

# The *GSE* REPORT™

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- UBS Warburg says that since Fannie & Freddie have been insuring an increasing number of loans that traditionally fell under the Alt-A area [subprime], the remaining conforming-sized loans in non-GSE portfolios usually entail more risk factors and require more stringent underwriting because they don't have GSE backing ([p. 14](#))
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## ***Major Events***

**Senator Wayne Allard (R-CO) is still on track to introduce the “Ginnie Mae Choice” proposal**

**The “Ginnie Mae Choice” proposal would expand homeownership by allowing Ginnie Mae to compete with Fannie & Freddie and would bring additional revenue to the federal government**

**Fannie’s Chairman Franklin Raines says the program should be questioned and scrutinized**

**Doug Robinson, a spokesman for Freddie, says the plan would hurt Ginnie Mae and would not help underserved borrowers**

**A study by mortgage economists finds that the savings to homebuyers could be significant under the “Ginnie Mae Choice” proposal and that the program would not harm Ginnie Mae or FHA**

- **Senator Wayne Allard (R-CO) is still on track to introduce the “Ginnie Mae Choice” legislation his staff said on October 4. “It’s something the Senator feels deserves a fair chance and is comfortable it would be a viable product that would have benefits to consumers,” said an Allard spokesman.** The aide said the Senator is expected to introduce the bill “very shortly.” The Allard aide further noted that a companion bill on the “Ginnie Mae Choice” proposal is expected to be introduced by Congresswoman Marge Roukema (R-NJ). Senator Allard is the senior Republican member of the housing subcommittee of the Senate Banking Committee, while Congresswoman Roukema is Chair of the House Financial Services subcommittee on housing and vice chair of the full committee. (*Reuters*, Mark Felsenthal, 10/4/01) **Allard’s spokesman said they hoped for a hearing on the bill next spring.** (*Dow Jones Newswire*, Jennifer Corbett Dooren, 9/28/01)
- **Supporters argue that the entry of Ginnie Mae into the market would give lenders an alternative to selling their low down payment mortgage loans to Fannie and Freddie and would virtually guarantee lower rates for some borrowers.** (*Washington Post*, Kenneth Harney, 9/15/01) **An aide to Senator Allard noted that putting another competitor into the secondary mortgage market, which is currently dominated by Fannie and Freddie, is likely to result in lower costs for borrowers.** (*Reuters*, Mark Felsenthal, 10/4/01)

### Background on “Ginnie Mae Choice” proposal

- ***Washington Post* columnist Kenneth Harney reported that the proposal promises to cut interest rates and application costs for homebuyers who can’t afford a large down payment. The proposal is aimed at borrowers with down payments of less than 20%. The intended beneficiaries of the proposal are first-time homebuyers, consumers with high debt-to-income ratios, minorities, and consumers with slightly imperfect credit histories.** (*Washington Post*, Kenneth Harney, 9/15/01)
- Harney noted, “[b]y broadening the base of capital market sources of money available to fund such buyers, the plan would try to generate greater competition -- and better terms -- on mortgages with low down payments.” Supporters of the proposal said some borrowers would cut up to 1.5 percentage points off their mortgage rates, as well as hundreds of dollars in loan fees. (*Washington Post*, Kenneth Harney, 9/15/01)

- **The proposal would allow Ginnie Mae to compete with Fannie and Freddie [which currently dominate the conventional mortgage market] on pricing and terms for low down payment mortgages.** Currently, Ginnie Mae purchases and guarantees only federally insured FHA and VA loans. Under Senator Allard and Congresswoman Roukema’s proposed legislation, Ginnie Mae would be allowed to purchase conventional loans that carry private mortgage insurance, allowing Ginnie Mae to securitize privately insured conventional mortgage loans in competition with Fannie and Freddie. Loans covered by the legislation could go as high as \$275,000 under current rules, and allow down payments of less than 3 percent. (*Washington Post*, Kenneth Harney, 9/15/01)
- Under the proposal, private mortgage insurers would provide most of the insurance on the mortgages and protect Ginnie Mae from losses on defaults. Harney reported that private insurers have been the key proponents of the Choice proposal for more than a year, arguing that their electronic automated underwriting systems approve higher percentages of loan-worthy, low down payment applicants than Fannie and Freddie’s automated underwriting systems. The mortgage insurers cited a study of more than 150,000 loans that found Fannie and Freddie’s “accept” rates on low down payment applications from homebuyers with moderate FICO scores in the range of 620 to 660 to be just 61 percent, compared with 72 percent by private mortgage insurers’ electronic systems. (FICO scores of 620 to 660 indicate an applicant with slight to moderate credit-history blemishes.) The same study found Fannie and Freddie’s “accept” rates on African American borrowers to be 65.8 percent, compared with 76 percent for the private insurers. Hispanic “accept” rates by the private systems was 77 percent, by Fannie and Freddie, 72 percent. As Harney noted, “accept” decisions by the private insurers and Freddie and Fannie generally qualify the borrower for the standard interest rate and terms available at the time. Applicants that are not accepted either pay higher interest rates or are rejected. (*Washington Post*, Kenneth Harney, 9/15/01)
- Under the proposal, private insurers say they want to compete for the low down payment loans they claim are now priced too high by Fannie and Freddie. Choice supporters argue, “give us a shot to fund those loans, and thousands of borrowers will pay less.” (*Washington Post*, Kenneth Harney, 9/15/01)

#### Fannie & Freddie’s comments about the proposal

- In an interview with *Reuters* on October 2, Fannie’s Chairman Franklin Raines noted that the proposal should be questioned. Scrutiny of the proposal should examine who would benefit from the change, whether it would expand the market for home loans, and whether the government would be assuming additional risk, he said. (*Reuters*, Mark Felsenthal, 10/2/01) “It would appear to us that somebody – either taxpayers or consumers – is going to end up with the short end of the stick,” said Bob McCarson, a spokesman for Fannie. “One thing we do know is that these mortgage insurance companies have written it so they will not be the ones holding the short end.” (*Reuters*, Mark Felsenthal, 9/26/01)
- Doug Robinson, a spokesman for Freddie, said the proposal 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 proposal 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) Robinson claimed that the mortgage market is already being well served. "From our read, there are no clear benefits to homebuyers," he said. (*Dow Jones Newswire*, Jennifer Corbett Dooren, 9/28/01)

Mortgage economists find that the proposal would not harm FHA or Ginnie Mae

- **According to a new study by mortgage economists Ann B. Schnare and Susan E. Woodward, the savings to homebuyers under the proposal could be significant and could even turn applications rejected for regular interest rate pricing by Fannie or Freddie into loans funded at prevailing market rates by Ginnie.** (*National Mortgage News Web site*, 9/18/01) The study, which has yet to be released, says giving Ginnie Mae the ability to back mortgages beyond its current domain of government insured or guaranteed home loans would mean more low and moderate-income borrowers would be approved for loans, said people familiar with the study. In addition, it could lower mortgage costs for people whose credit history or economic status might have steered them to a higher interest rate mortgage, the report says. (*Reuters*, Mark Felsenthal, 9/26/01) Copies of the Schnare/Woodward study are expected to be released when the "Ginnie Mae Choice" legislation is introduced in Congress. (*National Mortgage News*, Brian Collins, 9/24/01)
- **"Ginnie Mae Choice" supporters believe the proposal could have generated \$30 billion in low down payment conventional mortgages in 2000 and taken most of its market share from Fannie and Freddie, as opposed to the FHA program. According to the financial analysis by Schnare and Woodward, the proposal would draw only 3% of its customers from the FHA program, which insured nearly \$95 billion in single-family loans last year. Most of the privately insured "Ginnie Mae Choice" loans would come from competing with Fannie and Freddie for A-paper borrowers seeking mortgages with loan-to-value ratios of up to 97%. Fannie and Freddie purchased a total of \$530 billion in loans last year and they could lose up to 5% of their business under the proposal. Supporters also believe the "Ginnie Mae Choice" proposal will allow some A-minus borrowers and some subprime borrowers to qualify for A-paper pricing.** (*National Mortgage News Web site*, 9/18/01; *National Mortgage News*, Brian Collins, 9/24/01)
- Critics have complained that the proposal will cannibalize the FHA program. **However, supporters argue that it will strengthen the FHA and diversify its revenue base. Under the proposal, the FHA and Ginnie Mae would benefit from a new source of revenue.** The FHA would receive 10 basis points for taking a second-loss position on "Ginnie Mae Choice" loans behind the private insurers and Ginnie Mae would receive an 8 basis point guarantee fee for securitizing the mortgages. The 18 basis points in fees is equivalent to the average GSE guarantee fee. On a \$30 billion pool, the financial analysis found that the two agencies would gain \$219 million in fees over the life of the loans. **Schnare commented that FHA has been losing market share and its best customers over the past six years. "This program is one way of bringing those borrowers back to FHA and making FHA's book of business more balanced," she told *National Mortgage News' MortgageWire*.** (*National Mortgage News Web site*, 9/18/01; *National Mortgage News*, Brian Collins, 9/24/01)
- **Woodward noted that the "Ginnie Mae Choice" proposal could provide substantial savings to low down payment borrowers with slightly damaged credit.** For example, an 8.5 percent mortgage at Freddie could be as low as 7 percent at Ginnie under the Choice plan. **Woodward and Schnare's study estimates that the federal budget would also benefit from Ginnie Mae's entry into marketplace competition. If Ginnie Mae purchased \$30 billion a year of low down**

