

The **GSE** REPORT™

Contents of GSE Report™

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 - Congresswoman Marge Roukema (R-NJ) plans to introduce similar legislation
 - Chad Yonker, a senior vice president at Fox-Pitt, Kelton, Inc., believes Fannie & Freddie’s lobbyists will have a difficult time defeating these bills because the proposals undercut Fannie & Freddie’s traditional argument that anything that threatens them also threatens homebuyers. “You can’t use that argument against competition - all competition would do is benefit consumers...This may give consumers better borrowing rates and that is why it will be difficult for Fannie and Freddie to argue against it.”
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 - The attorney for the company filing the suit alleges that Freddie may be operating outside its charter and may not even have the right to conduct business in the real-estate owned (REO) disposition industry. “I think there is a strong case to be made that Freddie’s business of managing and disposing assets for third parties is not something they have the right to do under the charter given by the United States Congress,” the attorney said.

Fannie Mae and Freddie Mac

- *Wall Street Journal* editorial calls for Fannie & Freddie to be privatized ([p. 10](#))
 - “The only purpose now served by Fan and Fred’s growing debt is to dramatize the already long list of reasons to truly privatize these companies once and for all. The task they were called to do – provide liquidity for the housing market – has been accomplished. Fan and Fred are not only unnecessary but dangerous. Off with their heads, so to speak.”
- HUD’s Office of Policy Development releases new research studies which find that Fannie & Freddie are lagging the private markets in serving low-income and minority borrowers ([p. 11](#))
- Fannie & Freddie dominate commercial mortgage lending in the first half of 2001 ([p. 15](#))
 - This is the first time Fannie & Freddie have been in the top position since MBA began surveying its commercial members
 - Life insurance companies, traditionally the largest source of funding, slipped to third place behind private conduits
- Fannie & Freddie purchased about 59% of all residential mortgage loans originated in the US during the first half of the year ([p. 17](#))

- Fannie & Freddie have shown an interest in purchasing a \$1 billion pool of subprime whole loans being sold off by EquiCredit, Bank of America's subprime unit ([p. 17](#))
- Fannie & Freddie's derivatives see huge growth in the second quarter ([p. 17](#))
 - Fannie grew its derivatives by 24.8%; Freddie's grew 20.2%
 - Michael Cheah, a portfolio manager at SunAmerica Asset Management, said the growth in Fannie & Freddie's derivatives portfolio is representative of the rapid overall growth of the two GSEs, the pace of which, he believes is unsustainable. "At some point it will burst," he said of the GSEs' growth trajectory. "The question is, when it bursts, who will be holding the bag?"
 - Fannie & Freddie's derivatives risk is a concern, reports *TheStreet.com*
- As the national debt shrinks, GSE debt skyrockets ([p. 19](#))
 - With the fading supply of Treasuries, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasuries as the new benchmark in the bond market

GSE debt news:

 - (1) Brian Collins with *National Mortgage News* notes that if the Social Security Trust fund began purchasing Fannie & Freddie's securities, this would be a "windfall" for the GSEs. "Of course, such a stamp of approval (U.S. Prime Investment) would confer the full faith and credit of the U.S. government on the two GSEs. And all pretext that Fannie and Freddie debt instruments are not guaranteed by Uncle Sam would be laughable."
 - (2) GSE debt issuance up sharply in the first half of 2001
 - (3) BondVision trading system will offer euro-denominated "quasi" government securities, including securities issued by Freddie
- The strategic alliances in which large lenders agreed to sell a majority of their loans to one GSE over another are still "holding pat, though anecdotal evidence suggests that these alliances may not have a bright future," reports *National Mortgage News* ([p. 21](#))

Fannie Mae

- Fannie approves the city of Ogden, UT as a Fannie Mae seller/servicer, enabling the city to originate and service residential mortgage loans that Fannie will purchase ([p. 22](#))
- Fannie purchased \$6 billion in single-family loans with down-payments of less than 5% last year, which was 2.7% of Fannie's total business last year ([p. 23](#))
- Fannie invests in two home equity deals ([p. 23](#))
 - The GSEs are starting to purchase home equity loans in the secondary market that are mainly used to pay off credit card debt or to make home improvements. "Home equity loans do not help families on the cusp of home-ownership get into homes." (*Citizens Against Government Waste*, Leslie K. Paige)
- Morgan Stanley Dean Witter analyst says Fannie is well prepared to manage potential earthquake related credit losses in California ([p. 24](#))
 - Fannie's portfolio includes \$46 billion of home loans, roughly twice Fannie's capital, within 10 miles of the San Andreas fault
- Fannie selects GMAC Commercial Mortgage as a lender for its "Dedicated Student Housing Pilot" program ([p. 24](#))
- 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. 25](#))
 - Fannie has 51 Partnership Offices open across the country
 - Fannie "wins the gratitude of politicians by staging local events with them, often to 'announce' its plans to buy local mortgages...It's almost as if Ford or Microsoft could allow politicians to gain some credit with voters for every Escort or Windows package sold in their district." - *Wall Street Journal*, Nicholas Kulish & Jacob M. Schlesinger, 7/25/01

Freddie Mac

- Freddie and McDonald's may work with local Realtors and mortgage brokers in their partnership program ([p. 32](#))
 - Freddie is equipping 25 McDonald's Corp. restaurants with personal computers and Internet access, with online information on homeownership and credit management at Freddie's Web site
- Freddie drops income caps on certain loans – change will benefit borrowers with higher income in low-income and minority neighborhoods ([p. 32](#))

- Freddie says it is investigating mortgage fraud in eastern Pennsylvania [\(p. 33\)](#)
 - Law enforcement officials say “much of the illegally obtained information used in mortgage fraud schemes runs through prominent automated underwriting systems without pause, because the systems lack fraud detection software.”
 - The two most notable automated underwriting systems that do not have fraud protection are Fannie & Freddie’s automated underwriting systems
- Freddie joins with USDA in rural rental housing initiative [\(p. 34\)](#)

Federal Home Loan Banks

- FHFB Chairman Timothy O’Neill schedules September 12 meeting to discuss dual FHLBank membership [\(p. 34\)](#)
- *Dow Jones Newswire* columnist John Connor notes “most everything about the FHLB System keeps getting bigger” [\(p. 34\)](#)
- FHFB issues two proposed rules for comment on the FHFB’s final capital rule for the FHLBank System [\(p. 35\)](#)
 - The rules will not impede the ability of the FHLBanks to buy obligations of Fannie & Freddie
- FHLBank of Seattle is creating a secondary market for mortgages made on tribal lands [\(p. 36\)](#)
 - FHLBank of Seattle to buy up to \$100 million in home loans under HUD’s Title VI of the Native American Housing Assistance and Self Determination Act
 - In related news, Fannie purchases its first HUD Title VI loan
- President Bush names John Thomas Korsmo to be a member of the FHFB [\(p. 36\)](#)
 - HUD designates HUD Assistant Secretary John Weicher to be HUD’s representative on the FHFB
- Fitch withdraws its ratings of the FHLBank of Pittsburgh, at the request of the FHLBank of Pittsburgh’s management [\(p. 36\)](#)
- Mortgage Partnership Finance (MPF) loans represent 26% of the FHLBank of Chicago’s assets [\(p. 36\)](#)

Farm Credit Administration/Farm Credit Banks

- District Court rules that the FCA acted within its authority when it issued its final rule on loan participations for Farm Credit System institutions [\(p. 37\)](#)
- FCA issues proposed rule that would allow a Farm Credit System institution to terminate its FCS charter and become a bank, a savings and loan association, or other financial institution [\(p. 37\)](#)

Ginnie Mae

- Ginnie Mae issues final rule governing book-entry procedures for payments to security holders [\(p. 38\)](#)

Major Events

America's Community Bankers (ACB) ask Fannie & Freddie to stop selling \$1,000 investment notes (debt) to consumers because it could harm banks' ability to attract deposits

- **ACB asked Fannie and Freddie to stop selling \$1,000 investment notes to consumers because it could be harmful to the deposit base of insured depository institutions. “Following extensive discussion at our most recent meeting, the board of directors concluded the issuance of such notes and their availability to the retail public through brokers or the GSEs themselves creates a competitive substitute for bank deposits,”** according to an August 31 letter signed by ACB's top elected officials addressed to Fannie's Chairman Franklin Raines and Freddie's Chairman Leland Brendsel. **“[W]e believe the debt is being marketed to the public with great emphasis on the implied government guarantee,”** said the ACB letter. **“We understand that the public believes it is buying agency debt with some form of government guarantee that in reality does not exist.”** The letter warned that individual investors might not understand the risks associated with the investment notes. **“[W]e believe the relatively unsophisticated nature of most purchasers of this debt means that they are largely unaware of the nature of the interest rate and call risks that they are assuming. We believe these investors frequently are buying instruments with risks assumed equivalent to those of insured deposit instruments, when in fact, the risks are much higher.”**
- **Although the GSEs' small-denomination investment notes comprise no more than 2% of the GSEs' long-term funding, ACB said the continued issuance of such debt could prove troublesome for banks that compete for consumers' cash against the stock market and other investment opportunities. “[B]ased on your size, this amount could grow to represent a substantial share of the market for deposits,”** the letter warned. **“And, since these instruments are not intended to be a substantial source of funding for your activities, they appear to be an attempt to establish a retail brand,”** which is inconsistent with the GSEs' secondary market function. The letter continued, **“Although retail presence in the market for small debt instruments is not immediately related to possible primary market activities by the GSEs, it would greatly facilitate such activities in the future.”** It would have little or no economic effect on the GSEs if they restricted their debt issuances to institutional investors, according to ACB, and it would “resolve a real economic and political problem” for seller/servicers. (*National Mortgage News Daily*, 8/6/01; *BNA Daily Report for Executives*, Adam Wasch, 9/7/01; *ACB Letter to Fannie's Chairman Franklin Raines and Freddie's Chairman Leland Brendsel*, 8/31/01)

Fannie & Freddie's comments about the ACB letter

- “We are taking the letter seriously, and we do intend to respond to ACB's letter,” a Fannie spokeswoman said. Freddie vice president Kirk Willison said, “We really do not think that [Freddie Notes] is a direct competitor of thrift deposits, but it does serve an important purpose for Freddie in allowing us to fulfill our mission.” (*National Mortgage News Daily*, 8/6/01)
- As noted in the July 6, 2001 *GSE Report*, thrifts and community banks fear that Fannie and Freddie's selling of their callable investment notes (debt) to individuals is competition for deposits. Critics note that by targeting consumers, the GSEs are offering a savings vehicle that competes directly with products like certificates of deposit. These new offerings are sold in amounts of as little as \$1,000. Fannie's program (launched in May) is called “Investment Notes,” while Freddie's program (launched in April) is called “FreddieNOTES.” Fannie's notes are offered through Merrill Lynch & Co., which serves as its principal dealer, while Freddie's are offered through the LaSalle Broker-Dealer Services.

Fannie Spokeswoman Janice Daue says Fannie sold nearly \$70 million of the notes in the first week they were offered and an average of \$50 million a week since. The average personal investor purchases \$60,000 of the notes at a time. Freddie's Senior Portfolio Director estimates that Freddie has sold \$1.3 billion of the notes to date.

- **“This is an overt example of mission creep that creates a more difficult entity for the government to control,”** said Joseph Ficalora, Chairman of the New York Community Bank in Westbury and Vice Chairman of the Community Bankers Association in NY. **“Not only are they building a customer base to sell future products to, they are creating a population of political constituents.”** (*American Banker*, Tommy Fernandez, 6/27/01) **On June 19, FM Watch called on the Senate Banking Committee and the FDIC to stop Fannie and Freddie from selling investment notes for individual, not institutional investors. “With these new programs, the GSEs are competing head-on with every bank and savings association in the country,”** said Mike House, FM Watch's Executive Director. **“Given that the GSEs enjoy a special exemption from the nation's privacy laws, these retail funding efforts are particularly egregious.”** (*FM Watch press release*, 6/19/01)

Treasury Undersecretary for Domestic Finance Peter Fisher is “skeptical” of Fannie & Freddie’s financing role

Cong. Richard Baker (R-LA) says the Bush administration’s position on overhauling regulation of Fannie & Freddie may be revealed at a hearing in late September

- Signaling administration concerns about Fannie and Freddie, Treasury Undersecretary for Domestic Finance Peter Fisher said he is “skeptical” about the current housing-finance system, adding that the administration “is going to be thinking about what the right competitive structure is for that industry going forward.” Fisher stated, “Things have changed” in housing finance in recent years. Undersecretary Fisher declined to elaborate on Fannie and Freddie and what options the administration is considering, or how seriously it would pursue any changes. “With regard to the GSEs, I think we’ve got to look forward and think about the next 20 years,” he said. (*Wall Street Journal*, Jacob Schlesinger, 8/31/01)
- The Bush administration’s formal position is unclear. However, Undersecretary Fisher’s comments indicate that top administration officials share at least some of the concerns of the previous Treasury administration. Privately, conservative economic aides express great sympathy for the GSEs’ critics, but are hesitant to enter into the politically risky fight with Fannie and Freddie that was launched by former Treasury Secretary Lawrence Summers. (*Wall Street Journal*, Jacob Schlesinger, 8/31/01)
- The *Dow Jones Newswire* reported that Undersecretary Fisher’s comments published in the Friday, August 31st edition of the *Wall Street Journal* “caught the bond market by surprise...though opinion was mixed as to its impact on agency [GSE] bonds.” Agency bonds were considerably weaker versus Treasuries on the morning of August 31, with their yield margins widening by about 0.02 percentage points in fairly thin markets. Versus interest rate swaps, another key valuation benchmark for agencies, they were largely unchanged. “The market is finally getting a sense that the administration shares some of the concerns that [former Treasury Secretary Lawrence] Summers’ administration did” regarding the GSEs, said Jeff Drobny, a senior trader for Cargill Global Trading in Minnetonka, MN. Drobny cited Undersecretary Fisher’s comments and Freddie’s announcement that it will sell a sizable \$10 billion in two- and 10-year reference notes, as reasons for the weakness in agency bonds August 31. Andre Moutenot, Executive Vice President of Fixed Income at Swiss Re Investors, tied the weakness in agencies to the dollar, which has encouraged foreign investors to sell out of dollar-

denominated investments (such as agencies) into euro-denominated investments. “We have significantly changed our view of the agency market in the near term” due in part to the weak dollar, he said, adding that he has reduced the firm’s agency exposure by about one-third. Moutenot is not concerned about added political risk to the GSEs. “I don’t see it as becoming an issue immediately or near-term,” he said. “At some point, there probably will be some issues that need to be addressed as to how big they [Fannie and Freddie] can get,” he said. (*Dow Jones Newswire*, Tyler Lifton, 8/31/01)

