

The **GSE** REPORT™

Contents of GSE Report™

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 - Fannie/Freddie watchdog group, FM Watch, says that the MBA, ACB, and the Financial Services Roundtable have all issued statements questioning Fannie & Freddie's activities
 - FM Watch says that HUD's “letters are significant because they illustrate that HUD...is taking greater notice of Fannie and Freddie's activities. Clearly, the GSEs and their actions are beginning to encounter increasing public scrutiny from regulators, Capitol Hill and the lending community.”
- The Consumer Bankers Association, the Consumer Mortgage Coalition, the Financial Services Roundtable and the National Home Equity Mortgage Association ask HUD to review Fannie & Freddie's “mission creep” and request that HUD adopt a “stronger stance” against the GSEs (*p. 8*)
 - The trade groups request that HUD examine Fannie & Freddie's expansion into mortgage insurance, subprime, home equity and real estate disposition
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- The GSEs' rising levels of debt issuance and excessive borrowing could drive up the price of housing (*p. 9*)
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 - “In hindsight, it seems clear that ramping up the issuance of agency paper during boom periods can be hazardous,” stated the FMC report
 - The FMC report warns that the increasing supply of mortgage credit – at a time when the economy is booming - creates economic distortions and drives up the price of housing
 - In related news, the Shadow Financial Regulatory Committee notes that an indication of the GSEs' unchecked growth is the growth of their borrowings in the financial markets. In 1998, the three largest GSEs (Fannie, Freddie, and the FHLBanks) borrowed more than the Treasury Department itself. The FHLBanks were the largest borrowers, with a total of \$2.5 trillion, followed by Freddie with \$2.1 trillion, and Fannie with \$843 billion
- The Shadow Financial Regulatory Committee urges Congress to repeal the FHLBank expansion provisions in the recently enacted Gramm-Leach-Bliley Act (*p. 10*)
 - The group notes that the GSEs, including Fannie & Freddie, distort the allocation of credit and drive out private sector competition

- Cong. Richard Baker (R-LA), Chairman of the House Banking Capital Markets, Securities and Government Sponsored Enterprises Subcommittee, says he plans to introduce legislation on the GSEs (p. 12)
 - Baker says he would like to strengthen the regulatory oversight of the FHLBank System, and he is still very much concerned about excessive arbitrage
 - Baker says he is willing to take whatever action is necessary to take Fannie & Freddie's safety and soundness regulator, OFHEO, out of the appropriations process
- OMB is moving away from a budget proposal to increase the Ginnie Mae guarantee fee (p. 13)
 - Worried about competition from Ginnie Mae, Fannie was reportedly pressing the Clinton Administration to increase the Ginnie Mae guarantee fee
 - This despite Fannie signing a joint trade letter in early 1999 to the OMB opposing any "fee" increase, including a Ginnie Mae guarantee fee increase
- Consumers are able to order carpeting, vinyl flooring by Armstrong, and appliances by Whirlpool at Freddie's retail HomeSteps sales center (window blinds are coming soon) (p. 14)
 - [Editorial Note: Selling carpeting, vinyl flooring, appliances and window blinds directly to consumers from its sales center is beyond Freddie's mission of providing liquidity to the secondary mortgage market. What's next?]
 - Freddie's HomeSteps retail mortgage center is currently being investigated by HUD [see lead story in *this GSE Report* on HUD's request for information on Freddie's HomeSteps initiative]
- Farm Credit System's Chief Regulator dies (p. 15)
 - Farm Credit Administration Chairman and CEO Marsha Pyle Martin died of cancer on January 9
 - Martin was the first woman in the Farm Credit Administration's history to be its Chairman and CEO

Fannie Mae and Freddie Mac

- *National Mortgage News* reports that Fannie & Freddie are likely to face more regulatory attention in the Year 2000 while their critics are going to be more vocal and organized (p. 16)
 - Collins notes that Fannie & Freddie are facing:
 - (1) HUD's proposal to increase their affordable housing goals;
 - (2) OFHEO's proposal for a risk-based capital standard on the GSEs; and
 - (3) Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker's (R-LA) desire to strengthen oversight of the GSEs and remove OFHEO from the appropriations process
 - [Editorial Note: Other issues facing Fannie & Freddie in the Year 2000 include:
 - (1) HUD's fair lending investigation of Fannie & Freddie's automated underwriting systems;
 - (2) HUD's investigation of recent business activities by Fannie & Freddie that may be beyond their missions;
 - (3) HUD's desire to issue a proposed rule that may limit the GSEs' non-mortgage investments;
 - (4) HUD's desire to make automated underwriting systems "open, transparent, and understandable";
 - (5) Proposals circulating that would expand Ginnie Mae's mission to compete against Fannie & Freddie; and
 - (6) The FHLBanks' continued success with its Mortgage Partnership Finance program – a direct competitor to Fannie & Freddie]
- Analysts expect Fannie & Freddie to post another round of double-digit earnings increases in the fourth quarter (Fannie & Freddie's retained portfolios are estimated to have increased in the fourth quarter) (p. 16)
 - Despite earnings growth, investors have reportedly turned their backs on the GSEs because of fears of a homebuying slowdown, a move away from fixed-rate mortgages in favor of adjustable rate mortgages, potential risks with the GSEs' expansion into nontraditional mortgage products, and political uncertainty
 - *Barron's* notes that it may take time for Freddie to get back in the good graces of investors, but the company enjoys a duopoly with Fannie that gives it a virtual license to print money
- *National Mortgage News* column by Brian Collins notes that Fannie & Freddie's much touted low cost mortgage insurance programs for high LTV loans – Fannie's Flex 97 and Freddie's Alt 97 – have been slow to catch on in the mortgage industry (p. 18)
 - Fannie & Freddie's Flex 97 and Alt 97 programs are currently being investigated by HUD [see lead story in this *GSE Report* on HUD's request for information on Fannie & Freddie's initiatives related to mortgage insurance]
- GSEs are continuing to increase their debt issuance and are increasingly positioning their securities as alternatives to Treasuries (p. 19)
 - Fannie & Freddie expect to substantially increase their debt issuance this year
 - Growth in GSE debt is being felt in the corporate market – competition from the GSE debt is pushing corporate spreads permanently wider – agencies issued roughly 80% more debt than the US Treasury in 1999
 - Corporate bond traders are increasingly using GSE debt instead of Treasuries to hedge
 - An Internet-based multi-dealer trading system that's already active in Treasuries plans to begin trading GSE debt in the first quarter of 2000 – providing another platform for agency debt

- Freddie sells the first global bonds ever marketed on the Internet
- Freddie's offering will be part of its monthly sale of Reference Notes, which it estimates will total \$65 billion this year, up about 30% from 1999 levels
- Freddie would like to increase the proportion of funds it borrows from capital markets outside the US to 50% from 30%
- Fannie introduces "Universal Debt Facility" that consolidates all of its outstanding debt offering documents and dealer agreements - Fannie says that by using the "Universal Debt Facility" it can issue Fannie debt securities in unlimited quantities
- Fannie & Freddie make a series of announcements on their technology products directed at brokers, realtors and consumers (p. 22)
 - [Editorial Note: This conflicts with the Mortgage Bankers Association's (MBA) policy statement on the GSEs - "The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers of vendors of those partners, including, but not limited to consumers, owners/ developers of housing, mortgage brokers, and other real estate professionals." (MBA GSE Policy Statement, 8/10/99)]
- Fannie & Freddie's safety and soundness regulator, OFHEO, issues a rule establishing hearing procedures in enforcement actions against Fannie & Freddie or their executive officers or directors (p. 25)
- Fannie & Freddie have become large purchasers of commercial multifamily loans (p. 26)
- Market sources speculate that Fannie or Freddie may have purchased Sallie Mae's recent \$2.06 billion asset-backed securities offering (p. 26)
- In compiling a Year 2000 wish list for regulators, the *American Banker* predicts that OFHEO's wish would be to implement the risk-based capital rules for Fannie & Freddie, or at least close the comment period (p. 26)
- GSEs continue to purchase home-equity deals (p. 27)
- Fannie & Freddie's loan purchases drop by half (p. 27)
- OFHEO announces staff changes and additions (p. 27)
- *Roll Call* reports that Fannie & Freddie devoted at least a 15% greater share of their contributions to Democrats this election cycle (p. 27)
 - Fannie & Freddie each contributed more than \$400,000 in total funds to both parties in the last election cycle

Fannie Mae

- US Marshals Service extends and expands Fannie's real estate owned (REO) deal (p. 28)
 - US Marshals Service is using Fannie to sell seized or forfeited properties instead of its prior practice of using realtors
 - Realtors are concerned about Fannie's REO program with the US Marshals Service
- Fannie forms strategic alliance with Prism Financial (p. 29)
 - The two companies plan to use the alliance for work related to market expansion, technology integration, and ancillary business services
- In a first, Countrywide Home Loans has raised \$200 million by securitizing its "excess servicing" on a \$30 billion portfolio of home loans (p. 29)
 - Fannie is guaranteeing the bonds as part of an alliance agreement announced with Countrywide
- According to the *American Banker*, market sources say that Fannie is the purchaser for both Countrywide's e-Easy Rate Reduction plan mortgage and First Tennessee's Motivator loans (p. 29)
 - Fannie reportedly plans to keep these loans in its portfolio rather than securitizing them
 - Laurie Goodman, a Managing Director at PaineWebber believes that the plan, as it currently stands, should not affect liquidity, but could if the plan was expanded. "We do believe that both Countrywide and Fannie Mae should be aware of the probable impact that further expansion of this program could ding TBA [to-be-announced MBS pools] liquidity."
- Fannie refutes Martin Luther King III op-ed that accuses Fannie & Freddie of perpetuating a minority housing gap (p. 30)
- An important credit consideration for Moody's Investor Service's rating of Fannie is its GSE status (p. 32)
- Fannie further expands into construction lending (p. 32)
 - Fannie finances a fund that will provide construction loans to homebuilders and developers at reduced interest rates
 - Fannie also begins construction-to-permanent mortgage pilot with First Federal Lincoln Bank
- Fannie begins initiative targeting second "gap" mortgages (p. 33)
- Fannie continues to hire politically connected employees (p. 33)
 - Fannie hires Senator Robert Bennett (R-UT) staffer as Director of its Utah Partnership Office
 - Fannie hires the Tennessee Governor's Strategic Planner
 - Fannie hires the Media Relations Assistant to the National Credit Union Administration Chairman

- 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 (*p. 34*)
 - Fannie claims to have 44 partnership offices in its press releases but official contact information for 10 of those offices is unavailable
- Several hundred of Fannie's employees on Y2K duty enjoy a sit-down dinner on New Year's Eve with a jazz ensemble and magicians and caricaturists for children (*p. 36*)

Freddie Mac

- Freddie announces that a family in Oklahoma was the first to take advantage of a \$10 million Native American Initiative (*p. 36*)
 - The initiative is a partnership with the Housing Authority of the Cherokee Nation, PMI Mortgage Insurance Co., First Americans Mortgage, Washington Mutual and Freddie
- Freddie hires Wall Street professional for Securities Marketing Vice President (*p. 37*)
 - Freddie also names Securitization Vice President
 - Former Freddie executive to start Internet small business lender portal

Federal Home Loan Banks

- The Federal Housing Finance Board issues a proposed rule to reorganize the Office of Finance so that FHLBanks have direct responsibility for the issuance of FHLBank consolidated debt obligations (CO), starting January 2, 2001 (*p. 37*)
 - FHFB proposes to transfer certain corporate governance responsibilities from the FHFB to the individual FHLBanks – taking the first steps mandated by the recently enacted Gramm-Leach-Bliley Act
 - FHFB publishes a formal notice that it has withdrawn its proposed rule governing participation and sales of whole advances
- FHLBank System's Mortgage Partnership Finance Program (MPF) is becoming a real competitor to Fannie & Freddie in the secondary mortgage market – competition in the secondary market benefits consumers (*p. 38*)
 - MPF loans grow 87% in 1999, national expansion continues
 - Eight of the 12 FHLBanks are expected to offer MPF to their members
 - HSBC Bank of Buffalo and Provident Bank of Montebello have started to originate their home loans through the MPF Program with the FHLBank of New York
- Former Chair of the Ohio Democratic Party to Chair Cincinnati FHLBank (*p. 39*)

Farm Credit System

- Co-Bank, a Farm Credit System lender, is planning to ask the government for permission to directly invest in agricultural cooperative companies (*p. 39*)
 - The American Bankers Association and the Independent Community Bankers of America say the power would give Co-Bank an edge over commercial banks and they vow to fight Co-Bank's efforts
- Farm Credit Administration proposes rule to allow Farm Credit System corporations to sell stock to non-System entities (*p. 40*)

Ginnie Mae

- Columnist asks the question, "What Effect Would a Privatized Ginnie Mae Have on Mortgage Costs?" (*p. 40*)

Major Events

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In a separate letter to Fannie, HUD threatens enforcement action against Fannie if the GSE fails to give more detailed information to HUD by January 31, 2000 on Fannie's automated underwriting system

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HUD is also reportedly preparing a letter to Freddie threatening enforcement action because of its incomplete response to HUD on its automated underwriting system

Fannie/Freddie watchdog group, FM Watch, says that the MBA, ACB, and the Financial Services Roundtable have all issued statements questioning Fannie & Freddie's activities

FM Watch says that HUD's “letters are significant because they illustrate that HUD...is taking greater notice of Fannie and Freddie's activities. Clearly, the GSEs and their actions are beginning to encounter increasing public scrutiny from regulators, Capitol Hill and the lending community.”

- The Department of Housing and Urban Development (HUD) is stepping up its regulatory authority over Fannie and Freddie. HUD sent three letters to the GSEs warning of enforcement action if the GSEs failed to comply with HUD's requests by January 31, 2000. Two of the letters (one to Fannie; one to Freddie) request more information on some of Fannie and Freddie's new activities. HUD indicated that these new programs might be a possible expansion by Fannie and Freddie beyond their original charters without HUD's permission. A third letter was sent separately to Fannie requesting more information from Fannie about its automated underwriting system. HUD is considering enforcement action for Fannie's failure to comply fully with government requests for information about its proprietary automated underwriting system as part of HUD's fair lending investigation of Fannie and Freddie's automated underwriting systems (which control 95% of the automated underwriting market share).