**payment loans, the federal government would gain \$219 million in fee generated revenue over the life of the mortgages.** (*Washington Post*, Kenneth Harney, 9/15/01) Schnare is a former Freddie Mac Senior Vice President and Woodward was a chief economist for HUD (1997-92) and the SEC (1992-1995). (*National Mortgage News*, Brian Collins, 9/24/01)

**American Enterprise Institute to hold October 17 lecture on the Congressional Budget Office's (CBO) study, which found Fannie & Freddie received \$10.6 billion in subsidies from the federal government last year**

**CBO Director Dan Crippen will review a Freddie Mac-commissioned study which criticizes the CBO's findings**

- AEI is hosting a lecture by CBO Director Dan Crippen on October 17 from 10:30 a.m. to noon at the AEI's Wohlstetter Conference Center (1150 17<sup>th</sup> Street, NW, 12th Floor).
- In May, the CBO issued a study on the size of Fannie and Freddie's subsidy, which estimated that Fannie and Freddie received \$10.6 billion in subsidies from the federal government last year (an increase of more than 50% from five years before). In response to the CBO report, Freddie commissioned a study by James C. Miller, a former Reagan Office of Management and Budget Director, and James E. Pearce, an economic consultant. The Miller-Pearce study is highly critical of the CBO report and its methodology and argues that Fannie and Freddie provide benefits to the housing market that exceed the size of their federal subsidies. (*AEI invitation to 10/17/01 lecture*)
- The CBO study also found that while Fannie and Freddie pass about 63% of their federal subsidies on to homebuyers in the form of lower mortgage prices but they retain more than a third of the subsidy (37%) for their shareholders and employees. The CBO also estimated that the GSEs have a 41 basis point borrowing advantage because of their special GSE status and estimated that Fannie and Freddie have a 30 basis point advantage on MBS. The CBO further noted that Fannie and Freddie's ties to the government lower the GSEs' borrowing costs in the financial markets, but raise the cost of borrowing to others in the market, including the Treasury. (See June 1, 2001 *GSE Report* for more details on the CBO study.)

**Capital Markets Subcommittee Chairman Richard Baker (R-LA) says work on his legislation to strengthen regulation of Fannie & Freddie (HR 1409) will wait until next year**

- In an interview on October 5 with *Dow Jones Newswire*, Cong. Baker said work on his bill to strengthen regulation of Fannie and Freddie will be delayed until next year. "Certainly the entire agenda of the subcommittee has been affected by the events of September 11," he stated. He noted that the Financial Services Committee is now more focused on money laundering and other issues directly related to the attacks.
- Cong. Baker did note that if for some reason Congress was still in town through November, it is possible he would hold a hearing on his GSE legislation. "I think there are windows of opportunity," said Cong. Baker about the chances of enacting his GSE legislation, or similar legislation next year. "But clearly the methodology has changed given the events of September 11 and Senator Sarbanes' chairmanship." Cong. Baker said he had hoped to hold a hearing this fall to get the view of the Federal Reserve and the Treasury Department on his bill. (*Dow Jones Newswire*, Jennifer Corbett Dooren, 10/5/01)

## **All GSEs**

### **Incoming President of the Mortgage Bankers Association (MBA) comments on the GSEs**

**“The issue of [GSE] mission creep continues to pop up among our members and among our leadership. And I think there are [fewer] doves around today than there were three years ago. People are becoming more hawkish.”**

**“There [would] be a lot less argument between our membership and the GSEs if there [were] a clear definition of mission.”**

- *Mortgage Banking* magazine did a profile piece on the incoming Chairman of the MBA - Jim Murphy, Chairman and CEO of New England Realty Resources Inc. The piece, written by Janet Reilley Hewitt, included several comments by Murphy on the GSEs.
- **As incoming President of the MBA, Murphy is already familiar with the MBA’s policy statement about the GSEs and is learning more about Fannie and Freddie’s mission creep. Murphy stated, “The issue of mission creep continues to pop up among our members and among our leadership. And I think there are [fewer] doves around today than there were three years ago. People are becoming more hawkish.”** Regarding the relationship of the MBA with Fannie and Freddie, Murphy stated, “I think the goal is to keep communications open between the GSEs and the association. That’s the thing that I think we have begun to accomplish this year. And we’re certainly much improved with Fannie. I think we have a way to go with Freddie in that regard.”
- **In terms of a solution in helping this communication between the MBA’s members and the GSEs, Murphy stated, “There [would] be a lot less argument between our membership and the GSEs if there [were] a clear definition of mission.”** Fannie and Freddie’s charters define the general purpose of the GSEs, but offers few specifics. Murphy explained, “You don’t want to [affect] the ability of the GSEs to continue to provide liquidity for the mortgage business in this country. On the other hand, if you see [in place] a single strong regulator, well-funded, with real oversight on the mission piece,” that would end a lot of the arguments. Murphy claimed that if there were a single strong regulator with strong regulatory powers and the ability to clearly define the GSEs’ mission, everyone would know what the boundaries are. “We don’t have that,” he stated. An “obvious” example of this lack of a clear mission definition is Freddie’s investment in LendingTree. “Many in the industry think that was a commercial loan and clearly outside the bounds,” said Murphy.
- **In Murphy’s opinion, the most pragmatic way to address mission concerns about the GSEs is through the regulatory process, not by opening up the GSEs’ charters to legislative amendments.** He scoffs at the notion that concerns about the GSEs will be addressed while he is President of the MBA. “That would be ambitious on my part to think that it was going to get solved on my watch, because it’s an issue that’s been around a long time,” he said. “...I see the [GSE debate] as a constant battle with progress made and measured probably in inches.”
- Murphy is concerned not only about the GSEs’ expansion into the single-family mortgage market, but also by the sharp inroads he has seen the GSEs cut into the life insurance industry’s share of the

apartment market. He said the commercial mortgage-backed securities (CMBS) market has also lost share in apartment lending to the GSEs. Murphy claimed that HUD's affordable housing goals for Fannie and Freddie are the root of this problem. "When HUD set the goals, it became apparent to most people in the industry that they [Fannie and Freddie] were going to be unable to meet them solely on the single-family side. So it forced them into the multifamily business in a much bigger way," Murphy said. "I think what is happening is you're seeing historic private-sector players crowded out of the business today. To the extent you think competition is a good thing, that's not a good thing for the multifamily business. But I am not about to point a finger and blame the GSEs. The issue is and the battle is, what are the affordable housing goals and are they appropriate," he said. (*Mortgage Banking*, Janet Reilley Hewitt, October 2001)