Fannie & Freddie’s comments

- In response to Undersecretary Fisher’s comments, Fannie spokeswoman Janice Daue said, “Fannie Mae has been and will continue to be a positive force in a very competitive housing-finance system,” and “we agree that there will continue to be a tremendous change over the next 10 years as the system stretches to meet the demand for housing.” Daue said Undersecretary Fisher’s comments had no effect on agency bonds. “It’s in line with other credit markets,” she said of the agency market. “If you read the (Journal) article very closely, the headline was totally out of context,” she said. A spokeswoman for Freddie referred comments to the Treasury Department. A spokeswoman for the Treasury Department said, “The intent of Mr. Fisher’s remarks were that the administration is looking at the housing finance sector as a whole over the next 20 years.” (*Dow Jones Newswire*, Tyler Lifton, 8/31/01)

Cong. Baker expects to hear administration’s position on GSE reform at a September hearing

- In related news, Cong. Richard Baker (R-LA), Chair of the Capital Markets Subcommittee of the House Financial Services Committee, expects to get the Bush administration’s position on GSE reform from the Treasury Department and HUD at a hearing in late September, a Baker spokesman said. Cong. Baker said in a recent interview that the administration has yet to clarify where it stands. “I’m still continuing to push the administration on giving us their position with regard to GSEs...and to further define the competitive model. I hope the administration could come to a clear-cut policy. That would be helpful.” (*American Banker*, Michele Heller, 8/22/01, 8/29/01)

Two senior lawmakers to introduce legislation that would expand homeownership by increasing competition to Fannie & Freddie in the secondary mortgage market

The legislation will allow Ginnie Mae to securitize privately insured conventional mortgage loans in competition with Fannie & Freddie

“We come from a perspective that says that the more competition out there, the better,” said an aide to Senator Wayne Allard (R-CO), who is planning on introducing the legislation. “Getting Ginnie Mae more flexibility is good for the market place, good for the consumers.”

Congresswoman Marge Roukema (R-NJ) plans to introduce similar legislation

Chad Yonker, a senior vice president at Fox-Pitt, Kelton, Inc., believes Fannie & Freddie’s lobbyists will have a difficult time defeating these bills because the proposals undercut Fannie & Freddie’s traditional argument that anything that threatens them also threatens homebuyers. “You can’t use that argument against competition – all competition would do is benefit consumers... This may give consumers better borrowing rates and that is why it will be difficult for Fannie and Freddie to argue against it.”

MBA forms task force to discuss the issue

- Two senior lawmakers plan to introduce legislation that would increase competition in the secondary mortgage market for conventional loans, which is currently dominated by Fannie and Freddie. Senator Wayne Allard (R-CO) has discussed the proposal with colleagues and expects to find co-sponsors for the legislation before introducing it some time in September, a staffer for Allard said. Senator Allard is the senior Republican member of the housing subcommittee of the Senate Banking Committee. Congresswoman Marge Roukema (R-NJ), Chair of the House Financial Services subcommittee on housing and vice chair of the full committee, plans to introduce similar legislation, one of her staff members said. **“We believe it would expand the pool of mortgages for first-time lower-income borrowers and borrowers in the moderate income range,” the Allard aide stated. The goal of the legislation is to expand home ownership by creating greater competition in the secondary mortgage market, including competition to Fannie and Freddie, according to the Allard aide. “We come from a perspective that says that the more competition out there, the better,” the aide said. “Getting Ginnie Mae more flexibility is good for the market place, good for the consumers.” A financial services industry representative, who spoke on condition of anonymity, said “If you have more outlets competing for mortgage products, you have better prices, and better prices for consumers.”** (*Reuters*, Mark Felsenthal, 8/21/01, 8/27/01)
- Ginnie Mae currently only guarantees loans insured by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), and other government programs. The legislation would expand the Ginnie Mae securitization program to include conventional mortgage loans that carry private mortgage insurance, allowing Ginnie Mae to securitize privately insured conventional mortgage loans in competition with Fannie and Freddie. Supporters of the legislation refer to this initiative as “Ginnie Mae Choice” because it would give mortgage insurers and mortgage lenders a new outlet to sell affordable housing loans, and more flexibility in developing high loan-to-value products. “Our view is that it would create more competition in the marketplace,” said an aide to Allard. “It would create a new product where the private sector assumes approximately half of the potential loss on a Ginnie Mae securitized mortgage.” As currently drafted, Senator Allard’s bill would allow Ginnie Mae to securitize \$50 billion in conventional loans under a pilot program. Ginnie Mae currently securitizes approximately \$100 billion in FHA and VA single-family loans annually.

The Ginnie Mae Choice program is targeted at loans with loan-to-value ratios of 80% to 97% and loan amounts of up to \$275,000 – which is the current Fannie/Freddie conforming loan limit. Ginnie Mae guaranteed pools of conventional loans would have several layers of private mortgage insurance that would cover 45% of the loss on a 97% LTV loan. **“I think this dramatically reduces the risk to the taxpayers. The private companies have the first loss. In a catastrophic situation, you still have the federal government,”** said an Allard spokesman. (*National Mortgage News Daily*, 8/29/01; *National Mortgage News*, Brian Collins, 9/3/01)

Ginnie Mae could be a real competitor to Fannie & Freddie in the secondary mortgage market

- **“Industry and political observers say Ginnie could pose a major competitive threat to Fannie and Freddie,”** reported Tommy Fernandez with the *American Banker*. Currently, Ginnie Mae’s mortgage bonds are backed by the full faith and credit of the federal government, and are considered safer than MBS issued by Fannie and Freddie, which investors believe have an implied government guarantee. Experts say Ginnie Mae offers better pricing and execution for lenders seeking to securitize their loans, so the smaller GSE could take a chunk out of Fannie and Freddie’s market share. **“There is nothing to stop Ginnie Mae from becoming a serious competitor to Fannie Mae and Freddie Mac – except for the fact that it is not allowed to extend outside the government market,”** said Chad Yonker, a senior vice president at Fox-Pitt, Kelton, Inc. A greater role for Ginnie Mae would stimulate competition through lower guarantee fees and **“better execution”** for mortgage banks, said Yonker, thus checking Fannie and Freddie’s growth. **“If you were to introduce another competitor in the market and it started taking a chunk of the business, growth will become very difficult for Fannie and Freddie,”** he said. Yonker believes Fannie and Freddie’s lobbyists will have a difficult time defeating these bills because the proposals undercut Fannie and Freddie’s traditional argument that anything that threatens them also threatens homebuyers. **“You can’t use that argument against competition – all competition would do is benefit consumers,”** said Yonker. **“This may give consumers better borrowing rates and that is why it will be difficult for Fannie and Freddie to argue against it.”** Financial consultant Bert Ely, however, stated that he is certain the bills will be killed. **“Fannie and Freddie will do their damndest to kill this,”** and the odds are with them. **“They want to be the only players under the tent.”** (*American Banker*, Tommy Fernandez, 8/30/01)

MBA forming task force to discuss the issue

- The MBA is forming a task force to study the Ginnie Mae Choice proposal. The proposal raises a lot of questions, according to MBA senior vice president Howard Glaser. **“On the one hand increased competition is a good thing. It potentially means lower costs for consumers and that is a positive,”** Mr. Glaser said. **“But there are a lot of questions about how it might operate, including the impact on Federal Housing Administration. Certainly, no one wants to weaken the FHA program,”** Mr. Glaser added. (*National Mortgage News Daily*, 8/30/01; *National Mortgage News*, Brian Collins, 9/3/01)

Fannie & Freddie’s comments on the proposal

- Doug Robinson, a spokesman for Freddie, said the plan would hurt Ginnie Mae and would not help underserved borrowers. It would hurt Ginnie Mae, he explained, by exposing it to mortgage credit risk for the first time; by letting it into the subprime market; and by weakening Ginnie’s FHA and VA loan securities as the strongest customers for such loans went instead for loans made possible by the charter change. (*American Banker*, Tommy Fernandez, 8/30/01) **“From what we have seen, the draft proposal does not seem to provide a clear homebuyer benefit. And it might increase the risk to taxpayers,”** said Robinson. He also suggested that the Ginnie Mae Choice program could **“cherry pick”** the FHA and VA’s best borrowers. **“We think any major change in the way that Ginnie Mae does business should be looked at very carefully from a public policy point of view,”** said Robinson. (*National Mortgage News*, Brian Collins, 9/3/01)

- A spokeswoman for Fannie said they were still reviewing the proposals and stated, “although we applaud efforts to increase the availability of affordable mortgage financing, any measure that supports affordable housing should be subject to the same safety and soundness provisions that protect homeowners with mortgages backed by Fannie Mae.” (*American Banker*, Tommy Fernandez, 8/30/01)

Foreclosure disposition company sues Freddie Mac’s HomeSteps Asset Management Services, alleging, among other things, breach of contract, misrepresentation, and unfair competition

The attorney for the company filing the suit alleges that Freddie may be operating outside its charter and may not even have the right to conduct business in the real-estate owned (REO) disposition industry. “I think there is a strong case to be made that Freddie's business of managing and disposing assets for third parties is not something they have the right to do under the charter given by the United States Congress,” the attorney said.

- Asset management and real estate-owned (REO) disposition specialist, Barr & Associates Inc. (Diamond Bar, CA), sued Freddie’s HomeSteps Asset Management Services, CitiFinancial Mortgage Corp. and Fairbanks Capital Corp. The suit, filed August 7, in the US District Court in the Central District of California, alleges among other things, breach of contract, misrepresentations, and unfair competition. The suit says Barr was under contract since November, 2000 to sell 118 homes owned by CitiFinancial (foreclosed loans). On April 10, the suit says, CitiFinancial told Barr that it had sold its real-estate owned (REO) foreclosure portfolio to Fairbanks Capital -- which then terminated the contract with Barr and gave it to Freddie’s HomeSteps. Like Barr, HomeSteps provides outsourcing for banks, lenders, and other firms seeking to unload foreclosed properties.
- Barr contends that the three companies terminated the CitiFinancial contract so quickly that its relationships with real estate agents have been irreparably harmed -- and that it may now go out of business. The suit asks for \$300,000 in actual damages plus an unspecified amount in punitive damage.
- Barr alleges that under the terms of its contract with CitiFinancial, Barr should have received 30 days written notice that its contract was terminated - the time it needed to properly inform the local real estate agents that were handling the sale of the properties and give them time to terminate their services. Barr contends that it was not given the 30 days notice. According to the complaint, this notice should have been done before Fairbanks and HomeSteps took over. In addition, the suit alleges that under the terms of the contract the defendants should have received Barr's written acknowledgment of the receipt of those termination papers before proceeding. According to the complaint, HomeSteps and Fairbanks interfered in the contractual relationship CitiFinancial had with Barr due to this “improper” reassignment. “The termination was essentially one or two days, maybe a few more at most,” said Barr's attorney in the case, Peter Langbord, in a telephone interview with the *American Banker*. HomeSteps interfered with Barr's listing arrangements with its real estate agents, Mr. Langbord said, and should have allowed time for the agents to contact Barr, at least for an explanation. The complaint further alleges that the defendants engaged in misrepresentation by taking over responsibility for the properties without any of the proper paperwork. The complaint also alleges that CitiFinancial distributed information on Barr's broker network that was supposed to remain confidential under the terms of the contract. Barr says that all these breaches of its contract ultimately damaged its relationships with real estate brokers.

Suit alleges Freddie may be operating outside its charter

- Mr. Langbord added that Freddie may be operating outside its charter and may not even have the right to conduct business in the REO industry. **“I think there is a strong case to be made that Freddie's business of managing and disposing [of] assets for third parties is not something they have the right to do under the charter given by the United States Congress,” he said.**
- A Freddie spokesman said the company does not generally comment on pending litigation but noted that HomeSteps has long done business as part of Freddie and that its third-party REO responsibilities are “well within our charter.” (*National Mortgage News*, Bonnie Sinnock, 8/27/01, *American Banker*, Tommy Fernandez, 8/29/01)

Fannie Mae and Freddie Mac

***Wall Street Journal* editorial calls for Fannie & Freddie to be privatized**

“The only purpose now served by Fan and Fred’s growing debt is to dramatize the already long list of reasons to truly privatize these companies once and for all. The task they were called to do – provide liquidity for the housing market – has been accomplished. Fan and Fred are not only unnecessary but dangerous. Off with their heads, so to speak”

- A *Wall Street Journal* editorial noted that the familiar national debt “has been heading toward extinction; it's now at 33% of GDP. At the same time, an unfamiliar debt -- that obscure yet dangerous collection of housing-related debt and credit guarantees -- has been burgeoning; it's now 23% of GDP, or about \$2.4 trillion, and growing so fast that it could be larger than the familiar national debt in just four years. The hooker is that this mortgage debt, like the familiar national debt, also has a claim to taxpayer money.”
- **The editorial stated “two sneaky companies” – Fannie and Freddie – generated this mortgage debt.** “They're sneaky because they are public companies that have a very special relationship with the federal government, resulting in some fabulous subsidies.” Unlike other private financial companies, the two companies enjoy a number of benefits from their GSE status, the most important of which is investors’ belief that Fannie and Freddie's debt is backed by the full faith and credit of the federal government, which translates into very low borrowing costs.
- A CBO study estimated that Fannie and Freddie’s subsidies were \$10.7 billion in 2000 -- \$9.7 billion from lower borrowing costs and \$1 billion from the tax exemption. “And here comes the really sneaky part -- Fannie and Freddie don't pass all their subsidies along to home buyers. In fact, the CBO found that Fannie and Freddie kept 37% of their subsidy.”
- **“But we are about to digress. (And, we admit, it's hard to keep to just one line of critical inquiry into Fan and Fred -- there are so many delicious possibilities.) Since Fan and Fred receive what amounts to an interest rate subsidy, it makes sense for them to issue debt like mad. And they do. But since this debt is assumed to be underwritten by taxpayers' money, it makes sense to ask how risky that debt is. We have and the answer isn't reassuring. In fact, it reminds us a lot of the savings-and-loan situation in the 1980s, and you know what happened to them.”**

