage News website*, posted 11/12/99; *HUD press release*, 11/12/99; *Wall Street Journal*, Jerry Guidera, 11/12/99; *BNA Daily Report for Executives*, Eileen Canning, 11/16/99)

- Cuomo said the system will be a totally transparent “glass box” that would let applicants see how the computer formula works and what the credit variables are. The scorecard “will tell you exactly how you get qualified and what you have to do” if the application falls short, Cuomo stated. “If a person doesn’t get FHA insurance, our new system will explain why,” he stated. “In effect, FHA’s new automated underwriting system will be like a glass box, exposed to the light of day and public scrutiny.” HUD’s press release noted that in contrast, some automated underwriting systems in use today are known as “black boxes” because outsiders aren’t allowed to examine their inner workings. [As reported in previous *GSE Reports*, Fannie and Freddie control 95% of the automated underwriting market share.] (*Washington Post*, Sandra Fleishman, 11/12/99; *National Mortgage News website*, posted 11/12/99; *HUD press release*, 11/12/99; *Wall Street Journal*, Jerry Guidera, 11/12/99; *BNA Daily Report for Executives*, Eileen Canning, 11/16/99)

Cuomo’s efforts are intended to address racial discrimination charges against automated underwriting systems

- **Cuomo said the “fully open and fully transparent scorecard aims to boost consumer confidence,” which he said is undermined by “the mystery” of the way Fannie and Freddie use scorecards now.** “Right now,” said Cuomo, “the machine spits out an answer: accepted, rejected. No one knows the basis on which the decision is made.” HUD officials say consumer groups are concerned about the discriminatory impact of automated underwriting systems. Cuomo stated that making the FHA automated scorecard transparent will ensure that lending is nondiscriminatory and will put pressure on other automated underwriting systems to be more transparent. **Fannie and Freddie “initiated the black box systems,” Cuomo stated recently, criticizing the two GSEs, “and now their investors are dictating their criteria for providing loans.”** (*Washington Post*, Sandra Fleishman, 11/12/99; *National Mortgage News website*, posted 11/12/99; *HUD press release*, 11/12/99; *Wall Street Journal*, Jerry Guidera, 11/12/99)
- [As reported in a previous *GSE Report*, an independent study commissioned for HUD by the Urban Institute found that that Fannie and Freddie’s underwriting guidelines may have an unintentional but adverse impact on borrowers with low incomes, limited wealth and poor credit histories which are “disproportionately minority.” The report also noted that Fannie and Freddie “do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities.” The report stated that “Primary lenders are making more aggressive efforts” to serve the lower income and minority home buyers “by offering loan products with underwriting guidelines that are more flexible than the GSEs’ guidelines.” (*Wall Street Journal*, 4/30/99; HUD Study, “*A Study of the GSEs’ Single Family Underwriting Guidelines*,” April 1999)]

MBA, ACB and consumer groups support the proposal

- The MBA has agreed to share the \$1 million cost of a public education campaign on the FHA scorecard and to advise the FHA on the underwriting system. (*Washington Post*, Sandra Fleishman, 11/12/99; *National Mortgage News website*, posted 11/12/99; *HUD press release*, 11/12/99; *BNA Daily Report for Executives*, Eileen Canning, 11/16/99)
- The ACB is also supportive of the program. **Brian Smith, Director of Research at the ACB, said the association was pleased with the announcement because consumers can use a system and see**

how it works, rather than having a black box system, like those used by Fannie and Freddie.

According to Smith and Sam Pincich, a regulatory specialist at ACB, Fannie and Freddie have their own black boxes, in which they look at information sent from other black boxes. Now, HUD is saying, “We want to have a system where we know how it works because we built it,” Smith told the *BNA*. “You will be able to see exactly what is there.” (*BNA Daily Report for Executives*, Eileen Canning, 11/16/99)

- Consumer advocates applauded Cuomo’s announcement to make FHA’s scorecard transparent. “The black box is truly a mystery to the public,” said David Berenbaum, Executive Director of the Equal Rights Center in Washington. “By having a more transparent process, I think the consumer wins.” (*Washington Post*, Sandra Fleishman, 11/12/99; *National Mortgage News website*, posted 11/12/99; *HUD press release*, 11/12/99; *Wall Street Journal*, Jerry Guidera, 11/12/99)

Fannie & Freddie have a virtual monopoly on the automated underwriting market

- At a recent Morgan Stanley Dean Witter investor luncheon, Fannie’s Chief Information Officer Bill Kelvie told analysts that Fannie had 60% automated underwriting market share and Freddie Mac had 36%. Kelvie also noted that 972 lenders now use Fannie’s automated underwriting systems (accounting for “virtually all” lenders of any size, according to Kelvie). The Morgan Stanley analysts further noted that “even in an open architecture environment, where lenders have a choice of accessing any of a number of systems via the Internet, Fannie Mae (and Freddie Mac) will continue to expand market share. The reason is that, no matter which computer system looks at a loan, it will ultimately drive that loan to the best execution, which will normally be the agencies.” [Editorial note: The best execution to the secondary mortgage market will always be the GSEs. Because of their GSE status, they have the lowest cost of funds over private companies.] (*Morgan Stanley Dean Witter analyst report, Fannie Mae: Investor Luncheon: New Products Could Help the Margin*, Kenneth Posner and Michael Courtian, 10/20/99)

Martin Luther King III writes an editorial accusing Fannie & Freddie of perpetuating a minority housing gap

King supports HUD’s proposal to raise Fannie & Freddie’s affordable housing goals

King believes HUD’s proposal is an excellent opportunity to let people in Washington know that there should be meaningful affordable goals placed on Fannie & Freddie. HUD’s goals should mean more than an increase in the overall percentage goals for Fannie & Freddie – the goals should actually make a real difference in the number of black and minority families that own their own homes.

King notes that despite Fannie & Freddie’s special exemptions and more than sufficient resources, the GSEs are lagging the primary market in serving borrowers that are low income, minority, and in underserved areas

- Martin Luther King III, president and chief executive officer of the Southern Christian Leadership Conference, wrote an editorial in the November 17, 1999 edition of the *Washington Times*, calling for an increase in the GSEs' affordable housing goals. King noted that in 1998 over 72% of white Americans owned homes, while only 46% of African Americans owned their own home. Since 1983, the percentage of whites owning homes has risen from 69.1% to 72.6%, while the percentage of African Americans has gone from 45.6% to 46.1%, a mere .05 percent. Therefore, noted King, the home ownership gap has risen from 23.5% to 26.5%.
- King acknowledged that the US government has long been aware of this discrepancy, authorizing mortgages through HUD's FHA program, the Veteran's Administration, and by designating the GSEs to promote low-income and minority home ownership in the secondary market. However, King went on to note, **"There are indications, however, that Fannie Mae and Freddie Mac could be doing a better job. . . the Urban Institute reported in April that neither Fannie Mae nor Freddie Mac is 'leading the industry in terms of affordable lending or outreach to underserved markets.' More importantly, for African American families, the Urban Institute concluded that the GSEs are not serving lower-income and minority borrowers to the extent these families receive mortgages from primary lenders."**
- King also quoted the July 1998 study by the General Accounting Office, which found that the GSEs have fallen short on providing affordable housing to minorities and low-income borrowers. **"Despite special exemptions and more than sufficient resources, Fannie Mae and Freddie Mac have been negligent in doing all they can do."** King further noted that the GAO concluded that the GSEs lag behind the primary market in most areas, including the categories of Very Low Income; African American; Underserved Areas; Low-Income Census Tract; and High African American Census Tract.
- King concluded his editorial by urging readers to support HUD's recent announcement to raise the GSEs' affordable housing goals. **"We have to have goals that mean more than an overall percentage increase, but will actually make a real difference in the number of black and minority families that own their own homes. Our goal should be to raise the percentage of African-American families owning a home to equal that of white families,"** concluded King. *(Washington Times, Martin Luther King III, 11/17/99)*

The GSEs receive exemption from privacy requirements imposed on other fully private financial institutions in the Financial Services Modernization Act (Gramm-Leach-Bliley Act - S. 900) that was signed into law by President Clinton on November 12

Language was inserted, however, into the Statement of Managers that narrowed the intent of the privacy exemption. That language will allow the regulator (the Federal Trade Commission) to blunt any potential benefits the GSEs may have received from the additional exemption language.

Fannie/Freddie watchdog group, FM Watch, calls the GSE privacy exemption "anti-consumer," providing the GSEs with a competitive advantage over the rest of the financial services industry at consumers' expense

FM Watch says its another "midnight raid by the government subsidized enterprises"

- The House and Senate overwhelmingly approved the Financial Services Modernization Act (S. 900) – the Gramm-Leach-Bliley Act of 1999 on November 4. The Senate voted 90-8 in favor of the bill,

while the House passed the bill by a 362-57 margin. President Clinton signed the bill into law on November 12.

GSE privacy exemption

- Originally, the GSEs had already received a secondary market privacy exemption in the underlying bill, as did all institutions engaging in secondary market activities. However, the GSEs asked for an even broader privacy exemption that was added by an amendment sponsored by Congressman Spencer Bachus (R-AL). The amendment, which was approved by the Conference Committee late in the evening on October 18, exempted the GSEs from certain privacy provisions and broadened the GSEs' exemption from the privacy requirements in the broader financial services modernization bill. The Bachus amendment exempts the GSEs from the requirements of the underlying legislation as long as they do not sell or transfer non-public, personal information to non-affiliated third parties. (Congressman Edward Markey (D-MA) added the word "transfer".) The Bachus amendment became part of an agreement reached by the Conference Committee on October 22.
- The Bachus amendment was then included in the statutory language of the financial services modernization legislation that was passed by Congress on November 4 and signed by the President on November 12. However, the following language was included in the Statement of the Managers to blunt the intent of the Bachus Amendment:

"The Conferees also excluded from this subtitle institutions chartered by Congress specifically to engage in securitization or secondary market transactions, so long as such institutions do not sell or transfer nonpublic personal information to nonaffiliated third parties. The Conferees granted the exemption based on the understanding that the covered entities do not market products directly to consumers" (Statement of Managers, Summary of Major Provisions, 11/1/99)

- The language inserted in the Statement of Managers was pushed by the Department of Treasury and gives the regulator (the Federal Trade Commission) the ability to negate the benefits the GSEs sought in the Bachus amendment.

