

The **GSE** REPORT TM

Contents of GSE Report TM

“Subsidies accorded to GSEs are, of necessity, at the expense of other federal or private sector initiatives and hence are ultimately financed by households, either through taxes or through the reduced accumulation of wealth.”
(Federal Reserve Board Chairman Alan Greenspan, 5/23/00)

Major Events

- Federal Reserve Board Chairman Alan Greenspan criticizes impact of benefits provided to Fannie, Freddie, and the FHLBanks (*p. 4*)
 - In a letter to Cong. Richard Baker (R-LA), Greenspan wrote the following:
 - (1) The GSEs’ subsidies come at the expense of increasing consumers’ taxes or reducing their wealth, and should be periodically examined by Congress;
 - (2) Suggests that the GSEs may have outlived the role for which they were first chartered;
 - (3) Believes the GSEs have a built-in advantage over private industry;
 - (4) Recommends that the 1995 CBO study be updated – the study found that the annual subsidies provided to the GSEs were worth \$6.5 billion, of which \$2.1 billion was retained by the GSEs’ shareholders, rather than passing through to homebuyers
 - Citizens Against Government Waste praises Chairman Greenspan for his comments
- American Enterprise Institute (AEI) holds its third conference on GSEs on May 23 – “Thinking About the Future of Fannie Mae and Freddie Mac” (*p. 6*)
 - Highlights of Luncheon Speaker Cong. Richard Baker (R-LA)
 - (1) Calls for an updated study by the CBO on the benefits that the GSEs obtain from government sponsorship
 - (2) Next hearing on the GSEs will be June 15 (moved from June 7)
 - (3) He may talk to Fed officials about systemic risk issues and ask the central bank representatives to testify at a later hearing
 - (4) There is increasing bipartisan interest in the GSE issue by Members – “I’m not out there by myself anymore” noting that “many people would be surprised by the vote count”
 - (5) Expects to bring his bill up for a vote in the fall
 - (6) Plans to hold three or four more hearings this summer and wants to hold a mark-up on his bill in September
- Fannie may be purchasing \$1 billion of loans originated by troubled subprime lender (Conseco), which appears to violate recent anti-predatory lending policies that Fannie set for purchasing loans (*p. 14*)
 - “Conseco breaks all the rules on Fannie Mae’s guidelines,” said one securitization pro
- Expanding its mission, Freddie extends a \$300 million line of credit to an apartment developer (*p. 14*)
 - This is the first time Freddie has extended a revolving line of credit

Fannie Mae and Freddie Mac

- Fannie & Freddie’s safety and soundness regulator, OFHEO, has its 2001 budget request cut by the House HUD-VA Appropriations Subcommittee (*p. 15*)
 - “At a time when lawmakers and others are voicing concern about risks posed by Fannie Mae and Freddie Mac, a House panel cut nearly \$5 million from the budget request of the agency [OFHEO] that regulates the financial safety and soundness of the two firms” (*Dow Jones Newswire, John Connor, 5/24/00*)

- House Banking Committee Ranking Minority Member John LaFalce (D-NY), House Banking Capital Markets Subcommittee Chairman Richard Baker (R-LA) and Subcommittee Ranking Minority Member Paul Kanjorski (D-PA) sent letters to the subcommittee leadership in support of OFHEO's budget request
- OFHEO says they need their full budget request – OFHEO notes that Fannie & Freddie have doubled in size since OFHEO began operating in 1993 and “OFHEO is the only thing standing between Congress and a situation where you have to decide whether you have to bail out these institutions”
- Analyst David Tice says Fannie & Freddie may have rescued the markets before, but this time may be different (p. 16)
- *National Mortgage News* website asked for viewer feedback on “What will happen when GSE issues are larger than those of the Treasury?” (p. 17)

Fannie Mae

- A column by Paul Muolo in *Mortgage Servicing News* speculates on why Fannie's call for lobbying help at the Mortgage Bankers Association (MBA) conference got a “skeptical lender response” (p. 17)
 - Some lenders don't feel much affinity with Fannie anymore
- Fannie says it expects to purchase \$400 billion worth of mortgages this year using its automated underwriting system (p. 17)
 - Fannie Chairman Franklin Raines says he expects electronic commerce will help the company increase its revenue by 10-14% and double its earnings per share in five years ending 2003
- Fannie continues to expand its technology reach to Realtors – Fannie is an equity investor in a web venture that would establish an Internet platform (p. 18)
 - The platform, announced by the National Association of Realtors and HomeStore.com, will be used by Realtors and homebuyers to order services, coordinate the closing and exchange data and documents with other parties involved in a home sale
- Fannie continues to expand its technology reach to brokers (p. 18)
 - Fannie announces an online partnership with Ellie Mae (a web-based firm that brings brokers together with funding lenders on the Internet)
- Fannie launches a “True Cost Calculator” on its consumer website to help borrowers “better determine what a particular mortgage actually costs” (p. 18)
 - *Mortgage Originator* magazine op-ed asks if any government agency checked Fannie's calculator for accuracy, or are they exempt under the “Secondary Market Arrogance Act?”
- 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. 19)
 - Fannie has 44 partnership offices open across the country
 - Charles Lewis, Executive Director of the Center for Public Integrity, stated that Fannie & Freddie's hiring of high level government and political officials blurs the line between public service and private enterprise. In his opinion, the recent hirings by Fannie and Freddie are an example of how “incestuous these quasi-governmental entities are with the people that ostensibly regulate them or have oversight over them.”

Freddie Mac

- America's Community Bankers (ACB) criticizes Freddie for violating its charter by participating in a joint Internet venture with Microsoft called HomeAdvisor Technologies (p. 21)
- Freddie completes its first transaction under new LIBOR ARM initiative (p. 21)
- Freddie provides credit enhancement to Los Angeles high-rise apartment complex (p. 21)
- Freddie announces a partnership with the National Hispanic Housing Council (p. 21)

Federal Home Loan Banks

- FHFB extends its comment period for proposed rule on FHLBanks' acquired member assets and core mission activities (p. 22)
 - The proposal does not limit investments in non-mission assets such as mortgage-backed securities (MBS), however, MBS will not be considered “core mission assets”
 - In related news, the FHLBanks' MBS investments continue to rise
- FHFB agrees to issue a proposed rule establishing a risk-based capital structure for the FHLBanks (p. 23)
- FHLBank of Topeka joins the FHLBanks' Mortgage Partnership Finance (MPF) program (p. 24)
 - The MPF program, a competitor to Fannie & Freddie in the secondary mortgage market, continues to grow in

popularity

- Jim McTague of *Barron's* notes that investors in Fannie & Freddie have more to fear from the FHLBanks' MPF program than political pressures
- FHFB Chairman Bruce Morrison noted that once the \$9 billion cap is lifted on the MPF program (expected to be lifted this year), he expects the FHLBanks to purchase \$30 billion in loans by the end of 2001 and \$100 billion by the end of 2002
- FHLBanks of Indianapolis, Cincinnati, and Seattle continue to develop their own loan-purchasing program (similar to the FHLBanks' MPF program) that will be another competitor to Fannie & Freddie in the secondary mortgage market (*p. 25*)
 - The FHLBanks plan to test the new program in the third quarter of this year

Farm Credit Administration/Farm Credit Banks

- The Farm Credit Administration issued guidance on a controversial proposal that would remove geographic boundaries and allow farm credit banks to compete in each other's territories (*p. 25*)
 - Banking industry consultant, Bert Ely, claims that the FCA's national charter effort runs the risk of encouraging risky lending

Major Events

Federal Reserve Board Chairman Alan Greenspan criticizes impact of benefits provided to Fannie, Freddie and the FHLBanks

In a letter to Cong. Richard Baker (R-LA), Greenspan wrote the following:

- (1) The GSEs' subsidies come at the expense of increasing consumers' taxes or reducing their wealth, and should be periodically examined by Congress;**
- (2) Suggests that the GSEs may have outlived the role for which they were first chartered;**
- (3) Believes the GSEs have a built-in advantage over private industry;**
- (4) Recommends that the 1995 CBO study be updated – the study found that the annual subsidies provided to the GSEs were worth \$6.5 billion, of which \$2.1 billion was retained by the GSEs' shareholders, rather than passing through to homebuyers**

Citizens Against Government Waste praises Chairman Greenspan for his comments

Greenspan states that the GSEs' subsidies come at the expense of increasing consumers' taxes or reducing their wealth, and should be periodically examined by Congress

