

The **GSE** REPORT™

www.gsereport.com

Contents of GSE Report™

Major Events

- [Federal Reserve Chairman Bernanke urges Congress to tie the GSEs' mortgage portfolios to their affordable housing mission \(p.3\)](#)
- [Timing of GSE Legislation in House and Senate \(p. 3\)](#)
- [The White House's FY2008 budget softens its tone on the GSEs' portfolios \(p. 4\)](#)

Fannie Mae and Freddie Mac

- [The GSE "holy war" continues, as Fannie and Freddie play the stalemate game \(again\) \(p. 6\)](#)
- [Bleeding Fannie and Freddie dry: "Death by a thousand restrictions" \(p. 7\)](#)
- [During this period of transition for the housing market, passage of GSE regulatory reform legislation is particularly important \(p. 10\)](#)
- [FHLBs don't fit the "yoke" of Fannie and Freddie in GSE reform debate \(p. 13\)](#)
- [Financial Services Roundtable renews its call for passage of GSE reform legislation \(p. 14\)](#)
- [Activists "rap" Fannie and Freddie for buying subprime mortgage-backed securities \(p. 14\)](#)

Fannie Mae

- [Fannie Mae plans to file its annual reports for 2005 and 2006 by year-end 2007 \(p. 16\)](#)
- [Fannie Mae eager to restart its ADC loan purchase program \(p. 17\)](#)
- [Judge rules against former Fannie Mae executives' push for February hearing on OFHEO's charges \(p. 17\)](#)
- [Goldman Sachs dropped as defendant in Fannie Mae lawsuit \(p. 19\)](#)
- [Fannie Mae financed \\$34.3 billion in multi-family rental housing in 2006 \(p. 19\)](#)

Freddie Mac

- [Freddie Mac closed a record \\$28.8 billion in multifamily loans in 2006 \(p. 20\)](#)
- [CRO Magazine ranks Freddie Mac 28th in "100 Best Corporate Citizens" \(p. 20\)](#)

Federal Home Loan Banks

- [FHLB-Atlanta agrees to pay interim CEO's consulting firm \\$100,000 a month \(p. 21\)](#)
- [FHLBs announce 4th quarter results \(p. 21\)](#)
- [The FHLBs' MPF Program forms partnership with USDA \(p. 22\)](#)

Ginnie Mae

- [HUD's top priority is to reform FHA \(p. 23\)](#)

Farm Credit System / Farmer Mac

- [NAR and NAHB voice support for expansion of mortgage lending authority for FCS \(p. 24\)](#)
- [ABA asks members to write letters in opposition of FCA's proposed rule amending criteria for entities eligible for financing by FCS institutions \(p. 25\)](#)
- [FCS reports net income of \\$2.4 billion for fiscal year 2006 \(p. 25\)](#)
- [FCA submits \\$47.5 million budget for fiscal year 2008 \(p. 26\)](#)
- [FCA proposes rule to amend priority claims for FCS member in liquidation \(p. 26\)](#)
- [Farmer Mac and the CFC close a \\$365 million transaction \(p.26\)](#)

Postal Service

- [USPS attributes its first quarter loss of \\$2.7 million to funding requirements of postal reform legislation \(p. 27\)](#)
- [GAO's assessment of challenges facing the USPS \(p. 27\)](#)
- [NRLC's membership rejects tentative contract agreement with the USPS \(p. 28\)](#)
- [Does the USPS's growing customer base hurt or help the agency? \(p. 28\)](#)
- [No junk mail bills proposed in three state legislatures would have "dire" consequences for USPS \(p. 29\)](#)
- [Bill proposed to extend the sale of the Breast Cancer Research Stamp \(p. 29\)](#)

TVA

- [TVA's budget reduction plans will likely change when agency passes its new strategic plan \(p. 30\)](#)
- [TVA announces first quarter results \(p. 31\)](#)

Major Events

Federal Reserve Chairman Bernanke urges Congress to tie the GSEs' mortgage portfolios to their affordable housing mission