GSEs did not need an extra exemption

- **According to an article by Kathleen Day with the *Washington Post*, Fannie and Freddie have what the companies themselves describe as the largest bank of information on consumers' home-buying habits. House Banking Committee Chairman Jim Leach (R-IA) said he did not believe the amendment was needed. The amendment, however, passed by voice vote, and several Congressional aides expressed concern that the exemption might permit the two companies to sell information from their database with little knowledge by consumers. (*Washington Post*, Kathleen Day, 10/19/99)**
- **The Mortgage Bankers Association said it wished Fannie had engaged the industry in a discussion of these issues earlier in the process. "It has caused some stir among some of our members," said Gene Swanzey, Director of Legislative Affairs for the MBA. (*American Banker*, Joshua Brockman, 11/3/99)**
- A *Credit Risk Management Report* article noted that because the privacy provisions in the bill apply only to primary market institutions that deal directly with consumers, Fannie already was exempted from disclosure and opt-out requirements for transferring customer information to third-parties.

However, industry market observers have long believed that Fannie has long-term plans to enter the primary market. **“Frankly, I think they got caught with their hand in the cookie jar,” says Mike House, Executive Director of FM Watch. “We think they intend to use [consumer] information down the road,” he stated. “They want to go to the primary market.”** Fannie Mae’s David Jeffers disagrees and says Fannie’s efforts to exempt themselves more broadly from the privacy provisions “wasn’t so much lobbying as a legal clarification.” (*Credit Risk Management Report*, 11/15/99)

- Cong. Bachus included a statement in the *Congressional Record* to further explain his reason for offering the GSE privacy amendment. He stated that his “objective in offering this amendment and securing its inclusion in the Conference Report was to exempt those operating in the secondary mortgage market from Title V [privacy provisions] to the extent that they engage in uses of information that Title V accepts as appropriate and as creating no additional obligation on the part of these institutions.” (*Congressional Record*, H11518-11519, 11/4/99)
- [Editorial note: Recognizing that the secondary market is different from the primary market, earlier this year, a broad cross-section of the financial services industry worked together with the GSEs to ensure that a secondary market exemption was afforded to all companies engaged in the securitization of assets, including mortgages. That secondary market exemption was included in the underlying bill. If the GSEs’ intent was to ensure that they received a secondary market exemption, then the language that had been included would have fully protected their interests without the need for an additional privacy exemption just for the GSEs .]

FM Watch says GSE privacy exemption is “anti-consumer”

- Fannie/Freddie watchdog group calls the GSEs’ privacy exemption “anti-consumer.” FM Watch stated in a recent bulletin:
 - **“Fannie Mae and Freddie Mac struck a blow to consumers ...They skirted federal privacy disclosure requirements in an amendment agreed to by the Conference Committee on S. 900, The Financial Services Modernization Act of 1999. It was yet another midnight raid by the government subsidized enterprises.**

Their amendment is anti-consumer. It exempts the largest database on homebuying habits in the financial services industry from provisions protecting consumer privacy....

In vintage fashion, Fannie and Freddie deployed smoke and mirrors and misled lawmakers. They did not fully explain their hidden agenda to Members who questioned the amendment’s purpose. There is no reason Fannie and Freddie should be advantaged over the rest of the financial services industry at consumers’ expense. Their amendment means that 20 million America families are vulnerable to privacy invasions because Fannie and Freddie hold their mortgages. Once again, Fannie and Freddie are choosing higher investor profits over consumers’ rights and interests.” (*FM Watch Bulletin*, 10/22/99)

[Editorial Comment: The GSEs’ effort to get an exemption from the privacy requirements in this legislation is significant. This exemption is likely to be a first step in what will be a methodical program to exempt the GSEs from the consumer protection laws that affect all other financial institutions. Over time, the exemption they sought would have been more valuable to them if the language inserted into the Statement of Managers had not been included.]

FHFB withdraws its anti-arbitrage proposal until the newly enacted FHLBank capital reforms in the financial services modernization bill (S. 900) are fully implemented (FHFB estimates this could take up to two years)

The anti-arbitrage proposal was an attempt by the FHFB to end the FHLBank System's controversial arbitrage practices. The proposal was made in response to criticism by the Treasury Department and Congress that the FHLBank System was using its implied government guarantee from its GSE status to borrow heavily at preferential rates and then investing the proceeds in higher yielding instruments that are often unrelated to its housing mission.

FHFB will resubmit a portion of the proposal that defines and authorizes new "member mortgage assets" which the FHFB says will encourage the FHLBanks to compete against Fannie & Freddie and give the FHLBanks alternatives to arbitrage-driven investments

FHFB withdraws anti-arbitrage proposal

- According to John Connor with *Dow Jones Newswire*, the FHFB withdrew its proposed anti-arbitrage rule that would end the FHLBank System's controversial arbitrage practices. Earlier this year, the FHFB proposed a rule – the Financial Management and Mission Achievement Regulation (FMMA) - that would, among other things, phase out the FHLBank System's non-mission related (arbitrage investments) over five years by requiring that 100% of investments be housing-related. The proposal was made in response to criticism from the Treasury and Congress on the FHLBanks' arbitrage activities and investments - specifically, using its implied government guarantee from its GSE status to borrow heavily at preferential rates and then investing the proceeds in higher yielding instruments that are often unrelated to the system's mission of assisting housing and community development. FHFB Chairman Bruce Morrison said the FHFB would revisit the arbitrage issue when the capital plans called for in the new financial services modernization law are submitted to the FHFB, which could take up to two years. (*Dow Jones Newswire*, John Connor, 11/16/99)

FHFB Chairman Bruce Morrison had promised to withdraw the proposal to avoid a moratorium on FHFB rulemaking

- As promised, the FHFB withdrew the anti-arbitrage portion of the FMMA proposal until the newly enacted FHLBank capital reforms in the financial services modernization bill (S. 900) are fully implemented. FHFB Chairman Bruce Morrison made his promise to withdraw the proposal in a letter sent to Senate Banking Committee Chairman Phil Gramm (R-TX) and House Banking Committee Chairman Jim Leach (R-IA) on October 18. Morrison agreed to withdraw the proposal when it appeared that Congress would place a two-year moratorium on implementation of the proposal. In his letter, Morrison acknowledged that there was "substantial concern" over the FMMA proposal and wrote, "Unfortunately, this legitimate concern regarding a far-reaching regulatory initiative has resulted in a proposal for a statutory moratorium on our regulatory authority. Despite the best efforts of well-meaning advocates, such statutory language can only lead to serious ambiguity and potential litigation over the independent regulatory authority of the Finance Board." In his letter, Morrison said the FHFB would "take no action to promulgate proposed or final regulations limiting assets or advances beyond those currently in effect," except as is necessary to protect the safety and soundness of the FHLBank System, until capital rules have become final. (*Capital Markets Report*, John

Connor, 10/18/99; *Dow Jones Newswire*, John Connor, 11/16/99; *FHFB Chairman Bruce Morrison letter to Senator Gramm and Cong. Leach*, 10/18/99; *National Mortgage News website*, posted 11/17/99)

Critics of FHFB's FMMA proposal included Fannie, ACB, and a group of savings associations

- Critics of the FHFB's FMMA proposal included the America's Community Bankers (ACB), a group of savings associations and Fannie Mae. "ACB did not want to see a moratorium," stated ACB's Director of Government Relations, Robert Davis. ACB reportedly did not want to address the FMMA proposal while the FHLBanks were adjusting to the new risk-based capital requirements that would be enacted as part of S. 900. "We ought to have a FMMA that is tailored to fully support the new regime of capital," he stated. A group called the Savings Association Trade Executives also reportedly wanted Congress to pass a two-year moratorium on implementation of the proposed changes, while Congress considered changes in the FHLBanks' capital structure. (*National Mortgage News website*, posted 10/4/99; *National Mortgage News*, Brian Collins, 10/25/99)
- **It was understood that Fannie was pushing for the moratorium on the FMMA proposal because it did not want to lose an important investor. The FHLBanks hold \$60 billion in mortgage-backed securities investments that are mostly Fannie and Freddie securities. Under the FMMA proposal, MBS – of which Fannie and Freddie are major issuers – were among the investments that would not count as mission-related under the proposal. The proposal would have called for the FHLBanks to divest their nearly \$60 billion of these MBS investments.** (*National Mortgage News*, Brian Collins, 10/25/99)

FHFB Chairman Morrison has stated in the past that he would support limiting the arbitrage investments of the FHLBanks if it is applied equally to Fannie & Freddie

- Morrison noted that the government has a double standard when it comes to arbitrage. "The Treasury speaks volumes about arbitrage when they talk about the Federal Home Loan Banks, and nary a peep about arbitrage when they speak about Fannie Mae and Freddie Mac," he said. "I support any investment restriction to the Federal Home Loan Bank that is applied equally to Fannie Mae and Freddie Mac. You write it down, I'll sign it." (*Dow Jones Newswire*, 2/26/99)
- In contrast to the FHLBanks, the FHFB stated that "the non-MBS investments of Fannie Mae have increased by \$12.1 billion and Freddie Mac non-MBS investments have increased by \$5.6 billion since December 31, 1996." A January 1999 FHFB report said the MBS investments of the FHLBanks were \$54.6 billion as of November 30, 1998. It said Fannie Mae held at least \$182.3 billion of MBS in its portfolio and that Freddie Mac held \$190.4 billion of MBS as of that date. The report notes that from December 31, 1996 to September 30, 1998, the net increase in MBS holdings was \$8.9 billion for the FHLBanks, \$53.9 billion for Fannie Mae, and \$74.0 billion for Freddie Mac. Further, at September 30, 1998, MBS holdings of the FHLBanks were 2.6 times their aggregate capital. As of the same date, the report notes that Fannie's MBS holdings were at least 11.6 times its capital, up from 8.3 times capital at the end of 1996, and Freddie's MBS holdings were 17.8 times its capital, up from 12.3 times capital at the end of 1996. (*America Banker*, 1/28/99; *BNA Daily Report for Executives*, 1/28/99; *Dow Jones Newswire*, 1/27/99; FHFB Report, "Federal Home Loan Banks' Investments and the Mission Character of the Federal Home Loan Banks' Balance Sheets," January 1999)