## ***Fannie Mae and Freddie Mac***

### **MBA and OFHEO meet on OFHEO's risk-based capital rule for Fannie & Freddie**

**MBA asks OFHEO to publish an interim rule, amend the rule, and make a series of technical corrections**

**MBA is concerned about the rule's treatment of AAA-rated and AA-rated mortgage insurance companies and that the overall rule would create "unintended consequences" for the multi-family housing market**

**[OFHEO is Fannie & Freddie's safety and soundness regulator. Under the risk-based capital rule, Fannie & Freddie are required to hold more capital against mortgages insured by AA-rated companies than AAA-rated companies]**

**In related news, AAA-rated mortgage insurance companies are lobbying HUD to maintain the preferred capital treatment of AAA-rated over AA-rated mortgage insurance companies in OFHEO's risk-based capital rule**

- MBA officials met with OFHEO Director Armando Falcon on September 21 to discuss "solvable" problems and unintended consequences of OFHEO's risk-based capital rule for Fannie and Freddie. According to MBA officials, OFHEO appears "very receptive" to the MBA's concerns about the rule. Cheryl Malloy, MBA Senior Staff Vice President for Internal Operations and Coordination, said Falcon seemed responsive to the MBA's concerns. "They're anxious to get out an interim rule to deal with the single-family issue," Malloy said. "But, because we pointed out significant problems with the multifamily rules, they've agreed to hold off until they've had a chance to review it. They were very receptive to our concerns."
- In a September 25 letter to OFHEO, the MBA said that the risk-based capital rule would sharply affect the GSEs' investments in both single-family and multi-family housing. "The rule, as published, will directly lead to fundamental changes in the multifamily and single-family mortgage markets," the MBA said. On the single-family side, the MBA claimed the risk-based capital rule's proposed "haircuts" required for AAA-rated versus AA-rated mortgage insurers would result in concentrations of the private mortgage insurance business with just a few companies. "The rule... would result in reduced competition and increased concentration of risk for the GSEs," wrote the MBA. The MBA argued that Congress, through the Secondary Mortgage Market Enhancement

Act of 1984, conferred parity on highly rated private label mortgage-backed securities (both AAA and AA) with securities issued by Fannie, Freddie, and Ginnie Mae. Thus, by treating the securities with “minimal” differential, OFHEO would follow Congress’ wishes.

- In addition to MBA’s concerns with the treatment of AAA-rated versus AA-rated mortgage insurance companies, Malloy also noted that OFHEO’s rule would create “unintended consequences” for the multi-family housing market, including: (1) elimination of GSE purchases of multi-family ARM loans; (2) severe reduction of GSE purchases of balloon mortgages; (3) sharp reduction of GSE purchases of loans with low income housing tax credits; and (4) a fundamental change in the ability of independent mortgage bankers to compete as lenders in the Fannie Mae DUS [Delegated Underwriting Servicing] program.
- The MBA requested that OFHEO publish an interim rule, amend the final rule, and make a series of technical corrections. (*Real Estate Finance Today*, Mike Sorohan, 10/1/01)
- Under the risk-based capital rule, Fannie and Freddie are required to hold more capital against mortgages insured by AA-rated firms than AAA-rated firms. Currently two mortgage insurers – GE Mortgage Insurance Corp. and United Guaranty Corp. – hold AAA-ratings. The other five mortgage insurers – Radian Group Inc., the PMI Group, Inc., MGIC Mortgage Insurance, Triad Guaranty Inc. and Republic Mortgage Insurance – have AA-ratings. Once the rule is implemented (next year), Fannie and Freddie will be required to take a “haircut” of 5% on exposure insured by a AAA-rated company and a 15% discount for AA-rated firms. (*American Banker*, Robert Julavits, 7/23/01)
- The AAA-rated mortgage insurance companies are lobbying to maintain OFHEO’s capital treatment of AAA-rated and AA-rated mortgage insurance companies. The AAA-rated companies contend the difference is warranted by the need to insure the financial soundness of Fannie and Freddie. They argue a change to the regulation after it was published in the *Federal Register* would indicate that OFHEO is susceptible to arm twisting from Fannie and Freddie. “Our grave concern is that – under intense political pressure from the very institutions it is supposed to regulate – OFHEO is about to compromise the newly published rules,” said Maurice Greenberg, the Chairman and CEO of American International Group, Inc. (the parent company of United Guaranty). (*Reuters*, Mark Felsenthal, 10/3/01)
- In letters addressed to HUD Secretary Mel Martinez, Dennis Nayden, the Chairman and Chief Executive Officer of General Electric Capital Corp. (the parent of GE Mortgage Insurance) and Maurice Greenberg argue against any changes to OFHEO’s rule. “In only three short months, punctuated by intense lobbying by the GSEs and certain AA mortgage insurance companies, OFHEO appears ready to ignore the data and succumb to political pressure,” writes Nayden in his September 20 letter. “In this time of economic uncertainty, any actions to reduce the amount of capital that the two GSEs must hold can only be met with skepticism concerning the motives behind them.” (*American Banker*, Robert Julavits, 10/3/01) “OFHEO must incent capital to remain committed to the industry and not lower the bar on safety and soundness standards,” wrote Nayden. (*Reuters*, Mark Felsenthal, 10/3/01)
- The AA-rated companies claim the rule is unfair. “The AAA-rated mortgage insurers are attempting through the regulatory route to use this to get themselves a competitive advantage in the marketplace that they haven’t been able to get through regular competition,” said Glen Corso, a

spokesman for the PMI Group, Inc., the parent company of AA-rated PMI Mortgage Insurance Co. (*Reuters*, Mark Felsenthal, 10/3/01)

### **Background on OFHEO's risk-based capital rule for Fannie & Freddie**

- After nine years in the making, OFHEO's final risk-based capital rule was published September 13 in the *Federal Register*. The final rule was first released on July 19. The rule establishes the level of capital Fannie and Freddie must maintain to survive a 10-year "stress test" mandated by Congress in the 1992 Act. OFHEO's risk-based capital rule was originally due December 1, 1994. The rule was subject to several rounds of comments over the nine-year period. The rule became effective once it was published in the *Federal Register*, however the rule will not be enforceable until one year after publication. (*Federal Register*, pages 47730-47875, 9/13/01)
- During an August 1 Congressional hearing, OFHEO Director Armando Falcon said OFHEO is open to changes in the risk-based capital rule. However, substantive changes to the rule after its publication in the *Federal Register* (September 13), would be subject to the Administrative Procedures Act (APA), and may be done through an expedited rule-making process. Falcon said he would be willing to reconsider the capital rule's treatment of AAA-rated and AA-rated mortgage insurance companies, through the rule-making process. (*National Mortgage News*, 9/17/01) OFHEO plans to run the first public test of the rule in February 2002, using Fannie and Freddie's fourth quarter 2001 numbers. Fannie and Freddie are also currently testing the risk-based model, however, it is not known if they will release their results before OFHEO releases the results of its first run. (*National Mortgage News*, 9/17/01)

**The consumer group, US Public Interest Research Group (PIRG), is concerned about Fannie & Freddie's pilot programs that would require only one credit report for a borrower, instead of pulling a borrower's credit report from all three of the national credit bureaus**

**"These mortgage gatekeepers [Fannie & Freddie] would be making a terrible mistake if they agreed to buy mortgages on the basis of one flawed credit score...The consumers most hurt by the flaws in their reliance on error-ridden credit scores are the low-income consumers their programs are supposed to help."**

- Edmund Mierzwinski, Consumer Program Director of US PIRG, gave the following remarks about Fannie & Freddie's pilot programs that would require only one credit report for a borrower, instead of pulling a borrower's credit report from all three of the national credit bureaus (Equifax, Experian and Trans Union):