HUD asks Fannie & Freddie for more information on the GSEs' new programs

- Concerned about expansion of the GSEs beyond their original charters, HUD requested more information from Fannie and Freddie on the GSEs' new initiatives. HUD sent letters dated December 21, 1999 to Fannie and Freddie saying that the GSEs began several new initiatives that HUD believes may be new programs. The letters note that Fannie and Freddie must get HUD approval before implementing new programs. HUD has also asked Fannie and Freddie to explain how the GSEs' initiatives impact the mortgage market and private sector competitors and asks what authority the GSEs have to engage in these new initiatives under their charters. The letters, signed by HUD Assistant Housing Secretary and Federal Housing Commission William Apgar, gave the GSEs a

January 31, 2000 deadline in which to provide detailed information to HUD or face enforcement action or even suspension of the programs until the agency completes its review.

- In its letter to Fannie, HUD requests more information about Fannie's initiatives dealing with mortgage insurance, Internet access to Fannie's automated underwriting system – Desktop Underwriter – by mortgage brokers and consumers, and the Home Depot pilot program for home improvement loans. HUD requested information from Freddie on its initiatives dealing with mortgage insurance, Loan Prospector (Freddie's automated underwriting system) on the Internet, and Freddie's HomeSteps Buying Center in Morena Valley, CA, which HUD describes as a real estate brokerage unit.
- According to a *Wall Street Journal* article by Jerry Guidera and Sarah Landis, Fannie Spokesman David Jeffers said "All of the products cited would not require program approval and all are designed to expand opportunities for more families in America." A Freddie representative was not available to comment. According to an *American Banker* article by Robert Julavits, an official for a major lender, who did not want to be identified, said that Freddie's HomeSteps program goes directly to consumers and thus is not consistent with Freddie's secondary market mission. "It's not in their charter, not in their mission, and it's a clear violation of the Mortgage Bankers Association's GSE policy statement," he said. (*BNA Daily Report for Executives*, Marc Selinger, 1/10/00; *American Banker*, Robert Julavits, 1/6/00; *National Mortgage News website*, posted 1/5/00; *National Mortgage News*, Brian Collins, 1/10/00)
- According to Marc Selinger with *BNA*, Fannie/Freddie watchdog group – FM Watch – welcomes the HUD letters. "We're very supportive of what HUD's doing," said FM Watch Spokesman Beneva Schulte. Schulte noted that the letters give ammunition to FM Watch's argument that Fannie and Freddie are moving beyond their charters and into competition with the private sector. (*BNA Daily Report for Executives*, Marc Selinger, 1/10/00)

Fannie is accused of dragging its feet in HUD's fair lending investigation of Fannie & Freddie's automated underwriting systems – HUD says Fannie's information to date is "unacceptable" and "grossly incomplete" - HUD warns of enforcement action if Fannie fails to provide more information

- HUD also sent a separate letter to Fannie on December 21, 1999 as a follow-up to its fair lending investigation of Fannie and Freddie's "black box" automated underwriting systems used by lenders to score potential mortgage borrowers. HUD sent letters to Fannie and Freddie back in February 1999 requesting detailed information on data collection and the criteria used in creating their automated underwriting systems. In HUD's December 21, 1999 letter to Fannie Chairman Franklin Raines, HUD's General Counsel Gail Laster criticized Fannie for providing information that "was grossly incomplete and did not provide the information necessary for HUD to even begin to perform its legal responsibilities." Laster also noted that Fannie included documents falsely labeled as confidential and proprietary and that the company ignored HUD's request that its Chief Executive Officer certify the information as truthful and correct. Laster returned the documents to Fannie and asked that Fannie provide more detailed and accurate information to HUD by January 31, 2000.
- Fannie officials have reportedly been slow to respond to HUD's request, arguing that the information is proprietary. According to HUD's letter, "Fannie Mae's posture to date has been and remains wholly unacceptable." HUD is threatening to levy fines through the Office of Federal Enterprise Oversight (OFHEO) against Fannie and its officers if Fannie does not provide a complete and accurate response. HUD warned that unless Fannie submits all the materials originally requested, along with the required certification no later than January 31, 2000, it would take enforcement actions. The following are

some of the formal courses of action HUD said it was prepared to pursue: (1) terminate or suspend the Statement of Understanding between HUD and Fannie implementing Fannie's automated underwriting system for FHA loans; (2) conduct an on-site verification to independently verify the accuracy and completeness of the information already provided by Fannie; (3) cease and desist proceedings; or (4) civil money penalties ranging from \$5,000 per day up to \$1,000,000 per day for serious violations.

- HUD feels that this fair lending investigation of Fannie's and Freddie's automated underwriting systems is important and timely because "the mortgage industry has undergone revolutionary technological change, particularly in the area of automated underwriting." **Laster wrote that, "The potential for these changes to adversely impact loan applications and borrowers based on their race, ethnicity, gender or other protected class characteristics is obvious. In this environment, the Department believes the American people have a right to know whether the underwriting criteria and systems that determine whether they can affordably achieve home ownership and that are developed by Fannie Mae and Freddie Mac – enterprises sponsored by their own Government – work fairly and equally."**

Freddie is also resisting supplying information about its automated underwriting system to HUD

- According to an article by Michael Schroeder in the *Wall Street Journal*, a senior HUD official said that both Fannie and Freddie have resisted supplying internal information about their proprietary automated underwriting systems. In addition, a HUD official said that HUD is preparing a letter to Freddie threatening enforcement actions because of its incomplete response.

Fannie & Freddie deny they have dragged their feet in the investigation

- Fannie cited concerns about the need for HUD to protect proprietary information as the reason that its information was incomplete, yet HUD said Fannie marked documents as "confidential and proprietary" that were in the public domain. HUD stated that "None of the information contained in those documents fits within the definition of 'proprietary' or 'confidential' information. These markings were false." Documents that were marked as proprietary included press releases, speeches made by Fannie executives and a list of Fannie's regional offices. "Claims for confidential treatment cannot be made for information that is publicly available and that confidential materials should be so certified," wrote Laster. **"The practice of knowingly marking documents as proprietary when they are known to be in the public domain undermines Fannie Mae's espoused concerns regarding the proprietary nature of the remainder of the required materials."** Fannie Spokesman David Jeffers called the designation of these documents as proprietary as "an inadvertent clerical mistake." Freddie Spokeswoman Sharon McHale said, "We feel we've provided them [HUD] with extensive information." (*HUD General Counsel Gail Laster letter to Fannie Chairman and CEO Franklin Raines, 12/21/99; Wall Street Journal, Michael Schroeder, 1/4/00; Dow Jones Newswire, Jerry Guidera, 1/4/00*)

Background:

- HUD has been investigating Fannie and Freddie's automated underwriting for almost a year. Fannie and Freddie's automated underwriting systems control approximately 95% of the automated underwriting market share. In February 1999, HUD sent letters to Fannie and Freddie requesting information to ensure that the GSEs' systems comply with fair-lending standards. An independent study commissioned for HUD by the Urban Institute in March 1999 found that Fannie and Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers. 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 noted that “Primary lenders are making more aggressive efforts” to serve the lower income and minority homebuyers “by offering loan products with underwriting guidelines that are more flexible than the GSEs’ guidelines.” Further, the report noted that “depository lenders are serving low- and moderate-income borrowers better than the GSEs and so the percentage of loans purchased by the GSEs that are originated to low- and moderate-income borrowers is less than the percentage of loans originated in the primary market.” The report also noted that “there is some evidence that the GSEs’ purchase of loans made to black and Hispanic homebuyers have actually declined (in share and absolute number) over the last two years.” (HUD/Urban Institute Study, “A Study of the GSEs’ Single Family Underwriting Guidelines,” April 1999)

FM Watch says HUD’s letters are significant

- **According to a FM Watch Bulletin, HUD recently joined the lender community in questioning Fannie and Freddie’s expansion into new lines of business to the detriment of homebuyers. FM Watch noted that in the past months, the Mortgage Bankers Association, America’s Community Bankers and the Financial Services Roundtable have each individually issued statements questioning Fannie and Freddie’s activities.**
- In July, the ACB said, “The Secretary of Housing and Urban Development should use his statutory authority to disallow new or modified programs that are inconsistent with the statutory mission of Fannie and Freddie.” In August, the MBA said, “The GSEs should introduce new products and services only when they directly relate to their core functions of providing liquidity and stability in the secondary mortgage market, including activities relating to mortgages for low and moderate income families.” And in September, the FSR expressed concern “that Fannie and Freddie have current and planned activities beyond their core missions including: providing liquidity for home equity and sub-prime loans, undertaking investment portfolio activities beyond housing as well as housing related investments that increase risk, creating consumer financial services ‘accounts’ tied to mortgages, undertaking real estate disposition activities, and other programs.”
- **FM Watch says the “letters are significant because they illustrate that HUD, Fannie and Freddie’s regulator, is taking greater notice of Fannie and Freddie’s activities. Clearly, the GSEs and their actions are beginning to encounter increasing public scrutiny from regulators, Capitol Hill and the lending community.” (FM Watch Bulletin, 1/11/00)**

The Consumer Bankers Association, the Consumer Mortgage Coalition, the Financial Services Roundtable and the National Home Equity Mortgage Association ask HUD to review Fannie & Freddie’s “mission creep” and request that HUD adopt a “stronger stance” against the GSEs

The trade groups request that HUD examine Fannie & Freddie’s expansion into mortgage insurance, subprime, home equity and real estate disposition

Only after HUD has conducted a thorough review, should these programs be allowed to proceed, if at all

- Marc Selinger with *BNA* reported that the Consumer Bankers Association, the Consumer Mortgage Coalition, the Financial Services Roundtable, and the National Home Equity Mortgage Association sent a joint letter to HUD urging the agency to “adopt a stronger stance against this so-called ‘mission creep’ by the secondary market agencies.” The trade groups suggested that HUD use its regulatory authority to require that Fannie and Freddie seek HUD’s approval before implementing new programs. “...[W]e believe that expansionist activities of Fannie Mae and Freddie Mac should be

carefully scrutinized and allowed to proceed, if at all, only after HUD has conducted a thorough review of the new programs as required by law and applicable [d]epartment regulations.”

- The trade groups argue that **“Fannie Mae and Freddie Mac are abusing their special charter powers to compete unfairly with non-GSEs. By utilizing their tax exemptions, government subsidies and other advantages, these GSEs can, and do, come to totally dominate markets which they enter because private industry simply cannot compete for long given all the advantages conferred by GSE status. It is precisely for this reason that that we believe the Congress intended that Fannie Mae and Freddie Mac confine their activities to situations where market imperfections justify a GSE presence. For Fannie Mae and Freddie Mac, that niche has historically been the secondary market for conventional home loans, particularly as it involves expanding affordable housing opportunities. It was never intended to be, nor should it include, expansion into programs like mortgage insurance, subprime and unrestricted home equity lending, third-party real estate disposition and even real estate brokerage.”**
- The trade groups felt Ralph Nader’s Congressional testimony was a good summary: **“It is obvious that some of the subsidy derived from their GSE status is being used, not for home buyers, but to increase corporate power and control over all facets of the mortgage business”** (*BNA Daily Report for Executives*, Marc Selinger, 1/10/00; *Joint banking trade association letter to HUD Secretary Andrew Cuomo*, 12/15/99)

The GSEs’ rising levels of debt issuance and excessive borrowing could drive up the price of housing

A Virginia think tank – the Financial Markets Center (FMC) – warns that a “mortgage bubble” could be developing due to excessive borrowing and rising levels of debt issuance by the GSEs, such as Fannie & Freddie

“In hindsight, it seems clear that ramping up the issuance of agency paper during boom periods can be hazardous,” stated the FMC report

The FMC report warns that the increasing supply of mortgage credit – at a time when the economy is booming – creates economic distortions and drives up the price of housing

In related news, the Shadow Financial Regulatory Committee notes that an indication of the GSEs’ unchecked growth is the growth of their borrowings in the financial markets. In 1998, the three largest GSEs (Fannie, Freddie, and the FHLBanks) borrowed more than the Treasury Department itself. The FHLBanks were the largest borrowers, with a total of \$2.5 trillion, followed by Freddie with \$2.1 trillion, and Fannie with \$843 billion (see next story on the Shadow Financial Regulatory Committee statement)

- **As reported in the *National Mortgage News*, the Financial Market Center – a nonprofit research-based think tank in Virginia – warns that a “mortgage bubble” is developing due to excessive borrowing by the GSEs. According to the FMC, at a time of federal government surpluses, the GSE debt instruments and mortgage-backed securities are becoming a substitute for US Treasury securities and more money is being funneled into the real estate markets. The FMC report warns that this increasing supply of mortgage credit can artificially increase housing prices if the supply of housing units cannot keep up with demand. The reason of the surge in mortgage credit is the investor demand for Fannie Mae, Freddie Mac, and the**

FHLBank debt. “Because GSE and pool issues present only negligible risks and bear an implicit government guarantee, investors turn to them eagerly as substitutes for Treasuries,” noted the FMC report.

- “Over the first three quarters of 1999, mortgage borrowing grew at a 10% annual rate,” the report says, noting that this is the highest rate of growth since the last housing boom in 1988. “However, the rapid expansion of mortgage debt may also have a downside, as the experience of the 1980s demonstrated. Between 1983 and 1988, home mortgage debt grew at annual rates of more than ten percent, peaking at 15.8 percent in 1987 and decisively driving up housing prices. **In hindsight, it seems clear that ramping up the issuance of agency paper during boom periods can be hazardous,”** the FMC says.
- **The author of the report, FMC Director of Programs Jane D’Arista warns that increasing supply of mortgage credit – at a time when the economy is booming – creates economic distortions that increase the price of housing. Once housing prices start increasing, people are pushed out of the market and are required to use more of their income to service mortgage debt. She warned that this will exacerbate the next economic downturn because household debt as a percentage of disposable income is already at an historical high of 95%. “Homeowners will be more squeezed, and they are more likely to lose their houses than in the past,” D’Arista stated. (National Mortgage News website, posted 12/28/99; National Mortgage News, 1/3/00; “Is a Mortgage Bubble Filling the Treasury Debt Vacuum?”, Flow of Funds – Review & Analysis, Jane D’Arista, Financial Markets Center, 3rd Quarter 1999)**

The Shadow Financial Regulatory Committee urges Congress to repeal the FHLBank expansion provisions in the recently enacted Gramm-Leach-Bliley Act

The group notes that the GSEs, including Fannie & Freddie, distort the allocation of credit and drive out private sector competition

- The Shadow Financial Regulatory Committee – a group of lawyers and economists currently doing research or practicing in the field of finance – issued a statement urging Congress to repeal the FHLBank expansion provisions in the recently enacted Gramm-Leach-Bliley Act (signed into law on November 12) before Congress loses the ability to control the FHLBanks. **The group notes that the GSEs, in general, distort the allocation of credit and drive out private sector competition. The group urges Congress to check the growth of all the GSEs, given the implications of this growth for competitive private financial markets.**
- According to Eileen Canning with *BNA*, during a December 13 meeting, the group said that the growth of GSEs, including the FHLBank System, is a big problem and argued that the Gramm-Leach-Bliley Act expands the System’s authority. “With the maturity of the housing financial system in the United States, it has become clear that this form of government support for residential finance is not necessary,” the Committee said in a statement. “Under these circumstances, the FHLBs should have been abolished, but Congress has been unwilling or unable to do so. Instead, over the last few years, the FHLBs have been allowed to extend their lending activities to commercial banks that were heavily engaged in housing finance.” - Shadow Financial Regulatory statement
- Under the Gramm-Leach-Bliley Act, banks and thrifts with assets less than \$500 million are permitted to pledge small business or agricultural loans for FHLBank advances. The law also allows these small banks and thrifts to join the FHLBank System without meeting a requirement applied to other

financial institutions calling for at least 10 percent of the institution's assets to consist of housing-related loans. The group stated that "The removal of that restriction makes additional FHLB subsidies available to small business and agriculture. Thus, far, from reining in the growth of the GSEs, Congress has actually expanded their potential role in the economy." The group notes that there is no "shortage" of small business and agricultural finance, "but there is always a constituency for maintaining or increasing government subsidies. As the competitive advantages of borrowing from the FHLBs become more apparent, that financing could increasingly become a staple of small business and agricultural lending. Efforts to cut it back or control it – like efforts to restrict the growth of Fannie Mae and Freddie Mac – will be met with protests from small banks as well as the affected groups."