- In his semi-annual monetary policy testimony before the Senate Banking and House Financial Services Committees, Federal Reserve Chairman Ben Bernanke repeated his concern about the size of the GSEs' portfolios and the systemic risk that they pose to the U.S. financial system. Bernanke suggested that one way Congress might limit the size of the GSEs' portfolios would be to "anchor" them to the GSEs' affordable housing mission. "What I would like to see is the portfolios more directly connected [to their mission], perhaps only affordable housing [mortgages] rather than all kinds of assets not related to affordable housing." He added, "That would be a direct way to create some limits on [the GSEs'] rapid expansion [of their portfolios], while still having a direct impact on affordable housing. ... We need to find some way that we can limit the growth of the portfolios." He pointed out that less than 30% of the GSEs' mortgage assets promote their AH mission, according to OMB's 2008 budget. Bernanke declined to take a position on the Democratic-backed proposal to force the GSEs to make a \$500 million contribution to an affordable housing fund. Representative Spencer Bachus (R-AL) argued that the fund would be "an added cost to lower and middle-income homeowners ... [which would] increase the cost of that home, or the availability of that home mortgage." (*Bloomberg*, James Tyson, 02/15/07; *Bloomberg*, James Tyson, 02/15/07; *Dow Jones Newswires*, Brian Blackstone and Benton Ives-Halperin, 02/15/07)

Timing of GSE Legislation in the House and Senate

- After Bernanke's testimony, Senate Banking Committee Chairman Chris Dodd (D-CT) told reporters that passing GSE regulatory reform legislation is one of his top priorities, but indicated that the Senate would likely approve a different version than the House bill. "We need to have our own Senate bill," he said. "I suspect it will be somewhat different than the one in the House bill." Dodd and other members of the Committee hope a compromise on reform legislation will be reached promptly. "My colleague from Delaware [Senator Tom Carper (D-DE)] has a strong interest as I do and we're going to move quickly here on a Senate bill," he said. The GSEs are not "an immediate threat" at this time and he's been assured that "things are in pretty good control," Dodd added. (*Market News International*, Margaret Chadbourn, 02/14/07; *American Banker*, Steven Sloan, 02/15/07)
- Following the Fed chairman's appearance before the House Financial Services Committee chairman Barney Frank (D-MA) told reporters that he expects his panel to mark up GSE reform legislation in March and plans for the full House to take up the bill in April. "We're going to move in March," said Frank, adding he expects the bill to "look like" the bill that the House approved in the previous Congress. He noted

that a number of the Republican criticisms of Fannie Mae and Freddie Mac are “inconsistent” and will have little affect on deliberations, as he fine tunes the bill. “They just don’t like housing” Frank said. In earlier comments, Frank said the GSE legislation will go to the House floor as a “Katrina package” of two bills to help the hurricane-ravaged areas of the Gulf Coast. The GSE regulatory reform bill will force Fannie and Freddie to pay \$500 to \$600 million a year into a fund that will be used to finance affordable housing in the Gulf Coast, said Frank. (*Market News International*, John Shaw, 02/16/07; *Bloomberg News*, James Tyson, 02/07/07)

The White House’s FY 2008 budget softens its tone on the GSEs’ portfolios

- The Bush administration’s Fiscal Year 2008 budget proposal reflects a new tone in its negotiations with lawmakers on GSE regulatory reform, by arguing that the new GSE regulator should have the power to cut the Enterprises’ mortgage portfolios but not required to do so (as argued in the 2007 budget). “A new [GSE] regulator must have clear authority to address and mitigate the risks posed by the GSEs’ retained portfolio,” the budget said. The administration again concluded that the GSEs’ portfolio growth has exceeded the growth of the overall mortgage market and the portfolios pose a full range of risk. Moreover, the GSEs’ portfolios have achieved “little for the GSEs’ housing mission” with “only about 30% of Fannie Mae and Freddie Mac’s retained portfolio holdings ...[being] eligible to qualify for any of the affordable housing goals” [while in contrast “about half of the MBS issued by others and whole loans” would qualify for the GSEs’ AH goals], said the administration. The GSEs’ massive portfolios are largely “comprised of holdings of their own guaranteed MBS, which could easily be sold.,” the budget said. “...The function of these portfolios is largely to increase profits, not facilitate affordable housing.”
- The FY2008 budget also seeks a clearer distinction between Fannie Mae and Freddie Mac’s primary and secondary mortgage market activities and new “clarity” regarding permissible activities under the GSEs’ charter acts, including the development of intellectual property. HUD will be completing a “Financial Activities Review” this year, which “will provide a baseline of information on Fannie Mae’s and Freddie Mac’s business and program activities. As part of this review, HUD will examine specific transactions to determine if they are consistent with Fannie Mae’s and Freddie Mac’s charter authorities.” The administration also addressed the issue of technology and the development of intellectual property, writing, “Through the development and delivery of new technology to the industry and by leveraging their funding advantage, there is potential for the GSEs to expand their business beyond the limitations of their Charter Acts, which prohibits both Fannie Mae and Freddie Mac from originating mortgages. Loan origination is the central function of the primary mortgage market, and the GSEs’ charter acts clearly restrict them to the secondary mortgage market. However, technological advancements have blurred the line that defines where the primary market ends and the secondary market begins. A new level of clarity is required to establish the permissible activities under the Enterprises’ charter acts, including the development of intellectual property.” The

administration called on Congress to create “a new regulatory structure for Fannie Mae and Freddie Mac” which set forth specific goals related to new powers of the GSE regulator, but did not include specific guidelines for an affordable housing fund, a provision that is included in draft legislation that is circulating in the House.

