

The **GSE** REPORT™

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Major Events

Hurricane Katrina brings devastation to the Gulf Coast region

- On August 29th, Hurricane Katrina, a Cat-4 storm, battered the Gulf coast with 140-mile-an-hour winds, devastating a 90,000 square mile area along the coast of Mississippi, Louisiana and parts of Alabama and triggering the evacuation of more than 248,000 residents. Risk Management Solutions estimates that the hurricane has caused at least \$125 billion in economic damage and could cost the insurance industry up to \$60 billion in claims, making the storm the most expensive natural disaster in the country's history. According to a CBO analysis, damage from Katrina could result in up to 400,000 jobs lost and slower U.S. economic growth in the near term. CBO director Douglas Holtz-Eakin said the economic impact seems likely to be "significant but not overwhelming" and could slow economic growth in the second half of 2005 by 0.50% to 1.00%. Previously, CBO had projected growth in the gross domestic product at 3.7% for 2005 and 3.4% for 2006. After an initial dip anticipated after Katrina, CBO said GDP growth should rebound in the first half of 2006 as rebuilding accelerates. In a September 6th letter to Congress, CBO said that progress in restarting oil refineries and pipelines in recent days blunts the potential for more significant economic damage from the hurricane. "While Katrina has devastated ordinary business, it will also likely lead to a boom in clearing and reconstruction activity, first in the areas along the coast that escaped persistent flooding, and then in New Orleans," said CBO. "This follows a pattern familiar from past natural disasters ...but with the caveat that such reconstruction may begin a bit less rapidly."
- Freddie Mac's chief economist Frank Nothaft agreed with CBO's findings. "We expect that near-term growth will now be a bit weaker than had been anticipated, due in very large part to the disruption in economic activity brought on by Katrina last week," said Nothaft. "However, the federal monies that will flow into the damaged areas and the lower interest rates brought on by the disaster will stimulate economic growth next year, making up for the slowdown in the last part of this year." While reconstruction demand in areas damaged by the hurricane will increase the costs for construction materials and could add 2% to 3% to the cost of a home, the added costs will likely be offset by lower mortgage rates, he added. In his analysis, Nothaft assumes that the Federal Reserve will temporarily "pause" their efforts to boost interest rates, while the Fed assesses the fragility of the economy and supports the credit needs of the recovery efforts.
- Adam Fox, a director at Fitch Ratings, believes that the near term effects of the storm on the real estate market may not be as severe as many thought, but cautions that steeper energy prices and an ensuing mold problem could be even more devastating. While the potential for mold infestation is "huge," it is difficult to gauge how pervasive the problem will be, what types of mold (toxic or harmless) must be dealt with, and the costs of eliminating mold from the affected properties, said Fox.

According to U.S. Bancorp Asset Management economist Keith Hembre, the extra energy tab to U.S. consumers could reach \$140 billion over the next twelve months. “The historical pattern is for shocks of this nature to initially be absorbed roughly equally between lower savings and lower purchases for other goods and services,” said Hembre. Since rebuilding efforts along the Gulf Coast are expected to drive economic growth in 2006, *Economy.com* revised its 3.5% annualized GDP growth projection for the first half of 2006 up to 3.9%.

- FDIC estimates that 280 locally-based institutions, including 164 in Louisiana, 100 in Mississippi, 15 in Alabama and one in Florida, were effected by Katrina, representing \$270 billion in assets and \$201.3 billion in deposits. By September 8, most of the banks in the affected areas were operating normally with only 423 of the 5,054 branches in the area still closed. The Board of Governors of the Federal Reserve System, the FDIC, the NCUA, the OCC, and the OTS (the “agencies”) called on all insured depository institutions to identify and implement measures to assist the financial needs of customers displaced by Hurricane Katrina. The agencies stated that providing customer access to deposit accounts and other financial assets is a top priority, and suggested several “reasonable and prudent” actions, including, among others, allowing loan customers to skip or defer some loan payments. In addition, the agencies encouraged depository institutions to amend “Customer Identification Programs” such that non-documentary verification methods may be used to verify an individual’s identity, thus easing the strict identification standards associated with opening an account.
- Katrina is expected to cause a surge in defaults on home mortgages in the storm-ravaged region. In Louisiana alone, officials estimate that as many 160,000 homes were ruined, while the Mortgage Bankers Association estimates that some 360,000 mortgages in the three-state area may be negatively impacted by the storm. While insurers will bear the costs of replacing those houses in many instances, lenders or other holders of mortgage debt and property owners will face possible losses for destroyed homes which had no flood insurance. Fannie Mae has announced relief programs for hurricane victims, allowing for the suspension of mortgage payments for up to 90 days and for reduced payments for up to 18 months. Freddie Mac announced a similar policy, allowing for a three month suspension of mortgage payments for every borrower with a Freddie-Mac owned single family mortgage in the FEMA designated zone, regardless of the condition of their home. Following the three month suspension, servicers have the discretion to continue suspending or reducing payments on these loans on a case-by-case basis depending on the each borrower’s circumstances, said Freddie Mac. In addition, Freddie Mac has given its servicers the discretion to return September mortgage payments that were already made, but not reported to Freddie Mac, and given borrowers the option of requesting the return of their September payment. Both Fannie and Freddie have asked servicers not to report to credit bureaus any reversed or suspended payments on loans affected by the hurricane and to suspend all late fees, collection and foreclosure activities in the storm-affected areas during the three month suspension period. Freddie Mac has also made a temporary exception to its insurance guidelines to expedite providing

payments to the borrowers. For mortgages that are current, Freddie Mac said that the servicer may release insurance proceeds without limitation for the repair of damaged properties and up to \$40,000 of the total insurance loss for delinquent loans.