- According to Jerry Guidera with the *Wall Street Journal*, **“Federal Reserve Chairman Alan Greenspan joined the mounting chorus of policy makers who have been criticizing government subsidies for Fannie Mae and Freddie Mac.”** Greenspan sent a letter to Cong. Richard Baker (R-LA) on May 19 noting that **the GSEs' subsidies come “at the expense of other federal or private sector initiatives and hence are ultimately financed by households, either through taxes or through the reduced accumulation of wealth.”** Greenspan thought it was appropriate for Congress to examine the subsidies enjoyed by the GSEs. **“Since these subsidies have important consequences for the structure and efficiency of the financial markets and the productive allocation of real resources, it is appropriate for Congress to periodically consider these implicit subsidies.”** An *International Strategy & Investment (ISI) Report* noted that the impact of Greenspan's letter will **“add momentum to legislative and regulatory efforts to rein in the GSEs.”**

Greenspan suggests that the GSEs may have outlived the role for which they were first chartered

- Guidera reported that Greenspan was of the view that the stabilizing role the three GSEs have traditionally played in the secondary mortgage market has been accomplished and may no longer be necessary. Greenspan writes, **“the FHLBs, Fannie Mae, and Freddie Mac were each chartered with the purpose of smoothing out regional imbalances in mortgage supply and integrating regional mortgage markets in the national capital markets.”** He added that, **“Much to their credit, they succeeded in accomplishing this goal many years ago. Today, however, these organizations alter the housing finance markets only to the degree that they pass through to homebuyers part of their government subsidies.”**

- Guidera noted that Greenspan stopped short of saying that the GSEs pose a threat to financial markets by taking advantage of the widespread investor belief that the government will bail them out if they get into trouble. “As a general practice, we do not comment on any institution or any particular group of institutions with regard to systemic risk,” he wrote. But Greenspan agreed with the notion that “the lower borrowing costs of these institutions, of course, reflect the belief that the government is unlikely to let [them] fail.”

Greenspan believes that GSEs have a built-in advantage over private industry

- Greenspan noted that the GSEs “collectively dominate” the US home mortgage markets and have a built-in advantage over private industry. “They clearly benefit from government sponsorship – particularly from their ability to borrow funds at a lower costs than comparably situated private sector borrowers.” He noted a 1994 HUD study that found that Fannie’s costs of capital would rise by \$3.6 billion and Freddie’s by \$1.275 billion per year if they had to fund themselves like other firms in the banking and finance industry.
- Greenspan noted that a 1995 Congressional Budget Office (CBO) study found that the annual subsidies provided to the GSEs were worth \$6.5 billion, of which the GSEs’ shareholders kept \$2.1 billion, rather than being passed through to homebuyers. Greenspan further noted that the data used in the CBO study is now five years old, “suggesting that a request to CBO for an update would be in order.”
- **Kathleen Day with the *Washington Post* noted that “Greenspan’s letter contradicts statements by Fannie Mae officials who have insisted that while Fannie Mae’s ties to government are beneficial, they are not subsidies.”**

Salomon Smith Barney analyst says Greenspan letter increases Fannie & Freddie’s political risk

- Salomon Smith Barney analyst Thomas O’Donnell lowered his 12-month price target on Fannie and Freddie as political pressure continues to hamper the agencies. **O’Donnell noted in his report that “Fannie and Freddie’s political opponents can now claim Greenspan as their own and this has sharply increased concern over political risk.”** (*Bloomberg News*, 5/24/00)

Fannie’s response to Greenspan letter

- “There’s nothing new or surprising here,” Fannie spokesman David Jeffers said. “Chairman Greenspan’s comments in this letter are consistent with the views he has stated publicly with regard to other federally chartered entities and the impact on the economy of the benefits those entities derive from their charters and from the federal bank safety net.” (*Wall Street Journal*, Jerry Guidera, 5/23/00; *Washington Post*, Kathleen Day, 5/24/00; *Letter from Fed Chairman Alan Greenspan to Cong. Richard Baker*, 5/19/00; *ISI Morning Political Report*, 5/23/00)

Citizens Against Government Waste praise Greenspan for his comments

- “Chairman Greenspan has added his respected voice to those of other budget authorities like the General Accounting Office and Congressional Budget Office,” said CAGW President Thomas Schatz. “GSEs like Fannie Mae and Freddie Mac receive billions of dollars in special government benefits which end up enriching GSE stockholders instead of promoting affordable home ownership.”

- **In response to Greenspan’s comments that the GSEs’ subsidies come at the expense of “other federal or private sector initiatives” and are “ultimately financed by households, either through taxes or through the reduced accumulation of wealth,” Schatz noted that “Fannie Mae and Freddie Mac try to have it both ways. Their stockholders are addicted to double-digit growth rates and enormous profits, while they spend millions on Washington lobbyists and public relations firms to preserve their government-subsidized status.” Schatz continued, “As Chairman Greenspan wrote today, the American people are ultimately paying the bill for Fannie Mae and Freddie Mac’s two-faced practices.”**
- Schatz stated that “We share Chairman Greenspan’s view that the GSEs have served an historically important purpose.” He concluded, “However, now they show symptoms of that age-old Washington malady, mission creep, Congress must act to ensure that their non mission-related activities and exploding debt load do not put taxpayers at risk.” (*US Newswire*, 5/24/00)

American Enterprise Institute (AEI) holds its third conference on GSEs on May 23 – “Thinking about the Future of Fannie Mae and Freddie Mac”

Highlights of Luncheon Speaker Cong. Richard Baker (R-LA):

- (1) Calls for an updated study by the CBO on the benefits that the GSEs obtain from government sponsorship**
- (2) Next hearing on the GSEs will be June 15 (moved from June 7)**
- (3) He may talk to Fed officials about systemic risk issues and ask the central bank representatives to testify at a later hearing**
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- AEI held its third conference on GSEs on May 23 on the future of Fannie and Freddie. The conference served to focus on how the political horizon has changed for the GSEs this year, particularly Fannie and Freddie. Last year's conference sought to identify the problems related to the GSEs maintaining their high profitability and stock price growth through aggressive expansion plans. Topics included: how government subsidies assisted the GSEs in capturing market share from fully private companies; the systemic risk presented by their size and growth plans; the difficulty of regulating such politically well-connected giants; and their lack of accountability for a poor affordable housing record, despite their liberal use of government-granted subsidies. This year, the discussion moved from the problem to possible solutions: how to implement privatization, or, instead, drive down subsidy value through increased competition; how to improve the regulation of the entities that are viewed as “too big to fail;” and how to assure that the GSEs acknowledged move into subprime loans increases their credit support to minorities and low-income markets.

- This shift was made even more evident with the disclosure of Fed Chairman Greenspan's letter to Rep. Baker (R-LA) (see earlier story in this *GSE Report*). Greenspan suggested that Fannie and Freddie may have achieved the goal for which they were created, and continuing their subsidies at current levels may be resulting in inefficient allocation of market resources. He encouraged Cong. Baker to request an update of the CBO subsidy analysis. Clearly, GSE subsidies and expansion plans are on the policy "radar screen." Hill and agency staff comprised a larger part of this year's conference audience, including staffers from the Senate Budget Committee, CBO, CRS, Treasury, HUD and OFHEO. Cong. Baker asserted that Members are following the GSE issues with greater interest, evidenced by higher attendance at his Subcommittee hearings and interest in when the next hearing is scheduled. Over and over again, he is being told that Congressional inquiry into the GSEs' growth, regulation and subsidy is appropriate and timely. Many of the speakers at the conference noted the difficulty, if not impossibility, of passing any legislation on the GSEs.

Peter Wallison, AEI Resident Fellow (Moderator of Conference)

- More interest in issue than when AEI held its first conference - a recognition that problems presented by Fannie and Freddie are more than a "food fight" in the mortgage industry.
- Fannie's recent hiring of a phone bank company to make calls in the districts of key lawmakers on behalf a phony organization called "The Coalition of Homeownership" seems desperate and unwarranted.
- GSE legislation will be difficult to pass.
- Something will have to be done soon to address the GSEs - not because of looming financial problems - but because Fannie and Freddie's growth rates are increasing so fast that before long they are going to run out of assets to buy, perhaps as early as 2003.
- This will cause their stock prices to drop and Fannie and Freddie will soon be looking for ways "to get out from under the government's thumb so that they can continue to grow."
- Fannie chose not to participate in this conference because they were denied the authority to structure the event. However, Wallison had earlier given Fannie an entire day - December 2, 1999 - to structure their own conference, and Fannie did not show.
- Although GSEs were created to promote homeownership, the percentage of people owning their homes hasn't increased substantially in the last few years - the homeownership rate has increased only 4% from 1960 to 2000 (63% to 67%).