- The administration proposed a budget of \$60 million for OFHEO for 2006 and \$67.6 million in 2007. [However, the agency’s budget will remain at \$60 million for the current fiscal year, after the House voted in February to leave budgets “flat” at most federal agencies (including OFHEO) for 2007.] In the FY 2008 budget, the administration proposes a \$66 million budget, which appears to be a 10% increase but is, in effect, lower than the agency’s 2007 budget proposal. In recent testimony before Congress, OFHEO director James B. Lockhart said that the three expensive legal battles his agency is waging against the former management of Fannie Mae and Freddie Mac related to their accounting scandals could eat up as much as 20% of his 2007 budget (or approximately \$13.5 million) and would likely drag into 2008. In a statement released February 5, Lockhart said he expected the \$66 million request for 2008 would be adequate to meet his agency’s needs. “While it is difficult to project the precise costs of litigation associated with OFHEO’s enforcement actions, at this point in time we believe the President’s budget request contains sufficient funding for the agency,” he said. In its 2008 budget, the administration proposes to increase OFHEO’s staff from 225 in 2006 to 259 by 2008. “The Budget proposes a new strengthened housing GSE regulator as an independent agency,” the budget said. “All OFHEO resources would be transferred to it. The Administration continues to support direct funding of these activities with mandatory assessments on Fannie Mae and Freddie Mac.” (*Analytical Perspectives: Budget of the United States Government Fiscal Year 2008*, 02/05/07; *Dow Jones Newswires*, Damian Paletta, 02/05/07; *American Banker*, Rob Blackwell and Stacy Kaper, 02/06/07; *Market News International*, Margaret Chadbourn, 02/05/07; *National Mortgage News*, Paul Muolo and Brian Collins, 02/12/07; *American Banker*, Patrick Rucker, 02/05/07)

Fannie Mae and Freddie Mac

The GSE “holy war” continues, as Fannie and Freddie play the stalemate game (again)

- In testimony before the House Budget Committee, Treasury Secretary Henry Paulson downplayed expectations for the Bush administration attaining all of its goals in creating a new GSE regulator. “I am hopeful we can get the things we need,” said Paulson said in testimony to the Committee. “I think we can work something through that we can get what we need to protect against systemic risk. There may be some people who think we can get more -- they may be disappointed.” Paulson said that he doesn’t intend to allow “the perfect to be the enemy of the good.” He added, “I feel very strongly that we need a regulator that’s independent, got more muscle, and a number of other changes. I also know people feel very strongly on both sides of this issue. I’ve never witnessed anything quite like this. It’s the closest thing I’ve witnessed to a Holy War.”
- Debate continues in Congress over a provision in which Fannie Mae and Freddie Mac would “contribute” annually \$500 million to an affordable housing fund. Representative Spencer Bachus (R-AL), minority leader of the House Financial Services Committee, continues to oppose the creation of the fund, arguing that it is “a tax on lower and middle income homeowners to finance a government housing program, the need for which is debatable.” Representative Paul E. Gilmor (R-OH) said he is “leery” of Congress dictating how the GSEs should fund AH housing. “We should treat them as what they are: private companies,” said Gilmore. “I would not, in a perfect world, be for government mandating them to take a certain portion of their profits ...and put them in a certain purpose. It’s a private company, just like General Electric.”
- Representative Richard Baker (R-LA), a senior Republican member of the panel, said he would support the AH fund, so long as the money couldn’t be used by the GSEs for political leverage. “I think there is agreement reached to provide for construction of the [AH] fund to ensure that it goes to its intended purposes and that no political activism would be permitted,” said Baker. “If we can get to that point in the discussions, I really do believe for the first time in world history, that we have a GSE bill that is not controversial.” He said he also supports creating “a strong penalty” for any group or individual found using the AH fund for political reasons. “I think there is a way to get to that,” Baker added. In a House Financial Services Committee hearing on the housing needs on the Gulf Coast, Roy Bernardi, the deputy secretary of HUD, told House panel, “If you can get the [financial] resources, we will do the job [of restoring low-cost housing to the hurricane damaged region].” When asked if he endorses the creation of an affordable housing fund financed by the GSEs, Bernardi replied, “Yes.”