FHFB will resubmit a portion of the FMMA proposal that defines and authorizes new "member mortgage assets" which could encourage the FHLBanks to compete against Fannie & Freddie

- The agreement to withdraw the FMMA proposal, however, does not impede the development of new mortgage purchase programs in the FMMA proposal. The FMMA proposal contains a proposed new class of investments called member mortgage assets that encourages the FHLBanks to develop mortgage purchase programs, giving banks and thrifts an alternative to selling their fixed-rate mortgages to Fannie and Freddie. Morrison stressed that the withdraw of FMMA “does not reflect a retreat from my belief that the FHLBanks can and should create new products for their members, such as MMA programs.” He stated that the portion of the FMMA rule that created the definitions and authority for new mission-related products such as member mortgage assets will be presented to the FHFB again “early in 2000.” Morrison believes that arbitrage concerns could be rendered moot if member mortgage investments are successful. “No one has disagreed that a FHLBank with value-added mission-related assets is preferable to one which relies on arbitrage for earnings,” he stated. “The question has always been the practicality of this deal.” (*Dow Jones Newswire*, John Connor, 11/16/99; *BNA Daily Report for Executives*, Kenneth Talley, 11/17/99)

Background on S. 900's FHLBank provisions

- The President signed the financial services modernization bill (S. 900) into law on November 12. The bill has the following 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. (REFCorp) obligation to a percentage of FHLBank income; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes a new capital structure based on two classes of stock. The law also expands asset powers of FHLBanks to include advances to community financial institutions for small business, small farms, and small agribusiness, as defined by the Finance Board. (Gramm-Leach-Bliley Summary of Provisions of Financial Services Modernization Act; *Wall Street Journal Interactive*, Dawn Kopecki, 10/12/99; *American Banker*, Barbara Rehm, 10/20/99)

American Bankers Association (ABA) releases a report calling for privatization of the Farm Credit System

ABA believes Congress could do more to help struggling farmers by privatizing the Farm Credit System and using the Farm Credit System's \$1 billion of annual subsidies to fund a tax credit to all farmers – not just the wealthy and the hobbyists

Independent banking consultant, Bert Ely – who delivered the report at the annual ABA conference earlier this month - stated that “The Farm Credit System increasingly serves America's larger, wealthier farmers, older farmers as well as hobbyist farmers...the ‘wealthy weekenders’...These are not the types of borrowers the FCS was chartered to serve.”

- The *American Banker* reported that a recent report funded by the American Bankers Association (ABA) recommends that Congress could do more for struggling farmers by privatizing the Farm Credit System, and using its \$1 billion of annual subsidies to fund a tax credit to all farmers -- not just the wealthy and the hobbyists. According to the ABA, the association has printed 10,000 copies and is planning to distribute the report on Capitol Hill and to agricultural banks nationwide. The ABA hopes to advance legislation based on the report's suggestion, noted the *American Banker* reporter, Craig Woker. The Farm Credit System has 196 agricultural lenders as members.
- According to Woker, independent banking consultant Bert Ely -- a long-time critic of the Farm Credit System - delivered the ABA's report “*The Farm Credit System: Reckless Past, Doubtful Future*” at the ABA's national conference in Colorado earlier this month. **Ely stated, “The Farm Credit**

System increasingly serves America's larger, wealthier farmers, older farmers as well as hobbyist farmers, which I tag the 'wealthy weekenders.'" Ely further stated, "These are not the types of borrowers the FCS was chartered to serve."

- Ely estimates that farm credit lenders save more than \$600 million by borrowing from the government at discount rates. In addition, they save about \$400 million a year by not paying federal taxes. The ABA's report also finds fault with the manner in which the Farm Credit System's loans are distributed. According to Woker, Farm Credit System institutions often compete for farmer's loans directly with community banks. As a result, noted Woker, more than two-thirds of the System's loans go to the slim number of farmers who sell more than \$250,000 worth of commodities per year, or to farmers who earn a majority of their income away from the farm.
- The Farm Credit System finds many faults with the ABA's report, noted Woker. Ken Auer, president of the Farm Credit Council, a trade association that represents most of the system's 196 lenders as well as the system's regulator, the Farm Credit Administration, called the report "nothing more than a lobbying tool," filled with "slanted information." According to Woker, the Farm Credit Administration believes the ABA is simply executing a long-term goal to get "the Farm Credit System out of the hair of commercial bankers." Marsha Pyle Martin, Chair of the Farm Credit Administration contends that if the Farm Credit System is really as robust and as expansion-minded as Ely says, then the banking industry should fear not support privatization of the Farm Credit System. "Does the commercial banking industry really want to compete with these institutions if they're able to take deposits and make loans to anyone, anywhere? . . . They'd have more authorities than they do now. One of the biggest drawbacks they face now is that they can't take deposits; and lets face it, people like to do one-stop-shopping," Martin stated. (*American Banker*, Craig Woker, 11/12/99)

Fannie Mae and Freddie Mac

Moving outside their mission of providing liquidity to the secondary mortgage market, Fannie & Freddie are both expanding into the home equity market

Morgan Stanley analysts report that Fannie's total home equity/home improvement loans are up \$1.3 billion year-to-date and will likely double last year's volume. Analysts note that if Fannie expands its home equity pilot with Home Depot into Home Depot's 1200 stores, Fannie could likely reach \$144 million in annual volume

[Editorial note: The majority of home equity loans are made to middle- to higher-income, non-minority homeowners for debt consolidation. Home equity borrowers already own their own homes. Home equity loans are a consumer loan product, not a product that helps homebuyers purchase a home.]

- As reported in the October 1, 1999 *GSE Report*, Fannie CEO Franklin Raines stated during a Merrill Lynch Investor's conference that one of the ways Fannie would increase its market share was by purchasing home equity loans – which he estimated was 6% of the \$12 trillion housing market. Raines stated, "Another way we're going to expand the mortgage debt market is to help consumers capitalize on the equity in their homes for things they need, whether it's reverse mortgages to finance retirement, or home equity loans to expand or improve their homes. For example, we have a pilot with Home Depot stores and some of our lenders where consumers can apply for

home improvement loans right in the stores. The demographics for these mortgage products are terrific as Baby Boom families grow and retire. This will move some of the equity side of the \$12 trillion housing market onto the debt side. (*Franklin Raines Speech before the Merrill Lynch Investor Conference, 9/14/99*)

Morgan Stanley Dean Witter analysts remarks about Fannie's home equity purchases

- In a recent Morgan Stanley Dean Witter analyst report, it was reported that Fannie's total home equity/home improvement loans are up to \$1.3 billion year-to-date (just under 1% of total purchases). The analysts, Kenneth Posner and Michael Courtian, believe Fannie is on pace to double 1998's volumes. "A pilot with Home Depot is working well. If rolled out to all of Home Depot's 1200 stores, a single loan per store per month would come to \$144 million in annual volume (assuming \$10,000 per loan). (*Morgan Stanley Dean Witter analyst report, Fannie Mae: Investor Luncheon: New Products Could Help the Margin, Kenneth Posner and Michael Courtian, 10/20/99*)

Freddie also expanding into home equity

- In an *Asset Sales Report* article, Freddie Mac Spokesperson Douglas Robinson stated "We've been a buyer of home-equity loans for a while...They support our mission and mortgage assets. They can be good uses of capital for our investors." (*Asset Sales Report, 11/8/99*)

Fannie begins selling short-term securities (Benchmark Bills) over weekly Internet-based Dutch auctions to its authorized dealer group

Two weeks later, Freddie announces that it will begin selling its short-term securities (Reference Bills) over weekly Internet-based Dutch auction

Dealers say Fannie's new program gives Fannie a higher return by cutting the dealers' commissions [Freddie's dealer commission is similar to Fannie's]

Chicago Board of Trade is exploring the possibility of offering futures on Fannie's new Benchmark Bills

Fannie announces new "Benchmark Bills" program over Dutch auction

- On November 4, Fannie announced a new "Benchmark Bills" program of selling its short-term securities over weekly Internet-based Dutch auctions (sellers gradually reduce their prices until a responsive bid is made) to its authorized dealer group. Under the auction, Fannie will announce the size of each auction, ranging from \$4 billion to \$8 billion for three-month securities and from \$1.5 billion to \$4 billion for six-month securities. Every Tuesday, Fannie will announce the size of each auction – bids will be accepted on Wednesday – and on Thursdays, the securities auctioned the previous day will settle via the book-entry system of the US Federal Reserve Bank. Bids of \$1 million or more in \$1,000 increments will be accepted from authorized dealers, but Fannie will limit individual dealers' allocation to 35% of the amount being auctioned, to ensure multiple dealers support each issue. Fannie said it will continue to issue other Discount Note maturities and post the rates on a daily basis. (*National Mortgage News, Terry Peters column, posted 11/12/99; National Mortgage News website, posted 11/4/99; Fannie press release, 11/4/99; American Banker, Joshua Brockman, 11/9/99;*)

Freddie announces new Reference Bill program over Dutch auction

- Just two weeks after Fannie's announcement of its new "Reference Bill" program, Freddie announced that beginning January 10, 2000 it will conduct regularly scheduled auctions of short-term securities

via an Internet-based Dutch auction process to its selected dealers. The securities will have maturities of one, three, six and 12 months and will supplement Freddie's existing discount note program. The issues are expected to have minimum sizes of \$3 billion for one-, two-, and three-month maturities and \$1 billion for six- and 12-month maturities. Freddie will announce its auctions on Fridays for the following week. (Fannie will announce its Benchmark bills on Tuesday for the same week.) To accommodate smaller investors, Freddie will accept non-competitive customer orders through participating dealers. Non-competitive orders must be for at least \$25,000 (with \$1,000 increments) and no larger than \$5 million. All Reference Bill auctions will also provide for a maximum of 15% of the total offering to be awarded on a non-competitive basis. All competitive bids must be for at least \$1 million, and in \$1 million increments, thereafter. Like Fannie, Freddie will limit individual dealers' allocation to 35% of the amount being auctioned, to ensure multiple dealers support each issue. Freddie said it will continue to issue other Discount Note maturities that are not in conflict with the Reference Bill auctions and post the rates on a daily basis. Effective immediately, Freddie's dealer group members will be paid a two basis point selling concession on discount note postings. Participating dealers also will receive a two basis point selling concession on all auction awards. (*National Mortgage News website*, posted 11/17/99; *PR Newswire*, 11/17/99)