- Stephen A. Blumenthal, Acting Director of the OFHEO, said, “To provide greater certainty to mortgage and financial markets in light of the devastating consequences of Hurricane Katrina, I have contacted the chief executive officers of Fannie Mae and Freddie Mac and informed them that OFHEO will work with them on any actions necessary to support recovery efforts in the affected region.” The Farm Credit Administration also encouraged its System institutions to utilize the provisions in the Board’s policy on disaster relief to assist their borrowers in the areas affected by Hurricane Katrina. The FCA encourages its members to consider several options to help their borrower-members, including the extension of the terms of loan repayment, restructuring a borrower’s debt obligations, easing some loan documentation or credit-extension terms for new loans to certain borrowers, and requesting that the FCA grant relief from specific regulatory requirements.
- On September 8, Moody’s Investors Services said that their preliminary review of Hurricane Katrina’s effect on real estate investment trusts and other real estate firms it rates, including mortgage banks, Fannie Mae and Freddie Mac, hasn’t turned up anything that would result in a ratings change. John J. Kritz, Moody’s managing director for real estate finance, said while it was likely that the exposure of mortgage banks, the Farm Credit Banks, the FHLBs, Freddie Mac and Fannie Mae were “considerable” on an absolute basis, the severity of damage to homes backed by these agencies would vary from minor wind or water damage to complete loss of home. Kritz noted that the Farm Credit Banks could also be affected by the degree of damage to shipping infrastructure, which impacts the farmers’ ability to bring product to market. Moody’s expects losses for the FHLBs and Farm Credit Banks will likely be modest. The credit agency believes Freddie Mac’s and Fannie Mae’s losses will likely be “higher, but not severe,” and will be spread out over several reporting periods. Fannie’s and Freddie’s policies of allowing loan servicers to grant forbearance to borrowers in areas affected by the hurricane could reduce the companies’ profitability over the short term. On balance, Moody’s said Fannie’s and Freddie’s earnings and capital bases should be more than adequate to absorb likely losses. Moody’s long-term concern is that local residents and businesses could leave the Gulf coast if the region is slow to recover, depressing property values and causing more borrowers to default. “Although Moody’s does not expect these factors to result in ratings changes, given the relative size of rated firms’ exposures in the affected areas, the matter bears monitoring,” said Kritz.
- To date, Congress has authorized President Bush’s request for \$63.2 billion in hurricane relief aid to fund the (approximately) \$700 million a day cost for relief efforts. Administration officials have told Republican lawmakers that the total federal relief efforts could reach as high as \$100 billion. Initial funding focuses on immediate needs, with more funding to be sought at a later date for long-term disaster relief projects. Given the government’s quick funding of hurricane relief, economists

say that the immediate financial consequences of Hurricane Katrina may not be as dire as originally feared, although longer term there is concern about the dent that Katrina will leave on the federal budget.

- Congress' agenda for the remainder of the year has been displaced by relief efforts for Hurricane Katrina victims and hearings for two Supreme Court vacancies. The House Judiciary Committee canceled its September 7th hearing on GSE regulatory reform legislation (H.R. 1461) to discuss hurricane recovery and allow members to attend Chief Justice William Rehnquist's funeral. Observers now believe that the delicate task of finalizing GSE regulatory reform will be pushed into 2006. "At this point, everything is really geared and focused toward immediate relief efforts," said House Majority Leader Delay (R-TX) spokesman Ben Porritt. "When regular legislative business begins to take precedence over the hurricane, work will resume." When asked about the status of H.R. 1461 by *Market News International*, Porritt said, "We'll work through the regular order to bring this bill to the floor."
- Peggy Peterson, spokeswoman for House Financial Services Chairman Michael Oxley (R-OH), said the Chairman and Representative Richard Baker (R-LA) have been working on legislative language for the affordable housing fund provision to prioritize projects in disaster-affected areas and projects serving disaster victims. Peterson said that Hurricane Katrina "really points up the need for a long-term affordable housing effort in this country. This is an effort to meet the critical need that's out there." Hurricane Katrina "reinforces the reason to have such a fund," said Representative Barney Frank (D-MA.). "Some people said, 'Well, it's going to be abused.' Well, let's see how it works in Louisiana." Andrew Gray, spokesman for Senate Banking Committee Chairman Shelby (R-AL), said "[GSE regulatory reform is] still a priority for Senator Shelby," but declined to specify a timeframe. "Our hope is that we'll continue to reach out and come to a compromise that will allow the bill to move forward on the Senate floor."
- Efforts to raise private and corporate donations for the hurricane victims began immediately after the storm ravaged the Gulf Coast. Among the corporate donors, The Fannie Mae Foundation has provided a \$500,000 donation to the American Red Cross and an additional \$500,000 donation for medium and long-term efforts supported by the housing industry to help the affected communities recover and rebuild. The Foundation will also match donations made by Fannie Mae and Foundation employees to hurricane relief efforts. Freddie Mac is donating \$10 million to aid organizations, including the American Red Cross, and is matching Freddie Mac employee donations to relief efforts. The company will double the match if donations support Habitat for Humanity's hurricane relief efforts.
- Charitable donations for hurricane relief efforts may be made to the American Red Cross (call 1-800-435-7669 or on through their website www.redcross.org) or to the Salvation Army (call 1-800-SAL-ARMY or through their website www.salvationarmyusa.org/USNSAHome.htm). Donations may also be made directly to the states to assist with relief efforts, by making checks payable to the

Louisiana Disaster Recovery Foundation, c/o Division of Administration, Post Office Box 3399944, Baton Rouge, LA 70804-9095; Mississippi Relief Fund, Post Office Box 3563, Jackson, MS 39207-3563; and/or Governor's Emergency Relief Fund, Post Office Box 1523, Montgomery, AL 36102-1523.

- The staff of *GSE Report* extends our sympathies and heartfelt best wishes to those who were impacted by Hurricane Katrina. (*Investor Business Daily*, Laura Mandaro, 09/02/05; *New York Times*, Edmund L. Andrews and Jennifer Bayot, 09/07/05; *National Mortgage News Online*, Paul Muolo, 09/06/05; *Bureau of National Affairs*, 09/09/05; *Washington Post*, Annys Shin, 09/09/05; *Associated Press*, Marcy Gordon, 09/08/05; *Freddie Mac Press Release*, 09/08/05; *Market News International*, Claudia Hirsch, 09/08/05; *Dow Jones Newswire*, Allison Bisbey Colter, 09/08/05; *InfoBytes*, Buckley Kolar, LLP, 09/09/05; *Associated Press*, Brad Foss, 09/09/05; *CQ Today Midday Update*, 09/07/05; *National Real Estate Investor*, Parke M. Chapman, 09/07/05; *Reuters News*, 09/07/05; *Dow Jones Newswires*, Danielle Reed, 09/07/05; *Agriculture Online*, 09/01/05; *National Mortgage News*, 09/05/05; *Wall Street Journal*, Robin Sidel, 09/08/05; *Reuters*, 09/08/05; *National Geographic News*, Willie Drye, 09/30/05; www.dhs.gov/interweb/assetlibrary/katrina.htm)

Freddie Mac's net income plunges 59% for the first six months of 2005

- Freddie Mac reported that its net income plummeted 59% during the six months ending June 30, 2005 to \$1.6 billion or \$2.22 a share from \$4.07 billion or \$5.74 a share for comparable period in 2004. Freddie's drop in GAAP earnings is more a reflection of the accounting rules that the company is now following rather than its financial health, said the company's management. CFO Martin F. Baumann attributed the \$2.5 billion drop in profit to both a decline in interest income and the impact of FAS 133 treatment of derivatives values, forcing the company to book temporary and often wide swings in the values of its derivatives in its income statement. Freddie also disclosed a roughly \$1.2 billion in unrealized losses on derivatives during the first half of 2005, compared to \$503 million in unrealized gains for the same period last year.
- Baumann attributed Freddie Mac's compressed profit margin during the first six months of 2005 to a shift in its asset mix, as borrowers continued to refinance higher-yielding, fixed-rate mortgages with non-traditional, lower yielding adjustable-rate loans. He added that he expects the change in loan mix which will depress earnings in the second half as well. "Many of these products, such as interest-only mortgages or option-ARM or negative amortization mortgages, have been around for quite a long time. But their share of the overall market has grown quite a bit recently," said CEO Richard Syron, noting that some estimate that 25% of all mortgage originations last year were interest-only or option-ARM mortgages. While Syron said Freddie's exposure to more controversial, non-traditional mortgages "remains quite modest," the company's purchases of interest-only, ARM and option-ARM loans as well as in mortgages with large balloon payments - accounted for 22% of the company's \$178

billion in purchases during the first half of this year. “These products still comprise only about 2% of our total guarantee exposure. It is worth noting that our credit guarantee to investor properties is also well below the general market at around 3% of our total credit guarantee portfolio,” Syron said.