- The group noted that **"the growth of the GSEs is a troubling phenomenon. Not only do the GSEs distort the allocation of credit by funneling financing to politically favored sectors of the economy, but once they have entered an area of financial activity the GSEs' implicit government backing allows them to drive out private sector competitors and achieve dominance in their markets. In addition, because they can provide financing at subsidized rates, the GSEs are able to muster substantial political support from the favored groups, which over time insulates them from Congressional oversight and could make them invulnerable to Congressional control. Fannie Mae and Freddie Mac are leading examples of this phenomenon."**
- The group believes there is unchecked growth of the GSEs. Fannie and Freddie have doubled in size every five years since 1970, and the group predicts that by 2003, almost 50 percent of all residential mortgages in the United States will be on the books of Fannie and Freddie. **Another indication of the unchecked growth is the growth of their borrowings in the financial markets. In 1998, the three major GSEs (Fannie, Freddie, and the FHLBs) – borrowed more than the Treasury Department itself. The FHLBs were the largest borrowers, with a total of \$2.5 trillion, followed by Freddie with \$2.1 trillion, and Fannie with \$843 billion.**
- Members of the Shadow Committee are:
 - George G. Kaufman, Loyola University of Chicago, Co-Chair
 - Robert E. Litan, Brookings Institution, Co-Chair
 - Richard C. Aspinwall, Economic Adviser
 - George J. Benston, Emory University
 - Charles W. Calomiris, Columbia University
 - Franklin R. Edwards, Columbia University
 - Scott E. Harrington, University of South Carolina
 - Richard J. Herring, University of Pennsylvania
 - Paul M. Horvitz, University of Houston
 - Hal S. Scott, Harvard Law School
 - Kenneth E. Scott, Stanford Law School
 - Peter J. Wallison, AEI

(BNA Daily Report for Executives, Eileen Canning, 12/21/99; Statement of the Shadow Financial Regulatory Committee on Federal Home Loan Banks, 12/13/99)

Cong. Richard Baker (R-LA), Chairman of the House Banking Capital Markets, Securities and Government Sponsored Enterprises Subcommittee, says he plans to introduce legislation on the GSEs

Baker says he would like to strengthen the regulatory oversight of the FHLBank System, and he is still very much concerned about excessive arbitrage

Baker says he is willing to take whatever action is necessary to take Fannie & Freddie's safety and soundness regulator, OFHEO, out of the appropriations process

- *BNA* conducted a telephone interview on December 2 with Cong. Baker. The following are excerpts from the interview:

BNA: “You have said in the past that you were considering introducing a bill to tighten oversight of the housing related GSEs [Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System]. Do you still plan to introduce one?”

Baker: “There will be legislation. I don't want to say exactly today what elements would be included in such legislation, but we're in the process now of doing homework to come up with a final product.”

BNA: “Do you plan to introduce any legislation to build on the Federal Home Loan Bank System reforms?”

Baker: “Again, not immediately. I would like to see the current set of rules implemented ... We have now allowed smaller banks access to capital that they have not previously had access to for business purposes..so the system's taking on more risk. I very much want to strengthen the regulatory oversight of the system. I'm still very much concerned about excessive arbitrage. I do not think investment in foreign debt is difficult to defend. So there's a lot of work to be done...”

BNA: “There's been talk of taking [the Office of Federal Housing Enterprise Oversight, which regulates Fannie and Freddie's safety and soundness] out of the appropriations process. Will you look at that in 2000?”

Baker: “Yes. It's something I strongly support. If we're going to have regulatory capacity that is capable of standing up to the scope and size of the GSEs, removing them from that appropriations process is an important step.”

BNA: “Will you introduce a bill?”

Baker: “I'm going to take whatever action...is required to get that done. If [it] needs to be a stand-alone bill or whether it's tied to some other proposal, the answer is yes.”

(BNA Daily Report for Executives, Marc Selinger, 12/13/99)

OMB is moving away from a budget proposal to increase the Ginnie Mae guarantee fee

Worried about competition from Ginnie Mae, Fannie was reportedly pressing the Clinton Administration to increase the Ginnie Mae guarantee fee

This despite Fannie signing a joint trade letter in early 1999 to the OMB opposing any “fee” increase, including a Ginnie Mae guarantee fee increase

- Brian Collins with *National Mortgage News* reported that the Office of Management and Budget (OMB) is no longer considering a 2001 budget proposal to increase the Ginnie Mae guarantee fee by 2 basis points. “We are encouraged by what we are hearing,” said Paul Reid, Executive Vice President of the Mortgage Bankers Association. “It would lead us to believe that it is not going to be in the budget,” he added. Others have indicated that the proposal is no longer being considered, however, no one is willing to say the issue is dead. According to Collins, the President’s budget is expected to be finalized in the next few weeks and the official budget document is scheduled to be released February 7.
- Both HUD and the MBA are opposed to increasing the Ginnie Mae guarantee fee, calling it a “tax on homeownership.” Instead, HUD has presented two revenue raisers to OMB that would expand Ginnie Mae’s mission. One proposal would let Ginnie Mae purchase its own mortgage-backed securities and the other proposal would allow certain conventional loans to be securitized by Ginnie Mae. “If people want revenues, let’s look at a potential expansion of Ginnie Mae,” said Reid. (*National Mortgage News*, Brian Collins, 12/27/99)

Fannie was reportedly pushing for the Ginnie Mae fee increase

- According to a *Wall Street Journal* article by Sarah Landis and Jerry Guidera, Fannie is reportedly pushing the Clinton Administration to increase the Ginnie Mae guarantee fee because Fannie is worried about competition from Ginnie Mae. The article noted that analysts say that proposals such as allowing Ginnie Mae to create an investment portfolio by purchasing their own mortgage-backed securities are also opposed by Fannie because it would put Ginnie Mae in direct competition with Fannie. Fannie officials deny that they have taken a position involving any Ginnie Mae proposals in the 2001 budget discussions. “It’s not true,” said Fannie Spokesman David Jeffers, “and whoever is spreading this around is drinking too much eggnog.” (*Wall Street Journal*, Sarah Landis and Jerry Guidera, 12/21/99, 12/22/99)
- As reported in the January 8, 1999 *GSE Report*, the OMB was considering including in the President’s FY 2000 budget a \$500 million user fee on Fannie and Freddie as compensation to the federal government for securities registration fees the agencies would pay to the SEC if they weren’t exempt from such fees by virtue of their GSE status and a three-point increase in the Ginnie Mae guaranty fee. Fannie called the user fee proposal a “tax on homeownership” and successfully requested that housing trade groups and consumer groups join with them in opposition to “any proposals which drive up the cost of home ownership for low-, moderate- and middle-income families.” A joint letter was submitted to OMB Director Jacob Lew in December 1998 opposing any “fee” increases, labeling them a “homeownership tax.”
- The letter to the OMB noted that “Rumors persist that the Administration is considering a variety of new ‘fees,’ or existing fee increases, and other items that will make it more difficult for American families to purchase homes... We have agreed to oppose any ‘homeownership tax’ – no matter the

source-that would make housing finance more costly or establish other obstacles to expanded homeownership.” The letter was co-signed by the Mortgage Bankers Association, the National Association of Home Builders, the National Association of Realtors, Fannie Mae and Freddie Mac. (Wall Street Journal, Jacob Schlesinger, 1/5/99; *Joint Trade Association Letter to OMB Director Jacob Lew*, 12/30/98)

Consumers are able to order carpeting, vinyl flooring by Armstrong, and appliances by Whirlpool at Freddie’s retail HomeSteps sales center (window blinds are coming soon)

[Editorial Note: Selling carpeting, vinyl flooring, appliances and window blinds directly to consumers from its sales center is beyond Freddie’s mission of providing liquidity to the secondary mortgage market. What’s next?]

Freddie’s HomeSteps retail mortgage center is currently being investigated by HUD [see lead story in this *GSE Report* on HUD’s request for information on Freddie’s HomeSteps initiative]

- According to a *National Mortgage News* article by Lew Sichelman of *United Features Syndicate*, more than 17,000 houses were sold across the country through Freddie HomeSteps. Sichelman notes that because Southern California is still emerging from its recent real estate recession, Fannie’s sales affiliate took the novel approach of opening the one-stop sales center to speed up sales. Baldwin Realty, a local firm, staffs the center. Buyers can also order carpeting and upgraded appliances at the sales center, and special financing is available for many of the properties. Sichelman profiled one consumer who was about to take advantage of a financing package that included a 95% first mortgage and an interest-only second lien held by a private investor. HomeSteps passed on private mortgage insurance and it provided extra money to cover closing costs. (*National Mortgage News*, Lew Sichelman, 1/3/00)
- **[Editorial Note: On Freddie’s HomeSteps website (HomeSteps.com), consumers are told that they can “add custom touches” to their homes, the costs of which can be rolled into their monthly payments. Consumers are able to upgrade their carpeting from Basic Plus to a line of classic or cut Berbers and upgrade their carpet padding. Consumers are also able to upgrade their vinyl flooring and are able to choose from two Armstrong vinyl upgrades, “both of which offer a no-wax surface, wear protection and stain resistance.” Finally, consumers are able to order appliances. According to Freddie, all of their stoves and dishwashers are made by Whirlpool and are available in white, almond or black. Consumers can choose a basic appliance package, or select from two upgrades, “all of which are on display at the HomeSteps Buying Center.” Consumers can upgrade to a new vent-a-hood or a space-saver microwave/vent-a-hood combination. The website notes that window blinds are coming soon! “Visit the HomeSteps Buying Center to view all of these upgrade options!,” says Freddie’s HomeSteps website. What’s next?]** (*HomeSteps.com website (www.homesteps.com)*, 1/13/00)]

Farm Credit System's Chief Regulator Dies

Farm Credit Administration Chairman and CEO Marsha Pyle Martin died of cancer on January 9

Martin was the first woman in the Farm Credit Administration's history to be its Chairman and CEO

- Farm Credit Administration Chairman and CEO Marsha Pyle Martin died of cancer on January 9, 2000. Martin, 61, had been Chairman and CEO since October 1994 and was the first woman in the 65-year history of the Farm Credit Administration to be its Chairman and CEO. Martin was also the first woman executive in the Farm Credit System, serving as Senior Vice President of the Farm Credit Bank of Texas. She was also the first woman to serve as Director of the Farm Credit System Insurance Corporation. Martin joined the Federal Intermediate Credit Bank of Texas in 1970 and worked there until her appointment to the FCA Board.
- The FCA credited Martin with spearheading the update to customer eligibility criteria that enabled greater access to System financing and revitalizing the staff of the FCA.
- According to Marc Selinger with the *BNA Daily Report*, a FCA spokeswoman said that Board Member Michael Reyna will serve as acting CEO because he is the only remaining Democrat on the three-member board. The White House would have to decide any further action, including a possible reappointment.
- According to the *American Banker* and the *BNA Daily Report*, Martin's death came as a surprise to many staffers. Reportedly Martin was only diagnosed with cancer within the past few weeks. Martin even attended the FCA's most recent Board meeting on December 9, 1999. "America's farmers and ranchers and the entire Farm Credit System lost someone...who was worked tirelessly for them and for all of agriculture," Reyna and fellow Board Member Ann Jorgensen said in a statement.
- The FCA canceled its January 13th Board meeting and scheduled a special meeting for January 27. According to the *BNA Daily Report*, the agenda for the special meeting on January 27 will include a controversial final rule to allow Farm Credit System customers to do business with the Farm Credit System lender of their choice, regardless of geographic location. The FCA is the safety and soundness regulator of the Farm Credit System. (*BNA Daily Report for Executives*, Marc Selinger, 1/11/00; *American Banker*, Craig Woker, 1/11/00; *FCA press release*, 1/9/00, 1/10/00)

Fannie Mae and Freddie Mac

***National Mortgage News* reports that Fannie & Freddie are likely to face more regulatory attention in the Year 2000 while their critics are going to be more vocal and organized**

Collins notes that Fannie & Freddie are facing:

- (1) HUD's proposal to increase their affordable housing goals;**
- (2) OFHEO's proposal for a risk-based capital standard on the GSEs; and**
- (3) Chairman of the House Banking Capital Markets Subcommittee Cong. Richard Baker's (R-LA) desire to strengthen oversight of the GSEs and remove OFHEO from the appropriations process**

[Editorial note: Other issues facing Fannie & Freddie in the Year 2000 include:

- (1) HUD's fair lending investigation of Fannie & Freddie's automated underwriting systems;**
- (2) HUD's investigation of recent business activities by Fannie & Freddie that may be beyond their missions;**
- (3) HUD's desire to issue a proposed rule that may limit the GSEs' non-mortgage investments;**
- (4) HUD's desire to make automated underwriting systems "open, transparent, and understandable";**
- (5) Proposals circulating that would expand Ginnie Mae's mission to compete against Fannie & Freddie; and**
- (6) The FHLBanks' continued success with its Mortgage Partnership Finance program - a direct competitor to Fannie & Freddie]**