- After more than a year of keeping a low profile on Capital Hill, Fannie Mae and Freddie Mac are actively weighing in on aspects of GSE reform through meetings by their lobbyists with House Financial Services chairman Frank (D-MA). Sources said that the GSEs' lobbyists raised issues similar to those raised on February 8th by Richard Syron, Freddie Mac chairman and CEO, who surprised attendees of the NAHB convention by aggressively attacking the proposed GSE reform bill. [\[Excerpts of Syron's speech appear below.\]](#) "The old arrogance is creeping back into both companies," said Armando Falcon Jr., OFHEO's former OFHEO director who is a principal at Canonbury Group. "It's history repeating itself. ... They are always out front saying, 'Yes, we want a bill,' but then they play the game to a stalemate." Freddie Mac spokesman Doug Duvall contented, "We are in no way ramping up our lobbying on the Hill. ...[Dick Syron gave the speech because] there are a number of very important issues to be decided in the upcoming debate. ...Dick felt he could contribute to this debate now by laying out a constructive view not voiced by the well-funded, hard-line critics of the GSEs." According to sources, GSE officials' objected to issues previously thought resolved, such as new capital requirements and program authority. Fannie and Freddie lobbyists have told lawmakers that any hike in minimum capital requirements should be temporary, said sources. Fannie's lobbyists are also pushing to gain control over the proposed affordable housing fund, said sources. "[The GSEs' lobbying] just shows that neither Fannie [nor] Freddie has really changed," said Mike House, executive director of FM Policy Group. "Last year there was all this talk by various individuals at Fannie and Freddie about how much they were changing, but it seems to be business as usual."
- Time will tell how much clout Fannie Mae and Freddie Mac have on Capitol Hill in the aftermath of their accounting scandals. And, it is unclear how far the GSEs are willing to push their objections to the proposed GSE regulatory reform bills. Even if Frank doesn't change the terms of his compromise agreement with the Treasury, lawmakers from both parties may try to make changes in response to Fannie's and Freddie's complaints, which would leave the fate of the bill in jeopardy and create another political stalemate. Peter Wallison, a fellow at American Enterprise Institute, said, "[Frank] will have some trouble [if the GSEs] will be working against him." (Dow Jones Newswires, Elizabeth Price, 02/07/07; Reuters, 02/08/07; Bloomberg News, James Tyson, 02/06/07; Dow Jones Newswires, Damian Paletta, 02/07/07; Bloomberg News, James Tyson, 02/07/07, American Banker, Joe Adler, 02/13/07; American Banker, Rob Blackwell and Steven Sloan, 02/12/07;

Bleeding Fannie and Freddie dry: "Death by a thousand restrictions"

- In a February 9 speech before the National Association of Homebuilders' convention, Freddie Mac chairman and CEO Richard F. Syron decried proposed changes in the GSEs' business model [as proposed in GSE regulatory reform legislation] at a time when Fannie and Freddie are needed the most. Syron said, "...The need for housing [in the U.S.] is burgeoning in the coming decades. Much of that housing will be for minorities and immigrants. Meanwhile, affordability challenges have risen for

everyone. And the GSEs' affordable housing goals and subgoals continue to rise rapidly. Simply put, the future demands on housing finance will be greater than ever – as will the need for the GSEs.”

- “[In the future,] the GSEs will be more important than ever. For the mortgage business will become harder as investors [in nontraditional mortgages] become more wary of risk and pricing for perfection comes to an end. And this, in turn, will only increase the need for mission-responsive institutions in housing finance. Fortunately for the public, the GSEs’ congressional charters oblige us to be responsive to a standard to which private equity firms, hedge funds, and even publicly held banks and financial institutions cannot be held accountable. Our charters specify that we must be a *continual* presence in the mortgage market, providing affordability, liquidity and stability. All of which begs the question[:] Why overly hamper us just when you’re going to need us most?”
- “[U]nfortunately, in some people’s minds the notion seems to be that the best GSE is the least GSE. The loudest voices in the debate have been those demanding not only to tighten oversight of the GSEs – which we agree with – but to diminish our tools and shrink the box within which the GSEs can operate. An outside observer might surmise that this kind of tightening is simply the way the entire regulatory pendulum is swinging in America these days. In fact, ...pendulums often swing too far. Too often, today’s solution becomes tomorrow’s problem. From Treasury Secretary Paulson and a number of other key financial leaders, we have heard wise calls for ‘striking the right balance’ in regulation – warning that ‘[e]xcessive regulation slows innovation, imposes needless costs on investors, and stifles competitiveness.’ However, no one is talking this way about the GSEs.”
- “‘Hold on,’ you may be thinking. ‘You GSEs brought this on yourselves.’ In many ways, you’re right. Freddie did *understate* its earnings – and for that we will be in the penalty box until our financial reporting is current. We lost the public trust on this front and it is up to us to earn it back. We don’t flinch from this responsibility one bit. It’s also clear to me the institutions were insulated, arrogant and run in an imperial manner. We have to make sure the GSEs never again make those mistakes.”
- “But the fundamental question here is[:] What are the implications of all this for the future? Why change the basic business model of the GSEs when ...we will be more needed than ever to help sustain the world’s most liquid and successful housing finance system? That is exactly the unintended consequence I am saying we need to worry about. I’ll explain why as succinctly as I can. Freddie Mac’s business model has been, for the most part, fairly simple. One basic market with pretty low risk; appropriate capital requirements; high leverage; and high volume. Now, look at some of the issues that are still very much a part of the GSE debate, thanks to our most hard-line critics.”
- “Some critics would like much higher capital – capital not tied to our inherent risk. Severely limited retained portfolios. Cumbersome restrictions on new products and