- “GAAP doesn’t really translate our business very well,” said Baumann. Instead, Freddie Mac offers a “fair value” analysis to better measure the company’s performance. On a fair value basis, Freddie’s assets grew by \$1.1 billion during the first half of 2005 to \$27.4 billion, representing an 8% annualized return on assets. Over the long term, Baumann said that the company expects its annualized return on the fair value of its assets to be in the “low- to mid-teens.” Freddie Mac said its share of the secondary mortgage market grew to 45% for the first six months of 2005, up from 41% for the same period last year. Freddie Mac projects that its retained portfolio, totaling \$673.9 billion at June 30, 2005, will grow about 5% for the year. At June 30, 2005, the company’s regulatory capital totaled \$36.1 billion, approximately \$12.1 billion over its minimum capital requirements and about \$4.8 billion over its 30% capital surplus required by OFHEO. Management said that the company is on track to return to timely financial reporting and expects to register with the SEC by the second quarter of 2006. Freddie Mac’s CEO Richard Syron told analysts that the company is “making excellent progress on improving the business in ways that will both advance our housing mission and reward our stockholders.”
- Analysts said that while Freddie had indicated its earnings would fall during the first half of the year, the declines exceeded their expectations. “[Freddie Mac’s] income has dropped dramatically” because of the increase in adjustable-rate mortgages, said David Dreman, chairman of Dreman Value Management. “But I’m a little nervous about reading this as a trend when we might be at the top of the bubble” in housing market, he said. Wall Street investors obviously didn’t like Freddie’s 2005 results, as its share price dropped as much as 3.85% in morning trading. Paul Miller, an analyst with Friedman, Billings, Ramsey & Co., and Edwin Groshans, an analyst with Fox-Pitt, Kelton, Inc., agreed that the plunge was a response to the 65 basis points tightening of Freddie Mac’s net interest margin. Miller pointed out that while investors look closely at the margin, it may not be as useful when evaluating Freddie Mac. “To be honest, we don’t know if that [margin is] hedged” or not, he said. The severity of the drop in interest income came as a shock, said Groshans “They did say they were going to have a material change in their net interest income, but not in my wildest dreams did I think it was going to be” so much, he added. (*Dow Jones Newswires*, Dawn Kopecki, 08/31/05; *Washington Post*, Annys Shin, 09/01/05; *Financial Times*, Richard Beales, 09/01/05; *Dow Jones Newswires*, Dawn Kopecki and John Seward, 08/31/05; *Bloomberg News*, James Tyson and Al Yoon, 08/31/05; *Dow Jones Newswires*, Allison Bisbey Colter, 09/01/05; *American Banker*, Matthew Quinn, 09/02/05)

Fannie Mae and Freddie Mac

Fannie and Freddie agree to resume issuing subordinated debt and improve their voluntary disclosures in formal agreements with OFHEO

- In formal agreements with OFHEO, Fannie Mae and Freddie Mac have agreed to reinstate their subordinated debt programs and to uphold and improve their voluntary disclosures. OFHEO said the companies have agreed to resume issuing subordinated debt and to maintain those programs under the same criteria agreed to by Fannie, Freddie, lawmakers, and administration officials in October 2000. The agreements allow the OFHEO to take enforcement action, including issuing cease-and-desist orders or fines, if the companies fail to comply, and expand the companies' voluntary disclosures for both duration gap and analysis of credit risk. Specifically, the agreement requires Fannie and Freddie to work with OFHEO to identify and use comparable methods in calculating their duration gap. Analysts have complained that Fannie's and Freddie's duration gap disclosures were inconsistent and provided limited insight into the condition of their balance sheets since the companies calculated those numbers using different methods and assumptions, which the GSEs largely kept confidential. OFHEO is also requiring the companies to provide regular monthly disclosures showing the impact that a 50 basis point shift in interest rates and a 25 basis point movement in the slope of the yield curve would have on the GSEs' financial condition. The companies will also have to provide new quarterly credit risk data showing the potential losses to each GSE if home prices suddenly declined by 5% across the nation, before and after receiving private mortgage insurance and other credit enhancements. "These agreements represent an evolution from a set of voluntary actions to a set of enforceable commitments that will be overseen by OFHEO and will operate within a predictable supervisory framework," said OFHEO Acting Director Stephen Blumenthal.
- In letters to OFHEO, Freddie Mac chief executive Richard Syron and Fannie Mae CEO Daniel Mudd also agreed to maintain separate portfolios containing an unspecified amount of "highly liquid assets" that will be closely supervised by OFHEO, along with a "functional contingency plan" providing at least three months of liquidity without having to raise funds by issuing additional unsecured debt. Mudd and Syron also said their companies will submit a subordinated debt issuance plan for OFHEO's review every six months.
- As the result of accounting restatements, Fannie Mae and Freddie Mac have slacked off in upholding their voluntary agreements in recent years, as the companies shifted resources to correct widespread deficiencies in their accounting and internal controls. Freddie suspended its subordinated debt program in 2003, but has continued to produce voluntary disclosures, said spokesman Michael Cosgrove. "We believe this [agreement] will significantly enhance the continuing effectiveness and flexibility of the commitments in promoting the safe and sound operations of the companies and

strengthening market discipline,” said Cosgrove. Fannie Mae hasn’t issued subordinated debt since 2003 and has failed to make several of the disclosures it promised to provide in its 2000 agreement. Issuing subordinated debt will be problematic for Fannie until it completes a multiple-year earnings restatement and resumes timely financial reporting, which is expected to happen after the second quarter of 2006. Freddie plans to publish timely financial statements in early 2006.