- Brian Collins with *National Mortgage News* reports that Fannie and Freddie are likely to face more regulatory pressure in 2000 while Fannie and Freddie's critics are likely to be more vocal and organized. Collins notes that HUD is about to issue a proposal to increase Fannie and Freddie's affordable housing goals, while OFHEO wants to complete its work on a final risk-based capital standard rule for Fannie and Freddie. Comments for the OFHEO proposal are by March 10, 2000. **"In the past, these regulatory proposals would have received only token support from a few GSE critics. But last year a coalition of trade groups came together to form FM Watch because of their concerns about the expansion of Fannie and Freddie's business activities. Now FM Watch is encouraging regulators to take a tough stance on GSEs."**
- Fannie and Freddie are also receiving oversight attention on Capitol Hill. Chairman of the House Banking Capital Markets Subcommittee Richard Baker (R-LA) wants to strengthen federal oversight of Fannie and Freddie and one of his goals is to remove OFHEO from the appropriations process. (*National Mortgage News*, Brian Collins, 1/3/00)

Analysts expect Fannie & Freddie to post another round of double-digit earnings increases in the fourth quarter (Fannie & Freddie's retained portfolios are estimated to have increased in the fourth quarter)

Despite earnings growth, investors have reportedly turned their backs on the GSEs because of fears of a homebuying slowdown, a move away from fixed-rate mortgages in favor of adjustable rate

mortgages, potential risks with the GSEs' expansion into nontraditional mortgage products, and political uncertainty

***Barron's* notes that that it may take time for Freddie to get back in the good graces of investors, but the company enjoys a duopoly with Fannie that gives it a virtual license to print money**

- According to a *Wall Street Journal* article by Janet Morrissey, Fannie and Freddie are expected to report strong fourth quarter earnings. The mean estimate of analysts surveyed by First Call/Thomson Financial estimates Fannie's earnings for the quarter at 97 cents a share, up 14% from the 85 cents a share (excluding a charge for early retirement of debt) of a year ago. Fannie's full-year earnings are estimated at \$3.70 a share, up 10% from \$3.26 a share (excluding charges) in 1998. Freddie is expected to post fourth quarter earnings of 77 cents a share, up 24% from 62 cents in 1998. Freddie's full-year earnings are expected to increase 27% to \$2.94 a share, from \$2.31 in 1998.
- Morrissey notes, however, that despite record earnings, investors have turned their backs on Fannie and Freddie in recent quarters due to fears about a homebuying slowdown, a move away from fixed-rate mortgages in favor of adjustable rate mortgages, potential risks with the GSEs' expansion into nontraditional mortgage products (such as home equity, manufactured housing and subprime loans) and political uncertainty. Morrissey notes that Fannie and Freddie rely on fixed-rate loans to increase their portfolios in order to grow. Analysts from Lehman Brothers, Prudential Securities and Salomon Smith Barney were quoted as saying the fears were overblown and all touted the stocks of Fannie and Freddie. However, as Morrissey notes there is a tremendous gap between the earnings performance and stock prices of Fannie and Freddie and the rest of the market. In 1999, she notes that Fannie's shares fell 16%, while Freddie's shares fell about 27%, while the Nasdaq composite soared 85.6%.
- Salomon Smith Barney Analyst Tom O'Donnell notes that Fannie and Freddie's retained portfolios also increased in the fourth quarter. He estimates that Fannie's increased about 12% on an annualized basis while Freddie's grew about 11%.
- Morrissey noted that political issues as well as Fannie and Freddie's move into nontraditional areas "have created some clouds of uncertainty around the agencies." Political issues mentioned in the article include OFHEO's proposed risk-based capital regulations on Fannie and Freddie, HUD's investigation into the underwriting practices of the GSEs, the possible privatization of Ginnie Mae, and the formation of Fannie/Freddie watchdog group, FM Watch. Analysts quoted in the article, however, believe the political risk has been exaggerated. (*Dow Jones Newswire*, Janet Morrissey, 1/5/99)

Barron's says Fannie & Freddie have virtual licenses to print money

- According to *Barron's Online*, Freddie has experienced a lot of growth in 1999 (27%), however, its share price has fallen 24%. The article notes that two main issues have dogged Freddie: its shrinking margins and growing size. "Wall Street fears that Freddie Mac's main business of buying home mortgages and financing the purchases with debt is growing less profitable. There's also concern that Freddie and Fannie have gotten so large, relative to the overall growth size of the mortgage market, that they will be hardpressed to generate their goal of midteens profit growth in a few years."
- The article further notes that Wall Street was concerned when Freddie's third-quarter profit report revealed a marked contraction in its interest margin to 0.76 of a percentage point from 0.83 in the second quarter, and 0.90-point in the third quarter of 1998. Freddie officials said the contraction reflected prudent management, including the lengthening of debt maturities and the purchase of

options that insulate the company's \$300 billion mortgage portfolio from rate shocks. However, Wall Street fears that Freddie is like a gigantic thrift getting squeezed by the narrowing gap between long and short rates. *Barron's Online* notes that **"It may take some time for Freddie to get back in the good graces of investors, but the company does enjoy a great duopoly position with Fannie that gives it a virtual license to print money."** The article further notes that the two companies have been using the Internet to their advantage. (*Barron's Online*, 12/13/99)

***National Mortgage News* column by Brian Collins notes that Fannie & Freddie's much touted low cost mortgage insurance programs for high LTV loans – Fannie's Flex 97 and Freddie's Alt 97 programs - have been slow to catch on in the mortgage industry**

Fannie & Freddie's Flex 97 and Alt 97 programs are currently being investigated by HUD [see lead story in this *GSE Report* on HUD's request for information on Fannie & Freddie's initiatives related to mortgage insurance]

- Brian Collins of *National Mortgage News* wrote a recent column noting that "Fannie Mae and Freddie Mac like to trumpet their initiatives to save homebuyers money, but their attempt to reduce mortgage insurance costs, and skim some MI premiums for themselves, does not appear to be working." According to Collins, both Fannie and Freddie announced last January, rollbacks of its mortgage insurance coverage requirements on high LTV (low down-payment loans). Collins noted that the MI measures called for a reduction in MI coverage on 95 LTV loans and 90 LTV loans to pre-1995 levels. At the same time, said Collins, the GSEs introduced a new MI reduction program that allowed borrowers the chance to buy down their MI coverage even further by either paying an upfront fee or by accepting a slightly higher interest rate. Collins noted that **"Whatever form of payment the borrower chooses, secondary market agencies are compensated for the increased risk in the form of a delivery fee that the lender pays directly to Fannie Mae or Freddie Mac."**
- **Collins notes however that Fannie and Freddie's programs have "barely made a dent in the market."** While Fannie and Freddie have declined to release their MI data, Collins cites a MI company source as stating that the GSEs only control about 3% of the MI market. A Freddie Mac spokesperson denied any problems, telling Collins, "our customers are making use of this product," but declined to release any figures. Collins' Fannie Mae source was a bit more candid, admitting, "we are not receiving significant deliveries of loans with the reduced option." Collins added, **"this admission should not be surprising since it is a hard sell for lenders to get homebuyers to pay an additional fee or pay a higher interest rate just for mortgage insurance."** In addition, **new MI cancellation disclosures that were released this summer is probably making the sale of the MI harder since MI payments tied to the interest rates cannot be cancelled, added Collins.**
- However, Collins said it is surprising that the MI rollback to 1995 levels has not overtaken the market. He noted that the overall reduction in mortgage insurance coverage has only accounted for 15% of the MI market. Collins said that one explanation for the small numbers is lenders' fear of Y2K difficulties -- lenders are afraid to convert their MI parameters until the year 2000. However, concluded Collins, "another reason may be that Fannie and Freddie have not put too much pressure on their customers to comply with the rollback in MI insurance."
- Collins' column concluded with a discussion about the GSEs' exclusive partnership deals with mortgage lenders that each entered into this year, including Fannie Mae's agreement with Countrywide and Freddie Mac's partnership with Norwest Mortgage. **"What is striking is that a lot of these exclusive deals involve lenders that have captive insurance arrangements with the**

private MI companies. As the lender, they take part of the risk and collect part of the insurance premium. One has to wonder if the GSEs' interest in signing exclusive deals has overshadowed their effort to save consumers money." (*National Mortgage News* website, Brian Collins, "Savings Time" posted 12/7/99)

GSEs are continuing to increase their debt issuance and are increasingly positioning their securities as alternatives to Treasurys

Fannie & Freddie expect to substantially increase their debt issuance this year

Growth in GSE debt is being felt in corporate market – competition from GSE debt is pushing corporate spreads permanently wider – agencies issued roughly 80% more debt than the US Treasury in 1999

Corporate bond traders are increasingly using GSE debt instead of Treasurys to hedge

An Internet-based multi-dealer trading system that's already active in Treasurys plans to begin trading GSE debt in the first quarter of 2000– providing another platform for agency debt

Freddie sells the first global bonds ever marketed on the Internet

Freddie's offering will be part of its monthly sale of Reference Notes, which it estimates will total \$65 billion this year, up about 30% from 1999 levels

Freddie would like to increase the proportion of funds it borrows from capital markets outside the US to 50% from 30%

Fannie introduces "Universal Debt Facility" that consolidates all of its outstanding debt offering documents and dealer agreements – Fannie says that by using the "Universal Debt Facility" it can issue Fannie debt securities in unlimited quantities

Fannie & Freddie expect to increase their debt issuance

- According to a *National Mortgage News* article by Ted Cornwell, Fannie and Freddie expect to substantially increase their debt issuance in 2000. In 1999, Fannie estimates that its non-callable, bullet Benchmark Notes issuance will total \$64.1 billion. Freddie issued \$49.5 billion in 1999 in its non-callable Reference Note program. Freddie projects a 30% increase in issuance in 2000. Freddie expects to issue \$65 billion in non-callable Reference Notes in 2000. Fannie has estimated that total long-term debt issuance is expected to be between \$120 billion and \$140 billion in 2000, but will not officially estimate how much of that is expected to be Benchmark Notes. Since Fannie began its Benchmark Note program in early 1998, it has issued more than \$100 billion of bullet Benchmark Notes. Since Freddie began its Reference Note program in April of 1998, it has issued \$70 billion of bullet Reference Notes. (*National Mortgage News*, Ted Cornwell, 12/20/99)

Growth in GSE debt is being felt in corporate market

- According to an *Investment Dealers Digest* article by Jeffrey Keegan, most fixed-income professionals are upbeat about the corporate bond market in 2000, however, there is a growing consensus that competition from the rapidly increasing federal agency debt programs (Fannie and Freddie) has pushed spreads permanently wider. The rapid growth of agency debt is making the high-grade market a crowded place. Jumbo debt issues from Fannie and Freddie are making up a larger proportion of the investment-grade bond market than ever, and are securing the time and money of

portfolio managers previously developed to corporates and mortgage securities. **“There’s no doubt that corporate spreads have been pushed out because the agencies have increased the overall supply of spread product,”** said one bond analyst.

- The article noted that the investor base for agency debt is beginning to include many new institutions that are attracted to the bullet structures, predictability, and liquidity that make the agency securities appealing corporate substitutes. The level of issuance by Fannie and Freddie is expected to increase in 2000 – Freddie should issue more than \$65 billion; Fannie over \$60 billion. **As the market grows, bond professionals predict that agency debt will continue to attract the attention of corporate and mortgage investors, making it difficult for corporate spreads to return to the tighter levels that were the norm just two years ago. The article estimates that the agencies issued about 80% more term debt in 1999 than did the US Treasury, coming in at about \$250 billion.** (*Investment Dealers Digest*, Jeffrey Keegan, 1/3/00)

Corporate bond traders using GSE debt to hedge

- A *Dow Jones Newswire* article by Tyler Lifton noted that corporate bond traders are increasingly using agency debt instead of Treasuries as hedging vehicles. Lifton points out that unlike Treasuries, agency securities can provide protection against not only interest rate exposure but also credit risk. According to a Salomon Smith Barney research report, the net amount of outstanding debt with maturities of one year or more from Fannie, Freddie, and the FHLBank System is estimated to have increased to \$250 billion in 1999 from \$111 billion in 1998. It’s this type of supply growth that has made agencies a viable hedging instrument, said Stephen Strobel, Vice President of Agency Trading for Norwest Investment Services. “Now there’s enough agency debt to make it acceptable to use as a hedge,” he said. The article further noted that the increasing use of agency debt for hedging has also increased agency activity in the repurchase market, making it more advantageous to be a holder of those securities, said Robin Grieves, Director of Fixed Income Research at HSBC Securities. (*Dow Jones Newswire*, Tyler Lifton, 12/17/99)

Internet-based trading system will offer GSE debt

- According to Tyler Lifton with *Dow Jones Newswire*, an Internet-based multi-dealer trading system, TradeWeb, plans to begin trading agency debt in the first quarter of 2000. TradeWeb, a web-based fixed-income trading system with eleven dealers, is already active in Treasuries. Adding agency debt into the on-line trading system creates another platform for agency debt. Market participants say that TradeWeb will likely offer agency bellwether benchmark securities, rather than smaller issues or callable debt on its system. TradeWeb’s dealer group includes Credit Suisse First Boston, Goldman Sachs, Lehman Brothers, Salomon Smith Barney, Merrill Lynch, Morgan Stanley Dean Witter, Greenwich Capital, Deutsche Bank, J.P Morgan, Barclays Capital and Chase Securities. (*Dow Jones Newswire*, Tyler Lifton, 12/23/99)

Freddie sells first global bonds ever marketed on the Internet

- Freddie issued a \$6 billion five-year Reference Note bond offering, the first ever international bond marketed over the Internet. The notes were priced to yield 6.941%, or 51 basis points above comparable Treasuries. According to Robert Julavits with the *American Banker*, some believe the deal signals the dawn of bond and debt security trading on the Internet. One official involved said Internet-based systems “will almost be the price of admission” by the second half the year. A Freddie spokesman said that similar marketing efforts will be extended to medium term notes and longer maturities.