- “One thing is for sure, if Fan and Fred are left undisturbed, the risk created by their debt is going to keep growing...It's not often (probably almost never) that a company finds itself in such a yummy situation -- government subsidies to feed private profits, the public to bear the risk. Indeed, Fan and Fred's fierce determination to stay at the feeding trough is legendary around Washington. They employ a bunch of lobbying firms; last year they spent over \$12 million to lobby Congress. (And we're not even going to mention how they threatened several large financial firms who criticized them. Talk about aggressive!)”
- “The only purpose now served by Fan and Fred's growing debt is to dramatize the already long list of reasons to truly privatize these companies once and for all. The task they were called to do -- provide liquidity for the housing market -- has been accomplished. Fan and Fred are not only unnecessary but dangerous. Off with their heads, so to speak.” (*Wall Street Journal editorial, 8/15/01*)

Response from Freddie's consultant

- James Miller, III, a former Director of the OMB and a consultant to Freddie Mac, wrote a response to the *Wall Street Journal's* editorial. Miller wrote, “even the best editorial page in America is occasionally misled.” He criticized the CBO study referenced in the editorial, saying it “is full of holes and consequently its conclusion is incorrect.” He acknowledged a “nexus” between Fannie and Freddie and the federal government. “It also appears certain there always will be – the real question is how to make the best of the situation. Curtailing the connection between the federal government and Freddie/Fannie while retaining it for other financial institutions would result in a misallocation of resources going into housing. Policymakers should therefore go slowly when considering fundamental changes in institutional arrangements that are working reasonably well.” (*James C. Miller III, Letter to the Editor, Wall Street Journal, 8/20/01*)

HUD's Office of Policy Development releases new research studies which find that Fannie & Freddie are lagging the private markets in serving low-income and minority borrowers

- In its publication, *Cityscape*, HUD's Office of Policy Development and Research released new studies providing perspectives on how Fannie and Freddie responded to their affordable housing goals during the first few years that they were in effect. The affordable housing goals for Fannie and Freddie were established in 1992 legislation. The opinions expressed in the studies are those of the authors and do not necessarily reflect the views of HUD or the US government. The articles are a product of small research grants that were made by HUD's Office of Policy Development and Research in 1997. A subsequent *Cityscape* volume will contain additional studies stemming from this grant program. The following are summaries of the studies in the first volume, “Fannie Mae and Freddie Mac in the Housing Finance System: I”

“The Effects of the GSEs, CRA, and Institutional Characteristics on Home Mortgage Lending to Underserved Markets”

- The study examined mortgage lending in underserved markets in the primary and secondary mortgage markets for metropolitan areas in Indiana, with an extensive analysis for South Bend/St. Joseph County, Indiana, focusing on GSE purchases in underserved markets by type of primary market lender from 1992-1996. The authors compared the goal-qualifying shares of the GSEs' purchases with the corresponding shares for conventional conforming mortgages originated in the primary mortgage market. For example, if the low-and moderate-income share of a GSE 's purchases is less than the corresponding share of mortgage originations for the mortgage market as a whole, or for a particular type of lender, the GSE is said to lag behind the market, or to lag behind the lenders in this segment of

the mortgage market. If such a share of a GSE's purchases exceeds the corresponding share of originations for the market, the GSE is said to lead the market.

- **The study found that, “although the government-sponsored enterprises (GSEs) – Fannie Mae and Freddie Mac – made gains in underserved markets during this period, at no time were they ever leading the market.”** The study found that the percentage of underserved market loans purchased by the GSEs over a five-year period was nearly 7 percentage points lower than it was for the loans they did not purchase (19.6% for GSE purchases, 26.4% for non purchases). Although the GSEs never led the market, over time they did at least close part of the gap. In 1992, GSE purchased loans contained 8.2 percentage points fewer loans from underserved markets than the loans they did not purchase. By 1996, the gap was only 5.7 percentage points. “Still, to say that the GSEs made gains is a long way from saying that they met their mandate to lead the market. At the same time that the GSEs were doing better, other primary and secondary market lenders improved nearly as much...Regardless of what caused the recent improvements in their performances, the GSEs still have a long way to go before they will be leading the market.” The study also found that Fannie’s underserved market performance was somewhat better than Freddie’s. However, the differences were small and inconsistent across years and metropolitan statistical areas (MSAs). “Whatever differences did exist between the GSEs were far smaller and less important than the differences between the loans the two GSEs together did and did not purchase.” (*The Effects of the GSEs, CRA, and Institutional Characteristics on Home Mortgage Lending to Underserved Markets*,” Richard Williams, University of Notre Dame, Eileen McConnell, Indiana University-Bloomington, Reynold Nesiba, Augustana College, *Cityscape*, Volume 5, Number 3, 2001; “*Guest Editor’s Introduction*,” John Gardner, Paul Manchester, HUD’s Office of Policy Development and Research, Susan Wachter, The Wharton School of the University of Pennsylvania)

“The Twin Mandates Given to the GSEs: Which Works Best, Helping Low-Income Homebuyers or Helping Underserved Areas?”

- The study examined the twin mandates of HUD’s affordable housing goals for Fannie and Freddie: to direct mortgage credit to neighborhoods that have been underserved by mortgage lenders, and to direct mortgage credit to low-income and minority households. Using the Kansas City metropolitan area as a test site, mortgages purchased by the GSEs in 1993-96 are compared with mortgages held by portfolio lenders in order to determine the performance of the GSEs in meeting these two objectives. The study found that borrowers are better served if credit is directed to them independent of location. Very low-income and minority borrowers fare better, in terms of the housing and employment opportunities of the neighborhoods in which they are located, than borrowers in underserved neighborhoods, suggesting that directing credit to low-income and minority households has the desired effect of helping these households purchase homes in areas where they can find good homes and good employment prospects. According to the study, **HUD's 1996-99 housing goals defined underserved tracts so broadly that nearly one-half of the tracts in the Kansas City area are categorized as underserved.** Because the definition is so broad, directing credit to these tracts means including many areas with stable housing stocks and viable job markets.
- The study found that directing credit to underserved areas is helpful only insofar as it helps direct credit to neighborhoods with slightly lower household income levels and higher incidence of minorities than found elsewhere in the metropolitan area. The author believed that neighborhoods that receive very low levels of mortgage credit seem to provide insufficient housing or employment opportunities to justify the effort that would be required to direct additional mortgage credit to them. **The study concluded that, relative to each of the mandates, the GSEs did not perform as well as primary credit lenders in the Kansas City metropolitan area in 1993-96. In terms of helping**

underserved areas, the GSEs lagged behind the industry in the proportion of loans found in these areas. In terms of helping low-income and minority borrowers, the GSEs also lagged behind the primary market in Kansas City. (*“The Twin Mandates Given to the GSEs: Which Works Best, Helping Low-Income Homebuyers or Helping Underserved Areas?”*, Kirk McClure, University of Kansas, *Cityscape*, Volume 5, Number 3, 2001; *“Guest Editor’s Introduction,”* John Gardner, Paul Manchester, HUD’s Office of Policy Development and Research, Susan Wachter, The Wharton School of the University of Pennsylvania)

“Performance of the GSEs at the Metropolitan Level”

- The study examined differences in the number and percent of GSE purchases of single-family loans made to minorities and low- and moderate-income borrowers in MSAs across the country. The objective was to determine whether differences in the extent of relationships between the GSEs and lending institutions, government agencies, and nonprofit community-based organizations explain differences between MSAs in the GSEs' purchases of loans made to traditionally underserved populations, including lower income families and minorities. The study began with a review of the national context for considering GSE performance at the metropolitan level. **The authors found that “[a]t the metropolitan level, lenders do better than both GSEs on average, under all three housing goals [low-and moderate income housing, underserved areas, and special affordable housing goals].” The authors demonstrated that across all MSAs, the percentage of GSE loan purchases that qualify for the housing goals is greatest in markets where lenders themselves make more loans to underserved populations and where median income levels are relatively high. Although the study found that economic and demographic factors affect the amount of business conducted by both GSEs and lenders, the shares of primary mortgage market originations for underserved populations across all MSAs generally exceeded the corresponding shares of the GSEs' purchases in 1996.**
- The authors conducted detailed analyses of the contribution of institutional relationships to GSE purchases of loans made to minority and low-and moderate-income populations in four metropolitan areas for 1995-96: Washington, D.C., Houston, TX, Columbus, OH, and Pittsburgh, PA. From these case studies, the study found that the GSEs purchased higher percentages of loans made to underserved populations in case study areas where linkages were the strongest between the GSEs and the local affordable housing system. The study concluded that institutional relationships could increase the GSEs' efforts to serve minority and lower income populations.
- The study provided recommendations regarding local planning processes, the national GSE affordable housing goals, and the GSE data reporting system. The study did not recommend establishing metropolitan-level goals, since the GSEs often negotiate with lenders on a regional or national level. However, while metropolitan-level goals were not recommended, the authors suggested that local Consolidated Plans and Analyses of Impediments required by HUD include discussions of GSE activity, which could aid in the design and implementation of affordable housing programs that build on the GSEs' institutional linkages with local affordable housing systems. The study recommended that the GSEs' affordable housing goals could use alternative benchmarks based on CRA income definitions. For example, the income targets for the GSEs' affordable housing goals could be changed by legislation to include targets for serving borrowers with incomes below 80% of area median income. Currently, the GSEs' low-and moderate-income housing goals only specify a percentage of GSE purchases that must be made to borrowers at or below 100% of area median income. The study found that lenders make a higher percentage of single-family loans to borrowers who earn 80% of area median income than the GSEs are purchasing and that CRA has been a key in motivating lenders to make loans to borrowers with incomes below 80% of area median income. HUD could also increase the existing special affordable housing goals to improve the GSEs' targeting

of lower income borrowers. The study suggested that GSE affordable housing goals could also include targets for reaching individual minority borrowers as well as high-minority areas and the subgoals or requirements in the GSE annual reports to HUD could differentiate among types of loans (for example, refinancings and home improvement loans). (*Performance of the GSEs at the Metropolitan Level*,” Patrick Boxall, KRA Corporation, Joshua Silver, National Community Reinvestment Coalition, *Cityscape*, Volume 5, Number 3, 2001; *“Guest Editor’s Introduction,”* John Gardner, Paul Manchester, HUD’s Office of Policy Development and Research, Susan Wachter, The Wharton School of the University of Pennsylvania)

“Fannie Mae and Freddie Mac in Nonmetropolitan Housing Markets: Does Space Matter?”

- The study investigated variations in GSE market share among a sample of 426 metropolitan counties in 8 census divisions. The study estimated conventional conforming mortgage originations from residential sales data, adjusted to exclude government-insured and nonconforming loans. The study then investigated whether GSE market shares differ significantly by location after controlling for the economic, demographic, housing stock, and credit market differences among counties that could affect use of the secondary markets. The study also investigated whether there are significant differences between the nonmetropolitan borrowers served by Fannie and those served by Freddie.
- The study found that proximity to metropolitan areas contributes significantly to explaining variations in GSE market shares among nonmetropolitan counties, but its effects are quite specific. One remote region—nonadjacent West North Central counties—had significantly lower GSE market shares than all others. **Generalizing from its sample of 426 counties to nonmetropolitan communities as a whole, the GSEs appear to serve smaller proportions of first-time and lower-income buyers in nonmetro areas than in the nation as a whole. The GSEs purchase significantly lower proportions of mortgages in smaller, poorer, and less rapidly growing nonmetro areas than in larger, wealthier, and more rapidly growing ones.** Secondary market underwriting guidelines may disadvantage those nonmetro residents, or mortgage originators in nonmetro areas may interpret guidelines too conservatively, or mortgage brokers may be less active in these locations. Without detailed data on loans applied for and originated and those purchased, the study claimed that identifying the source of the problem is difficult. **The study also found that there are significant disparities between the income levels of the borrowers served by each agency, with Freddie buying loans from borrowers with higher incomes than the incomes of borrowers served by Fannie.** Due to the unavailability of complete data on nonmetropolitan mortgage originations (such as the data compiled under HMDA within metropolitan areas), the study concluded that more precise conclusions about the extent to which the GSEs mirror primary mortgage originations in these areas could not be reached. (*“Fannie Mae and Freddie Mac in Nonmetropolitan Housing Markets: Does Space Matter?”* Heather McDonald, University of Iowa, *Cityscape*, Volume 5, Number 3, 2001; *“Guest Editor’s Introduction,”* John Gardner, Paul Manchester, HUD’s Office of Policy Development and Research, Susan Wachter, The Wharton School of the University of Pennsylvania)

“Fannie Mae and Freddie Mac Mortgage Purchases in Low-Income and High-Minority Neighborhoods: 1994-96”

- The study analyzed mortgage lending and GSE purchases in 10 large metropolitan areas from 1994 to 1996, focusing on the underserved areas goal established by HUD for the GSEs, and subdivided these areas between those with high and low housing costs (based on the median cost of owner-occupied housing) to determine whether the GSEs' affordable housing goal performance depends on housing affordability in an area. HUD defined underserved tracts in metropolitan areas based on low median incomes (relative to the MSA median) or high minority concentrations, based on the association of these proxies with low mortgage origination rates and high mortgage denial rates.