Mark Overend, Sallie Mae

- Not sure the Sallie Mae privatization plan is the ultimate resolution for a GSE, but it is a case study for what to do when a GSE "grows up" and moves to the next stage of its life cycle.
- Sallie's first 26-years as a GSE were "favorable."
- In the 90's things changed dramatically and it "was no longer fun to be a GSE anymore."
- In 1993, Congress effectively removed its funding advantage by: (1) imposing a 30 basis point per annum user fee on their activities; (2) mandated that Sallie serve as the lender of last resort; (3) imposed specific statutory minimum capital requirements; and (4) placed restrictions on areas of business allowed by the charter. Sallie also faced direct competition in the early 1990's from the Department of Education, which introduced the Federal Direct Student Loan Program.
- Sallie Mae, Congress, Wall Street, and academics all thought it was time Sallie should be privatized.
- 1996 privatization legislation created a corporate entity consisting of a state-chartered holding company, which owned the federally chartered GSE as well as the other non-GSE subsidiaries. The dissolution of the GSE was designed to take place over a 10-year period. During this 10-year period,

the GSE still conducts its traditional secondary market business, while the non-GSE portion of the business has no charter restraints on its business.

- It is still too early to fully evaluate the success and impact of Sallie's privatization but Overend believes consumers and shareholders have benefited from privatization.

Stephen Moore, CATO

- GSEs are no longer needed and they no longer serve a public purpose.
- The unrestrained growth of the GSEs has "become the greatest threat to the US capital markets today" - "One could make a strong case that Fannie Mae and Freddie Mac have engaged in far more predatory monopolistic behavior than the Justice Department's adversary, Microsoft."
- Fannie and Freddie operate at a cost to the economy due to: (1) their incredible debt explosion (risk to taxpayers); (2) their corporate welfare - at least 1/2 to 1/3 of the GSEs' benefits do not go to homebuyers; (3) their erosion of competitive markets in housing finance - GSEs' mission creep creates risk (the risk is borne by taxpayers not GSE shareholders).
- GSEs should be privatized - "Congress has two options: Fannie Mae and Freddie Mac should be made private, or they should not exist at all."
- "Politically unrealistic" to privatize the GSEs quickly or in a formal way since the GSEs are "political juggernauts" in Washington
- Instead, a series of small steps are recommended that would "de facto" privatize the GSEs including:
 - (1) Leveling the playing field by gradually "peeling away" the GSE benefits one by one (starting with repeal of the line of credit to the Treasury, then the exemption from state and local taxes, then the SEC exemption)
 - (2) Impose a 10-20 basis point user fee paid by GSEs for their lending (suggested by CBO)
 - (3) Shut down Fannie's political activities; Foundations should be immediately terminated. The GSEs' lobbying expenses are a "tax on home ownership."
 - (4) Lower ceiling on mortgages GSEs can purchase to median housing prices in market
 - (5) Impose a Congressional annual cap on GSE borrowing
 - (6) Increase equity requirements of GSEs
 - (7) GSEs are an inefficient system for promoting homeownership - Fannie and Freddie's subsidies should be abolished and the budgetary savings should be used to create a first-time homebuyer income tax credit

Dwight Jaffee, Professor, University of California, Berkeley

- Fannie and Freddie are "tacitly colluding duopolists"
- Fannie and Freddie have significant subsidies and market power
- Defines privatization as the simultaneous taking away of the GSEs' market power and their subsidies
- If Fannie and Freddie were privatized, two major changes would occur:

(1) In terms of monetary transfer benefits - US taxpayers gain, because they no longer guarantee Fannie and Freddie liabilities; Fannie and Freddie stakeholders lose, because they no longer receive the taxpayer subsidies; and the effect on mortgage borrowers is unclear - they might lose if mortgage rates rise, or they may be unaffected if the rates remain unchanged. Jaffee suggests that mortgage rates may actually be too low.

(2) In terms of resource allocation benefits - there are two: don't have to raise taxes since tax revenue will no longer be needed to backstop the Fannie and Freddie guarantee, and may reduce the resources allocated to conforming mortgage market securitization

- Suggests proposals for privatizing the GSEs:
 - (1) Congress is reluctant to remove the GSEs' subsidies - this is the right solution but unlikely to happen
 - (2) Instead, he suggests competition by letting competitors enter the system - Create a level playing field by giving the subsidies provided to the GSEs to all residential mortgage market institutions that meet certain conditions. Also, the benefits should be made explicit so the benefits are transparent and could be adjusted or reduced more easily.

Robert Van Order, Freddie Mac

- Freddie's past shareholders received the benefits of the GSEs' subsidies when Freddie went public, not current shareholders (Robert Seiler,* OFHEO, noted that the value of the charter and the franchise of Fannie and Freddie have increased over time since the companies went public - such as Fannie and Freddie's issuance of benchmark securities)
- Not sure discussions about Sallie Mae privatization were helpful since everyone was in favor of privatization, which isn't the case when discussing privatization of Fannie and Freddie
- "Banks are GSEs too" because they are subsidized like Fannie and Freddie in the form of deposit insurance (Peter Wallison, AEI, noted, however, that banks and thrifts are not federally guaranteed and FDICIA allows the imposition of a tax on a bank or thrift if the fund sinks below a certain level to cover losses and that bank capital would have to be exhausted before taxpayers are at risk)
- If Fannie and Freddie can't lobby because they receive a subsidy, then neither can banks, schools, and universities
- There is no empirical evidence of Fannie and Freddie "tacitly colluding"
- Competitive GSEs would be a compromise that may be worse than the alternatives because it may enlarge the subsidies
- Fannie and Freddie do not pose a risk to taxpayers like the S&L crisis. Thrifts were "an industry with no franchise, with nothing to lose by gambling. But we do have a franchise" and, therefore, an incentive to invest prudently. (*American Banker*, Erick Bergquist, 5/26/00)

Robert Seiler, OFHEO (personal remarks, not speaking on behalf of OFHEO)*

- He is agnostic on whether Fannie and Freddie should be privatized.
- Privatization will only be feasible if all of the seven stakeholders are taken under consideration (GSE shareholders, bondholders, lenders, borrowers, potential or actual competitors, non-profits and government)
- In response to Van Order's comparison of banks to GSEs, Seiler notes that although depositories are active in the jumbo market, the depositories largely participate through their mortgage subsidiaries, which he is not sure, receive the benefits of deposit insurance.
- Addressing concerns by competitors that privatizing Fannie and Freddie like Sallie Mae would harm competitors, he does not believe it is clear that Fannie and Freddie would have a huge dominant position

- Sallie Mae privatization taught us five things:
 - (1) Government may have to take interim steps to lower the market value of Fannie and Freddie (e.g., reducing the charter value through user fees, etc.);
 - (2) Policymakers may want to apply pressure through the budgetary process or parties outside the authorizing committees;
 - (3) Any exit fees should be small;
 - (4) Alternative means to subsidizing conforming fixed-rate mortgage market might be needed to compensate borrowers; and
 - (5) Alternative benefits must be found to compensate stakeholders in affordable housing who may lose the affordable housing goals imposed by HUD

Alex Pollock, FHLBank of Chicago

- Possible GSE outcomes in five to 10 years: (1) monopolistic market domination by Fannie and Freddie (certainly possible); (2) privatization (theoretically attractive, but not likely); and (3) competitive GSEs (desirable and practical).
- Only a GSE can compete with a GSE - best way to ensure GSE benefits are passed through is to encourage competition among housing GSEs
- More regulation or legislation will only make the GSEs less efficient and more costly
- Congress should promote competition by treating all three GSEs as equally as practicable - FHLBanks should have the same capital treatment, taxation and affordable housing goals as Fannie and Freddie
- Agrees with Fannie Chairman Raines that Cong. Baker's GSE bill will have a negative impact on innovativeness

Tom Stanton, Attorney At Law

- Must address the GSE issue from a public policy and a political level - the policy problem is the growing concentration of risk; the political problem is how can we deal with the GSE problem without being excoriated for threatening "the American dream."
- Fannie and Freddie have doubled in size every five years. They are taking over the mortgage market and they are too big to fail
- There doesn't appear to be any natural limits against the growth of the GSEs
- Whenever anyone advocates stronger regulation of the GSEs, they are unfairly accused by the GSEs of trying to ruin the housing system
- The government may lack the capacity to talk about privatizing the GSEs, let alone do anything about them. Anyone in a position of public responsibility to oversee or comment on GSEs is subject to unfair criticisms from the GSEs, which is a "danger to our democratic process."
- He believes it is difficult to address the political problems, so then you must address the concentration of risk problem and the way to do this is to charter multiple competing GSEs (called Nancy Maes) that would be given the same benefits as Fannie and Freddie
- Government could create a regulator, similar to the OCC under Treasury, that could charter many GSEs
- Suggests that legislation to charter multiple GSEs might consider: (1) requiring the GSEs to contribute to an Affordable Housing Fund (instead of today's GSE affordable housing rules that don't work); (2) imposing a 10% limitation on the amount of conforming mortgages that any GSE could hold (to reduce risk); (3) adapt some of the too-big-to-fail provisions from FDICIA to the GSEs.
- Competing GSEs could serve as a transition between giving up GSE. The government, after creating the new GSEs, could sunset their beneficial status over five years, turning them into

regular private companies. But even without full privatization, competing GSEs would provide benefits over today's status quo.