- In a Barclays Capital research note, strategist K. N. Sundararajan wrote, “It is possible that we will see subordinated debt issuance in early 2006,” adding that the issuance and “comforting” disclosures makes the senior debt of the GSEs attractive. (*Dow Jones Newswires*, Dawn Kopecki, 09/02/05; *American Banker*, Marc Hochstein and Erick Bergquist, 09/06/05; *Bloomberg News*, Al Yoon, 09/02/05)

OFHEO to review inefficient and burdensome regulations and evaluate revisions

- On September 7, OFHEO published a Notice of Regulatory Review in the Federal Register, stating that the agency will review its regulations to consider whether existing regulations have become inefficient or create unwarranted burden, and will identify possible revisions. OFHEO is requesting public comments on its regulations for consideration in the regulatory review. Written comments on this Notice must be received no later than November 7, 2005. (*Federal Register*, Vol. 70, No. 172, September 7, 2005)

OFHEO reports largest U.S. house price increase in more than 25 years

- According to an OFEHO study, U.S. house prices increased 13.43% from the second quarter of 2004 to the second quarter of 2005, representing the largest four quarter increase since 1979. Appreciation in the second quarter was 3.2% for an annualized rate of 12.8%. “There is no evidence of prices topping out,” said OFHEO chief economist Patrick Lawler. “On the contrary, house price inflation continues to accelerate, as some areas have experienced relatively slow appreciation are picking up steam.” The Pacific region continues to exhibit the fastest appreciation, while the slowest appreciation continues to be the West South Central division, consisting of Texas, Oklahoma, Arkansas, and Louisiana. Nevada continues to experience the highest appreciation rate of 28.1% over the past year and 5.5% (or 22.0% annualized) over the past quarter. Thirty of the 265 MSAs had four quarter appreciation exceeding 25%. Lawler said, “The continued price increases are a result of many factors including low mortgage interest rates and the apparent impact of speculative investing. The robust appreciation rates are striking both in terms of their magnitude and in their geographic scope. However, they are likely unsustainable given the underlying inflation rate, income growth and other factors.” (*OFHEO Press Release*, 09/01/05)

- New home sales in July soared to a seasonally adjusted annual rate of 1.41 million units, representing a 6.5% increase from June pace of 1.32 million, according to the Commerce Department. Tentative signs show that the housing market may be starting to peak in late summer with existing home sales declining 2.6% in July from the previous month, as new homes surged to a record. Also in July, the National Association of Realtors reported that its pending home-sales index in July declined 1% on a seasonally adjusted basis from June, although it was still up 3.5% from a year earlier. (*Associated Press*, 09/02/05; *USA Today*, Sue Kirchhoff, 09/02/05; *Wall Street Journal*, James R. Hagerly, 09/02/05)
- According to exclusive survey figures compiled by *National Mortgage News*, interest-only loans accounted for 26% of all loans funded in the second quarter, compared to 21% during the first quarter. Adjustable rate mortgage production totaled 51.3% of loan originations in the second quarter, the highest percentage since *NMN* began collection production statistics a decade ago. (*National Mortgage News*, Paul Muolo, September 3-4, 2005)
- “Home sales and housing starts are still expected to set a new record this year,” said Frank Nothaft, Freddie Mac vice president and chief economist. “The devastating effects of Hurricane Katrina will likely drive up costs of construction materials once the rebuilding effort gets underway and may slow deliveries of new homes in other areas of the country as resources are reallocated to Louisiana, Mississippi and other areas affected by the storm. It is too soon to know the full impact on the economy from the storm. Home sales in areas not affected by hurricane Katrina should remain strong and support continued home-price appreciation, especially since interest rates have fallen in recent weeks. Prior experience in Florida shows that home prices in hurricane disaster areas fall temporarily and then recover. We hope that will be the case here.” (*Freddie Mac Press Release*, 09/06/05)
- On NAHB’s “Seiders on Housing” blog, Dave Seiders, chief economist of the NAHB, notes that on August 26th, Federal Reserve Chairman Alan Greenspan characterized the current “housing boom” as one of America’s major “economic imbalances” and blamed the boom for everything from a low national savings rate to a burgeoning trade deficit. Seiders write, “Chairman Greenspan once applauded housing’s dramatic contributions to the economy and he steadfastly argued against charges of price ‘bubbles’ in the U.S. housing markets. Maybe the Chairman has just become frustrated by the Fed’s inability to raise long-term interest rates and take the starch out of housing despite more than a year of monetary tightening. Whatever the reason, perhaps the Chairman should take a step backward and recognize yet another benefit to be reaped by the ‘housing boom.’ Hurricane Katrina seriously damaged the energy production and transmission infrastructure in the Gulf region, all but promising historically high energy costs for the foreseeable future. At a time like this, large amounts of housing equity-- created by those dratted price increases-- is a Godsend, providing a buffer to household finances and helping the economy weather the storm.” (<http://nahbblog.blogs.com/>, *Seiders on Housing*, Dave Seiders, 09/08/05)

- Richard DeKaser, chief economist for National City Corp, believes that the economic disruption caused by Hurricane Katrina could hold down on mortgage rates and prolong the life of the housing boom. “It is likely to extend the longevity of what otherwise seemed like a five-year housing boom that was nearing its end,” said DeKaser in an interview with *MortgageWire*. He expects mortgage rates to stay below 6% until December, assuming the Federal Reserve does not raise the federal funds rate at its September 20 meeting. “We are likely to see some delay in the Fed’s tightening efforts,” he added. (*National Mortgage News Online*, September 10-11, 2005)

Fannie and Freddie are “no longer” the 800 pound gorilla in the derivatives market
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- There’s good and bad news in the interest rate swaps market. As a result of the steady shrinking of Fannie’s and Freddie’s mortgage portfolios and the companies’ shift from fixed rate to floating rate exposure, the GSEs have significantly reduced their presence in the swap market. According to OFHEO, Fannie’s and Freddie’s combined derivative positions was approximately 4.1% of the total notional amount for end-user financial institutions at year-end 2004 versus 6.5% in June 2004 and 10.5% as of June 2001. Moreover, the companies’ derivative positions have likely fallen more or stabilized so far this year. While the swaps market has continued to grow as more institutional investors get permission to use the instruments, Fannie and Freddie “are not the 800-pound gorilla that was once so feared by the markets,” said Gerald Lucas, senior agency and Treasury strategist at Banc of America Securities. Michael Mackenzie writes in the *Dow Jones Newswire*, “Lower systemic risk is good, but the mortgage giants were a major source of trading revenues for Wall Street dealers prior to getting their wings clipped by regulators last year.” (*Dow Jones Newswires*, Michael Mackenzie, 08/26/05)
- *The Financial Times* also notes the changing structure of financial market risk, as it relates to Fannie Mae and Freddie Mac. In recent years, central bankers and regulators warned about what could happen to Fannie Mae and Freddie Mac when the interest rate curve inverts or fixed-income markets become more volatile. With their trillion-dollar derivatives positions, the potential hedging requirements of Fannie and Freddie could well have overwhelmed the capacity of the exchange-traded and over the counter markets if they actually had to cash in their chips. For a long time, the central bankers felt their warnings to policymakers were largely ignored due to the enormous political influence of Fannie and Freddie and their constituencies, such as the homebuilders and realtors. A series of accounting and executive compensation scandals discredited the GSEs and empowered OFHEO to force changes in their management and operations and require higher capital levels. These changes have led to a dramatic reduction in systemic risks from the GSEs. Richard Dorfman, a GSE analyst at the First Manhattan Consulting Group, said, “The OFHEO is coming to the view that the competency of risk management at the Enterprises has become quite satisfactory, even though the report references the need to improve and elevate