- The study provided an indication of whether, and to what extent, service by the primary mortgage market is relatively low (based on lending volumes) in the census tracts designated as underserved by HUD. The study found that although low income and high minority representation are, on average, indicators of low levels of mortgage activity, they may not identify neighborhoods with relatively low lending volumes in all 10 metropolitan areas. The study examined whether the primary market serves high-cost and low-cost areas equally well. The study found that homeownership is more difficult for lower income households in areas where homes are more expensive relative to area median income, and that mortgage-lending activity in low-income tracts is below the level in middle-income tracts in some, but not all, of the MSAs studied. Specifically, the study concluded that lending in low-income tracts is relatively low more often in the low-cost MSAs than in the high-cost MSAs.
- The study also considered whether loan purchases by Fannie and Freddie are concentrated within or outside of these underserved census tracts. The study found that GSE purchase rates from low-income tracts were often, but not always, lower than the rates from middle-income tracts. Shortfalls were smaller for Fannie than for Freddie, particularly for home purchase loans. Purchase rates in high-minority, middle-income tracts were much closer to parity with purchase rates for other middle-income tracts, with Fannie purchase rates at or exceeding parity in most MSAs, and Freddie purchase rates at or near parity in most cases in 1994-96. Both GSEs had shortfalls in purchase rates in the three low-cost MSAs that exhibited low origination rates in low-income tracts. The study discussed constraints that face the GSEs, such as the GSEs' conforming loan limits, charter-based underwriting standards, and competition from government-backed lending programs and special affordable lending programs by banks and thrifts, that may differentially impact GSE purchases across MSAs. (*"Fannie Mae and Freddie Mac Mortgage Purchases in Low-Income and High-Minority Neighborhoods: 1994-96,"* James Pearce, Welch Consulting/Unicon Research Abstract, *Cityscape*, Volume 5, Number 3, 2001; *"Guest Editor's Introduction,"* John Gardner, Paul Manchester, HUD's Office of Policy Development and Research, Susan Wachter, The Wharton School of the University of Pennsylvania) [The *Cityscape* editor's note that although Pearce began working for Freddie as a contractor in 2000, he had never been employed by or worked as a contractor for Fannie or Freddie until after his research on this project was completed.]

Fannie & Freddie dominate commercial mortgage lending in the first half of 2001

This is the first time Fannie & Freddie have been in the top position since MBA began surveying its commercial members

Life insurance companies, traditionally the largest source of funding, slipped to third place behind private conduits

- Fannie and Freddie together funded the largest share of loans originated by commercial mortgage members of the MBA during the first half of 2001, nearing 30% of total originations and surpassing 60% of multifamily originations, according to survey results released by the MBA. This is the first time Fannie and Freddie have been in the top position since MBA began surveying its commercial members two years ago. Life companies, traditionally the largest source of funding for commercial mortgage bankers, slipped to third place behind private conduits.
- Total originations by all investors for the first six months of 2001 were \$32.6 billion, up more than 30% from the same period last year but down 12% from the \$37.1 billion reported for the second half of 2000. Most of the increase was attributable to lending for multifamily properties where the volumes increased to \$16.2 billion in the first two quarters of 2001 compared with \$10.1 billion in the same period last year, with much of that increase going to Fannie and Freddie.

- Together Fannie and Freddie funded 28.8% of the dollar volume of loans originated by commercial mortgage bankers. Fannie's share was 19.6%, while Freddie's was 9.2%. The next largest source of funds was private conduits with a 24.3% share, followed by life insurance companies with 22.9%. In comparison, the GSEs' share was only 18.6% during the first half of 2000, with life companies at 28.5%, and conduits at 23.8%.
- "Fannie Mae and Freddie Mac have significantly increased their share of our members' multifamily business in a very short period of time," said Jay Brinkmann, MBA's senior director of research and economics. "As recently as the first quarter of last year, the two companies' combined share of our members' multifamily originations was 40 percent. By the second quarter of this year, they have captured a little over 60 percent of the market." (*MBA press release, 8/23/01; National Mortgage News Daily, 8/23/01*)
- **Fannie and Freddie could assume the same powerful presence in apartment financing they have in home funding, Brinkmann said. "The pattern has been established on the single family side, now we're watching what develops on the multifamily side," he said.** (*Reuters, Mark Felsenthal, 8/23/01*) Experts say that Fannie and Freddie will become the market's dominant sources of multifamily capital in the next five years. Fannie and Freddie together now own \$75 billion of the \$411 billion of outstanding multifamily debt -- loans for dwellings with five or more rental units -- much of it bought in the past five years. "If Fannie and Freddie continue at this pace, they are going to have a greater share, maybe a majority of the mortgage debt outstanding," said David Cardwell, vice president of finance and technology for the National Multifamily Housing Council. Fannie's CEO Franklin Raines displayed a "rapacious appetite" for multifamily products during a conference last month for multifamily lenders in Colorado Springs that his company sponsored. "Contrary to popular belief, we're not just a homeownership company," Mr. Raines said during a speech at the conference. "Fannie Mae is a major rental housing company. Over the last couple of years, our multifamily business has taken off like an F-16." **Ken Bacon, Fannie's vice president for multifamily lending, has been challenged to increase the company's business in the sector by 1,000% in the next nine years, Mr. Raines said.** (*American Banker, Tommy Fernandez, 8/23/01*)
- In related news, a *Moody's Investors Service Special Report* on commercial lending noted that multifamily continues to be among one of the highest leveraged asset classes. Moody's noted, "Although we generally view multi-family as an asset class as having a favorable risk profile, the mid 90s Moody's LTV [loan-to-value] ratios that we continue to see have counteracted many of its benefits. It has become increasingly apparent that it takes such leverage in order to compete with the GSEs." (*Moody's Investors Service, "CMBS 2Q Review: 'Offenders' Rise as Property Owners Refinance Vs Sell", Tad Philipp, 7/13/01*)
- Also, responses to *National Mortgage News Daily's* survey question on whether the involvement of Fannie Mae and Freddie Mac in the multifamily market will eventually reduce competition wound up dead even. The final tally was 257-257. (*National Mortgage News Daily, 9/7/01*)

Fannie & Freddie purchased about 59% of all residential mortgage loans originated in the US during the first half of the year

- During the first half of the year, Fannie and Freddie purchased \$679 billion in mortgages, or about 59% of all residential loans originated in the US, according to figures compiled by *National Mortgage News*. Based on their performance over the first six months of the year, Fannie and Freddie could purchase well over a record \$1.2 trillion in mortgages this year. Through the first seven months of 2001, Fannie purchased \$423 billion in mortgages, Freddie purchased \$256 billion. Both Fannie and Freddie have purchased more loans during the first seven months of the year than they did for all of last year. In July, Fannie purchased \$74.58 billion in mortgages, a 132% increase from July of last year. Freddie purchased \$49.65 billion in July, a 282% increase from July of last year. (*National Mortgage News*, 8/27/01)

Fannie & Freddie have shown an interest in purchasing a \$1 billion pool of subprime whole loans being sold off by EquiCredit, Bank of America's subprime unit

- Fannie and Freddie have shown interest in a \$1 billion pool of subprime whole loans being sold off by EquiCredit, Bank of America's subprime unit, sources have told *MortgageWire [National Mortgage News Daily]*. Goldman Sachs & Co., the investment banker on the deal, did not return telephone calls concerning the matter. Goldman is also trying to sell EquiCredit's servicing platform and the accompanying \$25 billion in subprime servicing rights. A source familiar with the \$1 billion in whole loans said Fannie has looked at the deal, but has apparently passed on it, while Freddie is still interested. A Fannie spokesman said the company does not talk about deals it may be contemplating. A Freddie spokesman said that Bank of America is a Freddie Mac customer, adding, "We're always looking to help customers improve the liquidity of their balance sheets." EquiCredit's product menu included A-, B and C credit quality loans. Bank of America recently sold all of EquiCredit's 96 subprime wholesale branches and announced plans to liquidate \$26 billion in receivables. EquiCredit was the third largest subprime lender in the US. (*National Mortgage News Daily*, 8/27/01; *National Mortgage News*, 8/27/01)

Fannie & Freddie's derivatives see huge growth in the second quarter

Fannie grew its derivatives by 24.8%; Freddie's grew 20.2%

Michael Cheah, a portfolio manager at SunAmerica Asset Management, said the growth in Fannie & Freddie's derivatives portfolio is representative of the rapid overall growth of the two GSEs, the pace of which, he believes, is unsustainable. "At some point it will burst," he said of the GSEs' growth trajectory. "The question is, when it bursts, who will be holding the bag?"

Fannie & Freddie's derivatives risk is a concern, reports *TheStreet.com*

- Fannie and Freddie experienced enormous growth in their derivatives portfolios during the second quarter, according to recently released data. Freddie held a notional amount of \$692.7 billion in derivatives as of June 30, up from \$576.19 billion at the end of March, a 20.2% increase in three months. Fannie grew its derivatives book by 24.8% during the same period, to \$435.94 billion from \$349.43 billion. The second quarter was the largest quarterly increase ever for Fannie's derivatives book, said Jonathan Roman, vice president of corporate finance at Fannie.

- Fannie and Freddie cited the following as reasons for the growth in derivatives: strong growth in their mortgage investment portfolios; the refinancing wave during the first half of the year, and the large amount of bonds called by the GSEs.
- As Tyler Lifton with *Dow Jones Newswire* notes, the notional value of Fannie and Freddie's outstanding derivatives does not reflect their exposure to institutional credit risk, which is the possibility that one or more of their counter-parties cannot honor the derivative contract. The GSEs measure this risk by calculating the cost of replacing the derivatives in which they have a positive position should a counter-party default. Fannie was exposed to \$419 million at the end of the second quarter, while Freddie was exposed to \$800 million in institutional credit risk, of which \$700 million was fully collateralized. (*Dow Jones Newswire*, Tyler Lifton, 8/24/01)
- Fannie and Freddie claim they do not speculate with derivatives and are considered to be the best risk managers in the business. **However, the growth of their derivatives books raises concerns among some people because of the complexity of the instruments and their potential for wild swings in value. Michael Cheah, a portfolio manager at SunAmerica Asset Management, said the growth in Fannie and Freddie's derivatives portfolio is representative of the rapid overall growth of the two GSEs, the pace of which, he believes, is unsustainable. While most observers consider it a victory that Fannie and Freddie have rebuffed efforts to rein in their growth, Cheah sees it as a "red flag." Concerns over the GSEs' systemic risk they pose and Congressional efforts to bring them under stronger regulatory supervision have in no way produced "a slowdown in their risk-taking appetites," Cheah said. "At some point it will burst," he said of the GSEs' growth trajectory. "The question is, when it bursts, who will be holding the bag?"** (*Dow Jones Newswire*, Tyler Lifton and Joe Niedzielski, 9/6/01)
- As noted in the August 10, 2001 *GSE Report*, *TheStreet.com* reported that **Fannie and Freddie's derivatives risk is a concern. Fannie and Freddie use derivatives to hedge against prepayment risk. "For the most part, they've repeatedly gotten their bets right. But over the past 10 years, both institutions have massively changed their business plans to carry much more risk on their own balance sheets. As a result, any hedging failure could crush earnings" "Fannie and Freddie look very much like huge hedge funds that are continuously betting on prepayment risk. Like other large hedge funds, they may get it right for years and then have one terrible year."** (*TheStreet.com*, Peter Eavis, 7/10/01) [See August 10, 2001 *GSE Report* for more on *TheStreet.com*'s article.]

As the national debt shrinks, GSE debt skyrockets

With the fading supply of Treasurys, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasurys as the new benchmark in the bond market

GSE debt news:

- (1) **Brian Collins with *National Mortgage News* notes that if the Social Security trust fund began purchasing Fannie & Freddie's securities, this would be a "windfall" for the GSEs. "Of course, such a stamp of approval (U.S. Prime Investment) would confer the full faith and credit of the U.S. government on the two GSEs. And all pretext that Fannie and Freddie debt instruments are not guaranteed by Uncle Sam would be laughable."**
- (2) **GSE debt issuance up sharply in the first half of 2001**
- (3) **BondVision trading system will offer euro-denominated "quasi" government securities, including securities issued by Freddie**

Background on GSE debt

- As reported in previous *GSE Reports*, as the national debt shrinks, GSE debt has been skyrocketing. As the national debt is paid down, the supply of Treasury securities shrinks. Investors, traders, borrowers, and even the US Federal Reserve are being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark are the debt securities of Fannie and Freddie. Investors view them as "almost" as good as US Treasurys because of the implicit government guarantee of Fannie and Freddie's securities. Fannie and Freddie would like to replace Treasurys as a benchmark security and the agencies both have bond issuance programs (Fannie – Benchmark bond program; Freddie- Reference bond program) that mirror traditional Treasury operations in size and regularity.
- Criticisms of the GSEs' skyrocketing debt have increased. "Efforts by Fannie Mae and Freddie Mac to become bigger players...raise concerns among some policy makers. The two firms are privately owned. Their securities are considered safe largely because the markets assume that the government, which created both agencies, will stand behind them. If this is true, it means taxpayers are assuming an ever larger risk as Fannie Mae and Freddie Mac expand, while the companies' shareholders enjoy profits at taxpayers' expense." (*Wall Street Journal*, 2/3/00) Says Jim Murphy with *Dow Jones Newswire*, "Combined Fannie, Freddie, and the FHLBanks have \$2.6 trillion – T as in trillion – of outstanding debt...I can't explain why the amount of outstanding debt is so huge. I would think that \$2.6 trillion would be enough to provide every man, woman and child in the US who doesn't own a home with the equivalent of a custom-designed palace on two acres in the Hamptons." (*Dow Jones Newswire*, Jim Murphy, 4/12/00)

Brian Collins with *National Mortgage News* notes that if the Social Security trust fund began purchasing Fannie & Freddie's securities, this would be a "windfall" for the GSEs

- As noted in the August 10, 2001 *GSE Report*, *Newsweek's* Wall Street editor, Allan Sloan, supports the Social Security trust fund purchasing Ginnie Mae securities (or Fannie & Freddie securities) instead of Treasurys. (*Washington Post*, Allan Sloan, 8/7/01) Brian Collins with *National Mortgage News* noted that "[o]fficial Washington must be on vacation, because there was hardly any reaction" to the column. "Social security is always a controversial subject in Washington. But investing the nation's retirement funds into the mortgage securities of the government-sponsored enterprises should have blown some circuits."