**"We're watching closely as the two government-subsidized mortgage securitization powerhouses--Fannie Mae and Freddie Mac - consider amending their automated underwriting systems to base their decision on whether a loan is conforming on a one-bureau score, rather than a three-bureau analysis. These mortgage gatekeepers would be making a terrible mistake if they agreed to buy mortgages on the basis of one flawed credit score. Fannie and Freddie have tremendous market power that could be used to help us improve the accuracy of the credit reporting system, by insisting that credit report and credit score accuracy be improved. Instead, when they are not either buying self-serving ads or influence-peddling in Washington, they persist in penny-wise, pound-foolish attempts to marginally lower the cost of mortgages, without recognizing that the inherent error bias built into their decision-making models costs consumers on the margin thousands of dollars each in excess mortgage costs for sub-prime loans. The consumers most hurt by the flaws in their**

**reliance on error-ridden credit scores are the low-income consumers their programs are supposed to help.”**

- Mierzwinski’s comments were included in an article adapted from notes from the keynote address before the first Fair Credit Reporting Act conference of the National Association of Consumer Advocates, 9 June 01, Las Vegas, NV. It also appears as the cover story in the July/August 2001 issue of NACA’s newsletter, *The Consumer Advocate*. (July/August 2001 issue of NACA’s newsletter, *The Consumer Advocate*)
- As noted in the June 1, 2001 *GSE Report*, consumer activists say the pilot programs could hurt people with marginal credit.
- **“National credit industry leaders call [the pilot program] dangerous and potentially harmful to borrowers and taxpayers alike.”** (*Washington Post*, Kenneth Harney, 5/12/01)

#### Consumer activists concerned

- **Consumer activists said the policy change might lead to riskier loans or drive more consumers into the subprime category. The activists note that a single-file requirement would leave borrowers at the mercy of credit reporting errors. “Fannie has the market power to be part of the credit-report nightmare solution instead of compounding the credit nightmare problem, as they are doing,” said Ed Mierzwinski, Consumer Program Director for the US Public Interest Research Group. Mr. Mierzwinski added that credit reports and scores are “notoriously inaccurate,” leaving consumers at the margins vulnerable. “It’s absurd for Fannie to consider results from only one repository instead of looking for anomalies between all three and determining which one is most accurate,” he said.**
- David Berenbaum, Senior Vice President of the National Community Reinvestment Coalition, is also concerned about the pilot program because lower credit data requirements could lead to more subprime loans. He noted that consumers must be allowed to review their credit report prior to a credit check, and that “liberal standards” should be applied to ensure that “the most favorable report is used.” (*American Banker*, Tommy Fernandez, 6/1/01)

#### Credit industry experts concerned

- **Credit industry experts oppose the plan, calling it radical. They note that currently almost all the major lending organizations examine borrowers’ credit files from all three national credit bureaus because the information on each borrower varies from bureau to bureau, sometimes significantly. According to a statement by the National Credit Reporting Association, score variances of 100 points or more on the same consumer from different credit repositories are not uncommon. Studies on credit scores have shown that variances of 50, 80, and even 100 points are not uncommon and can disqualify applicants for a home loan or push them into a “subprime” credit category, costing them thousands of dollars more in interest and fees over the life of the mortgage.** (*Washington Post*, Kenneth Harney, 5/12/01; *National Credit Reporting Association, Inc. Position on Fannie Mae’s Proposed Single Pull Strategy*, January 2001)
- **Credit industry critics of Fannie’s pilot program warn that pulling only one credit file could open a Pandora’s box. “If only one file is [examined]...will that file be missing important [negative] information?” said Terry W. Clemens, Executive Director of the National Credit Reporting Association. “Will a loan decision be based on credit data that does not even**

**belong to the applicant? How can the minimal savings this plan might provide consumers justify the potential overcharging of thousands of dollars of interest” because of erroneous, negative information? Clemens expressed “deep concerns” over Fannie’s pilot program, saying it raises the prospect of greater risk in lending and more chance of unfairly giving borrowers worse credit ratings than they deserve. “It’s quicker and cheaper, but it’s really not doing Fannie Mae or the consumer justice,” said Clemens. “The quality of the loan decision is going to suffer, there’s no way around it.”** (*Washington Post*, Kenneth Harney, 5/12/01; *Reuters*, Mark Felsenthal, 5/14/01)

- Credit industry experts note that the variances among the credit bureaus occur because each of the bureaus receives credit information, public records, and debt-collection reports from different networks of sources in each geographical region. **Only by accessing files at all three national bureaus, and then merging them, can a creditor be certain of getting everything on file about the consumer.** (*Washington Post*, Kenneth Harney, 5/12/01; *American Banker*, Tommy Fernandez, 6/1/01) (For more information, please see the June 1, 2001 *GSE Report*.)

#### **GSE debt news:**

- (1) After the September 11 attacks, many economists now expect the US to run a deficit and Treasurys will become more available**
- (2) Foreign central banks purchase more Treasurys than agency debt in the third quarter**
- (3) Freddie issues first large euro-denominated issue in the global markets since the events of September 11**

#### Background on GSE debt and the supply of Treasurys

- Over the past few years, as the national debt was being paid down and the US was running budget surpluses, the supply of Treasury securities shrunk. Investors, traders, borrowers, and even the US Federal Reserve were being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark were the debt securities of Fannie and Freddie. Investors viewed them as “almost” as good as US Treasurys because of the implicit government guarantee of Fannie and Freddie’s securities. Fannie and Freddie began bond issuance programs (Fannie – Benchmark bond program; Freddie- Reference bond program) to mirror traditional Treasury operations in size and regularity as an alternative benchmark.
- After the September 11 attacks, many economists now expect the US to run a deficit and Treasurys will become more available. The economy was unstable even before the attacks, which are boosting US spending on rebuilding and defense. Now, “it’s extremely doubtful the US will be running a surplus for the upcoming fiscal year, and probably will run a deficit,” said Gerald Lucas, Senior Government Strategist at Merrill Lynch. “Treasury supply will not be decreasing any more.” (*Reuters English News Service*, 10/3/01)

#### **Foreign central banks purchase more Treasurys than agency debt in the third quarter**

- Foreign central banks purchased more US Treasurys than agency debt in the third quarter, as US government spending increased and investors fled to the safest dollar-based securities after the September 11 attacks. In recent quarters, foreign central bank holdings of US Treasurys had gradually fallen while agency holdings increased. The Federal Reserve said it held \$602.3 billion of Treasurys and \$128 billion of agency debt in custody for foreign accounts in the week ended September 26. Those Treasury holdings rose from \$577.3 billion at the end of June, while agency

holdings were unchanged. Investors initially sold agency debt and other spread products after the attacks. After that selling bout, buyers then rushed back to agencies as an alternative safe haven. The past quarter's push by some accounts to outweigh Treasuries has not reversed the year's trend toward agencies. Foreign central bank Treasury holdings rose \$13.1 billion so far this year, while agency holdings gained \$25.2 billion, based on Fed custody holdings data. (*Reuters English News Service*, Lynn Adler, 10/3/01)