risk management.” However, Dorfman says: “One form of risk management begets another form of risk”--credit risk. Until a couple of years ago, Fannie and Freddie were shifting huge amounts of interest rate risk from U.S. homeowners to the derivatives market speculators, helping to fuel the housing boom. Now, more interest rate risk is being borne by the homeowners in the form of adjustable rate mortgages and other “innovative” or risk-increasing products, resulting in a higher and higher proportion of Fannie’s and Freddie’s balance sheets being comprised of these variable rate products. When interest rates increase, there will be less risk of a financial market crisis, but a much larger number of small-size defaults by homeowners. Securities dealers won’t need a giant bailout, as once feared, but there will be a lot of written-off ARMs. John Dizard writes in *Financial Times*, “It is still hard to see the long-term shareholder value in these stocks. But the end of the world risks are much reduced.” (*Financial Times*, John Dizard, 09/06/05)

Is the “perfect storm” for hedge funds approaching?

- Andrew W. Lo, finance professor at the Sloan School of Management at MIT, has been studying hedge fund failures and risks, and concludes that another hedge fund industry shakeout is likely in the near future. In a paper published by the University of Chicago, Lo concludes the hedge funds’ smooth returns, far from proving that hedge funds are safe, may be a warning sign of pending trouble for the industry. While his premise may not necessarily hold true for every individual fund, Lo demonstrates in his paper that measuring the smoothness of returns gives economists a good way to estimate the level of relatively illiquid investments in the hedge fund world, providing economists a means to measure industry-wide liquidity risks without knowing the specifics of the investments -- information that hedge funds don’t disclose.
- According to Lo’s measures, hedge fund investments are less liquid now than they were 20 years ago. His study shows that the same pattern of investing preceded the 1998 global hedge fund meltdown and the 1987 stock market crash. Lo argues that while a hedge fund crisis appears to be sudden and to be caused by unforeseen events, the breakdown is in fact the late stage of the problem. As more hedge funds compete for the same slice of the pie, he observed, their managers feel that they have no choice but to “leverage up,” boosting their returns by borrowing more money to make bigger investments, which in turn makes the investments more prone to a sudden credit crisis. Highly leveraged hedge funds are vulnerable to having their lenders cut off credit when they think that their money may be at risk, which would force the hedge funds to close out their positions at the worst possible time – a repeat of the cycle that brought down Long Term Capital Management.
- Lo’s data suggests that the current situation in the hedge fund industry is serious, since the industry may have already entered a period of lower returns, following a downturn in April that hit virtually every category of hedge fund pursuing every kind of strategy. “The concern that I and others have is that we’re approaching the perfect

financial storm where all the arrows line up in one direction,” Lo said. The more money that is invested in hedge funds, “the bigger the storm will be,” he added.

- What could trigger a crash is anyone’s guess. Lo believes that an oil-price increase to \$100 a barrel, as predicted by one Goldman Sachs analyst, could do it. Or, a tightening of lending rules at Fannie Mae and Freddie Mac could set off a “humongous unwinding” in credit markets, said Lo. Alternatively, the spark could be something much smaller, he said. (*New York Times*, Mark Gimein, 09/04/05)

FASB is “touching-up” FAS 133 and FAS 140

- The Financial Accounting Standards Board’s plans to clarify some of the uncertainty surrounding the treatment of qualifying special purpose entities has reached fruition with the issuance of three exposure drafts of revisions to FAS 140 and FAS 133. The provisions of the drafts, for which the comment periods end October 10, will be effective for instruments acquired after December 15. The exposure drafts can be found at http://www.fasb.org/public_comment/. (*CFO.com*, Ed Zwirn, 08/22/05)

Changes in the regulatory landscape

- Donald T. Nicolaisen, the chief accountant of the SEC, has announced that he will step down on October 28, following two years of service in which he implemented new standards of disclosure and financial control for the agency. Nicolaisen, 61, came to national prominence in 2004 after he ordered Fannie Mae to revamp its accounting practices -- a strong rebuke that triggered the company’s \$10.8 billion financial restatement and change in management. Nicolaisen also prodded businesses to improve disclosures to investors and worked to improve public confidence in the accounting industry following the failures of Enron and WorldCom. Nicolaisen said, “I am very proud of what we have accomplished and the steps we have taken to protect investors and to provide stability for our markets.” Although SEC chairman Christopher Cox encouraged him to remain on the job, Nicolaisen said he is ready to return to the private sector and his family in Tewsbury, NJ, noting that “my wife has had me on loan down here for a couple of years.” Cox said Nicolaisen “served with distinction during challenging times, and has met every challenge -- most notably by establishing landmark new protections for investors” under the Sarbanes-Oxley Act. (*Bloomberg News*, Laurence Arnold and Demian McLean, 09/07/05; *Washington Post*, Carrie Johnson, 09/08/05; *Dow Jones Newswires*, Judith Burns, 09/07/05)
- While the Bush Administration is keeping mum on plans to name a successor to Federal Reserve Chairman Alan Greenspan, the Fed announced that it is revising its schedule for the first quarter of 2006 in preparation for Greenspan’s impending departure. The Fed’s policymaking committee will compress its normal two-day meeting on interest rates into a single session January 31, 2006. “This change avoids a meeting that spans the terms of two chairmen,” said the Fed, confirming that

January 31 likely would be Greenspan's last day of his an 18-year tenure. "[I]n keeping with past practice, Chairman Greenspan plans to attend this meeting." (*CQ Today Midday Update*, 09/09/05)

Fannie Mae

Senator Rudman's review of Fannie Mae's accounting expected "by year-end"

- Fannie Mae's external investigators plan to complete by year-end a report regarding Fannie Mae's estimated \$10.8 billion in accounting errors said former Senator Warren Rudman (R-NH), who is heading the review. "Our timetable is still for having this report with an '05 date on it, and we're hoping we can do that unless something else comes up that causes us problems," said Rudman in an interview with *Bloomberg News*, but declined to say which month the report would be released. In September 2004, Fannie Mae's board of directors hired Rudman and his law firm, Paul, Weiss, Rifkind, Wharton & Garrison L.L.P., to conduct an external investigation of the company's accounting practices. "Completing this restatement is Fannie Mae's No. 1 corporate priority," said Fannie Mae CEO Daniel Mudd last month. (*Bloomberg News*, James Tyson, 09/11/05)

Fannie Mae's departing general counsel will join Collier Shannon Scott at yearend

- At the end of 2005, Ann Kappler, Fannie Mae's executive vice president and general counsel, will join Collier Shannon Scott to lobby and practice public-policy law. Previously, Kappler served as a clerk to Supreme Court Justice Harry Blackmun. (*The Hill*, 09/07/05)