- Collins noted, “It is not necessarily a bad idea to invest Social Security funds in Ginnie Maes,” as Ginnie Mae securities already carry the full faith and credit of the U.S. government, and they are actually backed by real estate assets. Collins warned, “[t]he only problem with the columnist’s suggestion is that there are already some government and quasi-government agencies, namely Fannie and Freddie, that invest in Ginnie Mae securities.” In addition, the Federal Reserve has made statements that it may begin buying and selling Ginnie Mae securities as part of its monetary policy operations. “While there are \$600 billion in Ginnie Mae MBS outstanding, these other agencies are not lightweights and they can obviously move markets...One would have to wonder if Ginnies would make good investments for taxpayers if other government agencies are buying and selling these securities for their own profit, or to steer economic policy.”
- Collins added, **“the idea of the Social Security trust fund’s investing in Fannie and Freddie MBS could only appeal to the two GSEs. There are \$993 billion in Fannie Mae MBS outstanding and \$576 billion in Freddie Mac MBS outstanding. And guess what -- Fannie Mae owns 34% of its own MBS and Freddie Mac owns 31% of its MBS in portfolio. What a windfall the two GSEs would reap if a huge investor like Social Security suddenly entered the market. Of course, such a stamp of approval (U.S. Prime Investment) would confer the full faith and credit of the U.S. government on the two GSEs. And all pretext that Fannie and Freddie debt instruments are not guaranteed by Uncle Sam would be laughable. This improbable scenario would allow Fannie Mae and Freddie Mac to ride safely on Uncle Sam’s back, knowing that their interests and the interests of the nation’s retirement system are inextricably linked.”** (*National Mortgage News Daily*, Column by Brian Collins, 8/27/01)

GSE debt issuance up sharply in the first half of 2001

- Led by Fannie, Freddie, and the FHLBanks, “federal agencies” more than doubled their long-term debt issuance during the first half of 2001 to \$425.4 billion, compared to \$201.9 billion issued during the same period last year, according to a new report by the Bond Market Association. At the same time, gross coupon issuance of U.S. Treasury securities decreased by 8.8% to \$155.1 billion during the first half of 2001, compared to \$170 billion issued in the first half of 2000. “Federal agencies” include Fannie, Freddie, the FHLBank System, Sallie Mae, the Farm Credit System, and the Tennessee Valley Authority.
- “Much of the step-up in (agency) issuance was attributable to Freddie Mac and Fannie (Mae), whose retained portfolio has recently increased,” the report said. “Short-term federal agency debt outstanding rose slightly to \$730.5 billion as of June 30, from \$724.6 billion at the end of March,” the report said. Freddie’s long-term debt issuance of \$111.1 billion during the first half of this year was up 173.6% from the same period a year ago, while Fannie’s \$123.3 billion in long-term debt issuance in the first half of 2001 was up 160.1% from the same period a year ago. The largest long-term agency debt issuer in the first half of 2001, with a volume of \$165.2 billion (up 72.8% from a year ago), was the FHLBank System. Sallie Mae, the Farm Credit System, and TVA issued a total of almost \$26 billion in debt in the first half of the year. (*Dow Jones Newswire*, John Connor, 8/14/01)

BondVision trading system will offer euro-denominated “quasi” government securities, including securities issued by Freddie

- BondVision, an online dealer-to-customer trading system created by MTS SpA, said it will begin offering euro-denominated “quasi” government securities on September 4. The system will offer all of the euro-denominated securities, including securities issued by the European Investment Bank, KfW and Freddie. BondVision, a consortium of 26 fixed-income dealers organized as a Regulated Market under the Investment Services Directive with European passport, allows institutional clients to connect via the Internet at no cost and request quotes from a number of BondVision Dealers on over

500 euro-denominated fixed-income securities listed on the MTS system. (*Dow Jones Newswire*, Henry Teitelbaum, 9/3/01)

The strategic alliances in which large lenders agreed to sell a majority of their loans to one GSE over another are still “holding pat, though anecdotal evidence suggests that these alliances may not have a bright future,” reports *National Mortgage News*

- Newly released government statistics reveal that some high-volume residential lenders are selling a large portion of their conventional production to one GSE and not the other. According to an analysis of 2000 Home Mortgage Disclosure Act (HMDA) data conducted by *National Mortgage News*, “strategic alliances” between a handful of top producers and Fannie and Freddie “are holding pat, though anecdotal evidence suggests that these alliances may not have a bright future.”
- The 2000 HMDA results reveal that some top producers may favor one GSE but continue to sell a small portion to the other GSE. For example, Wells Fargo Home Mortgage sold about \$31 billion in home mortgages to Freddie in 2000 and just \$2.5 billion to Fannie. Bank of America Mortgage sold \$10.8 billion to Freddie last year and just \$677 million to Fannie. Wells Fargo and Bank of America have strategic alliances with Freddie.
- The two GSEs began to enter into these alliance agreements in 1999 as a way to get lenders to channel most of their production toward them. In return for a lender agreeing to sell most of its production to a GSE, the GSE would offer, usually, a reduced guarantee fee and other perks. (*National Mortgage News*, Paul Muolo, 9/3/01) Using HMDA data, *National Mortgage News* released the following charts:

Top Sellers of Loans to Fannie in 2000 (Dollars in Thousands)			
Rank	Company	Volume	Loans
1	Countrywide Home Loans	\$28,990,386	233,219
2	Fleet National Bank	\$12,223,174	91,041
3	NAMCO Asset Management	\$10,744,446	82,049
4	Cendant Mortgage	\$10,085,103	76,762
5	Chase Manhattan Mortgage	\$7,916,053	60,031
6	GMAC Mortgage	\$6,456,176	50,766
7	Suntrust Mortgage, Inc.	\$5,602,300	43,696
8	Flagstar Bank	\$5,572,627	42,268
9	WaMu Bank, FA	\$5,552,808	39,950
10	Citimortgage Inc.	\$4,690,721	36,596
11	Homeside Lending, Inc.	\$4,405,948	36,558
12	First Horizon Home Loan Corp.	\$4,109,278	31,456
13	ABN AMRO Mtg. Group Inc.	\$3,897,840	28,389
14	RBMG, Inc.	\$3,295,591	25,235
15	First Union Mortgage Corp.	\$3,163,396	26,871
16	Wells Fargo Home Mortgage	\$2,508,798	12,122
17	CTX Mortgage Company	\$2,357,688	17,514
18	Bank One, NA	\$2,225,205	19,884
19	Ohio Savings Bank	\$1,775,643	12,621
20	Prism Mortgage Company	\$1,596,185	10,884
Top 20 Total:		\$127,169,366	977,912
Notes: Figures based on Home Mortgage Disclosure Act data for 2000. Source: <i>National Mortgage News/MortgageStats.com</i> (<i>National Mortgage News</i> , Paul Muolo, 9/3/01)			

Top Sellers of Loans to Freddie in 2000 (Dollars in Thousands)

Rank	Company	Volume	Loans
1	Wells Fargo Home Mortgage	\$19,812,947	145,400
2	Wells Fargo Funding	\$11,254,730	78,616
3	Bank of America, NA	\$10,814,452	83,820
4	ABN AMRO Mtg. Group Inc.	\$9,946,446	80,303
5	National City Mortgage Co.	\$5,361,818	43,543
6	Principal Residential Mtg. Inc.	\$3,680,715	28,921
7	Chase Manhattan Mtg. Corp.	\$3,584,917	28,671
8	PNC Mortgage Corp. of America	\$3,390,548	26,632
9	Countrywide Home Loans	\$3,024,647	26,164
10	Old Kent Mortgage Co.	\$2,536,195	20,209
11	Firststar Bank, N.A.	\$2,511,721	21,597
12	Cendant Mortgage	\$2,233,223	19,085
13	Crossland Mortgage Corporation	\$1,990,244	17,256
14	Greenpoint Mortgage Funding	\$1,705,329	14,382
15	Flagstar Bank, FSB	\$1,698,508	13,744
16	Branch Banking And Trust Co.	\$1,433,635	11,305
17	Lasalle Bank NA	\$1,209,072	8,942
18	Fifth Third Mortgage Company	\$1,145,225	10,748
19	First Horizon Home Loan Corp.	\$917,427	7,729
20	HSBC Mortgage Corporation	\$900,520	6,981

Notes: Figures based on Home Mortgage Disclosure Act data for 2000. Source: *National Mortgage News/MortgageStats.com* (*National Mortgage News*, Paul Muolo, 9/3/01)

Fannie Mae

Fannie approves the city of Ogden, UT as a Fannie Mae seller/servicer, enabling the city to originate and service residential mortgage loans that Fannie will purchase

- Fannie announced the opening of the new Ogden Business Information Center, which provides resources and loans to small businesses and mortgage financing to area residents. **Ogden is the first city in the nation to be approved as a Fannie Mae seller/servicer, thereby enabling the city, through the Business Information Center, to originate and service residential mortgage loans that Fannie will purchase.** The Center is the second in Utah. Ogden City funded the \$500,000 cost of development for the Center through city funds. Ongoing expenses will be funded by the city and through revenues generated by the Center's lending activities. The Small Business Administration provided reference materials, computers and software and the Service Corp. of Retired Executives will provide consulting and counseling services. The Utah Small Business Development Center will utilize the Center as a satellite center to provide the full range of its small business programs. (*Fannie press release*, 8/28/01) Michael Hernandez, regional vice president at Fannie, called it a "historic partnership" that will become a national model. (*Knight-Ridder Tribune Business News*, Cheryl Buchta, 8/29/01)

Fannie purchased \$6 billion in single-family loans with down payments of less than 5% last year, which was 2.7% of Fannie's total business last year

- In a July 31 letter to Cong. Harold Ford, Jr. (D-TN), Fannie's Chairman Franklin Raines noted that Fannie purchased nearly \$6 billion in single-family loans with down payments of less than 5% last year. According to officials at Fannie, all the \$6 billion in loans were conventional loans, not high-LTV loans that are government insured or guaranteed. In 2000, Fannie purchased \$225 billion in whole loans and mortgage-backed securities, and \$69 billion of those loans (counting the securitized loans) had loan-to-value ratios greater than 80%. Raines noted that 31.2% of Fannie's total single-family business had LTV ratios greater than 80%. "Last year alone we purchased nearly \$6 billion in high LTV loans, loans with less than 5% down," Raines said. The \$6 billion represents 2.7% of Fannie's total business last year. Freddie declined to release any dollar figure on its high-LTV purchases. Freddie's 2000 annual report shows that 2% of its purchases involved loans with LTV ratios above 95%. Cong. Richard Baker (R-LA) has commented that the bulk of the two GSE's loan purchases involve loans to borrowers who have a large amount of equity in their homes or the resources to put down large down payments. Fannie and Freddie strongly disagree. (*National Mortgage News Daily*, 8/17/01; *National Mortgage News*, Brian Collins, 8/20/01)

Fannie invests in two home equity deals

The GSEs are starting to purchase home equity loans in the secondary market that are mainly used to pay off credit card debt or to make home improvements. "Home equity loans do not help families on the cusp of home-ownership get into homes." (*Citizens Against Government Waste*, Leslie K. Paige)

- Fannie wrapped \$1.22 billion of home equity loan-backed paper via the lead of Countrywide securities. The loans backing the deal were conforming under Fannie's new program despite the "blemished credit" histories of the borrowers in the pool. *Asset Securitization Report* noted that the implicit government guarantee behind Fannie took any default risk out of the issue. The \$510 million floating-rate AV1 class, with a 2.5-year average life, priced at par with a coupon of 13 basis points over one-month Libor, versus a spread of 14 over for a three-year class of the most recent Option One FSPC T-35 deal. Sources close to the offering added that most of the classes were oversubscribed. (*Asset Securitization Report*, Kevin Donovan, 8/13/01) Long Beach Mortgage issued a multi-class debt offering of an asset-backed bond pooling home equity loans worth slightly over \$1 billion. There are two AAA-rated classes of debt. One AAA-rated tranche has an insurance wrap provided by Fannie, worth \$579.208 million. Another AAA-rated tranche totaled \$270.604 million. Also an AA-rated class totaled \$66.955 million and an A-rated class is worth \$59.229 million. The offerings BBB-rated class is \$38.628 million. (*Reuters*, 9/5/01, 9/6/01)
- **The GSEs are starting to purchase home equity loans in the secondary market that are mainly used to pay off credit card debt or to make home improvements. "Home equity loans do not help families on the cusp of home-ownership get into homes."** (*Citizens Against Government Waste; Government Waste Watch*; Winter 2001, Leslie K. Paige)
- **FM Watch notes, "The GSEs read their charters as allowing them to purchase home equity loans, even though only about 30 percent are used for home improvement...A study by the Consumer Bankers Association found that over 70 percent of home equity loans are used for debt consolidation or other purposes not related to home improvement. The GSEs are exploiting loopholes in their charter to expand beyond the mission Congress intended when they purchase home equity loans. By definition, home equity loans go to borrowers that already own**

a home, and these loans finance a wide range of consumer spending.” (“*GSE Mission Creep: The Threat to American Consumers*,” *FM Watch*, March 2001)

Morgan Stanley Dean Witter analyst says Fannie is well prepared to manage potential earthquake related credit losses in California

Fannie’s portfolio includes \$46 billion of home loans, roughly twice Fannie’s capital, within 10 miles of the San Andreas fault

- Morgan Stanley Dean Witter analyst Kenneth Posner said that Fannie is well prepared to manage potential earthquake related credit losses in California, in part because the aggregate loan-to-value ratio for its California portfolio is under 60% and Fannie benefits from the geographic diversity of its portfolio. Posner’s report noted that the U.S. Geological Survey estimates that there is a 70% chance of a major earthquake hitting the San Francisco Bay Area in Northern California during the next 30 years, and that there is an 80% to 90% chance of a major earthquake in Southern California over the next three decades. This means lenders and investors in mortgages will likely take a hit from earthquake damage during that time period. Fannie’s portfolio includes \$46 billion of home loans, roughly twice Fannie’s capital, within 10 miles of the San Andreas fault.
- The Morgan Stanley report also noted that sturdy construction of single-family homes, coupled with homeowner equity and land value, should protect mortgage portfolios from all but the most severe earthquakes. Morgan Stanley said it decided to take a look at earthquake risk to the GSEs after being asked about the issue by investors. Concerns evidently arose from comments made by Warren Buffet, whose company sold its large stake in Fannie and Freddie last year. As a result, Morgan Stanley analysts spoke with Fannie’s executives about California earthquake risk. (Freddie’s executives declined to discuss the issue with the Morgan Stanley analysts.)
- While saying earthquake risk is a major issue for the California housing industry, Morgan Stanley concluded, “Fannie Mae’s risk exposure to earthquake damage is mitigated by a significant cushion of equity and land value in the properties it finances, the wide geographic dispersion of its portfolio and the relative resilience of single-family homes to all but the most violent of shaking motions.” In most cases, the report claimed, lenders won’t incur losses from damage to stand-alone, single-family homes, because the damage will not be severe enough to cause the owner to abandon the property and default, the analysts said. Moreover, Fannie has retained consultants to study the issue and established policies for evaluating the risk to multifamily projects it finances. (*National Mortgage News*, Ted Cornwell, 9/3/01)