Fannie's new programs increases Fannie's returns by cutting the dealers' commissions

- Fannie's new Benchmark Bills program does away with Fannie's three- and six-month discount note maturities but dealers have said it is unknown what impact a change in commission structure will have on the program. Under the discount note program, participating dealers received a five basis-point spread, or commission, for the notes they took down, they said. Under the new Benchmark Bill program, this spread has been reduced to two basis points, resulting in better returns to Fannie. [Freddie also announced that its Dealer group members will only be paid a two basis point selling concession on discount note postings and a two basis point selling concession on all auction (Reference bills) awards.] Despite adding regularity to the discount-note market, some dealers see Fannie's new Benchmark Bills as a negative move. "From a dealer perspective, it certainly cuts into the discount-note program," said Art Frank, Director of MBS Research at Nomura Securities. "The selling concession from a dealer perspective declines on the benchmark bills, and while the benchmark doesn't eliminate all discount notes, they eliminate discount notes of three- and six-month maturity and certainly would expect to diminish the discount note program for maturities of two, four and five months." (*Dow Jones Newswire*, David Feldheim, 11/9/99; *Mortgage Backed Securities Letter*, Frank Musero, 11/15/99)
- Fannie held its first Benchmark Bills via Dutch auction over the Internet on November 9 - a \$5.0 billion 3-month Benchmark Bill due February 10, 2000 and a \$1.5 billion 6-month due May 11, 2000. Settlement of the first auction was Friday, November 12 due to the Veterans' Day holiday on Thursday, November 11. According to an article in *Real Estate Finance Today*, market professionals said the pricing at the auction was aggressive and probably did not leave much profit, if any, for dealers. Market sources said firms undertake underwritings of large issues at marginal profitability – and even at a loss – to enhance their underwriting rankings. Being ranked among the top underwriting firms usually leads to other lucrative business that compensates for the lack of profitability. (*Fannie announcement*, 11/10/99; *Reuters*, 11/10/99; *Dow Jones Newswire – Capital Markets Report*, 11/10/99)
- **Several primary dealers outside the selling group were upset with Fannie's debut Dutch auction sale and were disappointed not to be included. "We're disappointed with Fannie Mae over the selection process," said one head trader at a primary dealer firm. "We're a big player in the bill market and we got no consideration. They have...a whole gaggle, some minority broker-dealers and**

women-owned broker dealers. But the primary dealers are not that well represented.” (*Reuters*, 11/10/99) (As reported in the October 1, 1999 *GSE Report*, Fannie recently began a program that sets aside portions of its Benchmark note and bond sales for minority and women-owned securities firms.)

Chicago Board of Trade considering offering futures on Fannie’s new Benchmark bill program

- According to Christine Marie Nielsen with *Dow Jones Newswire*, the Chicago Board of Trade is considering the possibility of offering futures on Fannie’s new Benchmark Bill. “We talk to members and customers on a regular basis and there is a lot of interest in this area,” said Chicago Board of Trade Spokesperson Katherine Spring. Spring said no timeline had been set yet regarding when the new futures product could be launched at the Chicago Board of Trade. She said the recommendations for the product specifications have not yet been finalized nor has the plan been approved through proper channels. (*Dow Jones Newswire*, Christine Marie Nielsen, 11/9/99)

The conforming loan limit for Fannie & Freddie could increase by nearly \$20,000 (8%) next year

Fannie & Freddie may be able to purchase homes as high as \$259,440 (currently their ceiling is \$240,000)

- According to *National Mortgage News*, Fannie and Freddie could increase their reach into the mortgage market by nearly \$20,000 if the government’s cost figures for September are any gauge. The maximum amount on single-family loans that can be purchased or securitized by Fannie and Freddie is determined annually by changes in the average cost of houses sold from one October to the next. If September averages were used instead, the “conforming loan limit” would rise 8.1% in January 2000 from the current \$240,000 to \$259,000. A jump in the limit of almost \$20,000 would be the second largest ever recorded, exceeded only by an increase of \$19,850 from 1986 to 1987. (*National Mortgage News website*, posted 10/28/99)
- As reported in previous *GSE Reports*, in a speech before the Merrill Lynch Investor Conference, Fannie’s Chairman Franklin Raines stated that Fannie and Freddie are expanding into jumbo loans (\$240,000 or more which, by law, cannot be bought by Fannie and Freddie). Here’s how Fannie is using a “back door” into jumbos: Raines noted that “clever” lenders are breaking jumbo loans into two components and are structuring the jumbo debt amount into a first lien that is below the \$240,000 GSE cap, with the remainder of the loan amount secured by a second mortgage. (*National Mortgage News*, 10/4/99). [Editorial note: If the conforming loan limit is increased to \$259,000, it is likely that Fannie will still use a back door into loans that are greater than that level. The GSEs’ subsidies were never meant to be passed along to these wealthy homebuyers.] While Fannie’s Chairman told analysts that Fannie has found a back door into the jumbo market, Fannie’s Vice Chair told the press that Fannie has no intention of entering the market for jumbo mortgages. According to a *Mortgage Servicing News* article by Karen Thomas, Fannie’s Vice Chair Jamie Gorelick said that Fannie has no intention of entering the market for jumbo mortgages, but will continue to buy and securitize mortgages under \$240,000, “for the middle class and underserved.” (*Mortgage Servicing News*, November 1999)

The Mortgage Brokers Association (MBA) and the National Association of Mortgage Brokers (NAMB) are working on a proposal to register every brokerage company and every broker in the US (and ultimately, possibly others involved in origination, such as appraisers) as a means to control fraud

The MBA and NAMB cannot force broker companies and individual brokers to register, but the plan under discussion would encourage brokers to register by having Fannie, Freddie, and HUD refuse to do business with any brokerage company or broker that does not have a registration number

Some worry that Fannie & Freddie would use the registration as a tool to help them enter the mortgage origination business, dealing directly with brokers

- According to an *American Banker* and *Mortgage-Backed Securities Letter* article by Lawrence Richter Quinn, the MBA and NAMB are working on a proposal to register every broker and brokerage company in the US (and ultimately, possibly others involved in origination, such as appraisers) as a means of controlling fraud. Quinn notes there are currently 30,000 US mortgage brokerage companies and approximately 500,000 individual mortgage bankers and brokers.
- The NAMB has reportedly been working on the registry for the past five years, and in recent months it has gained the support of the MBA, while Fannie and Freddie have been official “observers” at development meetings. Recently the working group on the initiative began to consider detailed questions on exactly how much personal information brokers and brokerages will have to furnish. The proposed national registry system could be in place as early as 2001, but observers believe it will take several more years for it to be fully implemented. Quinn asks, “How do those behind the NAMB effort plan to force all brokers to become registered?” Legally, they cannot be forced to do so. Rather, in the plan under discussion, the secondary market agencies – Fannie, Freddie, and the Department of Housing and Urban Development, for instance – would refuse to buy a loan originated by any broker or refuse to do business with anyone who does not have a registration number, Quinn notes.
- Some skeptics worry about the “Big Brother syndrome: whether the secondary agencies will use registration as a ready-made tool to help them enter the origination business, dealing directly with brokers,” wrote Quinn. “There’s something of a conspiracy theory out there,” says one banker. “The thinking is that the availability of a registration list will help these agencies enter the origination business directly. But it’s foolish thinking. With a registration list, it may help them enter the business in one day. Without it, they can do so in three.” (*American Banker*, Lawrence Richter Quinn, 10/12/99; *Mortgage-Backed Securities Letter*, Lawrence Richter Quinn, 10/25/99)

Fannie & Freddie both rank in *Washingtonian* Magazine’s “Great Places to Work”

- *Washingtonian* magazine’s November 1999 issue highlighted 50 Washington-area businesses that “offer generous pay and benefits, interesting work, friendly offices, and the chance to get ahead.” Fannie and Freddie were listed along with other Washington businesses such as America Online, Discovery Communications, and Marriott as businesses that fit this profile. Both received high marks for the perks offered to employees.

- Fannie was praised for its forgivable mortgage program, where employees qualify for a forgivable loan of up to \$15,000 or 7 percent of the purchase price of the home, whichever is less, that is offered to employees that have been working at Fannie for two years, and who remain for five more. In addition, Fannie employees have geriatric care manager to help with aging parents, and can receive a monthly stipend for utilizing public transportation. Overall, Fannie was judged as best overall employer; the best place to work if you want to buy a house; the business with the most minorities and women in upper management; the best place for working mothers and fathers; and the best business if you commute by Metro (Washington’s subway). At Fannie, staffers can also order a take-home dinner from Chef Howie Velie and his kitchen staff, and it will be ready when they leave the office.
- *Washingtonian* Magazine’s praise for Freddie centered around Freddie’s community involvement through the Freddie Mac Foundation, which donated \$13.2 million to charities last year, noted the magazine. Freddie employees can receive tuition reimbursements, have access to a fitness center, and eat at a cafeteria with low-fat food. Freddie also loans beepers to expectant parents and sponsors three childcare centers within one mile of their headquarters. Overall, Freddie was judged by *Washingtonian* as the best place to work if you desire a caring company. (*Washingtonian* Magazine, Wayne Nelson, Ellen McLellan, Brooke Foster, and Shari Dalphonse, 11/99)

Fannie Mae

Fannie is charging a higher guaranty fee for its subprime (alt-A, A-) and niche products (home equity, home improvement, and reverse mortgages).