- Competitive GSEs would (1) reduce mortgage interest rates; (2) reduce risk; (3) reduce the adverse consequences for innovation and competition that Fannie and Freddie cause through their market power; and (4) assure that a greater portion of the federal subsidy flows through the GSEs and into the housing market.

Edward Golding, Freddie Mac

- The GSE controversy has occurred because competitors think that the GSEs are causing them too much competition, and driving down costs and speeding up the mortgage process.
- He criticized Stanton's proposal of competing GSEs and compared it to the S&L crisis. Stanton is operating on the false premise that smaller institutions carry less risk than two large organizations, but not all institutions will be able to manage risk. Concentrating risk among many different organizations does not reduce risk and may create regional concentration of risk with many GSEs than just two GSEs. [Editorial Note: The only thing more dangerous than many institutions that are undercapitalized is two very large (too-big-to-fail) institutions that are undercapitalized because the risk is overly concentrated.)
- Freddie is one of the strongest institutions in the world - S&P give them a "AA-" rating without any of the subsidies (Stanton noted that S&P rating reflects S&P's belief that the GSEs would be able to borrow at any time in the capital markets, unlike other institutions.)
- In terms of the FHLBanks' MPF program, he does not think the FHLBanks could withstand the risk-based capital stress test imposed on Fannie and Freddie. (Pollock noted he would be happy to be under the risk-based capital stress test. MPF disperses risk among many institutions; the credit risk of mortgages was not the problem during the S&L crisis - interest rate risk was the problem. Stanton noted that the risk-based capital proposal was flawed and that a GSE would fail financially before it would fail the stress test.)
- Stanton places his hope on more regulation of multiple GSEs reducing risk, but Golding notes that the regulators did not "get it right with the S&Ls."

Cong. Richard Baker (R-LA)

- Called for an updated study by the CBO on the benefits that GSEs obtain from government sponsorship.
- Next hearing on the GSEs will be June 15 (moved from June 7) with testimony from housing groups, lending representatives, and other interested parties.
- May talk to Fed officials about systemic risk issues and ask the central bank representatives to testify at a later hearing. (*Dow Jones Newswire*, Jerry Guidera, 5/23/00)
- He has learned that having a productive, rational conversation on public policy with the GSEs is not possible without inflammatory remarks by the GSEs and a high level of rhetoric involved.
- He accused Fannie and Freddie of being unwilling to participate in a debate on his bill. He noted that both were given copies of the legislation before the bills were introduced and both attended meetings with him to discuss the legislation and both were asked for modifications to the bill. Yet both testified that "We have not had an opportunity to communicate" on the bill. He will again submit the legislation to the GSEs for their input.
- He said there is increasing bipartisan interest in the GSE issue by Members - "I'm not out there by myself anymore" noting that "many people would be surprised by the vote count"
- Expects to bring his bill up for a vote in the fall - "There will be a vote," he said. "Congress will be asked to make a decision."
- He told reporters after his speech that he plans to hold three or four more hearings this summer and wants to hold a mark-up on his bill in September. (*National Mortgage News Daily*, 5/24/00)

- It is appropriate to examine the GSEs - “You do not do maintenance on your airplane when you are on the way down”
- He took issue with Fannie Chairman Franklin Raines testimony about Fannie’s Home Depot partnership, noting that the GSEs have new product offerings that impose on the private markets and don’t facilitate individuals getting a home.
- He took issue and disputed Raines’ recent statements on the following:
 - (1) “When the Fed raises short term rates, home mortgage rates go down” (Baker questioned why the Fed’s increase in interest rates the day of the last hearing may have had more affect on the cost of home ownership than whether a subcommittee makes an inquiry into the operation of the GSEs);
 - (2) “We buy our own mortgage-backed securities to ensure that mortgage rates remain low” (Baker noted that the purchasing of MBS has more to do with profits. “Now that Fannie owns 48% of its own portfolio in its own securities, one can see the day when interest rates can really be low if you get that percentage of the portfolio up just a bit more.”);
 - (3) “Fannie Mae was never insolvent. The fact there was just a waiver of taxes due by the Congress was not a loss to the taxpayer, it was a loss of revenue”; (Baker noted that Fannie did have financial problems.); and
 - (4) “There is no subsidy to the GSE, but if there is one, 100% of it flows through to the consumer” (Baker referenced CBO’s study that 2/3 of the GSEs’ subsidies flow to consumers, and Greenspan’s letter that the “benefits of GSE status are substantial”)

William Apgar, HUD

- GSEs have significant benefits in the marketplace and therefore have significant responsibilities
- Thinks HUD’s proposed affordable housing rule balances safety and soundness responsibilities and mission
- Would like HUD to be able to assess Fannie and Freddie for the cost of regulating the GSEs. HUD must have proper resources to examine the GSEs
- He doesn’t perceive FHA competing in any meaningful way with Fannie and Freddie and doesn’t believe HUD has an inherent conflict in regulating the GSEs.
- He shares concerns that substantial growth of the GSEs can cause systemic risk
- If Congress didn’t ask the GSEs questions, then they would be derelict in their duty to examine important public policy issues
- Thinks HUD has done a reasonable job in regulating the GSEs - not convinced that current regulatory structure needs to be scrapped but he thinks it should be reviewed
- There must be a better way for HUD to examine the GSEs’ new programs before reading about them in the newspaper, but he understands the need to balance with innovativeness
- Healthy competition between the agencies is one of the best market regulators.

John Brown, Essential Information

- He presented a map of Fannie and Freddie’s market share purchases of conventional loans in 1998 by Census Tract of the Chicago Metropolitan area to demonstrate that more needs to be done in the area of affordable housing for underserved neighborhoods.
- There are problems with the affordable housing goals for Fannie and Freddie because (1) the housing goals are not targeted properly and the definitions were muddled; (2) legislation prohibited sub-goals; and (3) the performance of single-family and multi-family are combined.
- He suggested: (1) that GSE market share should be examined to see what areas need encouragement; (2) the need for clearly separate housing goals for 1-4 families and multi-family; (3) need stronger push for Fannie and Freddie to purchase CRA loans; (4) review GSE

performance at neighborhood level; and (5) affordable housing goals should be enforceable and separate housing categories should be given for home purchases and refinancings.

- Examination of market share data has found that across the US, there is a greater level of GSE activity in high-income and white neighborhoods than there is in low-to-moderate and minority neighborhoods (particularly in the heartland) - there's an income and race disparity in GSE activity

John Weicher, The Hudson Institute

- The GSEs can be constrained to serve public policy purposes, given the political will to do so. But it is not easy; there are perhaps unexpected pitfalls in the process and enforcement takes a long time, involving many skirmishes and arguments.
- Hard to contain GSEs on paper, by charter, law, and regulation
- The charter/goals/regulation are not enough to keep the GSEs in line.
- Congress is too busy to be the regulator.
- The GSEs have a talent for creating programs by little steps
- The GSEs are prevented from originating mortgages, yet there are varying definitions of "originate."
- The lack of definition in their charter - "mission" is never clarified, making it easier for the GSEs to justify their actions. GSEs frequently describe their powers in terms that bear no close relationship to the charter acts. They tend to refer to their "mission" – not a clearly defined concept - rather than their "purposes"

Ron Feldman, FRB of Minneapolis (personal remarks, not speaking on behalf of FRB)*

- GSEs have significant control over their subsidies - risk-taking and volume largely determine the size of the GSE subsidy/
- Suggests:
 - (1) an annual assessment of GSEs by a rating agency could be used as an informational item or to limit the GSEs powers by regulatory action (e.g., couldn't issue debt unless meet certain rating);
 - (2) imposing a fee to compensate the government for implicit credit support - policymakers would have more control of the subsidy if fee was set "marginally";
 - (3) altering the GSEs' current budgetary treatment and subject the GSEs to standard reviews and potential reform; and
 - (4) restricting traditional operations such as limiting debt financings or the amount of mortgages financed
- There is an inherent difficulty in accessing the size of the subsidy and reforms could have unintended consequences
- The GSE form is not the best form for controlling subsidies

Francis L. Cavanaugh, Public Finance Consultant

- Congress should end all subsidies to GSEs. This is the preferred approach, but should consider what to do if Congress again fails to act to end subsidies to the GSEs.
- Suggests alternatives to ending all subsidies: (1) providing explicit federal guarantees of GSE securities (because the government is not getting the full value for its implicit guarantee); (2) charging them a guarantee fee that could be put in a reserve fund should GSEs fail; and (3) allowing the Social Security Trust Fund to invest in the GSE securities
- The GSEs may want to privatize before paying escalating fees
- "It would increase the investment outcome of Social Security and other trust funds, since interest rates on GSE securities are, and will be, significantly higher than the rates on Treasury securities," he said. "It is ironic that pension and retirement funds of state and local governments and private

corporations are now benefiting from the higher rates on GSE securities, which are backed by the federal government, but the federal pension plans are not.”