Fannie selects GMAC Commercial Mortgage as a lender for its “Dedicated Student Housing Pilot” program

- Fannie selected GMAC Commercial Mortgage Co., to participate as a lender under its “Dedicated Student Housing Pilot” program, reported *National Mortgage News Daily*. The program provides owners and operators of student housing more attractive loan options, GMACCM said. “GMACCM expects to handle a minimum of \$150 million in permanent loans and interim floater loans for dedicated student housing and \$100 million in student housing construction by year-end,” said Ed Andrew, vice president and coordinator of GMACCM’s student housing initiative. “We expect a significant portion of this permanent loan business to meet Fannie Mae’s underwriting criteria.” Under the pilot, Fannie adopted new standards for considering the purchase of loans secured by properties that provide dedicated off-campus student housing. Students must comprise at least 80% of the properties’ tenant base, GMACCM said. (*National Mortgage News Daily*, 8/28/01)

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 51 Partnership Offices open across the country

Fannie “wins the gratitude of politicians by staging local events with them, often to ‘announce’ its plans to buy local mortgages...It’s almost as if Ford or Microsoft could allow politicians to gain some credit with voters for every Escort or Windows package sold in their district.” – *Wall Street Journal*, Nicholas Kulish & Jacob M. Schlesinger, 7/5/01

Fannie has 51 partnership offices

- According to Fannie’s Web site, the company has 51 partnership offices open across the country (http://www.fanniemae.com/contact/partnership_offices.html, 7/20/01). An editorial in *National Mortgage News* took an in-depth look at Fannie’s New Mexico Partnership Office. The editorial noted that early on, lenders viewed Fannie’s local offices with suspicion, “thinking they might be advance guards in the GSE’s stealthy advance into the origination business.” The editorial noted that the New Mexico office “shows it to be more in the community development business than any other, acting in some ways like a nonprofit housing intermediary to tug together deals from a variety of sources.” The editorial claimed that much of Fannie’s “House New Mexico” effort is devoted to affordable housing, and a considerable portion to minorities. The editorial concluded, “It’s hard to imagine Fannie Mae hitting its lofty affordable housing goals...without the efforts of roll-up-the-shirt sleeves local operations like House New Mexico.” (*National Mortgage News, Editorial*, 8/27/01)

Senator Mike Crapo (R-ID), Senator Larry Craig (R-ID) and Cong. Mike Simpson (R-ID)

- Fannie joined with Senator Crapo in helping Kimberly, ID families and local housing leaders build new homes for working families, as part of a self-help housing effort led by Mercy Housing Idaho. Mercy Housing Idaho is leading the initiative, which will help ten local families build their future homes. HUD provided grant money administered by the IHFA, USDA provided mortgage loans through the Section 502 program, and Rural Community Assistance Corporation and Northwest Regional Facilitators provided technical assistance and support. Fannie provided \$10,000 in seed money to help Mercy Housing Idaho cover administrative costs associated with this effort. (*Fannie press release*, 8/27/01)
- Fannie held similar events with Senator Larry Craig (*Fannie press release*, 8/14/01) and Cong. Simpson (*Fannie press release*, 8/8/01)

Senator Robert Bennett (R-UT) and Ogden, UT Mayor Matthew Godfrey

- Fannie joined Senator Robert Bennett (R-UT) and Ogden, UT Mayor Matthew Godfrey and representatives from the US Small Business Administration to announce the opening of the new Ogden Business Information Center, which provides resources and loans to small businesses and mortgage financing to area residents. **Ogden is the first city in the nation to be approved as a Fannie Mae seller/servicer, thereby enabling the city, through the Business Information Center, to originate and service residential mortgage loans that Fannie will purchase.** The Center is the second in Utah. Ogden City funded the \$500,000 cost of development for the Center through city funds. Ongoing expenses will be funded by the city and through revenues generated by the Center’s lending activities. The SBA provided reference materials, computers and software and the Service Corp. of Retired Executives will provide consulting and counseling services. The Utah Small Business Development Center will utilize the Center as a satellite center to provide the full range of its small business programs. (*Fannie press release*, 8/28/01) Michael Hernandez, regional vice president

at Fannie, called it a “historic partnership” that will become a national model. (*Knight-Ridder Tribune Business News*, Cheryl Buchta, 8/29/01)

Senator Bill Frist (R-TN) and Memphis, Mayor W.W. Herenton

- Fannie joined with the above named officials and representatives from the LeMonye-Owne Community Development Corporation to review the progress on the transformation of a public housing development into new College Park, a new housing development. Fannie invested \$4.7 million in College Park. Fannie made Low-Income Housing Tax Credits equity investments in College Park through its partners, Enterprise Social Investment Corporation (\$2.2 million) and Key Affordable Housing Capital LLC (\$2.5 million), for a total of \$4.7 million. College Park will include 411 units comprised of 261 family-rental units, 70 single-family homeownership units and 80 rental units for senior residents. (*Fannie press release*, 8/23/01)

Senator Byron Dorgan (D-ND) and Linton, ND Mayor Mel Jahner

- Fannie joined with the above named officials and representatives from the US Department of Agriculture Rural Development, Hogue & Hogue LP, Lewis and Clark Regional Development Council, the City of Linton, Security State Bank, and the North Dakota Housing Finance Agency to celebrate the opening of Hogue Manor, an historic landmark which is undergoing a \$1.7 million conversion to affordable senior apartments. Fannie provided a \$70,000 loan to bridge the final tax credit payment. (*Fannie press release*, 8/21/01)

Senator John Ensign (R-NV)

- Fannie joined with Senator Ensign, Nevada Bank & Trust, and PHH Mortgage Services to celebrate a new web-based technology partnership, which enabled Nevada Bank & Trust to make available to its customers loan decisions in minutes through a new Home Buyers’ Assistance Web site that is accessible through the bank’s existing Web page. The technology is made possible through PHH Mortgage Services’ proprietary lending platform, which is powered by Fannie’s underwriting technology. (*Fannie press release*, 8/24/01)

Senator Harry Reid (D-NV)

- Fannie joined with Senator Reid and representatives from CitiMortgage to announce a new \$200 million partnership for affordable mortgage lending to Nevada families over the next five years. In Nevada, CitiMortgage has committed to originate and Fannie has committed to purchase \$200 million in affordable mortgage loans, as part of a \$12 billion initiative to provide flexible mortgage products through all CitiMortgage affiliates and business partners. (*Fannie press release*, 8/23/01)

Senator Ted Stevens (R-AK)

- Fannie joined with Senator Stevens, the Alaska State Home Builders, and the Alaska Housing Finance Corporation to celebrate the first year of the Cold Climate Housing Research Center, an industry-based nonprofit institute to promote innovative cold-climate homebuilding. The CCHRC was established by the Alaska State Home Builders Association with assistance from the Alaska Housing Finance Corporation and Fannie. (*Fannie press release*, 8/16/01)

Senator Tim Johnson (D-SD)

- Fannie joined with Senator Johnson and Citigroup and Access Capital Strategies LLC to announce the “South Dakota Community Investment Initiative,” a \$5 million investment to increase affordable homeownership in South Dakota. Citigroup’s Center for Community Development Enterprise has made an investment of \$5 million into an Access Capital Strategies Community Investment Fund to be used to purchase Fannie mortgage-backed securities comprised entirely of mortgages made by

participating South Dakota lenders to finance the purchase of homes in rural communities by borrowers earning less than 80% of the area median income. (*Fannie press release*, 8/14/01)

Cong. Danny Davis (D-IL) and Cong. Bobby Rush (D-IL)

- Fannie joined with the above named officials, representatives from the Congressional Black Caucus Foundation, the Chicago Westside Branch of the National Association for the Advancement of Colored People, and other local housing leaders to announce a local “WOW” initiative to increase homeownership among African Americans in the Chicago area. Participating lenders supporting the WOW initiative nationally include: Chase Manhattan Mortgage Corporation; CitiMortgage; Cendant Corporation; Countrywide Home Loans; Irwin Mortgage; Washington Mutual; and Wells Fargo Home Mortgage. Chicago-based Austin Bank and US Bank are participating in the initiative locally. (*Fannie press release*, 8/27/01)

Cong. John Shadegg (R-AZ) and Governor Jane Hull

- Fannie joined with the above named officials and representatives from the Arizona Mortgage Lenders Association to announce a \$15 billion five-year affordable housing investment plan for Arizona. (*Fannie press release*, 8/30/01)

Cong. Grace Napolitano (D-CA) and Whittier, CA Mayor Allan Zolnekoff, and Police Chief David Singer

- Fannie joined with the above named officials to announce the success of the Whittier Police Residence Incentive Program, an employer-assisted housing benefit that offers \$10,000 to help law enforcement officers become homeowners throughout the city. The funds can be used for the purchase of the property and closing costs, and can be coupled with a mortgage obtained by the borrower from a first-mortgage lender. The non-interest bearing loan is forgivable after ten years. The pilot was financed through \$60,000 in general fund money by the city. (*Fannie press release*, 8/28/01)

Cong. Charles Gonzalez (D-TX) and City Councilman Enrique Barrera

- Fannie joined with the above named officials and representatives from the San Antonio Alternative Housing Corporation and JPMorgan Chase to celebrate the conversion of a 94-unit town home development from a rental property to a “for sale” development for low-and moderate-income residents. Town home prices range from \$62,000 to \$71,000. JPMorgan Chase and Fannie provided \$4.655 million in debt financing for the acquisition and development of the property. Fannie purchased 50% of the loan originated by JPMorgan Chase. The developer, the San Antonio Alternative Housing Corporation, is providing an additional \$100,000 in subordinated debt financing. (*Fannie press release*, 8/27/01)

Cong. Jerry Kleczka (D-WI), Waukesha, WI Mayor Carol Lombardi and Waukesha County Executive Dan Finley

- Fannie joined with the above named officials and representatives from the State of Wisconsin, City of Waukesha, Waukesha County, Community Housing Initiative, Inc., C-CAP, Inc, local lenders and housing partners, and new homeowners to announce the grand opening of the Phoenix Heights subdivision, the largest single-family brownfield redevelopment in Wisconsin. Phoenix Heights consists of 69 new homes ranging from 1,000 square feet to 1,650 square feet, with prices ranging from the upper \$110,000s to the lower \$170,000s. Fannie made a \$1 million investment in the Phase III development of Phoenix Park through the company’s American Communities Fund. (*Fannie press release*, 8/27/01)

Cong. Roger Wicker (R-MS) and Tupelo, MS Mayor Larry Otis

- Fannie joined with the above named officials to celebrate new homeowners who were able to purchase homes with down payment assistance from the state and as little as 1% from their own funds. Down payment assistance was provided through the Housing Revolving Loan Program (HRL), a \$5 million initiative created and funded by the Mississippi Legislature. Fannie has approved a \$3.6 million underwriting experiment, which requires borrowers to contribute only 1% of the purchase price toward down payment or closing costs. Fannie has committed to purchase eligible first mortgage loans originated by Bancorp South and Trustmark in conjunction with the HRL program. (*Fannie press release, 8/22/01*)

Cong. Gary Miller (R-CA) and Yorba Linda, CA Mayor Michael Duvall

- Fannie joined with the above named officials and representatives from Financial Freedom at a reverse mortgage seminar offered by Financial Freedom for Orange County seniors. (*Fannie press release, 8/20/01*)

Cong. Jerry Lewis (R-CA) and County Supervisors Dennis Hansberger and Jerry Eaves

- Fannie joined with the above named officials and the County of San Bernardino to announce the results of the Neighborhood Initiatives Program, a pilot that enabled the county to buy, rehabilitate, and resell foreclosed homes to families. San Bernardino County's Neighborhood Initiative Program was created as a pilot when Cong. Lewis developed federal legislation that enabled local governments to establish a geographically-specific "Asset Control Area" to buy properties from FHA at a deep discount. Once in local government possession, the properties were rehabilitated and resold to families at an affordable price with all the net proceeds returned to neighborhood revitalization programs in order to benefit specific areas. Cong. Lewis obtained \$15 million in federal appropriations to help San Bernardino County be the first in the nation to begin buying, renovating and reselling the FHA-foreclosed homes. On behalf of the county, Fannie is renovating and reselling these homes. An additional 90 homes are under renovation in preparation for sale to homebuyers. (*Fannie press release, 8/18/01*)

Cong. Loretta Sanchez (D-CA) and Garden Grove, CA Mayor Bruce Broadwater

- Fannie joined with the above named officials to welcome families into new homes in Brentwood Village, a mixed-income single-family development that upon completion will offer 65 new homes for working families and first-time homebuyers. Financing for Brentwood Village was made possible through a partnership that includes: The Lee Group developer and general contractor; the City of Garden Grove's Agency for Community Development, which assembled the land for development; and Imperial Bank, which provided \$10.9 million in construction financing. Fannie provided both debt and equity financing, lending \$1 million in debt to the city's community development agency, and investing \$1.2 million in equity with The Lee Group. (*Fannie press release, 8/18/01*)

Cong. Michael Bilirakis (R-FL) and Largo, FL Mayor Robert Jackson

- Fannie joined with Mayor Jackson and housing leaders to announce a mortgage product for county teachers in Pinellas, Pasco, and Polk Counties. The Teachers Appreciation Mortgage Initiative offers a low interest mortgage loan as well as access to down payment funds from the Housing Finance Authorities (HFAs) of Pinellas, Pasco, and Polk counties. The initiative was designed by the HFA of Pinellas County in collaboration with Fannie, and is offered in partnership with Pasco and Polk counties and local lenders. A statement of support by Cong. Bilirakis was included in Fannie's press release. Fannie purchased \$4.3 million in single-family, tax-exempt mortgage revenue bonds out of the \$20 million tax-exempt bond jointly issued by the three HFAs. (*Fannie press release, 8/30/01*)

Cong. Todd Akin (R-MO)

- Fannie joined with Cong. Akin and the St. Louis County Economic Council to announce Fannie's Down Payment Assistance Investment Note. The investment note will provide \$1 million in funds to the Economic Council, which will use the fund proceeds to provide loans to St. Louis County first-time homebuyers through participating lenders. The program has no borrower income limits. The Economic Council issues the note – which Fannie purchases – and uses these unrestricted proceeds from the sale to fund second mortgage loans that finance part of a borrower's down payment or closing costs. (*Fannie press release, 8/31/01*)