Fannie Mae retains funding flexibility in 2006

- Fannie Mae has published its 2006 debt calendar, giving the GSE the maximum flexibility in issuing benchmark non-callable notes. The company plans to continue issuing benchmark non-callable notes on a monthly basis next year in minimum sizes of \$3 billion. While Fannie did not specify if it would tap the two-, three-, five-, or ten-year maturity in any given month, the company indicated that it "aimed" to tap each of the four maturities at least once in 2006. Fannie also retained the option to skip issuance on any particular month, allowing the company to "better gauge investor needs and demands for specific structures at time of issuance." One agency debt analyst said that Fannie Mae's calendar served little purpose except as kind of a reservation to keep other major agency or supranational issuers from tapping the debt markets on a given week of each month. (*Dow Jones Newswires*, Allison Bisbey)

Fannie Mae ramps up its financing of AH multifamily rental units

- During the first six months of 2005, Fannie Mae invested \$11.8 billion in multifamily rental housing units, of which over 92% are affordable to families earning at or below their area's median income. Up to 60% of all multifamily units financed by Fannie were earmarked for low- and very-low income individuals and families, while over 62% of these loans were made in underserved markets and neighborhoods in the U.S. The company's loan production included a \$7.2 billion of DUS product, including \$3.2 billion in small loans of \$3 million or less, and \$3.4 billion in large loans of \$25 million or greater, along with another \$1.1 billion in "Multifamily Affordable Housing." Fannie Mae's senior vice president of multifamily lending and investment Richard Lawch, said, "As Fannie Mae works diligently to become a stronger company, multifamily will emerge a stronger unit and be in an even better position to serve the affordable housing market, and our lenders." (*Origination News*, September 2005)

What is the appropriate role of an employer in a frothy real estate market?

- Fannie Mae points out that the market froth has also begun to affect employers – specifically the 13% of employers offering mortgage assistance to their employees and 9% offering down payment assistance [according to the Society for Human Resources Management]. As riskier loan options such as interest-only and option ARM mortgages become more attractive to potential homebuyers, employers offering its employees assistance in purchasing homes need to increase their vigilance over the consumer education about the pitfalls of home buying provided to the employees. Beth Marcus, director of workforce housing at Fannie Mae, said "From an employer's business perspective, if you have an employee who ends up in a bad mortgage that they can't afford, that employee will be distracted from work and less effective. But the question is, what is the appropriate role for the employer to prevent that situation?" (*Employee Benefit News*, Kelley M. Butler, 09/01/05)

Fannie Mae updates its e-mortgage specs

- Fannie Mae has updated its electronic mortgage specifications to mandate that lenders use open standards including MERS and MISMO when transacting with them electronically. Mark Oliphant, director of the e-mortgage program at Fannie Mae, said, "...[W]e are updating [our standards] we want it to reflect our acceptance of MISMO. The e-note has to be in accordance with the MISMO SMART Doc standard for us to accept it. ...The major update was reflective of our support and systems

integration with the MERS eRegistry. (*National Mortgage News*, Anthony Garritano, 09/05/05)

Freddie Mac

Freddie Mac appoints chief enterprise risk officer

- Anurag Saksena has joined Freddie Mac as senior vice president and chief enterprise risk officer, reporting directly to Chairman and CEO Richard F. Syron. In this role, Saksena will be responsible for providing an independent, cross-divisional assessment of Freddie Mac's management of and exposure to operational, credit and market risk and reporting these assessments to senior management and the board of directors. With 17 years of experience in establishing and managing risk frameworks in organizations of varying size, complexity and cultures, most recently Anurag served as head of enterprise risk management at General Motor's Corp.'s finance subsidiary, General Motors Acceptance Corp for the past five years. (*Freddie Mac Press Release*, 08/30/05)

Freddie Mac declares third quarter dividends

- The board of directors of Freddie Mac has declared a quarterly dividend on the corporation's common stock of \$0.35 per share. The board also declared the quarterly dividends on the corporation's preferred stock in accordance with the terms of the issues. Third quarter dividends will be payable on September 30, 2005, to stockholders of record as of September 19, 2005. (*PRNewswire*, 09/09/05)

Freddie Mac warns loan sellers and servicers on refinance incentives

- In a letter, Freddie Mac's vice president of single-family marketing James J. Cotton reminded sellers and servicers that they are responsible for monitoring prepayment rates on loans that they sell to the company. Cotton said any sellers providing borrowers with refinance incentives to refinance early could be disqualified or suspended from selling to Freddie and could also be required to repurchase the affected mortgages, or reimburse Freddie for losses and claims arising from these practices. Cotton added that mortgages that are subject to inappropriate refinancing arrangements often have high interest-rates, low loan-to-value ratios, and high credit scores. Often these loans are refinanced multiple times within an unusually short period of time at the same or a higher interest rate. Cotton's letter follows Freddie's April announcement that it had discovered a mortgage broker had been providing borrowers with financial incentives to refinance early. Company spokesman Michael

Cosgrove said that Freddie Mac hasn't identified any additional mortgage brokers engaged in these practices, it simply wanted to reinforce its message. (*Dow Jones Newswires*, 09/01/05)

Freddie Mac: The "icon of opportunity"

- At the end of August, Freddie Mac kicked off a new advertising campaign, featuring an egg rather than pictures of happy homeowners to tell its story. In full pages advertisements appearing in the *Washington Post*, *Wall Street Journal*, and *Barron's*, the image of an egg appears with a roof, windows and door sketched over it to resemble a house, along with the slogan "The most valuable egg in the American nest." Its text continues, "Congress started Freddie Mac 35 years ago with a simple mission. Help keep mortgage rates stable and low, so more people can own their own homes. It's working." Since research shows that people have only the foggiest notion of what Freddie is about, Bruce Haynes with National Media Inc. said that his ad agency decided to communicate at "a values level." Thus new campaign uses the egg, rather than references to "government sponsored entity" and "mortgage-backed securities."
- While branding strategists approved of the message, saying the egg evokes "protecting and building a future," Freddie critics such as financial consultant Bert Ely see the egg as a high-paid lobbyist delivering a subtle political message. Ely said, "Eggs can break. What is implicit in the ad is, 'Don't screw up the works.'" Haynes rejected Ely's criticism, saying the ad has nothing to do with GSE regulatory reform legislation. Instead, Haynes said the egg "is an icon of opportunity." (*Washington Post*, Annys Shin, 08/29/05)

Freddie Mac celebrates values at the 20th Annual Black Family Reunion

- On September 10-11, Freddie Mac will sponsor the 20th Annual Black Family Reunion, marking the company's fifth year in partnering with the National Council of Negro Women an event which attracts more than 500,000 attendees to celebrate the strengths and values of the African American Family. (*Freddie Mac Press Release*, 09/08/05)

Federal Home Loan Banks

FHLBs of New York and San Francisco became SEC registrants effective September 29th