- Warburg Dillon Read, Salomon Smith Barney, and Merrill Lynch underwrote Freddie's notes. According to the *American Banker*, only some of Freddie's sales, however, actually involved the Internet. Only Warburg Dillon Read accepted orders over the Internet through a new Internet sales entity, DebtWeb, which accesses 4,000 institutional investors. Orders could be submitted on an outright basis or against the sale of other bonds, including US Treasuries. Warburg declined to say what percent of the deal was sold via DebtWeb, but noted it was a solid response for a first-time offering. Warburg marketed the bonds over the web internationally to Europe and Asia while Merrill was responsible for the domestic side. Salomon Smith Barney and Merrill Lynch accepted orders only through traditional channels. According to the *Investment Dealers Digest*, Merrill's sales reps received customer orders and then entered data into a Merrill webpage, which enabled Freddie, Merrill and investors to see the book for the dealing being assembled in real time. Merrill plans to introduce a fully operational web program in the next few quarters that would allow customers to directly purchase securities over their web browsers.
- Warburg claims that the deal is the "first ever international bond to be marketed, and subscribed for, over the Internet." Freddie claims that it "is believed to be the first agency bond issue to be offered to investors via the Internet." Last year, Pittsburgh made a municipal bond offering over the Internet that was worth close to \$57 million. The offering is part of Freddie's monthly sale of Reference Notes, which it estimates will total \$65 billion this year, up by about 30% from 1999 levels.
- According to a *Dow Jones Newswire* article by Tyler Lifton, Fannie introduced Internet marketing to the agency market, holding Dutch auctions over the Internet for its weekly Benchmark Bills program. (*American Banker*, Robert Julavits, 1/11/00; *Dow Jones Newswire*, Tyler Lifton, 1/5/00; *Chicago Tribune*, 1/7/00; *Inman News Feature*, 1/6/00; *Agence France Presse*, 1/6/00; *Reuters*, 1/4/00; *PR Newswire*, 1/4/00; *Financial Times*, 1/5/00; *Freddie press release*, 1/6/00; *Investors Dealers Digest*, Christopher O'Leary, 1/10/00)

Freddie would like to increase the proportion of funds it borrows from capital markets outside the US

- According to a *South China Morning Post* article by Peter Chan, Freddie would like to increase the proportion of funds it borrows from capital markets outside the US to 50% from 30%, according to Freddie Chairman Leland Brendsel. He was visiting Hong Kong as part of a three-stop Asian roadshow for the company's securities. The other Asian stops are Singapore and Beijing. Peter Horvath, Director of Freddie's debt marketing, says the 30% of funds the company raised overseas was split about equally between European and Asian investors. Horvath said he expects more demand from Europe than Asia in 2000. (*South China Morning Post*, Peter Chan, 12/16/99)

Fannie introduces "Universal Debt Facility"

- Fannie announced a comprehensive debt offering document – the "Universal Debt Facility" – that consolidates all of its outstanding debt offering documents and dealer agreements. The document will provide investors with a single document containing all information related to their investment in any Fannie debt – whether short- or long-term; bullets or callables; fixed- or floating-rate; US dollar- or foreign-currency denominated brought to market as Benchmark Securities or in other transactions. Using the Universal Debt Facility, Fannie says it can issue Fannie debt securities in unlimited quantities. The document replaces the Offering Circulars for the Global Debt Facility, Medium-Term Notes, Short-Term Notes, and Debenture programs, and applies to debt securities settling after January 3, 2000. (*National Mortgage News website*, posted 1/6/00; *Fannie press release*, 1/6/00)

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

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

- Fannie & Freddie are reportedly expanding their portability websites. These websites offer brokers and in some cases, consumers an automated underwriting “portability.” The pilots allow brokers and in some cases consumers to use the GSEs’ automated underwriting systems to receive an underwriting decision prior to a lender bidding and winning the deal.

[Freddie’s portability website: Freddie’s pilot is with IMX Exchange which allows brokers to receive an automated underwriting decision from Freddie’ automated underwriting system, Loan Prospector, over Freddie’s Internet site prior to a lender bidding and winning a deal. Freddie is also beginning a pilot with E-Loan that uses Freddie’s automated underwriting system to give consumers instant loan approvals online.]

IMX Exchange, which has a pilot with Freddie, forms alliance with Byte Enterprises and Contour Software to allows brokers seamless access to IMX Exchange

- IMX Exchange formed an alliance under which brokers that use Byte Enterprises and Contour Software loan origination systems will gain seamless access to IMX Exchange. Once enough fields on an application are filled out, the broker will receive a pop-up screen indicating that the loan is ready to be bid by IMX. Brokers will receive bids within a minute, said IMX Chief Executive Officer Richard Wilkes. (*National Mortgage News website*, posted 12/7/99)
- IMX announced that it is pilot testing enhancements to enable mortgage brokers and lenders to service the subprime market more efficiently. Three lenders and 44 broker offices in five states are testing the new program. (*National Mortgage News website*, posted 10/11/99)
- As reported in the September 10, 1999 *GSE Report*, a *National Mortgage News* article by Matt Strickberger noted that lenders are concerned that an automated underwriting pilot by Freddie with IMX Exchange will give brokers “portability.” The pilot allows brokers to run borrower information through Freddie’s automated underwriting system, Loan Prospector, prior to a lender bidding and winning a deal. According to an editorial in *National Mortgage News*, 2,500 brokers and 100 wholesalers have signed onto the new product.
- Strickberger points out that this pilot is controversial as lenders fear that with automated underwriting portability, lenders would lose control of the process. “This deal amounts to a direct relationship with the broker,” said one lender. “It’s a fungible automated underwriting decision among those lenders involved in the pilot. No lender is involved in the process, until they bid and win the bid. That disenfranchises the seller-servicer.”
- In the *National Mortgage News* editorial, Freddie’s Director of Marketing, Sharon McClung told editors that mortgage bankers were “worrying for nothing.” She noted that “Freddie Mac is ill-equipped for dealing with the consumer,” and said the agency relied on its seller-servicers for risk management. McClung told editors she did not foresee Freddie ever working directly with brokers,

however when pressed to rule it out she deferred the question to higher management. According to *National Mortgage News*, IMX plans to develop relationships with five additional automated underwriting services, and has a verbal agreement with pmiAura. (*National Mortgage News*, Matt Strickberger, 7/19/99; *National Mortgage News Editorial*, 9/6/99)

Freddie begins partnership with E-Loan

- E-Loan is launching a new online mortgage application process that the company developed with integration support from Freddie's automated underwriting system, Loan Prospector. The new process allows consumers instant loan approvals online, along with customized rates and real-time rate locks over the Internet. The new application process is being piloted as one of several online lending options for customers of Baldwin Real Estate Services (which staffs Freddie's HomeSteps retail homebuying center). Mortgage loan applicants can apply online with the help of a Baldwin representative using a special web site. **According to Cameron King, Senior Vice President of E-Loan, Freddie's partnership with E-Loan "is the first example using one of the agencies' engines to provide true approval at the point of sale."** (*Realty Times*, 12/23/99; *Business Wire*, 12/21/99; *American Banker*, 12/28/99; *Dow Jones Newswire*, Jerry Guidera and Sarah Landis, 1/5/00)

[*Fannie's portability website: Fannie's pilot is with Priceline.com which allows consumers direct access to Fannie's automated underwriting system, Desktop Underwriter, allowing consumers "to name their price for mortgage loans on-line." Fannie has denied that it has ever attempted to provide to portability on its website in defending its iQualify and openclose.com web ventures, yet sources close to iQualify maintain that the site still offers portability on its website and that Fannie is aware that portability is still being offered on the website.*]

Priceline.com, which has a pilot with Fannie, announces that it is bringing its name-your-own mortgage service in Florida to the New York tri-state area

- According to *InternetNews.com*, Priceline.com, after successfully launching its name-your-own mortgage service in Florida, is debuting its service to the New York tri-state area. PricelineMortgage will now be available to homebuyers in New York, New Jersey and Connecticut. (*InternetNews.com*, 11/22/99)
- As reported in the September 10, 1999 *GSE Report*, Priceline.com's partnership with Alliance Capital Partners provides consumers direct access to Fannie's automated underwriting system, Desktop Underwriter. The new venture, called Pricelinemortgage, will allow consumers to find out if their bid for a mortgage has been approved in as little as a few minutes. Alliance Mortgage, Alliance Capital's mortgage subsidiary, will provide loan decisions rendered by Fannie's system on the Priceline.com mortgage site. LendingTree, a multilender site that formed an alliance with Priceline.com will also participate in the new partnership. Ben Ness, Senior Vice President of Financial Services at Priceline.com noted that by partnering with the subsidiary of a thrift, Priceline is automatically licensed to operate in all 50 states. Under the partnership, borrowers would also receive a guaranteed maximum loan closing cost quote and an on-line rate lock-in if their bid was accepted. (*National Mortgage News website*, posted 8/2/99; *American Banker*, 9/3/99; *Wall Street Journal Interactive*, 9/1/99; *Business Wire*, 9/1/99)

Other portability pilots attempted by Fannie include iQualify.com and openclose.com

- According to a *National Mortgage News* article by Matt Strickberger, many were surprised at Freddie's introduction of the IMX pilot, considering Fannie's iQualify and openclose.com's inability to attract lenders until it eliminated portability from the site. [iQualify, owned by Finet.com, was the first website that allowed consumers direct access to Fannie's automated underwriting system; openclose.com was a website owned by mortgage.com that did allow brokers direct access to Fannie's

automated underwriting system but after criticism by lenders, the site was modified. The site now requires brokers to choose a “premier lender” every time they use the site to get a loan approved by Fannie’s automated underwriting system to ensure that there is no “auctioning” of Fannie’s automated underwriting system-approved loans by brokers.]

- Despite Fannie’s denial that it never planned to offer portability of Fannie-automated underwriting approved-loans, according to Strickberger’s article, a source close to iQualify, which is no longer a standalone site, but part of Finet’s Interloan website, confirms that it still offers portable automated underwriting decisions on the site [using Fannie’s automated underwriting system]. Fannie, is according to the source, aware that a portable automated underwriting decision is still offered on the site and that Finet plans to add other automated decision-makers to the site to camouflage Fannie’s effort to maintain a portable site.
- Further, according to a *Mortgage Technology* article excerpted from Faulkner & Gray’s “*Mortgage Technology Directory*,” Finet.com announced a new auction service, rolling out primarily on HomeSeekers.com, that would let buyers receive competitive bids for their purchase-mortgage business once they find a house they like and get an offer under contract. The auction service would qualify borrowers upfront through iQualify [uses Fannie’s automated underwriting system]. Finet reportedly proposes to eliminate lender “wobble room” once lenders make aggressive bids. When the lender makes a bid on Finet, said L. Daniel Rawitch, Vice Chairman of Finet, the notion is that “there is no turning back” from honoring the bid. (*National Mortgage News*, Matt Strickberger, 7/19/99; *Mortgage Technology*, article excerpted from Faulkner & Gray’s “*Mortgage Technology Directory*,” September/October 1999)
- In related news, Finet.com, which owns iQualify.com, has seen a few key executive members depart the firm. Mark Korell, Finet’s Chairman and CEO, will be leaving Finet.com effective January 15, 2000. According to *National Mortgage News*, a source familiar with the company noted that the departure came after an erosion on the firm’s revenues and net income. Another Director, Stephen Sogin, was named as interim chief executive and a search committee has been formed to find a permanent replacement. Finet reported \$40 million in losses in fiscal-year 1999 and earlier in 1999 the company’s stock prices nearly flat-lined at 40 cents a share. Meanwhile, Monument Mortgage founder Jim Noack and iQualify co-founder Lee Decker left Finet to create a new start-up called Xpede after Monument and iQualify folded into Finet in 1998. Xpede proposes to let lenders deliver Internet loans more efficiently than multilender competitors such as E-Loan and Quicken Mortgage. By integrating Fannie’s automated underwriting system, Xpede claims to automate every step of the mortgage process – except for document signing and recordation. Xpede offers to power Web sites under a lender customer’s own brand. (*National Mortgage News website*, posted 12/17/99; *Inman News Feature*, 12/17/99; *Inman News Feature*, 9/20/99)

Other technology announcements:

Fannie and First American Financial Corp. announce agreement

- Fannie and First American Financial Corporation announced an agreement to provide lenders with electronic access to First American’s products and services over Fannie’s MORNETPlus Network. Under the agreement, lenders will be able to request title insurance, flood certification and appraisals. (*Inman News Feature*, 12/23/99; *Business Wire*, 12/21/99; *Fannie press release*, 12/21/99)

HomeStore.com, which is partly owned by Fannie, may have links to at least two lenders, one of which is Mortgage.com

- According to *Mortgage Servicing News*, after HomeStore.com completes a recently announced acquisition (for which it paid \$80 million), it will have links to at least two lenders, one of which is Mortgage.com. Fannie owns a 3.09% Equity Interest in HomeStore.com. HomeStore.com owns Realtor.com (the largest home-listing site on the Internet and official site of the National Association of Realtors), HomeBuilder.com, SpringStreet.com (rental properties), Commercial Source.com (commercial real estate), HomeFair.com, and Remodel.com. (*Mortgage Servicing News*, November 1999; *National Mortgage News*, 10/25/99)

HomeStore.com strikes deal with Sundial to allow customers compare more than \$6,000 wireless service plans

- HomeStore.com and Sundial Marketplace Corp. have struck a deal. Sundial.com will provide its shopping services for wireless products and services to the SpringStreet.com customer base of renters and relocators. (*Inman News Feature*, 12/1/99)

Fannie provides a technology grant to the NAACP's Community Development Resource Center so the office can buy computers and use Fannie's Desktop Home Counselor software to provide home-buying information to consumers

- Fannie formed a partnership with Bank One and the NAACP's Community Development Resource Center (CDRC) in Gary, IN. As part of the partnership, Fannie presented a \$1,500 technology grant to the CDRC to assist the organization with the purchase of new computer equipment. The technology grant will allow the office to utilize Fannie's Desktop Home Counselor software to provide a source of home-buying information to consumers. As part of the partnership, Fannie will purchase the mortgages originated under this partnership. (*Fannie press release*, 12/14/99)

Fannie & Freddie's safety and soundness regulator, OFHEO, issues a rule establishing hearing procedures in enforcement actions against Fannie & Freddie or their executive officers or directors

- According to John Connor with *Dow Jones Newswire*, the Office of Federal Housing Enterprise Oversight (OFHEO) issued a hearing procedure rule in the *Federal Register* on December 28, 1999. The rule specifies that hearings are to be open to the public unless OFHEO's director determines a public hearing would be contrary to the public interest. According to OFHEO, the rule provides OFHEO personnel, Fannie and Freddie, and the GSEs' directors and executive officers, and other interested parties with the guidance necessary to prepare for and participate in these on-the-record hearings. The rule takes effect on January 27, 2000.
- When Congress created OFHEO in 1992, it gave OFHEO the authority to issue cease-and-desist orders in connection with its regulatory responsibilities. Prior to issuing such orders, however, OFHEO must conduct hearings on the record and provide the subjects an opportunity to participate in such hearings. Prior to imposing civil money penalties, OFHEO must also provide notice and the opportunity for a hearing to the persons subject to the penalty. The rule includes provisions related to prehearing procedures and activities, the conduct of the hearing itself, and the qualifications and disciplinary rules for practice before OFHEO. According to Connor, the rule authorizes appropriate sanctions for transgressions such as unduly delaying the proceedings and "contemptuous conduct," which is defined to include conduct that is "dilatatory, obstructionist, egregious, contumacious, or unethical." (*Dow Jones Newswire*, John Connor, 12/28/99; *Federal Register*, pages 75201-72522, 12/28/99)

Fannie & Freddie have become large purchasers of commercial multifamily loans

- Multifamily mortgages either guaranteed or owned by Fannie totaled \$35.3 billion in November, up from \$30.3 billion in December 1998. Multifamily loans in Freddie's retained portfolio grew to \$12.3 billion in November, from \$8 billion in December 1998. (*Dow Jones Newswire*, Sarah Landis, 1/3/00)

Market sources speculate that Fannie or Freddie may have purchased Sallie Mae's recent \$2.06 billion asset-backed securities offering

- According to an article by David Feldheim with *Dow Jones Newswire*, Sallie Mae tapped the market with a \$2.06 billion asset-backed offering. According to market sources, the transaction was a "bought deal," meaning it was virtually all sold going into the transaction and was structured with the buyer in mind. An official at Sallie Mae declined to comment at length on the transaction but did say that "someone showed us a deal," which confirmed market talk that the sale was arranged on the basis of reverse inquiry. Several knowledgeable market sources believe the buyer had to be another agency, mostly likely Fannie or Freddie. Neither GSE was willing to comment, stating that it is official policy not to report on what they buy as investments. (*Dow Jones Newswire*, David Feldheim, 12/23/99, 12/22/99)

In compiling a Year 2000 wish list for regulators, the *American Banker* predicts that OFHEO's wish would be to implement the risk-based capital rules for Fannie & Freddie, or at least close the comment period.