Fannie says its new products save consumers money, yet Fannie may be eating up the potential consumer savings by charging higher guaranty fees that are passed along to borrowers

Analysts say that Fannie is pushing its automated underwriting to the point-of-sale so that Fannie will have the “first look” at evaluating these “niche products” before pushing them aside to consumer finance companies or alt-A securitizers that have historically dominated these sectors

- According to a recent Morgan Stanley Dean Witter analyst report, Fannie’s volume of new products (Alt-A, A-, home equity, home improvement, and reverse mortgages) is running around 15% of total purchases year-to-date. [An example of Fannie’s A- product is its much advertised “Timely Reward Payments” product. A Salomon Smith Barney analyst report estimates that non-traditional businesses (less-than-prime loans, home equity loans, affordable housing, commercial real estate mortgages, the immigrant market, manufactured housing, reverse mortgages and high loan-to-value loans) make up over 25% of Fannie and Freddie’s purchase volume and “are on a sharp trajectory north.” (*Salomon Smith Barney: How Political Opposition Can Be Positive for Fannie/Freddie’s growth*, 10/11/99)] **The Morgan Stanley analyst report notes that increasing volumes of these new products should help Fannie’s guaranty fee income because Fannie apparently charges higher guarantee fees for these products.** The analysts write that “Of note, ‘niche’ products amount to 42% of the market (by our estimate, 51% according to Fannie) – meaning that there should be plenty of room for the agencies to expand in these sectors over time.”
- The report also noted that Fannie’s automated underwriting system allows the company to get a “first look” at “niche” products. **“By pushing technology out to the point of sale, Fannie Mae ensures that its systems will have a chance to evaluate niche products before they are shunted away to the specialists that have historically dominated these sectors (e.g., consumer finance companies**

or alt-A securitizers.” (Morgan Stanley Dean Witter, Fannie Mae: Investor Luncheon: New Products Could Help the Margin, Kenneth Posner and Michael Courtian, 10/20/99)

**Congress is asked to investigate problems with an apartment housing complex – Longwood Estates
- owned by the Finch Group in partnership with Fannie**

Finch Group defaulted on its mortgage and Longwood may be in jeopardy of demolition

- According to an article in the *Cleveland Plain Dealer*, residents in an 820-unit housing complex – Longwood Estates – are asking Congress to investigate “broken promises” that may lead to the closing of their building. The Cleveland City Council also passed a resolution that called on HUD officials to keep Longwood open by providing federal money for emergency repairs and allow a new partnership to move forward with a long-range redevelopment plan. The new owner, the Finch Group, which became a partner with Fannie in Longwood in January, has defaulted on the \$12.8 million mortgage on the complex. Cleveland City Councilman say HUD officials had agreed that a monthly federal Section 8 subsidy, which pays for most of the rent for the tenants, could go to repairs, and not the mortgage.
- According to the article, HUD says it can either foreclose and relocate residents or back a plan by the owners to demolish and rebuild Longwood as townhouses, duplexes, and apartments with private entrances and back yards. Reportedly, rebuilding Longwood would come mostly at taxpayers expense. (*Cleveland Plain Dealer*, 9/14/99)

Fannie’s borrowing crowds smaller corporate issuers, making it difficult for smaller issuers to compete

- According to a *Reuters* article, Fannie recently issued a large deal that dominated the investment-grade market. On November 2, Fannie sold \$8 billion in Aaa/AAA rated notes. Tom Seay, who manages \$600 million of A or higher-rated debt for Gradison McDonald Asset Management in Cincinnati, said when Fannie issues such a large deal “it creates its own demand, and people who manage against the Lehman Aggregate Bond Index want it.” That could create pressure on smaller corporate issues, he said. In recent weeks, when companies sold large blocks of debt, smaller issuers often stood aside, leaving buyers to bid prices higher for what amounted to the only game in town. The smaller issuers then tended to come to market in clusters. “I haven’t heard the term ‘crowding out’ used, and normally that’s what you fear when you see a big issue like this,” said Seay. “But I think the bigger problem might be a company that comes in with, perhaps, a \$200 million corporate bond issue, which might have a hard time being picked up. Eight billion will overwhelm \$200 million.” (*Reuters*, 11/2/99)

Texas votes to make reverse mortgage lending – a version of home equity lending - easier in the state

Fannie is one of the earliest and most vocal proponents of reverse mortgages – Two major types of reverse mortgages available today are the federally insured reverse mortgage, called the FHA Home Equity Conversion Mortgage and the Fannie Mae Home Keeper loan

Reverse mortgage borrowers can use their funds anyway they wish – to pay for home improvements, health care, prescriptions, travel, etc.

Consumer advocates and housing officials warn that the reverse mortgage loans carry high costs and may not be right for everyone – Consumers Union issued a report warning consumers that the loans can be expensive and are more complicated than traditional mortgages

[Editorial note: Congress never intended the GSEs to assist homeowners with financing travel costs, etc. Fannie’s mission is to provide liquidity to the secondary mortgage market.]

- By a 64%-36% margin, Texas voters on November 2 approved a constitutional amendment (Proposition 2) to remove flaws in a law allowing reverse mortgages in the state. Reverse mortgages have been allowed in Texas since 1997, however, little reverse mortgage lending has actually been done in the state due to legal uncertainties. The constitutional amendment will put the state’s law in compliance with national standards by raising the eligible age to 62 from 55 and revising the circumstances triggering repayment of a reverse mortgage. The law was also reportedly vague about when the lender could demand repayment, which made any reverse mortgage originated in Texas unpalatable to the secondary market. The amendment clarified that if a reverse mortgage borrower dies, or vacates the home for 12 months without the lender’s approval, the lender can demand repayment. The amendment is expected to make reverse mortgage lending more attractive in the state. Liz Scholz, Director of Senior Products for Fannie, said Fannie will now begin purchasing reverse mortgages originated in Texas in January. (*BNA Daily Report for Executives*, Kurt Fernandez, 11/4/99; *American Banker*, 11/4/99; *Fort Worth Star-Telegram*, 10/20/99; *American Banker*, Marc Hochstein, 11/10/99; *National Mortgage News website*, posted 11/3/99)
- According to an editorial by Mark Fogarty in *National Mortgage News*, “Reverse mortgages are a version of home equity lending, since these products are usually marketed to seniors that have finished paying their original mortgages and are now converting their equity to cash.” According to the National Reverse Mortgage Lenders Association, a reverse mortgage is a loan that enables senior homeowners (those 62 and over) to convert part of their equity in their home into tax-free income without having to sell the home, give up title, or take on a new monthly mortgage payment. Reverse mortgages are available to senior homeowners who own their home or condo free and clear, or nearly so. Borrowers can use the funds anyway they wish - to pay for home improvements, health care, prescriptions, travel, etc. Borrowers make no monthly payments on a reverse mortgage during its term. The loans becomes repayable when the borrower dies, sells the home, or permanently moves out. The repayment amount cannot exceed the value of the home. The two major types of reverse mortgage products available today are the federally insured reverse mortgage, called the FHA Home Equity Conversion Mortgage, and the Fannie Mae Home Keeper loan. Since the Fannie Home Keeper product has larger loan limits, it appeals to people with more expensive homes. According to Fogarty, many if not most of the senior homeowners who take out these loans are A credits (which is

why Fannie and Freddie want to buy them). (*National Mortgage News website Editorial by Mark Fogarty*, posted 11/15/99; *PR Newswire*, 9/30/99; *St. Petersburg Times*, 11/8/99)

Consumer groups warn about the danger with reverse mortgages

- According to a *St. Petersburg Times* article, consumer advocates and housing officials warn that reverse mortgages carry high costs and might not be right for everyone. Consumers Union, publisher of *Consumer Reports*, issued a 57-page report warning consumers about concerns with reverse mortgages. Consumers Union warned that the loans can be expensive and are more complicated than traditional mortgages. Closing costs and fees can sometimes amount to more than what the borrower actually gets from the loan, especially if the borrower moves, sells, or dies shortly after the loan is made. Reportedly, this is because the majority of the loan's costs accrue at the beginning of the loan, before the borrower has received significant income under the terms of the loan. Also reverse mortgages can be difficult to understand, thus making it difficult to comparison shop. The true cost of the reverse mortgage depends on how long the borrower lives, future interest rates, and how much their home will increase in value. The article notes that over the years there have been problems and lawsuits by seniors or their heirs claiming deceptive practices. (*St. Petersburg Times*, Teresa Burney, 11/8/99)

Fannie invests in another shopping mall

[Editorial note: Investing in shopping malls is outside Fannie's mission of providing liquidity to the secondary mortgage market.]

- Fannie announced that it made a \$700,000 equity investment in the Brownsville Renaissance Shopping Center through its American Communities Fund. The shopping center, a 26,874 square-foot shopping center, is located on a 2.7 acre site. The \$3 million new construction effort has a Caribbean marketplace theme representing the Bahamian cultural background of the community. (*Fannie press release*, 10/30/99)

Other investments Fannie has made in shopping centers this year:

- According to a *Miami Herald* article, Fannie invested \$1.2 million from its American Communities Fund in the Shops of Liberty City, a 79,000-square-foot shopping center. Redevco Enterprises invested another \$1.2 million in the project and the balance of the \$8 million project was funded by loans from SunTrust Bank and Eastern National Bank. (*Miami Herald*, 9/24/99, *Fannie press release*, 9/22/99)
- Maureen Warren, Vice President for Housing and Community Development for Fannie's Midwestern Regional Office in Chicago announced that Fannie has made an equity investment of \$2.84 million in the Lee-Harvard Shopping Center redevelopment, through the company's American Communities Fund (ACF). The investment will assist in the \$26 million renovation and rehabilitation of this 180,000 square foot shopping center located in Cleveland, OH. (*Fannie press release*, 2/18/99, *Cleveland Plan Dealer-Online*, 2/3/99)

Fannie begins commercial real estate pilot that allows borrowers to purchase rental properties – Fannie will purchase the loans