### **Freddie issues first large euro-denominated issue in the global markets since the events of September 11**

- Freddie marked the first anniversary of its euro Reference note program with a five billion euro 10-year issue (approximately \$4.6 billion) on September 26. Freddie has so far sold 20 billion euro-denominated debt under its euro Reference note program, which was launched last September. Funding costs have been higher than in the US market, but Freddie said in May that it would extend the program to encompass an additional 25 billion to 30 billion euros by December 2002. (*Reuters English News Service*, 9/26/01)
- On September 27 Freddie priced the euro Reference notes. The issue, due January 15, 2012, was priced at 99.207 to yield 5.23%, 46 basis points over the 5% German Bund security due July 4, 2001 and 33 basis points over the 6.5% French OAT bond due April 25, 2011. "We were extremely pleased with the substantial, broad-based participation of about 220 investors in this issue, given the current uncertainty and caution in the bond market," said Louise Herrle, Vice President and Treasurer at Freddie. The issue was the first large euro-denominated issue in the global capital markets since the events of September 11, Freddie Mac said. (*National Mortgage News*, 9/27/01)
- The issuance reflected a confidence among European investors in Freddie and a perception that the GSE is more intertwined with the US government than is actually the case, analysts said. "They [Freddie] have been issuing euros for a while and it has become a very substantial market for them as their name becomes well known within the investor base," said Victoria Wagner, an analyst with Standard & Poor's. "This is a market where investors would see them as a 'flight to quality' option." (*Real Estate Finance Today*, Chris De Reza, 10/8/01)
- Herrle said Freddie had achieved many aims during the first year of borrowing in euros. The investor base has been expanded by several hundred new accounts, and the cost of borrowing is now very close to that in dollars. She noted that around 220 investors took part in the September 26 issuance, many of them new to buying Freddie's bonds. "We have benefited from the flight to quality, although it was not the driving factor behind the deal's success," said Herrle. "We may have attracted some investors who might have previously bought lower-rated credits." (*Financial Times* (London), 9/28/01)

**UBS Warburg says that since Fannie & Freddie have been insuring an increasing number of loans that traditionally fell under the Alt-A area [subprime], the remaining conforming-sized loans in non-GSE portfolios usually entail more risk factors and require more stringent underwriting because they don't have GSE backing**

**Although there is a relative cheapness in the non-agency conforming Alt-A sector, analysts say that there is just not enough product out there to package a purely conforming Alt-A deal because so much of the Alt-As are purchased by the GSEs. "It is very difficult to go out and buy a package of conforming Alt-A at this point because there isn't enough production left over from what the agencies take up," said a mortgage strategist.**

- Some market players are noting that there is not enough Alt-A collateral left as Fannie and Freddie are now purchasing most of the supply. According to a recent report by UBS Warburg, non-agency, conforming, Alt-A paper is very cheap at current pricing. UBS said that since Fannie and Freddie have been insuring an increased number of loans that traditionally fell under the Alt-A area [subprime], the remaining conforming-sized loans in non-agency portfolios usually entail more risk factors and require more stringent underwriting because they don't have agency backing
- The higher risk profile causes non-agency conforming Alt-A collateral to be less refinanceable in a rally, which is one of the reasons why UBS finds value in them. However, although there is a relative cheapness in the non-agency conforming Alt-A sector, analysts say that there is just not enough product out there to package a purely conforming Alt-A deal. "It is very difficult to go out and buy a package of conforming Alt-A at this point because there isn't enough production left over from what the agencies take up," said a mortgage strategist. Currently, Alt-A deals are usually made up of a big proportion of jumbo-sized loans – in direct contrast to the way it was done in the past. In 1997, Alt-A deals were generally equally divided into conforming and non-conforming loans. And in 1998 to 1999, conforming and non-conforming Alt-A loans began to be placed into separate packages. "They have stopped doing that because the agencies are now so active in the Alt-A market and it has now become a matter of relative execution," said the strategist.
- According to a report by Salomon Smith Barney, some lenders prefer to sell eligible Alt-A loans to Fannie and Freddie due to better pricing and lower risk. Because of this, the average loan size and average loan-to-value of the loans in the non-agency Alt-A transactions has considerably increased. With the significant amount of eligible loans sold to the GSEs, jumbo loans are starting to comprise a larger share of private-label Alt-As in part because of competition from Fannie and Freddie. "The fact the GSEs have developed a bigger appetite for Alt-A loans means that Alt-A loans within the agency limit are more likely to go to the GSEs," said Mark Adelson, a director at Nomura Securities. "This leaves a greater proportion of loans with higher balances to be securitized in private transactions." (*Asset Securitization Report*, Karen Sibayan, 8/13/01)

### **Fannie & Freddie's purchases fell in August from the previous month**

**However, Fannie's purchases were up 106% and Freddie's purchases were up 122% over the same time last year**

- Fannie purchased \$68.9 billion in loans during August, a slight decline from the previous month, but a 106% gain compared to the same month last year. Even though Fannie's purchases declined from July and June, August was its third-best purchase month of the year. Fannie's August purchases included \$22.11 billion in mortgages acquired for its own portfolio, and \$46.88 billion in "lender originated" mortgage-backed securities. Fannie reported that its net interest margin increased by five basis points during the month of August to 111 basis points. Fannie's mortgage portfolio now stands at \$684 billion – a 19.5% gain over 12 months. Fannie's single-family delinquency ratio at the end of the month – 43 basis points – was unchanged from the previous three months. However, its multi-family delinquency ratio rose to 11 basis points from 7 basis points in July.
- Freddie acquired \$40.6 billion in mortgages in August – an 18% decline from the previous month. However, compared with figures for the same month last year, Freddie's purchases increased a staggering 122%. (*National Mortgage News Daily Website*, 9/21/01; *National Mortgage News*, 9/24/01)

### **Fannie & Freddie's earnings look even better now, analysts say**

- Fannie and Freddie's earnings may look even better after the September 11 attacks, analysts said. A major driving of Fannie and Freddie's earnings is the spread between where they can fund and where they can acquire mortgage bonds or mortgages for their own portfolio, said Salomon Smith Barney analyst Thomas O'Donnell. The wider the spread, the higher their earnings. That spread had been widening all year, thanks mainly to lower interest rates and a steeper yield curve, which resulted in decreasing agency funding levels and comparatively higher yields on mortgages and mortgage bonds, said Sanford C. Bernstein & Co. analyst Jonathan Gray. The spread appears to be even wider following the September 11 attacks, as investors are purchasing bonds the GSEs issue in a flight to quality, and spreads for some sectors of the agency yield curve tightened beyond pre-attacks levels, Gray said. Plus, with lower interest rates, mortgage rates are likely to stay at current low levels or fall, and consumers are more likely to refinance their homes. The benefits from lower interest rates and continuing refinancings would more than offset the negative effects of higher credit losses, which are typical in a recession, Gray said. (*Reuters*, Dan Wilchins, 9/28/01)

## Fannie & Freddie rank among the world's largest companies

- The *Wall Street Journal* released a listing of the world's 100 largest public companies. The rankings were based on the market value as of August 31, 2001, as determined by the *Wall Street Journal* Market Data Group (In millions of US dollars; financial data at December 31, 2000, exchange rates; percentage changes based on home currencies.) Fannie jumped to #39 from last year's ranking of #91. Freddie was ranked #87 and was not listed in last year's ranking.

2001 Rank	2000 Rank	Company (Country)	Market Value	Fiscal Year 2000 Sales*
39	91	Fannie Mae (US)	77,688	44,088
87	----	Freddie Mac (US)	43,805	29,969
89	----	Merrill Lynch (US)	43,093	44,872
92	----	DuPont (US)	42,714	28,268
99	52	Sony (Japan)	40,257	63,946

\* March 31, 2001, results are used for Japanese companies (*Wall Street Journal*, 10/1/01)

### OFHEO says Fannie & Freddie are adequately capitalized for this quarter under their minimum capital requirements

#### OFHEO does not yet report whether Fannie & Freddie are adequately capitalized under their risk-based capital requirements

- OFHEO Director Armando Falcon, Jr., announced that both Fannie and Freddie were adequately capitalized at June 30, 2001. The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the OFHEO Director to determine the capital level and classification of the Enterprises not less than quarterly. OFHEO determines whether the Enterprises are adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized.
- OFHEO determined that Fannie's minimum capital requirement was \$22.177 billion and critical capital level was \$11.297 billion at June 30, 2001. Thus, Fannie Mae's core capital of \$22.978 billion on that date exceeded the minimum capital requirement by \$801 million and exceeded the critical capital level by \$11.682 billion.\* Freddie's minimum capital requirement was \$16.303 billion and critical capital level was \$8.311 billion at June 30, 2001. Thus, Freddie's core capital of \$16.870 billion on that date exceeded the minimum capital requirement by \$567 million and exceeded the critical capital level by \$8.559 billion.\*