- The *American Banker* created a Year 2000 wish list for some of the financial services industry's leading Washington personalities. The wish for Office of Federal Housing Enterprise Oversight (OFHEO) Director Armando Falcon: risk-based capital rules for Fannie and Freddie, already five years in the making, finally get implemented or at least to close the comment period. (*American Banker*, 1/3/00) (OFHEO's proposed risk-based capital rule, based on a stress test, is currently open for public comment until March 10, 2000. The proposed risk-based capital requirement is the amount of total capital – core capital plus a general allowance for foreclosure losses – that Fannie and Freddie need to absorb projected losses flowing from future severe interest-rate and credit-risk conditions, plus 30 percent to cover management and operations risks.)

Under current non-risk-based capital rules, Fannie & Freddie were determined to be "adequately capitalized"

- OFHEO is required by statute to determine capital adequacy of Fannie and Freddie on the basis of both minimum and risk-based capital requirements. OFHEO's proposed risk-based capital regulation has not been finalized.
- OFHEO announced that under current non-risk-based capital rules (minimum capital rules), Fannie and Freddie hold enough capital to meet US guidelines. (The current rule is not risk-based like the proposed OFHEO rule.) As of September 30, 1999, both companies were determined to be "adequately capitalized." Fannie held core capital of \$17.22160 billion at September 30, which is \$121.82 million above the federally mandated minimum capital requirement of \$17.09978 billion. Freddie held core capital of \$12.04820, \$388.97 million above its minimum. Core capital includes common stock; some kinds of preferred stock; paid-in capital, or money the companies receive in

exchange for their stock; and retained earnings, or earnings that aren't paid out to shareholders. (OFHEO press release, 12/29/99; BNA Daily Report for Executives, Eileen Canning, 12/30/99)

GSEs continue to purchase home-equity deals

- According to Michael Gregory with *Asset Sales Report*, Countrywide Credit Industries came to market with a \$120 million piece of a \$340 million home-equity deal, wrapped by Ambac. The 3.69-year, A-2 class priced at 35 basis points over one-month Libor. "Most of the Country deal was bought up in pre-buy by the agencies," said one trader, referring to Fannie and Freddie. (*Asset Sales Report*, Michael Gregory, 11/15/99)

Fannie & Freddie's loan purchases drop by half

- According to Paul Muolo with *National Mortgage News*, loan purchases by Fannie and Freddie dropped by half in November 1999 as rising interest rates continued to suppress loan volumes. Fannie's purchases fell 42% to \$30.55 billion; Freddie's purchases declined 52% to \$15.58 billion compared to November 1998. Muolo noted that both Fannie and Freddie increased their purchases of ARM loans, but not enough to make up for the huge fall-off in fixed-rate refinancing activity. At the end of November, Fannie's portfolio totaled \$517 billion with an annualized growth rate of 19% compared to 11.6% in October. Freddie had a \$323 billion portfolio at the end of November, with a 33% increase over November of 1998. (*National Mortgage News*, Paul Muolo, 12/27/99)

OFHEO announces staff changes and additions

- OFHEO announced the promotions of H. James Schwing, Jill M. Weide and the addition of Alan Brubaker. Schwing was promoted to Chief of Staff at OFHEO. He joined OFHEO in 1998 and served as Executive Assistant to the Deputy Director and Acting Director. Previously, he was Executive Assistant to the President of Ginnie Mae, two years working for Sen. Herb Kohl (D-WI), and several years as an attorney in private practice in New York. Weide will replace Schwing as Executive Assistant in the Office of the Director. She has been with OFHEO for six years, most recently serving as Senior External Affairs Advisor. She served for eleven years on the staff of Sen. Donald Riegle, Jr. (D-MI). Brubaker joins OFHEO as Associate Director for External Relations. He served as Professional Staff Member on the Senate Banking Committee for two years, most recently as the Staff Director for the Subcommittee on Securities under Senator Rod Grams (R-MN). Prior to that, he handled banking, tax, and labor issues for Cong. Doug Bereuter (R-NE). He has also worked as a mortgage banker in Washington, DC. (*OFHEO press release*, 1/4/99)

Roll Call reports that Fannie & Freddie devoted at least a 15% greater share of their contributions to Democrats this election cycle

Fannie & Freddie each contributed more than \$400,000 in total funds to both parties in the last cycle

- According to a *Roll Call* article, among the corporations that have devoted at least a 15% greater share of their contributions to Democrats this cycle are Owens Corning, Fannie Mae, Freddie Mac, Scherring-Plough, Rite Aide Corp., Mirage Resorts and the American Financial Group Inc. The article noted that each of these companies gave more than \$400,000 in total funds to both parties in the last election cycle. A Senior Official at Fannie cautioned observers to "stay tuned" and not to draw any hasty conclusions, even as the corporation has given a majority of its contributions – 56% to

Democrats this cycle. “It is our intention always to maintain some form of balance” in gifts to the parties, said Fannie Vice President David Jeffers. The article noted that Fannie gave about 40% of its gifts to Democrats last cycle. (*Roll Call*, Ethan Wallison, 12/16/99) [The December 17th *GSE Report* noted that Fannie & Freddie were some of the largest “soft money” contributors to political parties.]

Fannie Mae

US Marshals Service extends and expands Fannie’s real estate owned (REO) deal

US Marshals Service is using Fannie to sell seized or forfeited properties instead of its prior practice of using realtors

Realtors are concerned about Fannie’s REO program with the US Marshals Service

- According to *National Mortgage News*, the US Marshals Service has extended and expanded its contract with Fannie to manage and sell seized residential properties. The US Marshals first contracted with Fannie in a 1998 pilot program.
- To date, Fannie has been assigned 105 properties and sold 79 – the US Marshals would like those numbers increased. The US Marshals service extended Fannie’s contract on October 1, 1999 for six months and increased the size of its territory from 15 judicial districts to 38 districts. *National Mortgage News* reports that there are only 94 judicial districts in the US. “Once the six months is up, then we will make the final decision on whether to expand or not,” said the US Marshals Service official. (*National Mortgage News*, 11/29/99)
- As reported in the July 9, 1999 *GSE Report*, Brian Collins with *National Mortgage News* reported that Fannie’s REO pilot with the US Marshals Service was one of the reasons that the California Association of Realtors (CAR) decided to monitor Fannie and Freddie’s real estate activities. CAR’s Board of Directors approved a motion in 1999 that stated that “CAR continues to dialogue with and monitor the government-sponsored entities’ business practices.” The article reports that realtors seem particularly concerned about Fannie and Freddie selling REO (real-estate owned) properties, especially if it’s not their servicing. **Of concern to CAR was Fannie’s contract with the US Marshals Service. Marcia Salkin, CAR’s Director of Public Policy pointed out the US Marshals are not lenders and they do not provide mortgage capital. “We have a little problem with that activity.” Fannie and Freddie also do not use the standard CAR sales contract, which creates “suspicion” on the part of agents representing buyers. “Some of the terms are not favorable to the buyers,” she said.**
- Collins also reported in June of 1999 that a group of realtor activists wanted CAR to do more to address the GSEs. The activists formed a group called the Government Sponsored Enterprise Containment Coalition. GSECC Spokesman Bruce Koklich believes CAR’s decision to monitor the GSEs is “a good start.” **Koklich, a California realtor who specializes in REO sales, stated, “I believe the monitoring will eventually make it clear to CAR that the agencies have lofty goals to expand further into the real estate brokerage market.” Koklich also pointed out that because of Fannie’s tax-exempt status, it passes on municipal transfer taxes to the buyer. Normally the seller pays these taxes, which range from \$200-\$300.** (*National Mortgage News*, Brian Collins, 6/28/99)

Fannie forms strategic alliance with Prism Financial Corp.

The two companies plan to use the alliance for work related to market expansion, technology integration, and ancillary business services

- Alliance agreements between lenders and the GSEs are continuing. Prism Financial Corp., Chicago, announced the formation of a strategic alliance with Fannie. The alliance includes work on technology integration, ancillary business services, and market expansion. Under the alliance, Prism agreed to sell the majority of its agency-eligible mortgage loans to Fannie, while expanding its product offerings and developing pilot products with Fannie. (*National Mortgage News website*, posted 12/23/99)

In a first, Countrywide Home Loans has raised \$200 million by securitizing its “excess servicing” on a \$30 billion portfolio of home loans

Fannie is guaranteeing the bonds as part of an alliance agreement announced with Countrywide

- According to Ted Cornwell with *National Mortgage News*, in a first, Countrywide Home Loans has raised \$200 million from a securitization of “excess” loan servicing fees from a portfolio of 242,000 mortgage loans with a principal balance of \$30 billion. According to an article by Joshua Brockman with the *American Banker*, excess servicing is servicing fees less servicing costs. Brockman noted that in this case, Countrywide securitized the excess on 242,000 loans it sold to Fannie but is still servicing. The *National Mortgage News* article notes that Fannie is guaranteeing the bonds, as part of an alliance agreement between Countrywide and Fannie. By securitizing servicing, Countrywide reduces the capital it has to hold against servicing rights.
- The securities were reportedly broken up into classes based on the interest rate on the underlying loans to help investors understand the prepayment risk on each class of securities. Since only the servicing fee is being securitized, not the principal on the loans, the securities behave like interest-only strips. In early November, Bear Stearns & Co. brought the transaction to market, raising about \$200 million for Countrywide – the net present value of the excess servicing rights. Bear Stearns reportedly brought the securities to market as collateralized mortgage obligations with a Fannie guarantee. Bear Stearns was able to provide data to investors on each loan in the servicing portfolio; Fannie and Freddie only provide aggregated data on the loans backing their securities. (*National Mortgage News*, Ted Cornwell, 11/29/99; *American Banker*, Joshua Brockman, 11/23/99)

According to the *American Banker*, market sources say that Fannie is the purchaser for both Countrywide’s eEasy Rate Reduction plan mortgage and First Tennessee’s Motivator loans

Fannie reportedly plans to keep these loans in its portfolio rather than securitizing them

Laurie Goodman, a Managing Director at PaineWebber believes that the plan, as it currently stands, should not affect liquidity, but could if the plan was expanded. “We do believe that both Countrywide and Fannie Mae should be aware of the probable impact that further expansion of this program could ding TBA [to-be-announced MBS pools] liquidity.”

- According to the *American Banker*, market sources said that Fannie is the buyer for both FT Mortgage’s Motivator loans and Countrywide’s eEasy Rate Reduction plan mortgages and is keeping

the loans in its portfolio rather than securitizing them. A Fannie spokeswoman declined to comment. Similar to Countrywide's product, FT Mortgage's Motivator loans are for people with damaged credit that offers a one-point rate reduction after the borrower stays current on payments for two years.

- As reported in the December 17, *GSE Report*, Countrywide Home Loan's new eEasy Rate Reduction plan (no refinance loan) product includes: no need to requalify (borrowers can phone or visit a website, no new credit report or new loan application is required); debt management (borrowers can lower their rates as soon as rates drop); quick implementation (after a request, the new rate takes effect the first day of the following month); and term flexibility (borrowers can lower their monthly rates and payments, without extending the term of the loan). The product is available for an up-front fee of 2.5 points, and each subsequent rate change is subject to the 2.5% fee. According to the *American Banker*, the fee can be rolled into the loan balance, provided the balance does not exceed the original amount, or part of it can be incorporated into the note rate.
- Although Countrywide would not say whether Fannie or Freddie was involved in the new loan's structure, *Inman News* learned that Fannie has entered into an exclusive agreement with Countrywide to offer these loans initially. **Representatives from Fannie would not comment on the plan. "I think that if they won't comment, that's kind of peculiar," said Clif Ulrich, Managing Director for Product Development at GMAC-RFC. "It almost makes me wonder why there's this secretiveness since Fannie Mae's customer is also the mortgage banker that deals directly with the consumer. You would think they would be wanting to discuss how they plan to structure this product."**
- Mortgage-backed securities market participants have been discussing how the program will be structured in the secondary market and how it will affect existing to-be-announced (TBA) pools. It is a general market consensus that the eEasy Rate Reduction Loans do not belong in conventional TBA pools. "I don't think that's good delivery for regular TBA pools. They'd have to set up a separate prefix for these," said Dale Westhoff, head of MBS Research at Bear Stearns & Co. "I would assume they would set up a separate program for these rate-reduction loans, and it would allow the coupon to reset." **Laurie Goodman, a Managing Director at PaineWebber believes that program "will only have a small impact on the TBA market." She stated that the program, as it currently stands, should not affect liquidity, but could if the plan was expanded. "We do believe that both Countrywide and Fannie Mae should be aware of the probable impact that further expansion of this program could ding TBA liquidity."** (*American Banker*, Marc Hochstein, 11/30/99, 12/22/99; *Inman News*, 11/12/99; *Mortgage-Backed Securities Letter*, Frank Musero, 11/29/99)

<p>Fannie refutes Martin Luther King III op-ed that accuses Fannie & Freddie of perpetuating a minority housing gap</p>
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- As reported in the November 19, 1999 *GSE Report*, Martin Luther King III, President and Chief Executive Officer of the Southern Christian Leadership Conference, wrote an editorial in the November 17, 1999 issue of the *Washington Times* accusing Fannie and Freddie of perpetuating a minority housing gap. King supports HUD's proposal to raise Fannie and Freddie's affordable housing goals and believes HUD's proposal is an excellent opportunity to let people in Washington know that there should be meaningful affordable housing goals placed on Fannie and Freddie. He noted that HUD's goals should mean more than an increase in the overall percentage goals placed on Fannie and Freddie – the goals should actually make a real difference in the number of black and minority families that own their own homes. King further noted that despite Fannie and Freddie's special exemptions and more than sufficient resources, the GSEs are lagging behind the primary

market in serving borrowers that are low income, minority and in underserved areas. King cited studies by the Urban Institute and the GAO that found that Fannie and Freddie could do more to promote low-income and minority homeownership and that the GSEs are lagging the primary market in serving these areas. A 1998 GAO study found that the GSEs lag the primary market in serving Very Low Income; African American; Underserved Areas; Low-Income Census Tract; and High African American Census Tract.