Marvin Phaup, CBO (personal remarks, not speaking on behalf of CBO)

- Provided a summary of the speakers at the conference.
- There is consensus that the future of the GSEs is a worthy topic of discussion but vast disagreement about why the future of the GSEs is important
- Uncontrolled growth and increased political power of the GSEs without any systemic limit to their power alarms reasonable people .
- The GSEs control their own growth, which also scares people.
- None of the proposals for the future of Fannie and Freddie are perfect (as is the status quo) and so important judgements need to be made.

Fannie may be purchasing \$1 billion of loans originated by troubled subprime lender (Conseco), which appears to violate recent anti-predatory lending policies that Fannie set for purchasing loans

“Conseco breaks all the rules on Fannie Mae’s guidelines,” said one securitization pro

- As reported in the May 5th *GSE Report*, Fannie announced anti-predatory lending policies on April 11. As part of their guidelines, Fannie said it will not purchase mortgages from lenders who “steer” consumers into high-cost mortgage products, attach single premium credit life insurance policies to mortgages, charge excessive fees, impose unfair prepayment penalties, don’t report a borrower’s full credit history to credit repositories and don’t maintain escrow deposit accounts for customers. (*Inman News Feature*, 4/11/00)
- Fast forward ahead just a month, and there are **rumors hitting Wall Street that troubled loan originator Conseco may be selling more than \$1 billion of its loans to Fannie. According to Christopher O’Leary with *Investment Dealer’s Digest*, “that possibility had mortgage and agency pros puzzled, as the “checkered past of Conseco and Green Tree would seem to violate many quality standards that the federal agency has set up for purchasing loans for its portfolio.”** Fannie declined to comment for the article, noting that it never comments on specific actions taken by its portfolio managers, but O’Leary noted that other market players were more vivid in their opinion. **“Conseco breaks all the rules on Fannie Mae’s guidelines,” said one securitization pro. “For one thing, they have actively originated Section 52 high rate loans in the past and have encouraged borrowers to take out credit life policies and have funded single premium payments.” He argued that both types of loans do not belong on Fannie’s books.** (*Investment Dealer’s Digest*, Christopher O’Leary, 5/29/00)

Expanding its mission, Freddie extends a \$300 million line of credit to an apartment developer

This is the first time Freddie has extended a revolving line of credit

- Freddie extended a \$300 million revolving line of credit to apartment developer Charles E. Smith Residential Realty, Inc. According to Smith Residential, this is the first time Freddie has extended a revolving line of credit. “The Smith Residential Facility is a new mortgage product designed specifically to respond to our borrower’s evolving requirements,” said H.L. Van Varick, Vice President of Negotiated Transactions at Freddie. (*Bloomberg News*, 5/30/00)

Fannie Mae and Freddie Mac

Fannie & Freddie’s safety and soundness regulator, OFHEO, has its 2001 budget request cut by the House HUD-VA Appropriations Subcommittee

“At a time when lawmakers and others are voicing concern about risks posed by Fannie Mae and Freddie Mac, a House panel cut nearly \$5 million from the budget request of the agency [OFHEO] that regulates the financial safety and soundness of the two firms.” (*Dow Jones Newswire, John Connor, 5/24/00*)

House Banking Committee Ranking Minority Member John LaFalce (D-NY), House Banking Capital Markets Subcommittee Chairman Richard Baker (R-LA) and Subcommittee Ranking Minority Member Paul Kanjorski (D-PA) sent letters to the subcommittee leadership in support of OFHEO’s budget request

OFHEO says they need their full budget request – OFHEO notes that Fannie & Freddie have doubled in size since OFHEO began operating in 1993 and “OFHEO is the only thing standing between Congress and a situation where you have to decide whether you have to bail out these institutions.”

- On May 23, The House HUD-VA Appropriations Subcommittee approved a spending plan that includes \$22 million in funding for OFHEO, which OFHEO Director Armando Falcon says is not enough. OFHEO requested \$26.77 million for fiscal year 2001. Even with the proposed cut, OFHEO’s budget would be above the current level of \$19.48 million.
- “The Subcommittee’s decision to deny OFHEO full funding strikes at the heart of our ability to fulfill our Congressional mission to regulate Fannie Mae and Freddie Mac,” said Falcon. “This decision demonstrates why our budget should not be subject to the political maneuverings of the entities we regulate and why OFHEO should be exempt from the appropriations process. This exemption is critical to our long-term success as the safety and soundness regulator of the Enterprises.”
- The House Appropriations Subcommittee denied that “political maneuverings” by Fannie or Freddie influenced their decision to reduce the funding to OFHEO. “It’s truly outrageous because Fannie and Freddie never spoke to our housing staff or to the Chairman about this particular issue,” said Elizabeth Morra, Spokeswoman for the House VA-HUD Appropriations Subcommittee. OFHEO Director Falcon said he did not want his previous comments to call into question the integrity of the panel, its Chairman or its staff. Falcon did, however, accuse Fannie of opposing an amendment last year to remove OFHEO from the Congressional appropriations process. “Had that amendment succeeded, we would not be faced with a proposed budget which does not meet our projected needs and OFHEO would be on the same footing as all other financial safety and soundness regulators.” A Fannie spokeswoman confirmed that Fannie has always maintained that OFHEO should be part of the appropriations process but that the company had never taken a position on any specific funding levels within that process. Louis Nevins, President of the Western League of Savings Institutions, believes OFHEO’s budget should be independent of the appropriations process “because the mere appearance of the possibility” that Fannie or Freddie might lobby to cut the budget “is bad even if it doesn’t happen at all.”

Cong. LaFalce, Cong. Baker, and Cong. Kanjorski support OFHEO's budget request

- House Banking Committee Ranking Minority Member John LaFalce (D-NY), House Banking Capital Markets Subcommittee Chairman Richard Baker (R-LA) and Subcommittee Ranking Minority Member Paul Kanjorski (D-PA) sent letters to the Subcommittee leadership the week of May 22 in support of OFHEO's budget request. **“OFHEO needs its full request to ensure that the ongoing growth and complexity of the Enterprises' operations are closely monitored,” Baker and Kanjorski wrote.** “The Enterprises continue to grow at a rapid pace and their operations are only increasing in complexity,” they wrote. “According to OFHEO, Fannie Mae and Freddie Mac presently are exposed to credit risk on more than \$2 trillion of mortgages, and their portfolio of mortgage assets exceeds \$850 billion, 350% larger than they were when OFHEO began operations in mid-1993. This amount is larger than the combined mortgage assets of the entire thrift industry,” they wrote. In a separate letter, Cong. LaFalce wrote **“As Congress debates the mission of GSEs and their regulation, the most important thing we can do this year is to give OFHEO the resources it needs to carry out its responsibilities to provide effective regulation of these GSEs.”**
- Falcon said he would ask the House Appropriations Committee to provide OFHEO's full budget request. He stated that the decision by the Subcommittee to cut their funding request would force OFHEO to “hire fewer examiners than what we need.” Working on the S&L cleanup and bank rescue legislation when he was a House Banking Committee Counsel convinced him that regulators “need to be proactive, aggressive” and need “resources.” He added “OFHEO is the only thing standing between Congress and a situation where you have to decide whether you have to bail out these institutions.” (*Dow Jones Newswire*, John Connor, 5/24/00; 5/25/00; *BNA Daily Report for Executives*, Eileen Canning, 5/25/00; *Bloomberg News*, 6/1/00)
- [Although OFHEO is subject to the appropriations process, it is not funded by taxpayers. Its funding comes from assessments on Fannie and Freddie. Other federal financial regulators are able to assess the entities they regulate directly, without being subject to the appropriations process.]