\*Although OFHEO's risk-based capital rule is final, the '92 Act provides a one-year period between its effective date (September 13, 2001) and the time OFHEO may classify an Enterprise based on its risk-based capital requirement. Therefore, during this period, OFHEO will continue to classify the Enterprises based on their minimum capital requirement. (*OFHEO press release*, 10/3/01)

#### Background

- OFHEO's final risk-based capital rule was published September 13 in the *Federal Register*, which establishes the level of capital Fannie and Freddie must maintain to survive a 10-year "stress test" mandated by Congress in the 1992 Act. The rule became effective once it was published in the

*Federal Register*, however the rule will not be enforceable until one year after publication.  
(*Federal Register*, pages 47730-47875, 9/13/01)

## **Fannie Mae**

### **Fannie cut to “buy” at A.G. Edwards**

- Analyst Joel J. Houck at A.G. EDWARDS & SONS INC downgraded Fannie to “buy” from “strong buy”. (*Bloomberg*, 10/4/01)

### **Are people who live near public transportation better credit risks?**

**A study on location-efficient-mortgage (LEM) programs, such as the \$100 million pilot by Fannie, finds that transportation savings assumed in LEM calculations are exaggerated and raises doubts that these borrowers are better credit risks**

- A *Forbes Magazine* article questioned whether people who live near public transportation are better credit risks. The article noted that environmentalists would like you to think so. The article noted that the latest in social engineering is the location-efficient mortgage (LEM) program, in which the purchaser of a house near public transportation can qualify for a mortgage as much as 45% larger than the borrower’s income would normally allow with a down-payment of only 3% of the purchase price. Fannie currently has a \$100 million Location Efficient Mortgage pilot available.
- *Forbes Magazine* noted that the LEM program was conceived by the Natural Resources Defense Council and developed with grants from the EPA and the Energy and Transportation Department. Fannie has agreed to purchase \$100 million of LEMs now offered in San Francisco, Seattle, Los Angeles and Chicago. The rationale behind looser underwriting guidelines for LEM borrowers is that buyers in areas with public transportation have lower transportation costs and so they can spend more money on housing. However, to qualify for a LEM, you don’t have to use public transportation. For example, Judy Peralta, who purchased a new home in Chicago this spring with a LEM drives her car to work every morning to her job in the suburbs because switching to public transportation would double her commute.
- In a soon to be published report, Economists Allen Blackman and Alan Krupnick of Resources for the Future (a DC think tank) raise serious concerns about LEM performance. They note that borrowers in areas that would qualify for LEMs have default rates that are the same as borrowers of similar income in areas that wouldn’t qualify – and that’s without the higher debt-to-income ratios or lower down-payments allowed under LEMs. The economists further argue that the transportation savings assumed in LEM calculations are exaggerated. (*Forbes Magazine*, Ira Carnahan, 8/20/01)

**Fannie hires prominent Republican public relations specialist, Chuck Greener, to be Senior Vice President for Communications**

**Fannie also hires a former aide to Senator Kit Bond (R-MO)**

- Fannie hired Chuck Greener, the highly regarded general manager of public relations firm Porter Novelli as Senior Vice President for Communications. Greener replaces John Buckley, who now works for AOL Time Warner. Greener's appointment at Fannie is subject to board approval. Greener will join Fannie in early November. As SVP for communications, he will be in charge of advertising, media relations, Internet and Intranet websites, and publications. Greener will also serve on the company's Operating Committee. Prior to joining Porter Novelli in 1995, Greener served for over two years as Director of Communications at the Republican National Committee. Prior to the RNC, Greener was Vice President of the Eddie Mahe Company. He also served for two years in the White House as a special assistant to President Reagan for Legislative Affairs, and for seven years as a congressional chief of staff for Cong. Bob McEwen (R-OH). (*Washington Post*, Al Kamen, 10/3/01; *National Mortgage News Daily website*, 10/3/01; *Fannie press release*, 10/3/01)
- Fannie has also hired Senator Kit Bond's (R-MO) banking counsel, David Bohley, to fill the newly created post of industry relations director. In his new position, Bohley will work with bankers and their trade groups to find common ground on policy issues. Bohley was a lawyer with Kirkpatrick & Lockhart prior to joining Senator Bond's staff. (*American Banker*, 10/1/01)

**Fannie raises the allowable attorney fees for foreclosures**

- In June, Fannie raised the allowable attorney fees for foreclosure-related matters in 48 states in its first comprehensive change in the attorney fees and foreclosure timelines since 1998. The three jurisdictions that were not increased are California (updated in 1999), Guam and Wyoming. Fannie also decided that foreclosures can be completed in a shorter timeline than previously allowed for a number of states. Fannie also added new firms and removed some existing firms from its list of Fannie-retained attorneys. (*Mortgage Servicing News*, 9/21/01)

**Fannie to use MortgageRamp technology**

**MortgageRamp is a technology provider for the commercial real estate industry**

- MortgageRamp, a technology provider for the commercial real estate industry, announced that Fannie will use MortgageRamp's DealCentral online technology platform to support loans delivered under Fannie's "aggregation facility." The arrangement will require MortgageRamp to create a customized platform for Fannie that will support the delivery of data to and from the GSE, MortgageRamp, and GMAC Commercial Mortgage Corp. "The enhanced DealCentral solution will support transaction waivers, loan approvals, and pipeline management for loans delivered under Fannie's aggregation facility, and could ultimately feed directly into our committing and delivery system," said Ken Bacon, Fannie's Senior Vice President for Multi-family Lending and Investment. (*National Mortgage News Daily website*, 10/1/01)

### **Fannie launches a “dedicated student housing” pilot**

- Fannie launched a “dedicated student housing” pilot program targeting properties that are at least 80% occupied by students. Fannie has provided less than \$100 million in financing through the program, which was launched this summer, according to Caroline Blakely, Vice President of Structured Transactions at Fannie. She noted that this sort of lending calls for “specialized risk assessment given that they (the collateral multi-family properties) are 80% tenanted by students.” Some of the factors taken into account by Fannie are the following: (1) the strength of the university; (2) the expected future matriculation rate at the university; (3) the size of the university (Fannie prefers universities with at least 10,000 students enrolled); (4) the functional obsolescence of the multi-family building; and (5) its proximity to the university.
- Fannie has signed on three lenders to the program – GMAC Commercial Mortgage, Green Park Financial, and Midland Mortgage. (*National Mortgage News*, 9/24/01)

### **Freddie Mac**

#### **Freddie “blacklists” a Poconos home builder, his mortgage company, and a local appraiser for alleged fraud**

##### **The “blacklisting” bars the group from doing business with Freddie**

- Freddie has “blacklisted” Poconos home builder Gene Percudani, his company Chapel Creek Mortgage, and appraiser Dominick Stranieri, barring them from doing business with Freddie. The group is among a handful of real estate professionals who have been accused of luring first-time homebuyers (many minority and low-income) into the Poconos area and then artificially inflating home prices and approving the homebuyers for mortgages beyond their financial needs. The action, one of the most severe penalties that can be imposed by a GSE, was taken recently following a five-month investigation into alleged real estate fraud in the Poconos. Fannie, the Monroe County district attorney, state attorney general, and the Federal Reserve Bank are also investigating mortgage real estate fraud in the Poconos.
- Freddie’s “blacklisting” of the group severely restricts the ability of a principal or company to obtain approval for mortgage loans because Freddie will not purchase any loans that went through a person or a company on the exclusionary list, banking officials said. “There would have to be major violations for Freddie Mac to place someone on its exclusionary list,” said Bud Carter, a spokesman for the National Association of Mortgage Brokers. “Anyone who does business with Freddie Mac would now avoid using that person, and it will have an impact on that person’s business,” said Carter. (*Associated Press*, 10/3/01)