- Fannie Chairman Franklin Raines wrote an editorial in response to Martin Luther King III's editorial in the December 10, 1999 *Washington Times*. He claims that according to data provided to HUD and the Federal Reserve gathered under the Home Mortgage Disclosure Act, Fannie outperforms the overall market when it comes to financing minority lending. He says that the GAO study referenced by King used outdated HUD data and that the Urban Institute study was based on interviews with a handful of lenders, not solid loan data analysis. [Editorial Note: In HUD's July 30, 1998 testimony before the House Banking GSE Subcommittee, General Deputy Assistant Secretary for Housing Ira Peppercorn stated that analysis of HMDA data show that "both GSEs lag other market participants in funding affordable housing loans for lower-income families and in underserved communities" and that "GSE data show that only a small portion of the GSEs' purchases support minorities." Peppercorn also noted that a study was conducted by the Federal Reserve Board that examined the degree to which different mortgage market institutions – the GSEs, FHA, depositories, and private mortgage insurers – are taking on the credit risk associated with funding affordable mortgages. "The study found that Fannie Mae and Freddie Mac together provided only 4-5 percent of the credit support for lower-income and minority borrowers and their neighborhoods." (*Statement presented by Ira Peppercorn, General Deputy Assistant Secretary for Housing, to House Banking Subcommittee on Capital Markets, Securities and GSEs, 7/30/98*)]
- When HUD Secretary Andrew Cuomo announced his proposal to increase Fannie and Freddie's affordable housing goals, Raines stated that "as tough as the new targets are, Fannie Mae immediately signed up." [Editorial Note: When Secretary Cuomo announced on July 29, 1999 that he was planning to increase the affordable housing goals, Fannie Chairman Franklin Raines participated in the press conference. He stated that "We're prepared to sign up for this. We like having stretch goals...It is not going to be easy...But Fannie Mae is going to do everything we can to get there." (*Fannie CEO Franklin Raines speech on HUD's Housing Goal Announcement, 7/29/99*) However, prior to HUD's official announcement, Fannie may have been working behind the scenes against the proposal. As reported in the June 25, 1999 *GSE Report*, an article by Jerry Guidera in the *Wall Street Journal* noted that the US Conference of Mayors passed a resolution during their June meeting in New Orleans (prior to HUD's announcement) pushing for higher lending goals for Fannie and Freddie, "despite a determined lobbying effort by the two GSEs to quash any statement of principle on the issue of lending to poorer families." (*Wall Street Journal, Jerry Guidera, 6/17/99*) Also, in a speech before the American Bankers Association on May 26, 1999 (prior to HUD's announcement), Fannie Vice Chair Jamie Gorelick made the following reference to the affordable housing goals: "Similarly, we have an issue regarding our housing goals. The Department of Housing and Urban Development tells us how many loans we should make as a proportion of our business at or below the median income of a community...Now if the goals are raised, what will happen is that we will have to allocate credit. We will have to say to a bank, 'I'm sorry, today you are offering me only a pool of loans from people who are above the median level of income in your community. We are full-up with those, and we can't take them' Now that undermines the liquidity function that we are here to perform. So I urge you when these come out to look at them as well, because we could lose it in that 13th inning. We could break a system that works very well." (*Fannie Vice Chair Jamie Gorelick before the American Bankers Association, 5/26/99*)]

- Raines noted that Fannie’s commitment to underserved families goes well beyond the HUD mandate, citing Fannie’s Trillion Dollar Commitment, to invest \$1 trillion to help 10 million underserved families become homeowners or obtain decent rental housing by 2001. He also cited Fannie’s 44 partnership offices, its purchase of over \$3 billion in CRA loans, and the Fannie Mae Foundation’s education efforts. (*Washington Times*, 12/10/99)

An important credit consideration for Moody’s Investor Service’s rating of Fannie is its GSE status

- According to *Wall Street Journal Interactive*, Moody’s Investor Service said it confirmed its triple-A ratings on the senior unsecured long-term global debt of Fannie, including its US and global medium-term note programs, and its global debt program. Moody’s said Fannie’s ratings “reflect its established leadership position in the USA’s real estate finance market, its substantial profitability, its modest risk profile, and its management depth...In addition, Fannie Mae’s GSE status and its significant public policy role in the US housing marketplace are important credit considerations.” (*Wall Street Journal Interactive*, 12/22/99)

Fannie further expands into construction lending

Fannie finances a fund that will provide construction loans to homebuilders and developers at reduced interest rates

Fannie also begins construction-to-permanent mortgage pilot with First Federal Lincoln Bank

- Fannie held a press conference with Senate Majority Leader Trent Lott (R-MS) and Cong. Roger Wicker (R-MS) to launch a \$12 million, low-cost construction loan fund to finance affordable housing. Fannie CEO Franklin Raines was also in attendance. The Mississippi Single Family Residential Housing Fund, financed by Fannie and a lender to be selected by the state, will provide loans to homebuilders and developers at reduced interest rates. Bruce Cain, Director of Mississippi’s Partnership Office said loans would be available at about 2 percent below the existing market rate. Fannie made a \$5 million investment in the Residential Housing Fund through the company’s American Communities Fund. The Mississippi Department of Economic and Community Development contributed \$5 million in matching funds to the Residential Housing Fund using proceeds from the sale of state general obligation bonds. MDECD will select a lead statewide lender to implement and administer the fund. The local lender will also participate in the fund by contributing an additional \$2 million. (*Fannie press release*, 12/9/99; *Associated Press*, 12/9/99)
- Fannie announced that First Federal Lincoln Bank is the first Nebraska lender in Fannie’s \$75 million construction-to-permanent mortgage pilot. During the pilot, First Federal Lincoln Bank will be able to lock in one interest rate for both the construction and permanent phases, selling the mortgages to Fannie as soon as the loans are closed, and providing one complete mortgage for their customers who choose to build their own homes. Under the pilot, home buyers can borrow up to 90% of the new home’s value, including the cost of the land, to build a single-unit, owner-occupied home. During the construction phase, the loan funds are disbursed to the borrower and/or builder as each stage of the home is completed and the borrower pays interest only on the funds disbursed. Once the home is built, the mortgage is automatically converted to a permanent loan. (*Fannie press release*, 12/8/99)

Fannie begins initiative targeting second “gap” mortgages

- Fannie held a press conference with Kauai, Hawaii Mayor Maryanne Kusaka, the Kauai County Housing Agency, and the Central Pacific Bank to announce a new initiative called the Kauai County Home Buyer Gap Mortgage Initiative. The initiative was redesigned using Fannie’s Community Seconds Lending Option to help reduce down payment and closing costs, and significantly lower the interest requirements on a second “gap” mortgage. A statement in support of the initiative by Senator Daniel Inouye (D-HI) was also included in the press release. The Kauai County Home Buyer Gap Mortgage Initiative helps homebuyers meet the costs of a home purchase not covered by a conventional first mortgage by offering a second “gap” mortgage loan. The new mortgage loans offer a low 1.5 percent down payment requirement, and do not require two months of reserve savings to qualify as was required under the previous program. In addition, the second gap mortgage carries a low interest rate of 3 percent, which is deferred for the first seven years of the mortgage. The conventional first mortgage will carry the market interest rate. The initiative is available at Central Pacific Bank to first time homebuyers earning up to 80 percent of the Area Median Income (\$51,700). Borrowers are required to participate in homebuyer education and counseling classes. (*Fannie press release, 12/9/99*)

Fannie continues to hire politically connected employees

Fannie hires Senator Robert Bennett (R-UT) staffer as Director of its Utah Partnership Office

Fannie hires the Tennessee Governor’s Strategic Planner

Fannie hires the Media Relations Assistant to the National Credit Union Administration Chairman

- According to a Fannie press release, Timothy Stewart joined the company as Director of its Utah Partnership Office. A statement of support by Utah Governor Mike Leavitt was included in the press release. Prior to joining Fannie, Stewart spent the last seven years working for US Senator Robert Bennett (R-UT) as a Legislative Assistant where he was responsible for appropriations, agriculture, water and power, public lands and natural resource policy development issues for the Senator. He also worked as a campaign assistant to Senator Robert Bennett (R-UT). In the same press release, Fannie announced that Fannie employee Robert Bennett (not the Senator) has been named Deputy of the Utah Partnership Office and will be transferring from Fannie’s Washington DC Internal Audit Department to the Utah Partnership Office. He has worked for Fannie for three years providing internal audits of the Treasurer’s Office and Capital Markets. Prior to joining Fannie, he spent six years at the Los Angeles Office of the Federal Deposit Insurance Corporation as a Bank Examiner. (*Fannie press release, 1/7/00*)
- According to the *Knoxville News-Sentinel*, Fannie hired Ralph Perrey, who served as Governor Don Sundquist’s (R-TN) point man in debate on tax reform. Perrey resigned from his position with Governor Sundquist effective December 30 and said he will work for Fannie. He worked for Governor Sundquist since 1987 – first as Press Secretary when Sundquist was a U.S. Representative in Washington. After Sundquist was elected Governor in 1984, Perrey was named “assistant to the governor for strategic planning.” (*Knoxville News-Sentinel, 12/15/99*)
- According to the *Credit Union Times*, Fannie hired Lesia Bullock, Media Relations Assistant to NCUA Chairman Norman D’Amours. Bullock left NCUA on December 21. Bullock, whom

D'Amours brought on as a political appointee in 1995, took up her post as a Media Relations Manager for Fannie on January 3. (*Credit Union Times*, 12/16/99)

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

Fannie claims to have 44 partnership offices in its press releases but official contact information for 10 of these offices is unavailable

- According to a listing on Fannie's website, the company currently has 34 partnership offices "officially" operating (contact information is available on these 34 locations on Fannie's website). Fannie's press releases, however, claim that they have opened 44 partnership offices.
- Fannie named Missy Staples Thompson as Minnesota Partnership Office Director. The Minnesota office, open since May 1995, is located in St. Paul. A statement by Cong. Bruce Vento (D-MN) praising Thompson's appointment was included in the press release. Thompson was President of Thompson Associates, Inc., a residential real estate marketing, sales, and consulting firm that she founded in 1987. The group specializes in developing and implementing programs for nonprofit and government organizations, with a special focus on education for first-time, low- and moderate-income homebuyers. Before forming Thompson Associates, she was Vice President of Brighton Development Corporation. She also served on the Board of Directors for the National Association of Realtors, and acted as NAR's liaison to Cong. Vento. She previously served on the Board of Directors for the Saint Paul Area Association of Realtors and spent one year as their president. (*Fannie press release*, 12/21/99)

Columbia, SC office in the process of being opened

- Fannie named Laura Evatt as Senior Deputy Director of its South Carolina Partnership office. Prior to joining Fannie, she was the multifamily production representative at HUD in Columbia, where she was responsible for establishing and maintaining relationships with FHA-insured lenders, national and local developers and non-profit organizations and state and local government entities. (*Fannie press release*, 12/17/99) [As of January 7, Fannie did not have the contact information for the Columbia partnership office on its website.]

Milwaukee, WI office in the process of being opened

- 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 January 7, Fannie did not have the contact information for the Wisconsin partnership office on its website.]

Newark, NJ office in the process of being opened

- Fannie announced that it is opening a partnership office in Newark, NJ and named as its director, Tim Toughey. Toughey had been Executive Director of the New Jersey Housing Mortgage and Finance Agency. He also served as Vice Chair of the Council on Affordable housing and was one of the original members of the Governor's Urban Coordinating Council. The partnership office does not appear to be open yet. According to the *Star-Ledger*, Fannie Vice Chair Jamie Gorelick said "One of

the astonishing facts is this city [Newark] is so happening, we cannot find space for our office.” (*American Banker*, 11/22/99; *Star-Ledger*, 11/17/99) [As of January 7, Fannie did not have the contact information for the Newark partnership office on its website.]

Other offices in the process of being opened

- Fannie announced plans to open or commitments to open partnership offices in the following areas: South Dakota; Bismarck, ND; Pittsburgh, PA; 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)

Senate Majority Leader Trent Lott (R-MS) and Cong. Roger Wicker (R-MS)

- Fannie held a press conference with the above officials to launch a \$12 million, low-cost construction loan fund to finance affordable housing. Fannie CEO Franklin Raines was also in attendance. (*Fannie press release*, 12/9/99)

Senator Wayne Allard (R-CO)

- Fannie and officials held a public hearing in northeast Denver on housing costs. Senator Allard, who chairs the Senate Subcommittee on Housing and Transportation, convened the hearing. (*Denver Post*, 12/17/99; *Denver Rocky Mountain News*, 12/17/99) As reported in the December 17 *GSE Report*, Fannie held a press conference with Senator Allard on December 3, 1999 as well.