Cong. Bob Ney (R-OH)

- Fannie joined with Cong. Ney to convene a housing roundtable to discuss Belmont and Monroe Counties' housing needs. (*Fannie press release, 8/30/01*)

Cong. Dave Baca (D-CA)

- Fannie joined with Cong. Baca to convene a housing roundtable to discuss San Bernardino, CA's housing needs. (*Fannie press release, 8/30/01*)

Cong. Adam Smith (D-WA)

- Fannie joined with Cong. Smith and the Tacoma-Pierce County Association of Realtors and local lenders to discuss Tacoma, WA's affordable housing needs and Fannie's new technology resources for lenders. (*Fannie press release, 8/30/01*)

Cong. Wes Watkins (R-OK)

- Fannie joined with Cong. Watkins to convene a housing roundtable to discuss the needs of Oklahoma's 3rd Congressional district. (*Fannie press release, 8/29/01*)

Cong. Doug Ose (R-CA)

- Fannie joined with Cong. Ose and representatives from Financial Freedom, in sponsoring a free reverse mortgage seminar offered by Financial Freedom for Davis, CA area seniors. (*Fannie press release, 8/29/01*)

Cong. Jim McDermott (D-WA)

- Fannie joined with Cong. McDermott and representatives from the Urban League of Metropolitan Seattle and Chase Manhattan Mortgage Corporation to announce the Homeownership Development Project, a comprehensive strategy to increase homeownership among minority and underserved families in the greater Seattle area. The Homeownership Development Project is part of a five-year collaboration between Fannie and the National Urban League (NUL) to increase homeownership resources in six targeted metropolitan areas including: Houston, TX; Rochester, NY; San Diego, CA; Seattle, WA; Stamford, CT; and Tucson, AZ. The Urban League of Metropolitan Seattle's Homeownership Development Project will offer comprehensive workshops consisting of home-buyer education, credit and budget counseling, free credit reports and analysis, debt-reduction counseling and mortgage financing guidance to help underserved borrowers overcome barriers to homeownership. Chase will offer participating families affordable low-down payment mortgage products, and participants completing a separate five-hour seminar are eligible for low-interest mortgages through the Washington State Housing Finance Commission's HouseKey program. Fannie will purchase eligible loans made under this initiative. (*Fannie press release, 8/29/01*)

Cong. Dave Weldon (R-FL)

- Fannie joined with Cong. Weldon to announce the opening of Melbourne, FL's newest energy efficient community, thanks to innovative mortgage financing announced by Mercedes Homes,

Florida Power and Light (FPL), Whirlpool Corporation, and Fannie. The Home Performance Power initiative includes zero-down payment mortgages that recognize the savings value of energy conservation in the loan evaluation process. Fannie has committed to purchase \$10 million in mortgages originated under this initiative in Central Florida. The initiative was announced as part of the opening of a new Mercedes Homes community designed to provide homebuyers with maximum energy efficiency and affordability. Almost 200 energy-efficient homes, priced between \$104,900 and \$175,900, are planned for the Westfield and Sandhill Trace developments in Grand Haven, FL. The Whirlpool Corporation will be offering its ENERGY STAR appliances for homebuyers at Grand Haven. Under the Home Performance Power initiative, homebuyers can apply home closing allowances toward closing costs when they include Whirlpool brand ENERGY STAR appliances in their Fannie financing. (*Fannie press release, 8/25/01*)

Cong. J.D. Hayworth (R-AZ)

- Fannie joined with Cong. Hayworth to convene a housing roundtable to discuss Flagstaff, Arizona's housing needs. (*Fannie press release, 8/25/01*)

Cong. Ruben Hinojosa (D-TX)

- Fannie joined with Cong. Hinojosa to convene a housing roundtable to discuss implementing Employer-Assisted Housing initiatives with major employers in the city of McAllen, TX. (*Fannie press release, 8/24/01*)

Cong. Susan Davis (D-CA)

- Fannie joined with Cong. Davis to convene a housing roundtable to discuss San Diego's housing needs. (*Fannie press release, 8/22/01*)

Cong. Henry Bonilla (R-TX)

- Fannie joined with Cong. Bonilla and representatives from the Middle Rio Grande Housing Finance Corporation and First Liberty Mortgage to announce the availability of low-interest mortgage financing and down payment and closing cost assistance through a \$10 million mortgage revenue bond purchase by Fannie. Bond proceeds will be available through First Liberty Mortgage to qualified borrowers. (*Fannie press release, 8/21/01*)

Cong. Pete Sessions (R-TX)

- Fannie joined with Cong. Sessions and REACH of Dallas, and Bank One Mortgage to welcome a disabled homebuyer and family to their new home thanks to the Dallas Home of Your Own (HOYO) Coalition, a group of public, private and nonprofit organizations that have come together to create homeownership opportunities for people with disabilities. (*Fannie press release, 8/16/01*)

Cong. Mark Green (R-WI)

- Fannie joined with Cong. Green and representatives from the Brown County Housing Authority, Neighborhood Housing Services of Green Bay, Options for Independent Living Inc., Integrated Community Services Incorporated, First Northern Savings Bank, M&I Marshall & Iillsley Bank, and other local housing partners to announce a new \$1 million Section 8 to Homeownership Initiative. The initiative will allow borrowers to apply their Brown County Housing Authority Section 8 voucher subsidy toward homeownership. Fannie will purchase the eligible mortgages originated by First Northern Savings Bank and M&I Marshall & Iillsley Bank under this initiative. (*Fannie press release, 8/14/01*)

Cong. Shelley Moore Capito (R-WV)

- Fannie announced mortgage relief for flood victims in West Virginia. A statement of support by Cong. Capito was included in Fannie's press release. (*Fannie press release, 8/14/01*)

Cong. Nydia Velazquez (D-NY)

- Fannie joined with Cong. Velazquez, Cypress Hills Local Development Corporation (CHLDC), Independence Community Foundation and BNY Mortgage Corporation to announce the first home purchase made possible through the Cypress Hills Homeownership Initiative Project (CHHIP). CHLDC and Fannie developed the initiative. CHLDC purchases and rehabilitates properties and then sells them to local residents with assistance provided through the New York State Division of Housing and Community Renewal. Fannie provided \$20,000 in initial seed money to enable CHLDC to purchase distressed properties. With BNY Mortgage, Fannie tailored its HomeStyle[®] purchase-renovation mortgage product especially for the CHHIP to enable families to obtain the loans with low down payments after the completion of the repairs. Independence Community Foundation provided funding to build the staff capacity at the CHLDC to administer Homeownership Initiative Project. (*Fannie press release, 8/13/01*)

Cong. Kevin Brady (R-TX)

- Fannie joined with Cong. Brady and the Montgomery County Housing Finance Corporation to announce a \$17.2 million mortgage revenue bond issued by the Montgomery County Housing Finance Corporation and purchased by Fannie. Bond proceeds will be made available through participating lenders for affordable mortgage funds and down payment assistance for area homebuyers. (*Fannie press release, 8/13/01*)

Cong. Judy Biggert (R-IL)

- Fannie joined with Cong. Biggert to convene a housing roundtable to discuss expanding homeownership opportunities in Illinois' Western and Southwestern Suburbs. (*Fannie press release, 8/8/01*)

Cong. Nick Lampson (D-TX)

- Fannie joined with Cong. Lampson to announce a \$25 million mortgage revenue bond agreement between local lenders, and the Port Arthur Housing Finance Corporation. Bond proceeds will be available through participating lenders for affordable mortgage funds and down payment assistance for area homebuyers. (*Fannie press release, 8/7/01*)
- Fannie also joined with Cong. Lampson in announcing a \$5 million mortgage revenue bond issued by the Galveston Housing Finance Corporation. Bond proceeds will be available through participating lenders for affordable mortgage funds and down payment assistance for area homebuyers. (*Fannie press release, 8/2/01*)

Cong. Harold Ford, Jr. (D-TN)

- Fannie joined with Cong. Ford to tour the historic Whitehaven neighborhood in order to explore revitalization opportunities. Cong. Ford also participated in a forum, led by Fannie, to coordinate a neighborhood improvement strategy for local community development corporations. (*Fannie press release, 8/6/01*)

Other local officials with whom Fannie held press opportunities:

- Fannie also held press opportunities with the following public officials:
 - (1) Flagler, CO Mayor Pro Tem Randy Fagerlund and Seibert, CO Mayor Jim Randall (*Fannie press release, 8/27/01*)

- (2) Omaha, NE Mayor Mike Fahey (*Fannie press release*, 8/17/01)
- (3) Miami, FL Mayor Alex Penelas, Florida State Senator Kendrick Meek and Florida State Representative Frederica Wilson, Chair of the Florida Conference of Black State Legislators (*Fannie press release*, 8/9/01)
- (4) Nashville, TN Mayor Bill Purcell (*Fannie press release*, 8/6/01)

Freddie Mac

Freddie and McDonald’s may work with local Realtors and mortgage brokers in their partnership program

Freddie is equipping 25 McDonald’s Corp. restaurants with personal computers and Internet access, with online information on homeownership and credit management at Freddie’s Web site

- As reported in the August 10, 2001 *GSE Report*, Freddie has announced a plan to equip 25 McDonald’s Corp. restaurants in the southeastern United States with personal computers and Internet access. Computer users will be guided to online information on homeownership and credit management at Freddie’s Web site. The computers will be equipped with different “blocking software to close off objectionable sites,” as well as with a “quick-click” feature that can instantly bring up the first page of Freddie’s homeownership content as the homepage. Freddie Spokesman Douglas Robinson stressed that the Freddie Web site would not serve as portal to steer users as prospects for mortgage lenders. “We’re not going to be a service to drive anyone to a particular lender,” he said. (*Reuters*, Richard Leong, 7/22/01; *National Mortgage News*, Amilda Dymi, 8/6/01) Robinson was quoted in an *Inman News* article stating that Freddie and McDonald’s may begin working with Realtors and mortgage brokers through the program, but the program is still under development. Robinson would not provide any specifics regarding lender or Realtor relationships. “The idea is definitely not finished,” he said. “We probably will need to bring in a stronger lender component because as these people begin learning more, they are going to begin reaching out (for mortgage options).” (*Inman News Feature*, Julie Clairmont, 8/23/01)

Freddie drops income caps on certain loans – change will benefit borrowers with higher income in low-income and minority neighborhoods

- Freddie announced it would allow borrowers with higher incomes to qualify for high LTV loans specifically targeted at low-income “central city” census tracts and minority neighborhoods. Freddie will no longer require area median-income limits on Affordable Gold Mortgages, Freddie Mac 100 Mortgages (with a second mortgage), or Alt 97 Mortgages (with a second mortgage) in those “concentrated areas,” according to Seller Bulletin 2001-6. “This change means additional homeownership opportunity for borrowers with higher income but less cash for downpayment and/or closing costs,” the company said. “And it helps to increase the rate of homeownership in and rejuvenation of concentrated areas, including HUD-designated central cities.” (*National Mortgage News Daily*, 8/15/01; *National Mortgage News*, Brian Collins, 8/20/01)

Freddie says it is investigating mortgage fraud in eastern Pennsylvania

Law enforcement officials say “much of the illegally obtained information used in mortgage fraud schemes runs through prominent automated underwriting systems without pause, because the systems lack fraud detection software”

The two most notable automated underwriting systems that do not have fraud protection are Fannie & Freddie’s automated underwriting systems

- Freddie announced that it is investigating allegations of loan origination improprieties and fraud in certain areas of the Pocono mountains in Eastern Pennsylvania. Allegations of fraud have been reported in the local newspapers, and a class action lawsuit has been filed. The lawsuit accuses certain local builders and lenders of “inducing customers” to purchase newly constructed houses “at prices well in excess” of their actual fair market value, according to Freddie. “Freddie Mac takes these allegations seriously and is actively pursuing its own investigation,” according to an industry letter. “We are also working closely with law enforcement agencies in these areas.” The GSE said there are other fraud “hot spots” it is watching, and urged lenders to practice fraud prevention. (*National Mortgage News Daily*, 8/23/01)
- Freddie warned lenders to use “due diligence” when approving mortgage loans in the Poconos region. Freddie spokeswoman Sharon McHale said the warning was the first issued in five years and was sent to remind lenders to be vigilant. Nearly a dozen investigators from Freddie have visited Monroe County in recent months combing through courthouse documents and interviewing homebuyers. Their probe began after the *Pocono Record* newspaper reported the use of inflated appraisals and phantom financing in the sale of new homes. The practice has contributed to the skyrocketing foreclosure rate in Monroe County as homeowners find they are unable to refinance or sell their homes. There have been more than 3,000 foreclosures in Monroe County since 1995. Some of them involved properties in which Freddie had purchased the loan. The exact number of defaulted properties in the Poconos region held by Freddie has not been revealed. Monroe County District Attorney Mark Pazuhanich formed a real estate task force and is sharing information with Freddie’s investigators. Pazuhanich says he will send his information to the FBI for their review. (*Associated Press*, 8/25/01)

Fraud slips through the cracks in automated underwriting systems

- **Law enforcement officials say “much of the illegally obtained information used in mortgage fraud schemes runs through prominent automated underwriting systems without pause, because the systems lack fraud detection software,” reports *Real Estate Finance Today*.** Automated underwriting has emerged as a particularly vulnerable area for mortgage fraud perpetration, lenders and experts said recently at a Mortgage Bankers Association’s mortgage fraud seminar. The problem stems from identity theft. While people used to have to physically collect information necessary to steal another’s identity, today they can gather most of the information online, which can sail through an automated underwriting system undetected because there are few stops along the way where the information is manually verified. **The two most notable automated underwriting systems that do not have fraud protection are Fannie and Freddie’s automated underwriting systems, said Connie Wilson, Executive Vice President at AppIntell Inc., a fraud audit group based in St. Charles, MO.**
- Some private companies have fraud detection systems, which provide data from multiple vendors to identify potentially fraudulent applications. Companies that do have check systems include Countrywide Home Loans and GMAC-RFC. (*Real Estate Finance Today*, Chris DeReza, 9/3/01)