Analyst David Tice says Fannie & Freddie may have rescued the markets before, but this time may be different

- Analyst David Tice noted that Fannie and Freddie helped rescue the markets during 1994 and 1998 but “it is unlikely the GSEs can act as forcefully this time.” Tice writes the following:

“First, the balance sheets of these companies are leveraged to the hilt. Fannie Mae has stacked \$575 billion in assets on 3 percent equity. As a result, Fannie no longer has the borrowing capability of years past. And while this was unthinkable just a few months ago the market may soon have its fill of GSE paper...How does this limit the GSEs ability to lend? For one thing, the GSEs' balance sheets include billions in short-term debt as the cost of funds seems to be rising. Remember, the GSE notes coming due are funding long-term assets already on the balance sheet. As these notes are rolled over, the GSEs may learn the market is playing by different rules. We think this ends the game of borrowing aggressively short term, investing long term, and hedging the mismatched assets and liabilities with derivatives. Without such help, the credit markets will remain in a crisis longer. Even without a crisis, don't look for the GSEs to continue to provide the credit necessary to further fuel the stock market bubble.” (*On Wall Street-Securities Data Publishing*, David W. Tice, 5/1/00)

***National Mortgage News* website asked for viewer feedback on "What will happen when GSE issues are larger than those of the Treasury?" (www.nationalmortgagenews.com)**

Fannie Mae

A column by Paul Muolo in *Mortgage Servicing News* speculates on why Fannie's call for lobbying help at the Mortgage Bankers Association (MBA) conference got a "skeptical lender response"

Some lenders don't feel much affinity with Fannie anymore

- As reported in the May 19th *GSE Report*, in a recent speech at the MBA's National Secondary Market Conference, Fannie Vice Chair Jamie Gorelick asked MBA members to tell the MBA to oppose Cong. Richard Baker's GSE bill. According to an *American Banker* article by Erick Bergquist, Gorelick's comments "ruffled feathers" at the MBA and sources said top MBA officials "read her the riot act" after the speech. The MBA has reportedly not made its opinion on Cong. Baker's bill public yet, but thought Fannie was out of line in using the MBA conference as a platform. (*American Banker*, Erick Bergquist, 5/11/00)
- Muolo speculated that Fannie received a "skeptical" response from lenders because some lenders don't feel much affinity with Fannie anymore and Fannie "continues not to get it." Lenders feel that although Fannie adds tremendous liquidity to the market, it also has major leverage over the industry because of its power to control guarantee fees and force lenders to buy back loans. Many small- to medium-sized lenders have not benefited from any guarantee fee breaks from Fannie, like some of the largest lenders which struck alliance deals with Fannie. An increasing number of lenders also do not think Fannie is marketing or talking to them anymore.
- **"Its [Fannie] customer is not the consumer – its customer is its seller/servicers. And as that old business 101 saying goes: the customer is always right...If Fannie Mae were smart it would take all those ad dollars that it plans to spend on 'political' ads and start doing some research into what it can do to help its seller/servicers."** (*Mortgage Servicing News*, Paul Muolo, June 2000)

Fannie says it expects to purchase \$400 billion worth of mortgages this year using its automated underwriting system

Fannie Chairman Franklin Raines says he expects electronic commerce will help the company increase its revenue by 10-14% and double its earnings per share in five years ending 2003

- According to Lew Sichelman with *National Mortgage News*, Fannie Vice Chair Jamie Gorelick told a "stunned" audience at the Mortgage Bankers Association's national secondary market conference that Fannie expects to purchase \$400 billion worth of mortgage this year using its automated underwriting system to underwrite and process the loans. (*National Mortgage News*, Lew Sichelman, 5/15/00)
- Speaking at a press briefing in London in conjunction with Fannie's 16th annual investor visit to the United Kingdom and Europe, Fannie Chairman Franklin Raines stated that electronic commerce

will help Fannie double its earnings per share by 2003 and increase its revenue 10-14% from 1999-2003. Raines said that Fannie was positioned to be at the center of the e-commerce process between consumers, lenders and investors. (*PR Newswire* (London), 5/8/00)

- A.G. Edwards & Sons analyst Joel Houck assigned its “Buy” rating on Fannie stock. Houck noted that e-commerce and the Internet provide Fannie an opportunity to grow its revenue over the next five years because Fannie is positioned at the “fulcrum” of the value chain in the mortgage industry’s revenues. In other words, reported Eric Avidon with *National Mortgage News*, electronic commerce could be the means by which Fannie captures a larger share of the mortgage industry’s revenues. (*National Mortgage News*, Eric Avidon, 5/15/00)

Fannie continues to expand its technology reach to Realtors - Fannie is an equity investor in a web venture that would establish an Internet platform

The platform, announced by the National Association of Realtors and HomeStore.com, will be used by Realtors and homebuyers to order services, coordinate the closing and exchange data and documents with other parties involved in a home sale

- The National Association of Realtors and HomeStore.com announced the launch of a new web venture that would establish an Internet platform to be used by Realtors and homebuyers to order services, coordinate the closing and exchange data and documents with other parties involved in a home sale. Founding equity investors include the NAR, HomeStore.com, Fannie Mae, VeriSign Inc., GMAC Real Estate, GMAC Mortgage and Wyldfyre Technologies, which was recently acquired by HomeStore.com. Fannie is expected to provide technology tools for the platform. The platform, called the Realtors Electronic Transaction Platform, is expected to be operation within a year. (*Wall Street Journal*, 5/22/00; *Dow Jones Newswire*, 5/19/00)

Fannie continues to expand its technology reach to brokers

Fannie announces an online partnership with Ellie Mae (a web-based firm that brings brokers together with funding lenders on the Internet)

- Fannie formed an online partnership with Ellie Mae that will make Fannie’s Desktop Originator on the web available on the Ellie Mae Business Center, providing brokers more options to access Fannie’s software technology. Brokers who use Desktop Originator on the web will have a point of access to mortgage transaction services, such as flood and title insurance, appraisal services, and credit report information, provided on Fannie’s MORNETPlus ® on the web. (*Fannie press release*, 5/9/00)

Fannie launches a “True Cost Calculator” on its consumer website to help borrowers “better determine what a particular mortgage actually costs”

***Mortgage Originator* magazine op-ed asks if any government agency checked Fannie’s calculator for accuracy, or are they exempt under the “Secondary Market Arrogance Act?”**

- Fannie announced that it launched a “True Cost Calculator” on its consumer website (www.homepath.com) to help borrowers “better determine what a particular mortgage actually costs.” **An op-ed in the April 2000 *Mortgage Originator* magazine stated that “I don’t mind Fannie Mae coming out with their new True Cost Calculator. I just wish they had named it**

something else. It makes all other cost calculators sound like they aren't true. What I want to know is, did any government agency check Fannie's calculator for accuracy? Or are they exempt under the Secondary Market Arrogance Act? I hope they don't forget about all the regional differences in loan charges. [Editorial note: Guaranty fees and technology delivery fees that Fannie and Freddie charge for their mortgage products should also be disclosed as part of the consumer's cost of obtaining a mortgage.] (*Fannie press release, 5/9/00; Mortgage Originator, April 2000*)

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 has 44 partnership offices open across the country

Charles Lewis, Executive Director of the Center for Public Integrity, stated that Fannie & Freddie's hiring of high level government and political officials blurs the line between public service and private enterprise. In his opinion, the hiring by Fannie & Freddie are an example of how "incestuous these quasi-governmental entities are with the people that ostensibly regulate them or have oversight over them."