Senator Bob Kerrey (D-NE)

- Fannie held a press conference with the above official and local housing groups to celebrate homeownership opportunities for people with disabilities. A representative from Senator Chuck Hagel’s (R-NE) office was also in attendance. (*Fannie press release*, 12/16/99)

Senator Daniel Inouye (D-HI)

- Senator Inouye and Fannie convened a new Hawaii Housing and Community Development Advisory Council with local housing experts and officials, mortgage lenders, Realtors, and builders. The Council’s first meeting was December 8 in Senator Inouye’s Honolulu office. (*Federal Document Clearing House, Congressional Press Release*, 12/8/99)

Cong. Peter Visclosky (D-IN)

- Fannie held a press conference with the above official to announce a partnership with Bank One and the NAACP to increase homeownership opportunities in Gary, IN. (*Fannie press release*, 12/14/99)

Cong. William Jefferson (D-LA) and New Orleans Mayor Marc Morial

- Fannie held a press conference with the above officials to announce that the company exceeded its goals of “House New Orleans.” (*Fannie press release*, 12/17/99)

Cong. John Conyers (D-MI)

- Fannie organized the grand opening of Detroit’s largest counseling collaborative. Cong. Conyers joined over 60 key partners from Detroit’s mortgage lending and nonprofit housing counseling organizations. The Detroit Homeownership Counseling Collaborative (DHCC), a newly created 501-(c)(3) nonprofit organization, will open its doors on January 4, 2000. (*Business Wire*, 12/14/99)

Columbus, OH Mayor Greg Lashutka

- Fannie held a press conference with the above official to celebrate the grand opening of Providence Glenn, a new 144 unit affordable rental housing community in northeast Columbus. Dayspring Christian CDC worked with Mt. Herman Baptist Church and New Salem Baptist Church to conceive the project and to build community support, coordinated with Concorde Capital to design the community with Rockford Homes, and to arrange the financing for Providence Glen. The project received a \$3.3 million permanent loan commitment through Key Bank under Fannie's Forward Commitment product line. This loan allows developers to lock in interest rates for their permanent financing at the time of construction. This was the last official housing event for the retiring mayor. (*Fannie press release, 12/9/99; Business Wire, 12/9/99*)

Las Cruces, NM Mayor Ruben Smith

- Fannie held a press conference with the above official and representatives of the New Mexico Mortgage Finance Authority to announce \$20 million in flexible mortgages. The "HFA 1% Option Loan" offers conventional mortgage financing for qualified first time homebuyers with a down payment requirement of as low as 1 percent from the borrowers own funds. (*Fannie press release, 12/16/99*)

Kauai, HI Mayor Maryanne Kusaka

- Fannie held a press conference with the above official and the Kauai County Housing Agency, and the Central Pacific Bank to announce a new initiative called the Kauai County Home Buyer Gap Mortgage Initiative. The initiative was redesigned using Fannie's Community Seconds Lending Option to help reduce down payment and closing costs, and significantly lower the interest requirements on a second "gap" mortgage. A statement in support of the initiative by Senator Daniel Inouye (D-HI) was also included in the press release. (*Fannie press release, 12/9/99*)

Several hundred of Fannie's employees on Y2K duty enjoy a sit-down dinner on New Year's Eve with a jazz ensemble and magicians and caricaturists for children

- According to the *Washington Post*, Fannie threw a New Year's Eve party for its employees on Y2K computer duty. Several hundred workers were given a sit-down dinner in the company's palatial Great Hall, serenaded by a jazz ensemble. Their children, who feasted nearby, were tended by babysitters and entertained by a magician and a caricaturist. (*Washington Post, Kirstin Downey Grimsley, 12/31/99*)

Freddie Mac

Freddie announces that a family in Oklahoma was the first to take advantage of a \$10 million Native American Initiative

The initiative is a partnership with the Housing Authority of the Cherokee Nation, PMI Mortgage Insurance Co., First Americans Mortgage, Washington Mutual and Freddie

- Freddie announced that Jim and Mary Cooper are the first members of the Cherokee Nation in Oklahoma to take advantage of a new \$10 million mortgage assistance program that enables Cherokee families to purchase homes with as little as one percent of the purchase price coming from their own funds. The Initiative is part of a partnership between the Housing Authority of the Cherokee Nation,

PMI Mortgage Insurance Co., First Americans Mortgage Corporation, and Freddie. The program is expected to help more than 200 families. (*Freddie press release, 12/20/99*)

Freddie hires Wall Street professional for Securities Marketing Vice President

Freddie also names new Securitization Vice President

Former Freddie executive to start Internet small business lender portal

- Freddie hired Mark Hanson as Vice President of Mortgage Securities Marketing in the Single-Family Securitization Group's Investor & Dealer Services Division. Hanson will oversee Freddie's Gold Participation Certificates and the company's relationship with institutional investors and securities information vendors. Hanson is also responsible for developing new security products and services. He was previously a Vice President at Lazard Asset Management, where he managed mortgage- and asset-backed positions for institutional clients since 1997. Since 1986, Hanson has held a number of positions, including a research/sales position in Donaldson, Lufkin & Jenrette's Taxable Fixed-Income Division, a Director of Research for Freddie's Securities Sales and Trading Group, and a Security Analyst at Metropolitan Life Insurance Company's Mortgage Securities and Portfolio Strategies Department. (*National Mortgage News website, posted 12/21/99; Freddie press release, 12/20/99*)
- Freddie named Paul Peterson as Executive Vice President of its Single Family Securitization Group. Peterson will oversee the operations of the Single Family Securitization Group, including: marketing, sales and production; risk assessment and model development, customer services and control; and investor and dealer services. Peterson replaces John Fisk, who left Freddie after 17 years to become Chief Executive of Loanchannel.com (an Internet-based small business lending portal based in Washington, DC). Peterson was previously Senior Vice President of Business Strategy. Prior to that position, he was Senior Vice President of the Servicer Division. (*National Mortgage News website, posted 12/23/99; American Banker, 12/28/99*)

Federal Home Loan Banks

The Federal Housing Finance Board issues a proposed rule to reorganize the Office of Finance so that FHLBanks have direct responsibility for the issuance of all FHLBank consolidated debt obligations (CO), starting January 2, 2001

FHFB proposes to transfer certain corporate governance responsibilities from the FHFB to the individual FHLBanks – taking the first steps mandated by the recently enacted Gramm-Leach-Bliley Act

FHFB publishes a formal notice that it has withdrawn its proposed rule governing participation and sales of whole advances

- The Federal Housing Finance Board (FHFB) issued a proposed rule that gives the FHLBanks direct responsibility for the issuance of all FHLBank consolidated debt obligations starting January 2, 2001. Further the FHLBanks would continue to be jointly and severally liable for the debt. The FHFB currently must approve CO issuances by the Office of Finance. The proposal would also allow the

office to manage joint obligations of the 12 FHLBanks and the Office of Finance would prepare the combined financial reports of the FHLBanks. The FHFBS also proposed that the Office of Finance serve as a central facility that the FHLBanks could use to manage programs such as Member Mortgage Assets. The proposed rule expands the Board of Directors of the Office of Finance to 24 members from three so that each of the 12 FHLBanks would be represented, along with six public members appointed by the FHFBS and six members elected by the FHLBanks. The FHFBS will accept comments on the proposed rule in writing on or before March 6, 2000. (*National Mortgage News website*, posted 12/15/99; *National Mortgage News*, 12/20/99; *American Banker*, 12/15/99; *BNA Daily Report for Executives*, Kenneth Talley, 12/15/99; *Federal Register*, 1/4/00, pages 324-338)

- Separately, the FHFBS issued a proposed rule that would transfer certain corporate governance functions from the FHFBS to the individual FHLBanks as first steps mandated by the recently enacted Gramm-Leach-Bliley Act. The new rule would let the banks decide on dividends, budgets, bylaws, hiring, and senior management salaries, as well as the format of advance applications. The new rule would also reduce the compensation of FHLBank Boards by as much as 48% - to \$25,000 for Chairman, \$20,000 for Vice Chairman, and \$15,000 for Directors. Terms for all Directors would become three years, rather than two years for those elected and four for those appointed. Comments on the proposed rule must be received in writing on or before February 2, 2000. To implement the statutory changes under the Gramm-Leach-Biley Act, the FHFBS also published an interim final rule removing regulations that required FHFBS approval for the following matters of corporate governance: selection and compensation of Bank officers and employees; entering into building leases and purchases; adoption and revision of Bank bylaws; dividend payments; application forms for Bank advances; Bank approval of conditional advances; and transfer of advances and advance participations. The interim final rule is effective on December 21, 1999, however, the FHFBS said it would accept written comments on the interim final rule on or before January 20, 2000. (*National Mortgage News*, 12/20/99; *American Banker*, 12/15/99; *Federal Register*, 1/3/99, pages 81-91; *Federal Register*, 12/21/99, pages 71275-71278; *BNA Daily Report for Executives*, Kenneth Talley, 12/15/99)
- The FHFBS issued a formal announcement that in light of the enactment of the Gramm-Leach-Bliley Act, the FHFBS is withdrawing its proposed rule that would have approved the sale of whole advances between FHLBanks under certain limited circumstances. (*Federal Register*, 12/22/99, page 71689)

FHLBank System's Mortgage Partnership Finance Program (MPF) is becoming a real competitor to Fannie & Freddie in the secondary mortgage market – competition in the secondary market benefits consumers

MFP loans grow 87% in 1999, national expansion continues

Eight of the 12 FHLBanks are expected to offer MPF to their members

HSBC Bank of Buffalo and Provident Bank of Montebello have started to originate their home loans through the MPF Program with the FHLBank of New York

- The FHLBank System's Mortgage Partnership Finance (MPF) program ended its second full year with strong growth in 1999. Outstanding loans increased 87% to \$1.8 billion from \$956 million a year earlier. The program has master commitments for an additional \$6.6 billion of loans, up 697% from \$829 million at the end of 1998. Four FHLBanks joined the program last year and two others are in the process of joining. Soon eight of the 12 FHLBanks will be offering MPF to their members.

- The MPF program is designed as an alternative for lenders to sell the mortgages into the secondary market. The MPF program splits the risks of fixed-rate mortgages between the mortgage lender and the FHLBank. The local lender, however, manages the credit risk and customer relationship of each loan, while the FHLBanks handles the funding, interest rate, liquidity and prepayment risk. The structure allows mortgage lenders to avoid the interest rate risk of their fixed-rate mortgages without paying costly guarantee fees to a secondary market agency. **Alex Pollock, President and Chief Executive Officer of the FHLBank of Chicago stated that the FHLBanks are the “only government sponsored enterprise able to effectively compete with the GSEs which dominate the secondary market...Competition among GSEs benefits our members and their customers...MPF is all about bringing more competition to the American secondary mortgage market.”** (*Mortgage Partnership Finance* ® press release, 1/5/00)
- In related news, Joshua Brockman with the *American Banker* reported that HSBC Bank USA of Buffalo and Provident Bank of Montebello, NY have started to originate their home loans through the MPF Program with the FHLBank of New York. “MPF gives us more wholesale funding choices – which is good for neighborhoods and good for American homebuyers,” said George Strayton, President of Provident Bank. Brockman noted that the FHLBank of New York began offering the MPF Program in April 1999 and has 13 lenders approved for membership. The FHLBank of New York reports master commitments in excess of \$500 million. (*American Banker*, Joshua Brockman, 12/21/99; *PR Newswire*, 12/15/99)

Former Chair of the Ohio Democratic Party to Chair Cincinnati FHLBank

- The FHLBank of Cincinnati Board of Directors announced that Paul Tipps, Principal, State Street Consultants, Columbus, was elected its Chair, effective January 1, 2000. Tipps was appointed by the FHLBank as a Member of the Cincinnati Bank Board of Directors in 1997. According to *PR Newswire*, he is one of the top lobbyists in Columbus, where he is one of two founding partners of State Street Consultants, a government affairs firm with affiliates throughout Ohio. Tipps sits on the Board of Directors of Janus Hotels & Resorts and is Past Chair of the Ohio Democratic Party and the Montgomery County Democratic Party. (*PR Newswire*, 12/29/99)

Farm Credit System

Co-Bank, a Farm Credit System lender, is planning to ask the government for permission to directly invest in agricultural cooperative companies

The American Bankers Association and the Independent Community Bankers of America say the power would give Co-Bank an edge over commercial banks and they vow to fight Co-Bank’s efforts

- According to Craig Woker with the *American Banker*, Co-Bank, a \$22 million asset Denver-based Farm Credit System lender, plans to ask the government for permission to directly invest in agricultural cooperative companies. Co-Bank lends to agricultural cooperatives such as Blue Diamond Growers and Land O’Lakes Inc. The American Bankers Association and the Independent Community Bankers of America said the power would give Co-Bank an edge over commercial banks, and both groups vowed to fight any new Co-Bank efforts.

- Co-Bank has not submitted a formal proposal to its regulator, the Farm Credit Administration, however, a Co-Bank Senior Vice President Jack Cassidy said that Co-Bank is talking with Clinton Administration officials about how existing law could be used to meet the needs of the lender's customers. (*American Banker*, Craig Woker, 12/29/99)

Farm Credit Administration proposes rule to allow Farm Credit System corporations to sell stock to non-System entities

- The Farm Credit Administration issued a proposed rule to allow Farm Credit System service corporations to sell stock to non-System entities and to allow System institutions to adopt bylaws allowing the issuance of unlimited amounts of certain classes of equities. Comments on the proposal are due January 24, 2000. (*Federal Register*, 12/23/99, pages 72041-72044)

Ginnie Mae

Columnist asks the question, "What Effect Would a Privatized Ginnie Mae Have on Mortgage Costs?"

- Lew Sichelman, a contributor to *Realty Times*, wrote a piece on Ginnie Mae and what would happen if Ginnie Mae were privatized. The columnist first pointed out a number of differences between Fannie and Freddie and Ginnie Mae. One important difference he noted is that Ginnie Mae is profitable. "Yes, so are Fannie and Freddie immensely so. But their profits go to stockholders, while Ginnie Mae's \$674 million last year alone, \$2.786 billion over the last five years are returned to the government's coffers."
- Sichelman takes the time to explain what Ginnie Mae does in order to put Ginnie Mae privatization discussions in perspective. He notes that HUD Secretary Andrew Cuomo and the Mortgage Bankers Association are against Ginnie Mae privatization. Sichelman provides the following quotes against Ginnie Mae privatization:
- "The proposed privatization of Ginnie Mae would be detrimental to the market and result in higher priced mortgages," says the MBA. "Any structural changes...could damage its ability to provide financing options to those borrowers who need it most...In addition, privatization could adversely impact the value of Ginnie Mae mortgage-backed securities if the full faith and credit of the federal government is reduced or eliminated."
- "If Ginnie Mae is sold, its affordable housing mission may be lost," says the National Low-Income Housing Coalition.
- "Without the guarantee, Ginnie Mae mortgage-backed securities, instead of trading at a better price than Fannie Mae or Freddie Mac MBS, would like trade at a worse price," says the *Mortgage-Backed Securities Letter*. "This price would translate into higher priced mortgages for consumers."

(*Realty Times*, Lew Sichelman, 11/29/99)

January 14, 2000