## **Freddie expands the distribution of its automated valuation appraisal model – Home Value Explorer**

### **Ellie Mae plans to make Freddie's technology available to over 100,000 brokers**

- Freddie announced that its Home Value Explorer (HVE) is now available to approved distributors through Advanced Logic Systems, Inc. (ALSI). In addition, Freddie is releasing a new version of its HVE automated valuation model (AVM). HVE is an AVM that provides estimates of current residential property in all 50 states and the District of Columbia. Freddie claims that the ALSI will make it easier for Freddie to perform frequent product enhancements and upgrades to its HVE service. (*Freddie press release, 9/26/01*) RealEc Technologies, a business-to-business e-commerce exchange for real estate transactions, announced that it has established a direct connection to ALSI for access to Freddie's HVE. (*PR Newswire, 9/25/01*)
- Ellie Mae announced that it has established a direct connection to Applied Technology Solution Integrators, Inc. (ATSI) for access to Freddie's HVE. "With Ellie Mae we are able to receive orders from over 100,000 broker desktops directory from the ePASS Business Center. In addition, the clients of Ellie Mae do not have to establish special connectivity in order to use this powerful tool. Any Ellie Mae customer can access it," said Paul Harkins, CEO of ATSI. Ellie Mae is the leading Internet enabler for the mortgage brokerage industry and the largest loan origination software provider in the US. Ellie Mae plans to make the technology available to over 100,000 brokers who use the company's ePASS Business Center. The ePASS Business Center is a business-to-business e-commerce platform that integrates brokers with service providers and participating wholesale lenders through the Internet. (*Business Wire, 10/4/01; National Mortgage News Daily website, 10/5/01*)
- Dattar Systems Inc., an e-commerce company, announced the integration of AppraisalTrac, Dattar's web-based collateral services workflow application, and Freddie's HVE provided by DataQuick Information Systems. The agreement allows AppraisalTrac clients access to Freddie's HVE as one of their AppraisalTrac workflow options. "Home Value Explorer gives AppraisalTrac clients another valuable resource to help in the appraisal review, risk assessment and quality control process," said Dattar Vice President Leslie Hurlburt. "Instead of having to go to various systems to order collateral services, our clients can order the services they need right from their workflow application. This helps keep all of the related information achieved with the appraisal order." (*Inman News Feature, 9/6/01*)
- As noted in the August 10, 2001 *GSE Report*, many of the nation's 85,000 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 Patrick Barta with the *Wall Street Journal*. "We're risking catastrophic losses in the residential real-estate market" if the automated appraisal systems turn out to be inaccurate on a wide scale, warned Don Kelly, a spokesman for the Appraisal Institute, whose members have met with several Congressional Members to voice their concerns. The appraisers also view the systems as the latest effort by Fannie and Freddie to expand into portions of the mortgage market that they don't already dominate. Fannie and Freddie "have just found another way to make a buck," said Joseph Murin, CEO of Lender's Service. Fannie and Freddie said their only interest is in eliminating unnecessary costs for homebuyers. Fannie and Freddie claim that only 10% or less of the loans they purchase qualify for a completely automated

appraisal, however they believe that percentage will increase. (*Wall Street Journal*, Patrick Barta, 7/20/01)

### **Freddie finalizes first two transactions under an agreement with the Rural Housing Service (RHS)**

- Freddie announced that its agreement with the Rural Housing Service (RHS) has produced two new transactions with P/R Mortgage & Investment Corporation: Carriage Green Apartments in Plymouth, IN, \$1.85 million, and Meadowood Apartments, in Rensselaer, IN, \$1.43 million. The principal borrower, who was the same for both transactions, chose 30-year mortgages with 30-year amortization schedules. Both transactions combine Section 42 tax credits, a Section 538 RHS guarantee on 90 percent of the loan, and an annual interest credit paid by RHS for the life of the loan. In addition, the borrower will use part of an Affordable Housing Program grant from the FHLBank of Indianapolis to cover the cost of converting several units into handicapped-accessible units. (*Freddie press release*, 10/2/01)

### **Freddie expands its multi-family presence in Boston**

- Freddie announced that since the beginning of 2001 it has purchased more than \$200 million of mortgages secured by multi-family properties located in the Boston metropolitan area. “Our ability to offer competitive pricing, Early Rate-Lock delivery and interest-only financing has given us a competitive edge,” said Mitchell Kiffe, Freddie’s vice president of Loan Production. “The expansion of our product line dovetailed nicely with the upswing in Boston’s economy and we’ve closed transactions of all types, including conventional mortgages, interest-only mortgages and seniors mortgages. We anticipate and look forward to a continuing flow of business from the Boston metropolitan area,” said Kiffe. Three of Freddie Mac’s recent Boston transactions include:
- Terrace Estates: Freddie purchased a \$22 million, 10-year interest-only mortgage from Legg Mason Real Estate Services to finance Terrace Estates, a 521-unit property located 15 miles northeast of Boston. According to Freddie, all of the units are affordable to families with low/moderate incomes and are housed in both townhouse-style and garden-style buildings. The new Freddie borrower, a Massachusetts nominee trust, elected to take advantage of Freddie’s Early-Rate Lock delivery option.
- Cliffside Commons Apartments: Freddie’s purchase of a five-year interest-only mortgage from Columbia National Real Estate Finance enabled a repeat borrower to take out a construction loan secured by a new 295-unit property in Malden, MA, located six miles Northwest of Boston. The borrower elected Freddie’s Early Rate-Lock option.
- Devonshire Apartments: A new Freddie borrower, a Massachusetts realty trust, elected financing through GMAC Commercial Mortgage Corp. The borrower chose Freddie’s Early Rate-Lock delivery option and an \$80 million 30-year mortgage with a 30-year amortization period that is interest-only for the first 10 years and then converts to a self-liquidating 20-year loan. Devonshire Apartments contain 475 units that are a mix of studio, one-bedroom, two-bedroom and three-bedroom. The property is located in Boston’s financial district. Many tenants can walk to work as well as to many of Boston’s points of interest, including Faneuil Hall Marketplace, the shopping district at Downtown Crossing, The Public Garden, the theatre district, the waterfront area and the government center. (*Freddie press release*, 10/5/01)

### **Freddie names Edmond Sannini as Senior Vice President and Corporate Controller**

- Freddie announced that Edmond Sannini has been named the corporation's SVP and corporate controller. In this capacity, Sannini will be responsible for the corporation's accounting and control function. Sannini, a finance industry veteran, most recently served as managing director and chief operating officer of J.P. Morgan Chase & Co.'s Global Finance Group. Since 1984, he has served in a variety of increasingly responsible roles at J.P. Morgan Chase & Co., including managing director and CFO of its Europe, Africa, Middle East and London operations.
- During his career at J.P. Morgan Chase & Co., Sannini played a leadership role in the financial integration of the Chase/Morgan merger. He also managed all corporate controller functions including public and regulatory reporting, legal entity controllers, accounting policies, regulatory relationships, treasury financial control and rating agency communications. (*Freddie press release, 10/1/01*)

### **Freddie announces new heads of capital deployment and credit risk management**

- Freddie announced today that David Andrukonis, senior vice president and chief credit officer will become head of Single Family Capital Deployment, a new position, and that Bob Tsien, formerly vice president of Multi-family Credit Risk Management was promoted to Senior Vice President and Chief Credit Officer.
- Andrukonis will report to Paul Peterson, executive vice president of Single Family. Previously, Andrukonis was Chief Credit Officer responsible for overseeing credit risk in the corporation's three main lines of business – Single-family, Investment and Multi-family. Prior to that he was senior vice president and general manager of the Seller Division, responsible for all marketing, sales and affordable lending activities.
- Tsien joined Freddie Mac in April 2000, and has been responsible for credit risk management of the multi-family mortgage portfolio. In his new position, Tsien will report to David W. Glenn, vice chairman and president of Freddie. Before joining Freddie, Tsien was director of risk management with Titanium Investment Company, West Palm Beach, a diversified real estate finance company engaged in conduit securitizations, discount loan purchases, mezzanine financing and CMBS trading. (*Freddie press release, 9/26/01*)