- According to the *Star Tribune*, Fannie began a pilot with U.S. Bank called the Neighborhood Investor loan program. The pilot allows borrowers to purchase small rental properties (one or two-units) within a mile of where they live with a minimal downpayment of only 3%. Under the pilot, US Bank

has committed to loan \$2.5 million in the Phillips, Central and Powderhorn Park neighborhoods in Minneapolis, MN. To be eligible, borrowers must have lived in one of the three targeted neighborhoods for at least one year. Fannie will purchase the loans from the bank. Borrowers will need landlord training and loan counseling. (*Star Tribune*, 10/28/99, 11/3/99)

Fannie moves outside its mission and invests again in construction lending

- According to a *Real Estate Finance Today* article, Fannie is working on a pilot with Home Depot where consumers can get home equity renovation financing and Home Depot will manage the contractors. (*Real Estate Finance Today*, 10/22/99) Morgan Stanley Dean Witter analysts note that if Fannie rolls the pilot out to all of Home Depot's 1200 stores, a single loan per store per month would come to \$144 million in annual volume (assuming \$10,000 per loan). (*Morgan Stanley Dean Witter analyst report, Fannie Mae: Investor Luncheon: New Products Could Help the Margin*, Kenneth Posner and Michael Courtian, 10/20/99)
- According to a *Des Moines Register* article, Fannie invested \$100,000 in a one-year certificate of deposit in Manufacturers Bank and Trust to promote new construction. The bank will offer borrowers construction loans that eventually becomes a mortgage sold to Fannie. (*Des Moines Register*, 10/21/99)
- According to the *Kansas City Star*, city officials in Kansas City are breaking ground on the 18th and Vine Project – adding shops and retail restaurants to the historic jazz district. The first phase of the commercial project will cost between \$35 million and \$37 million. The project will construct four new buildings, rehabilitate three existing buildings and reconstruct two others. The project is being paid for with \$20 million from Fannie in debt and equity and \$14.2 million from HUD. The jazz district corporation will earn revenue by charging companies to lease the 42,000 square feet of commercial retail space. (*Kansas City Star*, 10/26/99)
- According to a press release by Fannie, the company will expand its role in the Buffalo homeownership zone through a partnership with the City of Buffalo, M & T Bank and developer MJ Peterson. The current phase of development involves over 300 single-family homes, at a cost between \$87,000-\$120,000, representing over \$21 million in mortgage financing. (*Fannie press release*, 10/25/99)

An undisclosed dispute with Fannie caused Bay View to delay its purchase of Franchise Mortgage Acceptance Corp. thus causing Bay View to struggle on Wall Street

- According to an article by Matt Andrejczak in the *American Banker*, despite spectacular third-quarter earnings by California's Bay View Capital (a \$6 billion San Mateo banking company), "its profit prospects are an enigma on Wall Street." According to the *American Banker*, Bay View's stock has fallen about 35% since January. Analysts have reportedly reduced earnings estimates for next year by as much as 45 cents per share. The chief concern to analysts and investors is Bay View's much-delayed deal to purchase Franchise Mortgage Acceptance Corp., a Los Angeles originator of loans to fast-food restaurants, gas stations, and convenience stores.
- According to the article the \$282 million deal was originally scheduled to close in August. **However, in a conference call with analysts, Bay View officials conceded that the sale may not even close by its latest deadline, Nov. 1 due to an undisclosed dispute with Fannie Mae.** Bay View's President and Chief Executive Officer Edward Sondker, acknowledged that the future was unclear and

noted that Bay View may become a takeover target. The company anticipated earning significant revenues by reselling loans by Franchise Mortgage, but with the deal in limbo and the market for secondary loans uncertain, Sondker said he could not predict how much Bay View will earn next year. (*American Banker*, Matt Andrejczak, 10/28/99)

- In a follow-up article by the *American Banker*, Bay View announced on November 1 that it purchased Franchise Mortgage for \$282 million. However, the dispute with Fannie that held up the deal was never revealed. (*American Banker*, 11/2/99)

Fannie says it will begin purchasing newly originated CRA loans

Previously, Fannie would only purchase seasoned CRA loans, because they wanted to see at least 12 months of loan behavior (leaving lenders with the risk)

- Fannie announced that it will begin efforts to purchase or securitize CRA loans beyond seasoned portfolio transactions. Fannie said its efforts will allow lenders to sell Fannie newly-originated CRA loans. Fannie pledges to purchase at least \$10 billion in CRA loans by the year 2002. (*Fannie press release*, 10/12/99) According to an article by Joshua Brockman for the *American Banker*, Wall Street doubts banks will sell many loans to Fannie because of rising interest rates. According to Brockman's article, the market for CRA securitization is reportedly not as attractive now because it is largely dependent on favorable interest rates. Lenders subsidize their CRA loans by granting a below-market interest rate, so rising interest rates compound the risk of selling these loans. When interest rates went down in 1998, a flood of CRA securitization deals hit the market, because banks could make a profit or at least break even. However, with interest rates rising and expected to stay around 8% through the year 2000, traders believe that banks may now be reluctant to sell their CRA loans to Fannie. "No one is going to sell to them," said one trader on Wall Street, who described the environment as "underwater." In an environment with interest rates rising, "everything is less than market coupon," he stated. (*American Banker*, Joshua Brockman, 10/19/99)

Fannie drops Deutsche Bank from its list of preferred dealers – no reason given for dropping the Bank

- According to an article with *Financial Times*, Fannie dropped Deutsche Bank from its list of preferred dealers that will manage Fannie's \$50 billion benchmark funding program next year. ABN Amro will replace the bank. A spokesman for Fannie declined to comment on the reason for the move although the decision is understood to have followed an internal review of Fannie's key banking relationships. The article noted, however, that ABN Amro's promotion to Fannie's core group of dealers will not prove highly profitable in itself, since Fannie is believed to be extremely frugal when it comes to doling out fees to banks. (*Financial Times*, 10/25/99)

Countrywide and Bear Stearns have teamed up to offer a new first-of-its-kind residential mortgage-backed securities (MBS) deal – a derivative-style interest-only (IO) strip deal, made up of Fannie Mae collateral

The transaction is the first time an IO deal has been done in the agency sector

- According to a *Mortgage-Backed Securities Letter* article by Adam Tempkin, a first-of-its-kind residential MBS deal was launched recently by Bear Stearns & Co, which securitizes Countrywide Home Loans' excess servicing portfolio, made up of Fannie collateral. The transaction – entitled

FNSTRI 305 – is a derivative-style interest-only (IO) strip deal backed by 242,000 loans representing \$30 billion in collateral. Investors have been interested in the deal because it is the first IO deal done in the agency sector and it has the potential to limit investors' prepayment risk. The deal also gives mortgage market observers greater insights into weighted average coupon (WAC) dispersion data for Fannie pools, which Tempkin notes is typically very difficult to get from Fannie.

- “This deal is unique because we have access to loan-level data from Countrywide,” stated Dale Westhoff, Managing Director of MBS at Bear Stearns. “We’re securitizing the excess servicing strips from each of these Countrywide-Fannie Mae conforming loans, creating a series of fixed IO tranches from the excess servicing.” Countrywide officials declined to comment on the deal, however, Westhoff noted that Countrywide will retain the primary servicing on the transaction, and securitizing the small strip of excess servicing. (*Mortgage-Backed Securities Letter*, Adam Tempkin, 11/8/99)

***Buffalo News* says Fannie’s Buffalo Partnership office financed \$737 million in mortgages in first year?**

Fannie’s press release says Fannie provided \$737 million in affordable housing financing?

[Editorial note: Fannie creates the false impression that consumers can go to Fannie to get loans. Fannie does not provide loans to consumers, fully private financial institutions such as mortgage companies, banks and thrifts provide mortgages to consumers. Although Fannie says it has no interest in going direct to consumers, it does not appear that Fannie provided a clarification of its proper role to the *Buffalo News* nor does Fannie provide clarification in its press release that its “lender partners” actually provide the loans.]

- According to an article in the *Buffalo News*, Fannie’s Buffalo partnership office financed \$737 million in mortgages and grants over the past 12 months. The article claims that Fannie’s partnership office assisted 9,500 families. Only 23% of the consumers served by the office were first-time homebuyers and only 6% were minority applicants. Fannie announced in its press release that Fannie provided \$737 million in affordable housing finance. (*Buffalo News*, 10/26/99)

The youthful-age and recent arrival of Fannie CEO Franklin Raines complicate Fannie’s search for a new President and Chief Operating Officer to replace departing Lawrence Small

Fannie’s Managing Director of International Housing Finance Services, Martin Levine, will also be leaving the firm in January

- As reported in the October 1 *GSE Report*, Fannie announced that its President and Chief Operating Officer Lawrence Small will step down in early 2000 to become Secretary of the Smithsonian Institute. Small, 58, joined Fannie in September 1991. Prior to working at Fannie, Small was Vice Chairman of Citicorp/Citibank, where he worked for 27 years. According to the *American Banker*, Small was two years away from his planned retirement. According to the *New York Times*, Small was paid \$4.2 million last year. The *American Banker*, reported that Small was paid approximately \$4.25 million plus bonuses last year.
- According to the *Wall Street Journal*, Fannie’s search for a new COO “is complicated by the relative youth and recent arrival of its CEO Franklin Raines.” Raines “is going to be here for the foreseeable future,” said Thomas Nides, a Senior Vice President. Nevertheless, you want someone as your president who could step into the [chief’s] shoes.” Nides says Fannie seeks a financial executive, who

like Small, is “terrific on execution...and a fabulous employee coach.” The possible contenders cited by uninvolved recruiters includes Robert McCormack, a Citigroup Inc. executive who retired last spring at age 55. Fannie has retained Tom Neff, Chairman of Spencer Stuart USA, an executive firm, to assist in the evaluation of internal and external candidates to replace Small. (*American Banker*, Hala Habal, 9/21/99; *Associated Press*, 9/14/99; *Bloomberg News*, 9/13/99; *Dow Jones Newswire*, 9/13/99; *Fannie press release*, 9/13/99; *National Mortgage News website*, posted 9/14/99; *New York Times*, 9/20/99; *Reuters*, 9/13/99; *Wall Street Journal Interactive*, 9/14/99, 11/2/99)