- The FHLBs' Office of Finance announced that the FHLBs of New York and San Francisco became SEC registrants under the Securities Exchange Act of 1934, effective August 29, 2005, while the remaining ten Banks continue to work on the SEC registration process. According to the Office of Finance, the FHLBs of Atlanta, Dallas, Indianapolis, Pittsburgh and Topeka have announced plans to restate financial statements and are reviewing accounting matters primarily relating to the application of FAS 133. Additionally, the FHLBs of Boston, Chicago, Cincinnati, Des Moines and Seattle are in the process of completing accounting reviews primarily related to the application of FAS 133, but have not yet indicated if they plan to restate results. While the final impact will not be known until all of the restatements are completed, the Office of Finance does not believe the combined total of these previously identified adjustments will be material to the combined capital of the FHLB System, and does not believe that these restatements will have an adverse impact on the fundamental business of any Bank. The Office of Finance said it will resume publishing current combined financial reports of the FHLB System after all restatements are complete, and all FHLBs' SEC registrations are effective. (*Market News International*, 08/30/05; *American Banker*, Rob Blackwell, 08/31/05)

Ginnie Mae

Ginnie Mae enhancing electronic reporting system to reduce reporting burden

- Ginnie Mae is significantly enhancing its electronic commerce capabilities which will reduce the reporting burden on issuers and servicers. "In 2006, Ginnie Mae will be significantly changing the way we collect data from [issuers and servicers]," said Michael Garcia, director of single-family housing at Ginnie Mae. The agency's new electronic reporting system will also result in business changes, with the reporting of loan level data will be due on the second business day of each month rather than the 15th calendar day, said Garcia. (*Mortgage Servicing News*, September 2005)

In December 2005, Ginnie Mae will enhance its MBS disclosures

- Beginning in December 2005, Ginnie Mae will provide additional disclosures to improve the transparency of its mortgage-backed securities. The new monthly disclosure will include detail with respect to the reasons for unscheduled principle

pay downs and the number and unpaid balance of loans backing Ginnie MBS or VA insured loans that are 30 days, 60 days, and 90 days or more delinquent. (*HUD Memorandum*, Michael J. Frenz, 09/01/05)

Farm Credit System / Farmer Mac

The annual FCS “hit parade”

- Back by popular demand, *Farm Credit Watch* has published its fifth annual FCS salary review with CoBank’s Doug Sim topping the list with a salary of \$1.65 million, followed by Norwest FCS’s Jay B. Penick (\$919,000), F.F.C.B. Funding’s Jamie B. Stewart, Jr. (\$752,000), AgriBank’s William J. Collins (\$621,000), and American AgCredit’s Ron Carli (\$620,000). Over the 2001-2004 period, Penick reported the highest increase in salary of 119%. While Farm Credit Services’ former CEO Jack Webster is “missing” from this year’s list, Webster was paid \$1.9 million in 2004, which included a \$1.3 million severance payment. (*Farm Credit Watch*, Bert Ely, August 2005).

FCA board approves rule revising FCSIC insurance rules for securitized assets

- The FCA board of directors approved a final rule to make clear to FCS institutions how the Farm Credit System Insurance Corporation (FCSIC) will treat assets that have been transferred through securitizations. Similar to the FDIC’s and NCUA’s receivership regulations, the final rule delineates how the FCSIC, when acting as a receiver or conservator of an FCS institution, will treat assets transferred through securitization. Specifically, the rule restricts FCSIC’s use of special powers to reclaim these assets, if the transaction met all the requirements of a “true sale” under GAAP and other conditions defined in the rule. FCA said that the final rule does not expand any existing authority an FCS institution already has to engage in any transaction. The regulation will become effective 30 days after publication in the Federal Register. (*Bureau of National Affairs*, 09/05/05)

FCS members claim proposed changes in governance “unnecessary and burdensome”

- According to the July 15 issue of Farm Credit Council’s *The Insider*, the FCA received more than 330 letters commenting on proposed changes in the governance of FCS banks and associations. *The Insider* reported that FCS institutions are “firmly committed to good governance, ‘best practices’, and transparency in financial disclosures, but they were just as firm in stating that additional regulations in this area

are both unnecessary and burdensome.” (*Farm Credit Watch*, Bert Ely, August 2005).

Postal Service

Bush administration seeks to uphold five principals of postal service reform

- In an August 31st Congressional Advisory, the Institute for the Research of the Economics of Taxation stated, “The Administration has called for changes in H.R. 22 and S. 662. ...The changes the Administration seeks would clearly lower the budget costs. The question examined here is whether the changes would also be helpful in terms of Postal Service reform. The answer is that when the Administration’s proposals are evaluated strictly from a reform perspective, they are seen to be sensible, realistic, and helpful. ...The Administration has consistently said that Postal Service reform should be based on five principles: governance based on best practices, improved public transparency, greater flexibility in operations, a stronger regulator to provide more accountability, and financial self-sufficiency. ...While one might wish for stronger reforms, the changes sought by the Administration all move in the correct direction.” (*IRET Congressional Advisory*, Advisory No. 193, 08/31/05)

USPS adapts its postal network to service the Gulf coast

- The Postal Service is assessing damage to the postal facilities in the wake of Hurricane Katrina, and is attempting to adapt its network to restore mailing services to the storm ravaged areas in which more than 2.3 million residents remain without electricity. The Postal Service said that it is reentering storm-damaged areas when it is safe to do so to open postal facilities where possible or establishing mobile retail centers. On September 6th, there were 171 post offices offering full service in the storm-affected area, 13 offices with no service, 189 offices with partial service, and 133 offices categorized as “other” status. Information on the status of postal service in the Gulf coast area is available by zipcode online at www.usps.com. The USPS is setting up special ZIP codes for the Astrodome in Houston and for other sites being used to house evacuees. The Postal Services and Social Security Administration has also established pickup points for the evacuated Katrina victims to receive delivery of their monthly Social Security checks. Locations for these pickup points are also posted on the USPS website.
- The UPS Foundation is donating \$1,250,000 toward relief efforts for Hurricane Katrina and UPS is taking separate steps to assist its employees and their families in the affected areas. The Foundation’s donation will include \$500,000 in cash and up to \$750,000 of in-kind services for the shipment of medical and health-related items.

The funds will be divided between The American Red Cross, America's Second Harvest and other relief organizations that assist with long-term rebuilding activities.