Hiring of political officials blurs the line between public service and private enterprise

- A spokeswoman for the Fannie/Freddie watchdog group, FM WATCH, stated that "many of those hired by Fannie Mae and Freddie Mac are specifically assigned to oppose any legitimate debate on Capitol Hill, in the administration, in the White House and the industry, about Fannie Mae's and Freddie Mac's role." (*American Banker, Joshua Brockman, 7/16/99*)

Fannie has 44 partnership offices

- According to Fannie's website, the company has 44 partnership offices open across the country. (http://www.fanniemae.com/contact/partnership_offices.html, 5/22/00)

House Speaker Dennis Hastert (R-IL) and Aurora, IL Mayor David Stover

- Fannie announced that it had purchased a \$113 million tax-exempt bond issued by the City of Aurora, IL, the proceeds of which will be made available to homebuyers through participating lenders. Through the bond program, residents who qualify can receive 7.8%, 30-year fixed-rate mortgage loans and down payment and closing cost assistance. Statements of support by Speaker Hastert and Mayor Stover were included in Fannie's press release. (*Fannie press release, 5/25/00*)

Senator Pete Domenici (R-NM)

- Fannie announced mortgage relief for fire victims in Los Alamos County. A statement of support by Senator Domenici was included in Fannie's press release. (*Fannie press release, 5/23/00*)

Senator Jeff Sessions (R-AL)

- Fannie announced that Senator Sessions joined Fannie in a housing forum with East Alabama housing leaders. (*Fannie press release, 6/1/00*)

Senator Jim Bingaman (D-NM)

- Fannie announced the kick-off of the "Green Built: Albuquerque" tour of homes specifically designed to showcase energy efficient and environmentally friendly homes. A new energy efficient mortgage underwriting variance that factors energy savings in to the qualification process was also announced. Fannie announced a \$10,000 grant to the Home Builders Association of

Central New Mexico to support their efforts to develop an environmental rating system for newly built homes. A statement by Senator Bingaman was included in the press release. (*Fannie press release, 5/19/00*)

Senator Kent Conrad (D-ND)

- Fannie announced that Senator Conrad, Fannie, and the Tribal Leaders of North Dakota convened a housing roundtable on Native American issues. (*Fannie press release, 6/1/00*)

Senator Harry Reid (D-NV)

- Fannie announced that Senator Reid, Fannie, and the Inter-Tribal Council of Nevada convened a symposium on Native American housing issues. Fannie and Senator Reid also presented a check for \$10,000 to the Inter-Tribal Council to help cover the costs of training individual tribes and Indian housing authorities in mortgage finance lending. (*Fannie press release, 6/1/00*)

Cong. Richard Baker (R-LA)

- Fannie announced that it had sponsored a workshop at Southern University in Baton Rouge to assist pastors and ministers who provide housing and neighborhood revitalization services to their communities. More than 350 Louisiana pastors attended. A statement of support by Cong. Baker was included in Fannie's press release. (*Fannie press release, 5/22/00*)

Cong. Earl Pomeroy (D-ND)

- Fannie announced that Cong. Pomeroy joined Fannie and housing development directors from across the state for a community roundtable meeting. (*Fannie press release, 5/31/00*)

Cong. Xavier Becerra (D-CA)

- Fannie announced that Cong. Becerra met with Fannie's Los Angeles Advisory Council and officials from Fannie to discuss expansion of homeownership opportunities in underserved communities. (*Fannie press release, 5/31/00*)

Oklahoma City Mayor Kirk Humphreys and Councilwoman Ann Simank

- Fannie and the MidTown Redevelopment Corporation, and St. Anthony Hospital unveiled a design for the MidTown Revitalization District. Fannie provided \$20,000 to establish a two year Executive Director position for the MidTown Redevelopment Corporation; St. Anthony Hospital provided \$50,000. Statements of support by Humphreys and Simank were included in Fannie's press release. (*Fannie press release, 5/18/00*)

Jacksonville City Council President Ginger Soud

- Fannie announced a partnership with the Duval County Housing Finance Authority (HFA). Fannie has purchased a \$600,000 Down Payment Assistance Investment Note from the HFA. A statement of support by Soud was included in Fannie's press release. (*Fannie press release, 5/16/00*)

Freddie Mac

America's Community Bankers (ACB) criticizes Freddie for violating its charter by participating in a joint Internet venture with Microsoft called HomeAdvisor Technologies

- ACB said Freddie's joint venture with Microsoft to form HomeAdvisor Technologies (HTI), appears to have no benefit for its members and "raises serious public policy questions." In a letter to Freddie's President Leland Brendsel, ACB Chairman William Fitzgerald and ACB President and CEO Diane Casey noted that it would ask HUD and OFHEO to review the Freddie-HTI deal to determine if the agency is violating its charter which forbids originating loans. The May 5th letter states that the ACB has "concerns over this arrangement which appears to establish Freddie Mac as an investor in a company intended to deal directly with consumers and thereby put the Corporation in the primary mortgage market, an activity prohibited for a government-sponsored enterprise." The letter further noted that "the secondary market GSEs have grown to dominate every market they have entered on the strength for their government-conferred advantages. As a result, the housing finance market has become more exclusive, rather than inclusive." (*National Mortgage News Daily*, 5/9/00; *ACB Letter to Freddie Chairman Leland Brendsel*, 5/5/00)

Freddie completes its first transaction under new LIBOR ARM initiative

- Freddie purchased a \$120 million loan originated by Bankers Mutual and secured by the Elan at River Oaks Apartments, San Jose, CA. The original transaction, which closed in March 2000, was an \$86 million convertible adjustable-rate mortgage loan linked to the London interbank offered rate. "This is the first transaction under our new LIBOR ARM initiative that we announced in February," said Mitchell Kiffe, Vice President of Multifamily Loan Production at Freddie. (*National Mortgage News Daily*, 5/24/00)

Freddie provides credit enhancement to Los Angeles high-rise apartment complex

- Freddie completed a \$47.55 million tax-exempt bond credit enhancement transaction with TRI Capital Corporation to finance Promenade Towers, a 583-unit high-rise apartment complex located in downtown Los Angeles. The Freddie credit enhancement replaces a direct-pay letter of credit on \$47.55 million of variable-rate demand multifamily tax-exempt housing revenue bonds issued by the Community Redevelopment Agency of the City of Los Angeles. (*Freddie press release*, 5/8/00) According to Rent.net, Promenade Towers has a pool, spa and fitness center and all rooms come with basic cable included. Studio rents range from \$775-\$950; 1 bedrooms range from \$1000-\$1490; and 2 bedrooms range from \$1350-\$1900. (<http://www.rent.net>)

Freddie announces a partnership with the National Hispanic Housing Council

- Freddie and the National Hispanic Housing Council announced a \$40 million initiative to expand home construction, rehabilitation, and affordable homeownership opportunities for Latino families in California, Florida, Illinois, and Massachusetts. (*National Mortgage News Daily*, 5/12/00)

Federal Home Loan Banks

FHFB extends its comment period for proposed rule on FHLBanks' acquired member assets and core mission activities

The proposal does not limit investments in non-mission assets such as mortgage-backed securities (MBS), however, MBS will not be considered "core mission assets"

In related news, the FHLBanks' MBS investments continue to rise

- On April 12, the FHFB approved a proposed rule that would authorize the FHLBanks to acquire assets of their members through risk-sharing arrangements (like the Mortgage Partnership Finance (MPF program)) and define which activities are "core mission activities. The FHFB published the proposed rule in the May 3 *Federal Register*. The FHFB said it had received a number of requests for an extension on the comment period, so the FHFB extended the comment period from June 2, 2000 to June 15, 2000. A final rule is expected to be published in the fall.
- Specifically, acquired member assets (AMA) will mainly consist of whole mortgage loans originated by or held by a FHLBank member institution, provided that the credit risk is shared between the FHLBank and the member. The rule also specifies which FHLBank activities qualify as core mission activities, including: advances to members, standby letters of credit, targeted investments that support affordable housing and economic development activities, and small business investment corporations.

Proposal does not limit investments in non-mission assets such as MBS – Proposal says they just won't be considered "core mission assets"

- The proposed rule would not restrict beyond current law the FHLBanks' investment in non-mission-related assets such as mortgage-backed securities. The rule specifies that any limit on MBS that might be imposed by the FHFB in the future would allow the FHLBanks to hold to maturity any MBS that they held as of April 12, 2000. (*FHFB press release, 4/12/00; Federal Register, pages 25676-25692, 5/3/00, page 34127, 5/26/00*)

FHLBanks' MBS investments continue to rise

- According to a new FHLBank system financial report for the first quarter, the FHLBanks' investments in MBS increased to \$77.1 billion as of March 31, 2000 from \$73 billion at December 31, 1999. (*Dow Jones Newswire, 5/23/00*)

FHFB agrees to issue a proposed rule establishing a risk-based capital structure for the FHLBanks