- According to *Dow Jones Newswire*, Fannie’s Managing Director of International Housing Finance Services, Martin Levine, will be leaving Fannie in December to pursue other interests. Levine has been with Fannie since 1987. In his most recent position at Fannie, Levine was responsible for creating and managing advisory services to assist foreign governments and overseas financial institutions in meeting their housing finance needs. He previously was Fannie’s Senior Vice President for low- and moderate-income housing. Before his position at Fannie, Levine was Deputy Assistant Director of the Congressional Budget Office and before that was with the Department of Housing and Urban Development. (*Dow Jones Newswire*, John Connor, 11/3/99)

Former Fannie Chairman Jim Johnson optimistically claims that the homeownership rate in the US will surpass 70% by 2010

- According to *National Mortgage News*, Former Chairman of Fannie Jim Johnson (currently chairman of Fannie’s Executive Committee) says the homeownership rate in the US will surpass 70% by 2010. Johnson made his remarks during a National Homeownership Summit in Charlottesville, VA. Johnson said he expects mortgage originations to record their first \$2 trillion year by the end of the next decade, and maybe as much as \$3 trillion if mortgage rates fall enough to encourage a refinance boom during a strong housing market. (*National Mortgage News website*, posted 11/12/99)

Only after officials intervene, Fannie and Alliance Mortgage decide not to evict a woman who paid 28 years on her 30-year mortgage (woman had less than \$1,000 left on her mortgage)

- According to articles in the *Los Angeles Times*, officials intervened so that a woman, Lee Mary Hamilton, who faced eviction after paying more than 28 years on a 30-year mortgage. Hamilton’s lawyer said that a tentative settlement with Alliance Mortgage and Fannie had been reached. The deal was reached after Hamilton was inundated with offers of help after reading her plight in the *Los Angeles Times*. Los Angeles City officials and Senator Dianne Feinstein (D-CA) also wrote to HUD Secretary Andrew Cuomo asking him to intervene. Fannie and Alliance Mortgage agreed to buy back the house from a Newport Beach real estate speculator who bought it at a foreclosure auction, according to Hamilton’s Legal Aid lawyer, Tai Glenn. As part of the settlement, Hamilton agreed to drop her lawsuit against Fannie and Alliance. Glenn said the city of Los Angeles had offered to help Hamilton by writing off an \$8,500 home improvement loan to Hamilton and filing a friend-of-the-court brief in her behalf.

Background:

- For more than 28 years, Lee Mary Hamilton paid her 30-year mortgage, watching her principal fall to as low as less than \$1,000. Hamilton stopped making payments on the home in 1998, insisting that she had prepaid the loan and did not owe any more money. Alliance, acting through a trustee, foreclosed despite a letter from HUD saying that Hamilton might be right and asking the lenders to drop the matter and write off the remainder of the bill. Fannie Mae held her loan. In June of 1999, her house was sold for \$26,675 to Jess Mendoza, who had bought several nearby homes at foreclosure

auctions and resold them. Mendoza moved to evict Hamilton but she refused to move and has been fighting the eviction.

- Hamilton bought her house for \$11,250 in 1970 under a federal program, Section 235 of the National Housing Act, designed to encourage homeownership among the poor. The program contained provisions that were designed to make it extremely difficult for someone to default on a loan. The government would assist them financially and lenders were supposed to “bend over backward” to keep borrowers on track and were mandated to provide counseling to those who might go astray. **There was never any of the counseling mandated by law, Hamilton and her lawyer say. In fact, they say, neither Fannie nor Alliance Mortgage did anything to help Hamilton, aside from sending a series of threatening letters that only served to confuse her.** (*Los Angeles Times*, 11/1/99, 11/6/99)

Fannie is part of US/China housing cooperation initiative

- The US and China announced a housing cooperation initiative as officials from the two nations signed an agreement creating a US/China Residential Building Council. The initiative is intended to improve and expand housing development in the two countries. HUD Secretary Andrew Cuomo, Commerce Secretary William Daley and Chinese Construction Minister Yu Zhengsheng will chair the Council. The cooperation initiative will include visits by Chinese housing officials to the US as well as visits by US housing industry and government officials to China. American members of the Residential Building Council include among others: Fannie, the National Association of Realtors, the National Association of Home Builders, and the Mortgage Bankers Association. (*Dow Jones Newswire*, John Connor, 11/1/99; *White House Bulletin*, 11/1/99; *US Newswire*, 11/3/99)

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

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

- According to a listing on Fannie’s website, the company currently has 34 partnership offices “officially” operating. In an *Associated Press* article on October 30, Fannie said it will open its Milwaukee office on November 2, 1999. (*Associated Press*, 10/30/99) On October 18, Fannie issued a press release to announce that it had named Drucilla Pasley as Director of its Wisconsin Partnership Office. Prior to joining Fannie, Pasley worked as President and CEO of Firststar Community Investment Corp. According to a *Milwaukee Journal Sentinel* article, Pasley currently has no staff in the partnership office and is looking for a deputy and an administrative assistant for the office. (*Fannie press release*, 10/18/99; *Milwaukee Journal Sentinel*, 10/29/99) [As of November 17, Fannie, however, did not have the contact information for the Wisconsin partnership office on its website.]
- Fannie has also announced plans to open or commitments to open partnership offices in the following areas: Columbia, SC; South Dakota; Bismarck, ND; Pittsburgh, PA; Newark, NJ; Nashville, TN; Salt Lake City, UT and Cheyenne, WY. In a speech before the Long Island Housing Partnership’s Annual Meeting, Fannie Chairman Franklin Raines stated that Fannie hopes to expand to 45 partnership offices around the country by the end of the year. (*Fannie Chairman Franklin Raines speech before the Long Island Housing Partnership Annual Meeting*, 6/18/99)

Senator Kit Bond (R-MO), Senator John Ashcroft (R-MO), Senator Sam Brownback (R-KS), Cong. Karen McCarthy (D-MO), Cong. Dennis Moore (D-KS), Unified Government Wyandotte County/Kansas City, Kansas Mayor Carol Marinovich and Kansas City Missouri Mayor Kay Barnes

- Fannie held a press conference on November 1 with the above officials to announce a five-year \$4 billion “House Kansas City MSA (metropolitan statistical area)” investment plan and to announce the completion of the original “House Kansas City.” Statements of support from the above officials were included in Fannie’s press release. (*Fannie press release*, 11/1/99)

Senator Paul Sarbanes (D-MD), Senator Barbara Mikulski (D-MD), and Baltimore Mayor Kurt Schmoke

- Fannie held a press conference with the above officials to announce the grand opening of the Riverfront Townhomes located in Cherry Hill. The \$16 million redevelopment initiative was funded through a partnership between Landex of Maryland, the Cherry Hill Development Corporation, the Richman Group, Crestar Bank, the Maryland Department of Housing and Community Development and Fannie. Fannie invested \$10.9 million in the Riverfront Townhomes. (*Fannie press release*, 11/1/99) According to the *Kansas City Star*, “the master of ceremonies was Bill Brown, a former political aide and activist who now serves as director of the Fannie Mae office in Kansas City.” (*Kansas City Star*, 11/7/99)

Congressman John LaFalce (D-NY), Congressman Jack Quinn (R-NY) and Congressman Thomas Reynolds (R-NY)

- Fannie held a press conference to announce that it provided \$737 million in affordable housing financing for more than 9,500 families in the Buffalo area. (See earlier story in this *GSE Report*.) (*Fannie press release*, 10/25/99)

Congresswoman Carrie Meek (D-FL)

- Fannie announced a \$700,000 investment in a shopping center. A statement of support by Congresswoman Meek was included in Fannie’s press release. (*Fannie press release*, 10/30/99)

Huntsville, AL Mayor Loretta Spencer and Alabama A&M University President John Gibson

- Fannie held a press conference with the above officials to announce a partnership with Huntsville Housing Developments, Inc. (a non-profit organization). Fannie has agreed to purchase \$1.5 million in first mortgage loans originated by local lenders under the “Meadow Hills 2000” initiative. Under the initiative, Fannie has approved an underwriting experiment, through which local lenders require borrowers to make a 1% downpayment. Fannie will purchase first mortgage loans originated by AmSouth Bank, Colonial Bank, First Commercial Bank, Regions Bank, and South Trust Bank. (*Fannie press release*, 10/25/99)

Native American Pilot Partnership with the Department of Agriculture

- Fannie announced a partnership with the USDA called the Rural Housing Native American Pilot (RHNAP). The press conference was held to announce a family that recently moved into their own home on the trust lands of the Bay Mills Indian Community, a tribe affiliated with the Chippewa Nation. Under the partnership, USDA Rural Development guaranteed the loan for the family, Central Savings Bank issued the mortgage, and Fannie agreed to purchase the loan. (*Fannie press release*, 10/28/99)

San Francisco Mayor Willie Brown

- Fannie held a press conference with San Francisco Mayor Willie Brown to present a \$100,000 check from Fannie to the Northeast Community Federal Credit Union as part of its CDFI investments. (*Fannie press release, 10/19/99*)

Orlando Mayor Glenda Hood

- According to a Fannie press release, Fannie, the Florida Council of Churches, and the Enterprise Foundation hosted its first annual faith-based summit on housing and community development. Mayor Glenda Hood participated in the summit. (*Fannie press release, 10/21/99*)

Freddie Mac

Freddie is charging delivery fees (fees for using Freddie's technology) for its subprime (A-), its flexible mortgage insurance loans and its 97% loan-to-value mortgage products

[Editorial note: Freddie says its new products save consumer's money, yet Freddie may be eating up the potential consumer savings by charging delivery fees that are passed along to borrowers.]

- According to an article in the *American Banker* by Joshua Brockman, a spokeswoman for Freddie stated that its products with A-minus credit quality, its flexible mortgage insurance loans, and its 97% loan-to-value mortgage products all carry delivery fees for lenders. (*American Banker, Joshua Brockman, 9/14/99*) [Editorial note: The delivery fees are the cost that the lenders must pay to use Freddie's automated underwriting system. Lenders have no choice but to pay the higher fee if they want to provide the product because they must use Freddie's automated underwriting technology if they want to provide the product to consumers. Ironically, Freddie touts these programs as saving consumers money, yet charges hidden fees to consumers in these products.]