- Ultimately, the USPS will require funding to help repair postal infrastructure, ensure safe working conditions and restore full mail service to the storm-impacted Gulf Coast communities. Important questions need to be asked, writes the *e-NAPUS Legislative Newsletter*: “Will the USPS seek funds from subsequent emergency appropriations legislation to help repair postal infrastructure, ensure safe working conditions for its employees, and restore full mail service to storm-impacted Gulf Coast communities? If so, how will the request play in Congress, in light of Postal Service’s ‘lack of clarity’ on H.R. 22 and S. 662? If the USPS does not seek federal aid to repair its infrastructure, will the Postal Service amend its 2006 rate request and seek the funds from postal customers?” (*DMNews.com*, Melissa Campanelli, 09/07/05; *e-NAPUS Legislative Newsletter*, 09/02/05; www.postcom.org, 09/01/05)

In the wake of Hurricane Katrina, postal reform is likely to be sidetracked in Congress

- Postal reform is likely to be sidetracked, as the House Committee on Government Reform and the Senate Committee on Homeland Security and Governmental Affairs begin holding hearings on government’s failure to respond appropriately to the public’s needs regarding Hurricane Katrina. Postal advocates fear the issue, coupled with the administration’s objections to the measure’s budgetary impact and the Senate’s complicated post-Hurricane agenda, might keep the bill from coming to the floor in time to avert a looming postal rate hike. “We all have to assume that for the next 60 to 90 days, anyone who had anything else going on in Capitol Hill just has to wait patiently because Congress works on a triage system, where the most important and pressing issues take precedence, and clearly their energies need to be focused on the relief efforts and all of the fallout from Hurricane Katrina,” said Neal Denton, executive director of the Alliance of Nonprofit Mailers. “Movement on [postal] reform for this year is done,” said Gene Del Polito, president of the Association for Postal Commerce. “The question is whether or not anyone will want to bother with it in the next Congressional session.”
- Others are hopeful that behind-the-scene discussions on postal reform are will prove fruitful. “From what we can gather, Senate staff is still working to see if they can get something written that can be acceptable to get through on unanimous consent,” said Jerry Cerasale, senior vice president of governmental affairs at the Direct Marketing Association. “Those efforts are going forward. They are not being sidetracked because of the Hurricane Katrina investigation,” he added. Bob McLean, executive director of the Mailers Council, agreed. “Negotiations are continuing behind the scenes to try and work out some of the differences,” he said. “It doesn’t take that long to consider a bill like this, especially if it is considered under unanimous consent.” When the hearings on Katrina are through the Senate, “we’ll be ready to focus on postal reform,” Cerasale said. “That’s our hope, and that’s what we understand.” Some also expressed concern that debate over Supreme Court nominee

John Roberts could also stall postal reform. (*DMNews*, Melissa Campanelli, 09/09/05)

The only way is up

- According to the *Wall Street Journal*, “Hurricane Katrina is likely to slow growth and boost inflation pressures in the second half of this year, economists believe. But the economy could receive a modest boost early next year amid recovery efforts on the Gulf Coast.” Increased inflation means higher USPS costs, which will lead to higher postal rates. (*Wall Street Journal Online*, Tim Annett, 09/08/05; www.postcom.org, 09/09/05)

CBO evaluates effect of S. 662

- On September 1, CBO responded to Senate Budget Committee Chairman Judd Greg’s (R-NH) query about the long-term effect that the S. 662 would have on the USPS’ financial condition and implications for taxpayers and postal customers. CBO concluded that the effect of the bill on USPS costs would be small--about 1% over the next 25 years. The agency also concluded that returning the responsibility to finance the CSRS military credit to the U.S. Treasury and the elimination of the CSRS escrow account would reduce USPS budget pressures. However, much of the fiscal relief would be offset by requiring the CSRS to begin pre-funding the health care benefits of future retirees.
- Regardless of reform measures, the USPS will be challenged in the years ahead by declining revenue and increasing operational costs, CBO concluded. The USPS’ budget gap would have to be closed through a combination of productivity improvements, service reductions, rate increases, and taxpayer support, said CBO. However, the CBO admits that its assumptions are “inherently uncertain” since it is difficult to predict factors such as postal competition, the success of USPS productivity, future employee compensation, and health care inflation over the next 25 years.
- In a September 1st letter to Judd, CBO Director Douglas Holtz-Eakin wrote “Whether or not S. 662 is enacted into law, the Postal Service will face challenges in the years ahead in collecting enough revenues to cover its costs. The agency’s costs are on a trend to increase in real terms (in part because of rising costs for health care), whereas its revenues are threatened by increasing competition from e-mail and other forms of electronic communication. CBO estimates that if revenues were to grow at 1 percent less than the rate of inflation, costs over the 2026-2030 period would exceed revenues by as much as one-third—less, if lower mail volumes resulted in some cost savings. For USPS to continue paying its bills, any such gap would have to be closed through some combination of improvements in productivity, reductions in service, increases

in postage rates (which in turn could result in further reductions in mail volume), and federal support.” (*The Effects of S. 662 on the Long-Term Financial Outlook of the U.S. Postal Service*, Congressional Budget Office, 09/01/05; *E-NAPUS Legislative Newsletter*, 09/02/05)

Jim Walsh resigns from the USPS Board of Governors

- Effective immediately, John F. Walsh has resigned from the USPS Board of Governors. Walsh has served on the board since his appointment by President Bill Clinton in November 1999. (*Alliance of Non-profit Mailers*, 08/30/05)

Postal reform appears to be alive and well in Japan

- According to exit polls, Prime Minister Junichiro Koizumi’s ruling Liberal Democratic Party (LDP), seeking a mandate for the privatization of the country’s postal system, appeared headed for a landslide victory in elections for Japan’s lower house of parliament. Late Sunday (September 11), Koizumi said that it appeared the LDP had won a lower house majority in its own right, as the leader of the main opposition party conceded defeat. “I had hoped we would win a majority with our party alone, but we did even better than that,” Koizumi said. “I believe it was important to hear the people’s voice.” According to public broadcaster NHK and several commercial networks, exit polls indicated the Liberal Democrats stood to win as many as 309 of the powerful house’s 480 seats, an increase of 60 seats before Koizumi dissolved parliament last month. A second network, TBS forecast that LDP would win 307 seats. LDP’s main opposition party, the Democrats, was expected to win 104 seats, a loss of 71 seats (or 40%) from its previous 175 seats, according to NHK. The official vote count is expected to be available on Monday, September 12th. (*Associated Press*, Hans Greimel, 09/11/05)

TVA

TVA to cut smokestack emissions by encouraging “pollution-free” power

- In a test pilot program, Middle Tennessee State University’s solar site has 11 solar homes, including four low-cost, super-energy efficient Habitat for Humanity homes on the TVA grid. TVA pays 15 cents for every kilowatt hour of homegrown power produced by these solar homes, roughly double the six to seven cents a kilowatt hour homeowners pay for power from their TVA distributor, and throws in a \$500 bonus to each homeowner. While the amount of power generated by the solar homes is relatively small, program manager Ed Colston said, “...[I]t is much better from our standpoint to do it on a small scale and get those individuals involved, because there is a residual effect, a multiplier. Every one of those individuals who goes out and looks for a contractor and buys a system is contributing to the entire chain of the technology development.” In turn, TVA sells pollution-free power for a premium through its Green Power Switch to more than 8,200 homes and 428 businesses, including Tennessee’s state park system. (*Associated Press*, Duncan Mansfield, 09/03/05)

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