- Implementing provisions in the Gramm-Leach-Bliley Act, the FHFB agreed May 22 to seek comment on a proposed rule that would implement a new risk-based capital structure for the FHLBanks. The proposal will have a 90-day comment period after it is published in *the Federal Register*. As mandated by the Gramm-Leach-Bliley Act, the final rule must be approved by November 12. The FHLBanks would then have approximately nine months to submit new capital structure plans to the FHFB for approval, which would be phased in over five years. “The ultimate goal is a more permanent, risk-based structure that enhances the safety and soundness of the FHLBank System, and provides the capital base for the FHLBanks to pursue new mission-related business opportunities,” said FHFB Chairman Bruce Morrison.
- The Gramm-Leach-Bliley Act requires that the FHLBank System’s existing subscription capital structure be replaced by a structure with two classes of capital stock. Class A stock is redeemable on six months’ written notice to the FHLBank. Class B stock, the FHLBanks’ permanent capital, which is preferred by the FHLBanks, is redeemable on five years’ written notice to a FHLBank. The FHLBanks’ shareholders are their member financial institutions.
- The proposed rule would require each FHLBank to maintain a ratio of total capital to total assets of at least 5%. Each FHLBank must also weigh its permanent capital – the amount of Class B stock plus retained earnings – at 1.5 times paid-in value, so long as its total capital is not less than 4% of its total assets.
- Under the proposal each FHLBank would have the authority to issue either Class A or Class B stock or both. No member institution would be allowed to cast more than 20% of the votes in any election, and no member institution could hold more than 40% of any class of a FHLBanks’ stock. During a recent hearing, House Banking Committee Chairman Jim Leach (R-IA) criticized a previous FHFB provision that would have made stock tradable within the FHLBank system without limiting the amount of stock that any one investor could hold. “The idea that a [FHLBank] could be controlled by a single private entity, whether a commercial bank, or [savings and loan], affiliate of a securities company, or an insurance company, is deeply troubling.” (*Dow Jones Newswire*, John Connor, 5/22/00; *BNA Daily Report for Executives*, Kenneth Talley, 5/23/00; *American Banker*, Kevin Guerrero, 5/23/00)

FHLBank of Topeka joins the FHLBanks' Mortgage Partnership Finance (MPF) program

The MPF program, a competitor to Fannie & Freddie in the secondary mortgage market, continues to grow in popularity

Jim McTague with *Barron's* notes that investors in Fannie & Freddie have more to fear from the FHLBanks' MPF program than political pressures

FHFB Chairman Bruce Morrison noted that once the \$9 billion cap is lifted on the MPF program (expected to be lifted this year) , he expects the FHLBanks to purchase \$30 billion in loans by the end of 2001 and \$100 billion by the end of 2002

- The FHLBank of Topeka has joined the FHLBank System's MPF program. The MPF program, originally designed and sponsored by the FHLBank of Chicago, gives banks and thrift members an alternative secondary market execution for fixed-rate mortgages (an alternative to selling loans to Fannie and Freddie). The FHLBank of Chicago claims that institutions can also boost their profits under the MPF program by not having to pay loan guarantee fees to Fannie and Freddie. Under the MPF program, the FHLBank purchases the mortgage from the lender and assumes the interest rate risk, while the lender retains some credit risk not covered by mortgage insurance and servicing. (*National Mortgage News*, 5/23/00)
- As reported in the May 5th *GSE Report*, FHFB Chairman Bruce Morrison expects that all 12 FHLBanks will be participating in the MPF program, or a program similar to MPF, by the end of the year. At last count, outstanding loans in the MPF program increased 146% during the first quarter of 2000 to more than \$4.4 billion, up from \$1.8 billion at year-end. MPF master commitments (indicator for future volume) also rose sharply to \$24.2 billion from \$6.6 billion three months ago, an increase of 267%. Currently 126 members are approved to fund MPF loans, and an additional 78 are in the process of joining the program. Over 150 more members are in discussions to join.

Advantages of MPF over Fannie and Freddie

- Member institutions using the MPF program do not pay guarantee fees. According to a source at one of the FHLBanks, in 1999, Fannie and Freddie's guarantee fees averaged close to 20 basis points per year of the outstanding principal balance of each loan. The FHLBanks pay participating institutions 7 to 13 basis points per year for managing credit risk. So, rather than paying a fee to Fannie and Freddie, MPF participants would receive a fee for managing the credit risk. Fannie and Freddie complain that MPF program should be subject to the same oversight as Fannie and Freddie. A spokesman for one of the FHLBanks said "We would love to play by their rules." According to the spokesman, the FHLBanks operate under a stricter regime than Fannie and Freddie and that the FHLBanks hold more capital as a percentage of assets than Fannie and Freddie. (*American Banker*, Erick Bergquist, 4/17/00)

FHLBank competition should scare investors in Fannie & Freddie

- Jim McTague with *Barron's* noted that political problems continue to pile up for Fannie and Freddie, including Federal Reserve Board Chairman Alan Greenspan's concerns expressed to Cong. Baker in a May 2000 letter, while the debate on Capitol Hill has taken a toll on Fannie and Freddie's share prices. McTague argues that "investors have more to fear" from the FHLBanks. McTague noted that the MPF program, a competitor to Fannie and Freddie, can save the originator 19-20 basis points up front and as much as 100 basis points, or a full percentage point, over the life

of the loan if there is no default – “a big deal in a business where competitors mount epic battles for three or four basis points of profit.” He added that the MPF program gives originators an incentive to sell their strongest loans to the FHLBanks. **The MPF program is currently capped at \$9 billion, however, the board is all but certain to lift the cap this year and FHFBC Chairman Bruce Morrison noted that once the cap is lifted, he expects the FHLBanks to purchase \$30 billion in loans by the end of 2001 and \$100 billion by the end of 2002. “This could be serious for Freddie Mac and Fannie Mae, especially in years of declining mortgage originations,” said McTague.** Fannie bought \$370 billion worth of mortgages in 1999 and Freddie bought \$273 billion. (*Barron’s Online*, Jim McTague, 5/29/00)

FHLBanks of Indianapolis, Cincinnati, and Seattle continue to develop their own loan-purchasing program (similar to the FHLBanks’ MPF program) that will be another competitor to Fannie & Freddie in the secondary mortgage market

The FHLBanks plan to test the new program in the third quarter of this year

- According to Erick Bergquist with the *American Banker*, the FHLBanks of Indianapolis, Cincinnati, and Seattle plan to test their new mortgage purchase program during the third quarter of this year. The new program, temporarily called the Mortgage Purchase Program (MPP), is similar to the FHLBanks’ MPF program run by the FHLBank of Chicago. To distinguish it from the MPF program, the new program will have a regional focus and a unique risk-sharing plan. Like the MPF program, the new MPP program is designed to compete with Fannie and Freddie in the secondary mortgage market.
- According to Beth Nellist, Manager of Finance Communications at the FHLBank of Indianapolis, under the MPP program, instead of paying the seller a fee for providing credit enhancement, the FHLBank will create a credit reserve. Nellist noted that the FHLBanks participating in the MPP program will buy loans on comparable terms to what Fannie and Freddie would offer but will include incentives that Fannie and Freddie do not provide, such as a four-layer credit-protection structure that rewards sellers for making good loans. The MPP program is expected to have a different name at each of the FHLBanks, and back-office operations will be run separately. (*American Banker*, Erick Bergquist, 6/1/00)

Farm Credit Administration/Farm Credit Banks

The Farm Credit Administration issued guidance on a controversial proposal that would remove geographic boundaries and allow farm credit banks to compete in each other’s territories

Banking industry consultant, Bert Ely, claims that the FCA’s national charter effort runs the risk of encouraging risky lending.

- The Farm Credit Administration issued guidance May 3 on a controversial proposal that would remove geographic boundaries and allow farm credit banks to compete in each other’s territories. The FCA issued guidance instead of using a formal rulemaking process. The guidance describes how members can apply for a national charter. Nationally chartered associations will be required to meet several key conditions before the FCA will grant a national charter. The FCA also agreed to a proposed rule that would require stockholders in certain Farm Credit Associations in Alabama,

Louisiana, Mississippi, and New Mexico to vote on competitive charters that would allow eligible customers to borrow from multiple associations. Farm Credit Act amendments enacted in 1992 require stockholder approval on competitive charters involved in these four states. The proposed rule is open for comment for a 30-day comment period.

- Banking industry consultant, Bert Ely, claims that the FCA's national charter effort runs the risk of encouraging risky lending. Ely told *BNA* that "I am concerned about the risk of reckless lending proceeding under these new rules," he said. "Associations can now plunge into markets that they don't know anything about." Ely said the new provisions do not require lenders to provide the FCA with a new business plan before entering new markets in new territories. "They just need to ask their shareholders if they're ready to go – it's essentially a blank check to lenders to proceed at their own whims." He further noted that the national charter effort will lead to a consolidation of lending associations, and he predicts that the number of associations could drop from 175 associations to 50 or fewer associations. Such consolidation he feels will ultimately favor larger farms which "are the ones who need it the least." (*BNA Daily Report for Executives*, Adam Wasch, 5/16/00)

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