Freddie's borrowing causes Treasury bond prices to tumble

- According to a *Dow Jones Newswire* article, US Treasury bonds extended losses in afternoon trading on November 17 despite tame economic news from the Federal Reserve and the Labor Department. The article noted that the fears that the Federal Reserve may not be finished raising interest rates this year was one of the contributing factors. Also contributing to the decline was selling by dealers and investors in anticipation of a fresh supply of agency and corporate bonds – including a \$2.5 billion 30-year Freddie offering and a \$2.5 billion three-part offering by Lockheed Martin. This abundance of new supply reportedly weighed on Treasury prices. (*Dow Jones Newswire, 11/17/99*)

Freddie has former House Member Susan Molinari (R-NY) retained as a lobbyist

- According to a *Washington Post* article, former House Member Susan Molinari (R-NY) recently signed on with Fleischman-Hillard's Washington office as a Senior Public Affairs Consultant. Molinari will still keep her own company, lobbying on behalf of the Association of American Railroads, Freddie Mac, and iAdvance, the coalition of Bell operating companies. (*Washington Post, 11/4/99*)

Freddie's Senior Vice President of Government Relations is on House Majority Whip Tom DeLay's "Kitchen Cabinet"

- According to an article in the *Washington Post*, Freddie Mac's Senior Vice President of Government Relations Mitchell Delk is one of nearly 20 men and women - representing a broad cross-section of DC lobbyists - who are part of House Majority Whip Tom DeLays' "Kitchen Cabinet" – a group that meets weekly with the Majority Whip. (*Washington Post*, 10/18/99)

Federal Home Loan Banks

President Clinton announces his plans to renominate FHFBC Chairman Bruce Morrison and FHFBC Director J. Timothy O'Neill to the Federal Housing Finance Board (regulator of the FHLBank System)

Two other nominees, Franz Leichter and Douglas Miller, are still waiting for the Senate to vote on their nominations

Unclear when the Senate will take up the nominations

For the first time since the FHFBC was created, the FHFBC could have its first complete, full-time 5-member board (if the Senate confirms all nominations)

- On October 29, President Clinton announced his plans to renominate FHFBC Chairman Bruce Morrison and FHFBC Director J. Timothy O'Neill to the FHFBC. Morrison would serve another seven year term as Chairman of the FHFBC. According to the FHFBC, Morrison has served as a Member of the FHFBC since 1995. His current term expires on February 27, 2000. The new nomination, if approved by the Senate, would extend Morrison's term until February 27, 2007. Morrison is a former Democratic Congressman from Connecticut. O'Neill was originally nominated to the FHFBC in June 1995. His term expired February 27, 1997 but he has been left in a hold-over position on the FHFBC. If the Senate approves O'Neill, his service would expire in February of 2004. O'Neill was previously a partner in the law firm of O'Connor and Hannan and served as Senior Legislative Manager for International Affairs for the Treasury Department. (*BNA Daily Report for Executives*, Eileen Canning, 11/2/99; *Dow Jones Newswire*, John Connor, 11/1/99)
- According to John Connor with *Dow Jones Newswire*, with the recent nomination of Morrison and O'Neill to the FHFBC, "next year [FHFBC] could have its first complete, full-time board since it was created by Congress a decade ago." There are five positions on the FHFBC. Currently, only three positions are filled: FHFBC Chairman Morrison, FHFBC Director O'Neill, and a seat reserved for the Secretary of Housing and Urban Development or his designee (currently filled by Assistant HUD Secretary William Apgar). (*Dow Jones Newswire*, John Connor, 11/1/99)
- Two other FHFBC nominations are waiting confirmation by the Senate. In June, President Clinton announced his intention to nominate Franz Leichter, a New York state senator to be a member of the Board of Directors. According to White House press release, Leichter is a practicing attorney in New York, currently with the law firm of Walter, Conston, Alexander, and Green, P.C. He has been a member of the New York State Senate since 1975, serving on the New York State Banking Committee. (*BNA Daily Report for Executives*, 6/10/99) And in October of 1998, President Clinton

announced his intention to nominate Douglas Miller to serve on the FHFB, however, Congress adjourned for the year before considering his qualifications. Miller served as Chief of Staff and Administrative Assistant to Senator Larry Pressler (R-SD). The *American Banker* reported that Miller was hired on November 9, 1998 as Counselor to FHFB Chairman Morrison. (*American Banker*, 11/30/98; *National Mortgage News website*, posted 10/22/98, 6/9/99; *White House press release*, 10/21/98)

- A spokesman from the FHFB told the *BNA Daily Report for Executives*, that so far there is no word on when the Senate might take up these nominations. (*BNA Daily Report for Executives*, Eileen Canning, 11/2/99; *Dow Jones Newswire*, John Connor, 11/1/99)
- As we've noted in previous *GSE Reports*, the Finance Board is supposed to have five members, but since March of last year has only had three members: (1) FHFB Chairman Bruce Morrison; (2) Republican J. Timothy O'Neill and; (3) Art Agnos, a former San Francisco mayor who is with HUD and is filling the Board seat reserved for the Secretary of HUD or his designee. The White House fired a fourth member, Lawrence Costiglio in March of last year. Costiglio's firing left two vacancies on the five-member FHFB. Costiglio challenged his firing in court. According to John Connor with *Dow Jones Newswire*, a US Federal Appeals Court affirmed President Clinton's dismissal of Costiglio. In a judgement handed down October 8, 1999, a three-judge panel of the appeals court affirmed a lower court's decision that upheld President Clinton's March 1998 dismissal of Costiglio. Reportedly, Costiglio was many times at odds with the views of FHFB Chairman Bruce Morrison. Costiglio filed a lawsuit challenging his firing, arguing that he legally should remain in office until a successor was appointed and confirmed. (*Dow Jones Newswire*, John Connor, 4/15/99, 10/14/99) Costiglio's firing left two vacancies on the five-member FHFB. Costiglio's term as director expired in Feb. 1995, but he had been serving the agency in a holdover capacity until his March 1998 firing.

Farmer Mac

Farm Credit Administration proposes risk-based capital rule for Farmer Mac

- On November 12, the Farm Credit Administration (FCA) published its proposed risk-based capital rule for Farmer Mac. The FCA said the purpose of the proposal was to establish a risk-based capital stress test that will determine the level of regulatory capital necessary for Farmer Mac to maintain positive capital during a 10-year period where stressful credit and interest rate conditions occur. According to John Connor with *Dow Jones Newswire*, the goal of the risk-based capital rule is to align capital requirements with risk and avoid creating incentives for Farmer Mac to engage in inappropriately risky activities. In the notice published in the *Federal Register*, the FCA stated that the proposed rule includes definitions, methods, parameters and guidelines for developing and implementing the risk-based capital stress test. The proposed rule also specifies capital calculation, reporting, and compliance requirements, outlines the FCA's monitoring, examination, and enforcement activities, and prescribes certain policy requirements for business and capital planning.
- According to Eileen Canning with *BNA*, in general, the proposed stress test for Farmer Mac has the following five components:
 1. Data requirements to implement the test;
 2. A credit risk component to estimate losses during a period of sustained economic risk;
 3. An interest rate risk component to adjust interest rates for different scenarios;

4. A cash flow generator component to produce financial statements based on the credit risk and interest rate input; and
 5. A calculation component for Farmer Mac to use to solve for the starting regulatory capital amount.
- According to the notice, Farmer Mac must determine its risk-based capital at least quarterly and then submit data to the FCA. The GSE is also required to have a qualified independent external auditor review its implementation of the stress test and submit a copy of the evaluation to the FCA.
 - The FCA is required under the Farm Credit Act of 1971 to establish the risk-based capital test for Farmer Mac. Comments on the proposed rule are due March 13, 2000. (*BNA Daily Report for Executives*, Eileen Canning, 11/17/99; *Dow Jones Newswire*, John Connor, 11/12/99; *Federal Register*, page 61740-61764, 11/12/99)

Farmer Mac is feeling the full effects of the economic problems currently facing US farmers
--

- According to an article by Craig Woker with the *American Banker*, Farmer Mac as well as many banks that rely on Farmer Mac, “are feeling the full effects of the economic crisis confronting farmers across America.” Delinquent payments in Farmer Mac’s loan program for full-time farmers increased from 0.71% in June 1998 to 1.81% by March of 1999. By June 30, the number of delinquent borrowers had fallen back to 1.07%, however, Farmer Mac lenders worry it might climb again. “The farm crisis is a concern for the entire industry,” said Stephen Burier, Vice President of Zions Agricultural Finance in Ames, Iowa. “Farmers are facing a cash-flow problem, and we’re anticipating some challenges.” (Zions Agricultural is the largest Farmer Mac originator.) Northeast farmers were hit hard by drought over the summer and the Great Plains farmers had heavy rains this spring. Also, in 1998 and 1999, producers faced some of the lowest commodity prices in decades for products including wheat, soybeans and hogs. Effects of the crisis are reportedly already beginning at banks that make Farmer Mac loans. Eric Stiegers, the Farmer Mac manager at D.L. Evans Bank in Burley, Idaho estimates that about 40% of the Farmer Mac real-estate loans are being used to consolidate operating debt by using the farmer’s existing property as collateral. Stiegers believes that number will increase this fall. (*American Banker*, Matt Andrejczak, 11/1/99; *American Banker*, Craig Woker, 11/1/99)
- In related news, Farmer Mac announced net income of \$1.8 million (\$0.16 per share) for the third quarter, up 56% from \$1.1 million (\$0.10) last year. However, Farmer Mac President and CEO Henry Edelman stated that loan purchases and guarantees fell “significantly” below their second quarter levels as a result of a seasonal drop in agricultural originations and “economic uncertainties” from low commodity prices, natural disasters, and rising interest rates. Edelman stated that an expected \$8.7 billion increase in federal economic and disaster assistance for farmers “should bolster the near-term economic outlook for the agricultural sector.” (*National Mortgage News website*, posted 10/22/99)

November 19, 1999

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