## ***Federal Home Loan Banks***

### **FHFB solicits comments on multiple FHLBank memberships and the effects it would have on the FHLBank System**

- The FHFB approved on September 26 a notice and solicitation of comments that addresses the issue of multiple memberships in FHLBanks, particularly the ramifications it could have for the FHLBank System. The notice solicits public comment on a series of policy questions relating to whether single financial institutions should be allowed to become members of more than one FHLBank at the same time, particularly in cases where a member of one FHLBank district acquires a member institution in a different FHLBank district. (*FHFB press release, 9/26/01*) The notice

was published in the October 3 *Federal Register* with comments due by January 2, 2002. (*Federal Register*, pages 50366-50375, 10/3/01)

- “This issue relates to the consolidation that has been occurring in the banking industry, and raises a variety of questions about how the FHLBank System should respond to these changes,” said FHFBC Chairman J. Timothy O’Neill. “Since this is an issue of great importance to the future of the FHLBank System, we want the FHLBanks, their members and any other interested parties to make their views known. Their input will be of great assistance as we decide what our course of action will be.” (*FHFBC press release*, 9/26/01)
- In introducing the proposed solicitation, Scott Smith, Acting Director of Policy Research and Analysis at the FHFBC, noted that for all practical purposes the idea of single membership already has been challenged. “Currently there are more than 100 holding companies that through their subsidiaries have access to memberships in more than one FHLBank,” Smith said. “And there are nearly 200 members with branch offices that reach across FHLBank district boundaries.” Smith also said some members that are subsidiaries of holding companies and have affiliates that are members of other FHLBanks now have a status nearly equivalent to concurrent membership in more than one FHLBank district. “The current rules concerning which FHLBank or how many FHLBanks a member may join were initially designed nearly 70 years ago,” Smith said. “At that time the reach of financial institutions was significantly constrained by state laws, largely within a single state or smaller areas.” Since then, he said, statutory and regulatory changes, as well as the evolution of the financial services industry has had a significant impact on the operating environment of the FHLBanks and their members. (*BNA Daily Report for Executives*, Richard Cowden, 9/27/01)
- While neutral on the issue of dual FHLBank membership, FHFBC members said that granting such requests would have a dramatic impact on the future of the FHLBank system. “This is the most significant issue that the system needs to address,” said FHFBC Board Member Franz Leichter. “The dikes are beginning to crumble, and I don’t think we can play King Canute and ask that the tides not come. The changes in the financial world demand we look at the system so we can reconfirm its mission.” (*American Banker*, Rob Blackwell, 9/27/01) “Depending on how it is structured, it may serve to lessen the concentration of credit risks at those FHLBanks with very large and growing members,” staffer Scott Smith told the board members. “However, the advent of concurrent membership could undermine the cooperative nature of the system and lead to financial stress,” he said. Leichter noted that the FHFBC is not limited to two choices of approving or disapproving multi-district memberships. “Maybe we will have a solution which will recognize the activities of (nationwide) banks...without necessarily having to go to multi-district memberships,” he explained. (*National Mortgage News*, Brian Collins, 10/1/01)
- Opponents of dual FHLBank membership have argued that multiple memberships would force the FHLBanks to compete with one another and would give large financial institutions an unfair advantage. (*American Banker*, Rob Blackwell, 9/27/01) Many FHLBanks have members that are disproportionately large, Smith said, and operate across district boundaries. Eight of the FHLBanks have a single member with more assets than the bank itself, Smith said. The solicitation noted that inter-district activities of member banks have affected the regional function of the FHLBanks and that allowing concurrent membership in more than one FHLBank “would likely serve to increase the potential competition among the FHLBanks.” Such a prospect, the solicitation noted, could be beneficial by limiting the potential for concentration of risks associated

with having a one or a few large institutions in a single district. (*BNA Daily Report for Executives*, Richard Cowden, 9/27/01)

- The solicitation poses nine separate questions relating to: 1) consolidation of institutions within the banking industry; 2) how such consolidation affects the FHLBank System; 3) whether permitting multiple memberships by one institution would enhance or detract from the cooperative nature of the FHLBank System; 4) what alternatives might better address these issues, and 5) how it would affect the Affordable Housing Program (AHP). (*FHFB press release*, 9/26/01)
- The solicitation also poses eight questions about how to resolve the variety of regulatory issues that would need to be addressed if single institutions were allowed to join more than one FHLBank. Under current FHFB regulations, no single institution can be a member of more than one FHLBank. However, about 100 holding companies have two or more subsidiaries, each of which belong to a different FHLBank. (*FHFB press release*, 9/26/01)
- As noted in previous *GSE Reports*, 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.
- The FHFB also approved on September 26 a final rule on the AHP that streamlines monitoring requirements and enhances program implementation. (*FHFB press release*, 9/26/01) The final rule was published in the *Federal Register* on October 3. (*Federal Register*, pages 50296-50302, 10/3/01) In addition, the FHFB approved a final rule with technical amendments to the Community Investment Cash Advance program regulations, and a waiver extending until January 28, 2002 compliance with regulations relating to unsecured credit limits and minimum liquidity requirements. (*FHFB press release*, 9/26/01)

**Lenders participating in the FHLBanks' Mortgage Partnership Finance (MPF) program cannot currently sell their servicing rights but they can outsource to manage the portfolio**

**MPF may add a servicing-release option**

- The FHLBank of Chicago says it may introduce a "servicing-release" option, but at the moment lenders participating in the MPF program have to retain ownership of servicing rights on the loans they originate. The MPF program provides lenders an alternative to selling fixed-rate, conventional and guaranteed loans to Fannie and Freddie. Under the MPF program, the Chicago FHLBank acting as a secondary market for mortgage loans assumes the interest rate risk. The participating financial institution that originates that loan shares credit risk with the FHLBank, and that participating institution also retains servicing of the loan. (*National Mortgage News*, 9/24/01)
- Although lenders may not currently sell their servicing rights under the MPF program, that does not mean that lenders have to perform loan administration themselves, explained one subservicing expert. Greg Harney, Vice President of Essex Home Mortgage Servicing Corp, Norfolk, VA, says that subservicing can allow more lenders to participate in the MPF program. "By engaging an

approved subservicer, PFIs [participating financial institutions] can participate in the program without building servicing infrastructure,” he said. Harney noted that many small and mid-size lenders are not aware that they can participate in the MPF program by hiring a subservicer. Today, many of the MPF lenders that are using an approved subservicer are larger lenders that had subservicers already in place when they joined the program. (*National Mortgage News*, 9/24/01)

- While the FHLBank of Chicago has discussed creating a servicing-release option, such an option is not yet available. (*National Mortgage News*, 9/24/01) The Chicago FHLBank hopes to add servicing released transactions to the MPF program. Such a product “is critical” to the continued success of the MPF program, said Raymond Christian, President of the FHLBank of Atlanta, who announced the initiative at the Eastern Secondary Mortgage Market Conference. Due to consolidation in the servicing arena and the aggressive servicing multiples that are being paid, Christian said many members have found it more economical to sell their loans on a servicing-released basis. (*National Mortgage News*, Lew Sichelman, 9/17/01)

<p style="text-align: center;"><b>FHLBank of New York finds an interim headquarters after its headquarters was destroyed as a result of the September 11 attacks in New York City</b></p>
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- The FHLBank of New York has set up an interim office in Manhattan on the mezzanine level of the MetLife Building at 200 Park Avenue. A few of the FHLBanks’ departments, including accounting, will continue to operate out of the bank’s back-up facility in Jersey City. FHLBank of New York President Alfred DelliBovi said he expects to remain in the temporary headquarters for about a year while the bank seeks a permanent office in Manhattan. (*American Banker*, Laura Thompson, 9/27/01) As reported in the September 21 *GSE Report*, the headquarters of the FHLBank of New York at 7 World Trade Center was destroyed as a result of the September 11 terrorist attacks in New York, but all of the 150 FHLBank employees and four visiting bank examiners were safely evacuated.

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