Freddie joins with USDA in rural rental housing initiative

- Freddie and the United States Department of Agriculture (USDA) announced an agreement that will enable Freddie to purchase multifamily loans originated under USDA's Rural Housing Service (RHS) Section 538 program. According to Freddie, the RHS had "little success" selling loans originated under the 538 program in the secondary market. Freddie noted, "Low-income rural areas have been more difficult for industry participants to serve, due in part to the smaller populations of these areas, which attract fewer builders, developers and lenders. In addition, loans secured by multifamily properties in rural areas are typically smaller in size." Freddie noted the average Section 538 loan is \$1.6 million. Freddie's said its agreement will increase the availability of capital for the program and draw more borrowers and investors to the low-income rural rental housing market. As part of the agreement, all Program Plus[®] Seller/Serviceers with experience in rural lending are immediately eligible to sell Freddie's Section 538 loans. (*Freddie press release, 8/23/01; National Mortgage News Daily, 8/23/01; Dow Jones Newswire, John Connor, 8/24/01*)

Federal Home Loan Banks

FHFB Chairman Timothy O'Neill schedules September 12 meeting to discuss dual FHLBank membership

- FHFB Chairman Timothy O'Neill scheduled a September 12 meeting to discuss and issue a solicitation for comment on the effects dual FHLBank membership would have on the FHLBank System. The FHFB has three applications where members of one FHLBank have acquired a thrift in another FHLBank district and would like to assume the acquired institution's membership in the FHLBank: (1) Washington Mutual Bank, Stockton, CA (a member of the San Francisco FHLBank) acquired Bank United in Texas and wants to become a member of the Dallas FHLBank; (2) Fleet National Bank, Boston, MA (a member of the Boston FHLBank) acquired Summit Bank and wants to become a member of the New York FHLBank; and (3) Charter One, Cleveland, OH (a member of the Cincinnati FHLBank) acquired Alliance Bancorp and wants to become a member of the Chicago FHLBank. "This is the biggest issue that the Finance Board will face in 2001, so I want to make sure that we have an open process, a comprehensive process," said O'Neill. The solicitation of comments from the public will enable the FHFB to determine whether it should begin a subsequent rule-making process on the issue. (*National Mortgage News Daily, 8/14/01; National Mortgage News, Brian Collins, 7/9/01; FHFB pres release, 8/10/01*)

Dow Jones Newswire columnist John Connor notes "most everything about the FHLB System keeps getting bigger"

- According to John Connor with *Dow Jones Newswire*, "most everything about the Federal Home Loan Bank System keeps getting bigger, including membership, assets, loan volume, debt outstanding and investments." The FHLBank System's recent financial report for the six months ended June 30, 2001, said that membership was up to 7,865 from 7,777 at the end of last year, and total assets were \$664.9 billion at June 30, up \$11.2 billion from year-end 2000. The report noted "advances" were \$450.3 billion at June 30, up \$12.4 billion from the end of last year. It also noted that consolidated debt obligations outstanding - bonds and discount notes - increased to \$593.4 billion at the end of June from \$591.6 billion at year-end 2000.

- The report said the FHLBanks had average overnight discount notes outstanding of \$15.7 billion for the first half of this year, and that the daily roll over of these notes led to aggregate issuance of overnight discount notes of \$1.88 trillion during the first six months of 2001, up from \$1.64 trillion during the first half of last year. “During the first six months of 2001, issuance under the Global Debt Program was \$40.2 billion at par as the FHLBanks responded to funding opportunities in the global markets,” the report said. “The FHLBanks' global issuance at par in 2000 was \$46 billion and \$15.1 billion for the first six months of 2000.”
- The report said FHLBank investments increased to \$188.2 billion at June 30 from \$186.4 billion at the end of last year. Investment in mortgage-backed securities increased to \$85.2 billion at June 30 from \$81.3 billion at the end of last year. The FHFBS limits FHLBank's holdings of mortgage-backed securities to three times capital. As of June 30, 2001, mortgage-backed securities owned by the FHLBanks were 2.62 times combined capital. At June 30, 2001, investments were comprised of mortgage-backed securities (45.3%), Federal funds sold (28.5%), U.S. Treasury and U.S. agency obligations (7.3%), commercial paper (5.1%), and all other investments (13.8%). Total capital for the FHLBanks was \$32.5 billion at June 30, up \$1.2 billion from the year-end 2000 level, the report said.
- Net income did not increase. “FHLBanks' net interest income before loan-loss provision for the second quarter 2001 was \$745 million, which was \$73 million or 8.9% less than net interest income before loan-loss provision for the second quarter 2000.” (*Dow Jones Newswire*, John Connor, 8/15/01)

FHFBS issues two proposed rules for comment on the FHFBS's final capital rule for the FHLBank System

The rules will not impede the ability of the FHLBanks to buy obligations of Fannie & Freddie

- The FHFBS issued two proposed rules for public comment. One rule would make a small number of modifications to the final capital rule that the FHFBS published January 30, 2001. Many of the changes were identified in response to an advance notice of proposed rulemaking (ANPR), published March 7, relating to unforeseen issues not addressed in the capital rule. The other proposed rule would amend the unsecured credit provisions of the FHFBS's rules, which were adopted in the final capital rule and govern the amount of unsecured credit that a FHLBank can extend in various transactions with a third counter-party. The FHFBS is proposing the amendments based in part on comments received from the FHLBanks on the March 7 ANPR. The deadline for comments on the rules is September 7. (*FHFBS press release*, 8/10/01; *Federal Register*, pages 41462-41474, 8/8/01; *Federal Register*, 41474-41483, 8/8/01)
- According to John Connor with *Dow Jones Newswire*, the FHFBS's proposed rule that makes modifications to the final capital rule would do nothing to impede the ability of the FHLBanks to purchase obligations of Fannie and Freddie. The proposed rule would amend portions of the capital rule adopted last December that was viewed by some FHLBanks as potentially disruptive to their investment strategies and likely to force them to invest in instruments of lesser credit quality than the debt of other GSEs by tightening limits on the amount of unsecured credit FHLBanks could extend to a GSE counter-party. The offending portion of the capital rule was deleted by the FHFBS earlier this year, and the proposal released by the FHFBS on August 8 would set a “limit on unsecured credit exposure to GSEs of 100% of the lesser of FHLBank capital or the counterparty's capital.” The FHFBS said, “GSEs historically have been viewed more favorably by debt markets than the highest-rated corporate debt issuers.” (*Dow Jones Newswire*, John Connor, 8/8/01)

FHLBank of Seattle is creating a secondary market for mortgages made on tribal lands

FHLBank of Seattle to buy up to \$100 million in home loans under HUD's Title VI of the Native American Housing Assistance and Self Determination Act

In related news, Fannie purchases its first HUD Title VI loan

- The FHLBank of Seattle is creating a secondary market for mortgages made on tribal lands. The Seattle FHLBank received permission from the FHFB to purchase up to \$100 million in home loans made to Native Americans under HUD's Title VI of the Native American Housing Assistance and Self-Determination Act (NAHASDA). HUD's program will guarantee up to 95% of a loan made for housing on Native American land. (*American Banker*, Alan Kline, 8/27/01; *HUD press release*, 8/24/01)
- In related news, Fannie purchased its first HUD Title VI loan. The \$435,000 loan, extended by Century Bank FSB of Santa Fe, will help finance rental housing on the Pueblo of Pojoaque in New Mexico. The loan is the fifth to close in HUD's Title VI program, which has nearly \$200 million in lending guarantee authority. It is the first to be bought in the secondary mortgage market. Total volume in the Title VI program so far has been about \$10 million. (*Knight-Ridder Tribune Business News: Indian Country Today*, Rapid City, South Dakota, Mark Fogarty, 8/20/01)

President Bush names John Thomas Korsmo to be a member of the FHFB

HUD designates HUD Assistant Secretary John Weicher to be HUD's representative on the FHFB

- President Bush named John Thomas Korsmo on August 20 to be a member of the FHFB. Korsmo, most recently was President of Korsmo Consulting Services, and was a senior executive for Dakota Heartland Health System from 1997-98. Korsmo worked for Cass County Abstract Company, a real estate title abstracting firm, from 1997 to 1996, and founded Red River Title Services, The Title Company of Fargo, and Korsmo and Wheeler, a real estate law firm in which he is still active. (*Reuters*, 8/20/01) Korsmo is a former Chairman of the North Dakota Republican Party and one-time candidate for the US House. (*The Forum*, Janell Cole, 8/23/01) In related news, HUD designated HUD Assistant Secretary John Weicher to be HUD's representative on the FHFB. (*National Mortgage News*, 8/14/01)

Fitch withdraws its ratings of the FHLBank of Pittsburgh, at the request of FHLBank of Pittsburgh's management

- Fitch is withdrawing its ratings on the FHLBank of Pittsburgh at the request of FHLBank of Pittsburgh's management and does not reflect any adverse financial factors or the emergence of any negative ratings issues. Fitch will no longer perform ongoing surveillance of the FHLBank of Pittsburgh. (*Business Wire*, 8/31/01)

Mortgage Partnership Finance (MPF) loans represent 26% of the FHLBank of Chicago's assets

- The FHLBank of Chicago has 26% of its assets invested in one- to four-family mortgage loans acquired through the MPF program. The MPF program gives lenders an alternative to selling fixed-rate, conventional and guaranteed loans to Fannie and Freddie. It is currently offered by 10 of the 12 FHLBanks. The FHLBank of Chicago developed the MPF program four years ago, and the bank buys residential mortgages from member banks and thrifts, as well as from other FHLBanks that participate

in the MPF program. As of June 30, the Chicago FHLBank had \$37.5 billion in total assets, including \$9.8 billion in MPF loans, according to a second-quarter financial report issued by the FHLBank System's Office of Finance. Over half the MPF loans come from other FHLBank districts, a Chicago FHLBank official said. In total, there are \$19.6 billion in MPF loans outstanding, so the Chicago FHLBank holds half of all MPF loans in its portfolio. The second-largest holder is the Des Moines FHLBank, which has \$4.1 billion in MPF loans. (*National Mortgage News Daily*, 8/28/01)

Farm Credit System/Farm Credit Banks

District court rules that the FCA acted within its authority when it issued its final rule on loan participations for Farm Credit System institutions

- The U.S. District Court for the District of Columbia ruled August 23 that the Farm Credit Administration acted within its authority when it issued a final rule on loan participations for Farm Credit System (System) institutions. The final rule, issued April 25, 2000, repealed existing FCA regulations that required Farm Credit System lending institutions to obtain consent from other System institutions when purchasing participation interests made by a non-System lender located outside the purchasing lender's chartered territory. In his ruling upholding the FCA's position, U.S. District Court Judge Ricardo Urbina said, "The FCA is responsible for the well-being of American farmers and their efficient access to credit. If, in the FCA's judgment, this regulation provides the best possibility for achieving those goals, the court should not second-guess such policy decisions."
- The plaintiffs, the Farm Credit Bank of Texas and their affiliated Federal Land Credit Associations in Alabama, Mississippi, and Louisiana, filed a complaint against FCA on June 30, 2000, challenging the validity of the final rule issued by FCA. (*FCA press release*, 8/24/01)

FCA issues proposed rule that would allow a Farm Credit System institution to terminate its FCS charter and become a bank, a savings and loan association, or other financial institution

- The Farm Credit Administration re-issued a proposed rule in the *Federal Register* on August 20 that would allow a Farm Credit System (FCS or System) institution to terminate its FCS charter and become a bank, a savings and loan association, or other financial institution under another Federal or state chartering authority. The deadline for comments on the proposed rule is October 19, 2001.
- The rule is being re-proposed because the method for calculating the exit fee was changed from the previous proposal published November 5, 1999. Equity held by dissenting stockholders is included in the exit fee calculation in the re-proposal. In the November 5, 1999 proposal, a terminating institution would retire equities held by dissenting stockholders before the exit fee was calculated.
- "Our objectives in adopting this rule, said FCA Chairman and CEO Michael M. Reyna, "are to ensure the process is fair, all stockholders are treated equitably, and the remaining FCS institutions are safe and sound and can fulfill their congressional mandate of serving the credit needs of farmers, ranchers, and cooperatives."
- These changes are also being proposed to fulfill a statutory requirement. There are currently no pending applications from Farm Credit institutions to leave the System, and none are anticipated in the near future. FCS institutions were given authority to terminate System status by the Agricultural Credit Act of 1987. The existing rule, which applies only to small associations, has been in effect

since early 1991. An association is defined as small when its investment in its affiliated bank is 25 percent or less of the bank's capital or when its loan from the bank totals 25 percent or less of the bank's total loans. It covers most Farm Credit associations, but it does not cover large associations or banks. (*FCA press release*, 7/12/01; *Federal Register*, pages 43536-43549, 8/20/01)

Ginnie Mae

Ginnie Mae issues final rule governing book-entry procedures for payments to security holders

- Ginnie Mae issued a final rule on August 22 that governs payments on Ginnie Mae I and Ginnie Mae II Pass-Through Securities (“Ginnie Mae MBS”) registered in the name of a securities intermediary and clearing corporation (a “Depository”). The rule requires that payments on Ginnie Mae MBS due to Depositories be made in immediately available funds and supersedes any current provisions allowing those payments to be made by check. Payments to other security holders may be made by check or other means provided the security holder receives the check not later than the applicable payment date specified in the Ginnie Mae Mortgage-Backed Securities Guide. The final rule eliminates any requirement that a physical certificate representing a Ginnie Mae MBS or, for consistency, a Ginnie Mae multiclass security (“Ginnie Mae Multiclass Securities,” and together with Ginnie Mae MBS, “Ginnie Mae Securities”) be maintained by a Depository. In addition, in the final rule, because the Federal Reserve Banks are expected to become Depositories for all book-entry Ginnie Mae Securities, Ginnie Mae is (consistent with the practices of other Federal entities with securities on the Fedwire Book-Entry Securities System) adopting an appropriate version of the standard technical rules under which book-entry Ginnie Mae Securities will be held and transferred on such system. The final rule follows publication of a February 26, 2001 proposed rule, takes into consideration public comment on the proposed rule, and make certain changes at this final rule stage. The rule becomes effective on October 1, 2001. (*Federal Register*, pages 44258-44268, 8/22/01)

Correction: The August 10, 2001 *GSE Report* incorrectly reported that many of the nation’s 8,500 appraisers worry that automated appraisal systems, in many cases provided by Fannie and Freddie, are not always accurate and could put them out of business, according to a *Wall Street Journal* article. The correct number of appraisers cited in the article is actually 85,000, not 8,500. (*Wall Street Journal*, Patrick Barta, 7/20/01)

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