programs. And no increase in our ability to help high-cost states such as California, New York, Florida and other areas where the challenges of housing affordability – *and* changing demographics – are most acute. That’s a pretty damaging set of demands. Whatever it is they answer, it’s *not* the wise call I cited earlier for ‘the right regulatory balance.’ Instead, these changes would make the GSEs less competitive, less profitable and less relevant. Ultimately this would put us in a tight box that doesn’t work for our mission, our shareholders, or I would respectfully add, for you. If that’s what results from this process, fine – but let’s realize that we won’t succeed in satisfying anyone, and let us go on to doing something else.”

- “Capital is one key issue on which we ought to be very leery of unintended consequences. It’s especially puzzling to contemplate a dramatic increase in required capital for the GSEs, at the same time as our main competitors may have their capital requirements substantially *eased* under Basel II. In a recent study for the Mortgage Bankers Association, Professor Mark Flannery of the University of Florida found that even at current GSE capital levels, big banks under Basel II may be required to hold *less than half* the equity capital of the GSEs against prime mortgage credit risk. That will put a big squeeze on the GSEs’ securitization business – the one area where there is the least controversy over what the GSEs do.”
- “Let’s look at another issue: new program authority. With the demographic changes ...[in] the mortgage market, ...the GSEs will need to be *more* innovative and agile than ever. Yet some critics insist on new program restrictions that would force us to wait for regulatory approval before purchasing any innovative new product or undertaking any new activity. Such changes would harm homebuyers and home builders alike.”
- “Another key issue is higher loan limits in high-cost states. I spent much of my life as a regional economist, ultimately becoming head of the Federal Reserve Bank of Boston. And I can tell you, assuming a uniform cost of living across the United States simply does not make sense.”
- “You’ve heard me talk about the retained portfolio before. In 2003, the GSEs held 21 percent of U.S. mortgage debt. Last year it was 13 percent. That trend doesn’t sound like market dominance or an increased concentration of risk to me! Without a healthy and robust retained portfolio, Freddie would not have been able to do nearly as much after Katrina as we have. For example, we bought \$1 billion of state and local mortgage revenue bonds in the Gulf Region, and pledged to purchase up to \$300 million of mortgages that our lenders had in the pipeline – even if the homes behind these mortgages were now damaged or the homeowners no longer had steady incomes because their workplaces were destroyed. Both of these initiatives depended heavily on our retained portfolio, and its ability to spring quickly into action. Our rapid response also would have been hampered by the new program restrictions that some of our critics seek.”

- “One source of opposition to our retained portfolios is that they can be profitable. But that’s an indispensable part of the GSE model: *there need to be profits*. And if the extremists in this debate get what they want, the results will bleed the GSEs dry – death by a thousand restrictions. ‘Profit’ is not a dirty word in talking about the GSEs. It is what allows us to be private-sector institutions, using private-sector methods to respond to market realities. The congressional genius in designing the GSEs was to benefit millions of America’s homeowners and renters every year, without direct federal aid. If something bad befalls the GSEs, the first line of defense is not the taxpayer, it’s roughly 100 billion dollars in private shareholder capital. But shareholders demand an adequate return on their investment. And if that return falls too low, the model simply will not work.”
- “Don’t get me wrong. We do favor GSE oversight legislation. And I personally supported a specific bill back in March of 2004. However, this is so important to what we do, it would be irresponsible not to have an opinion on what’s going to happen now. To the contrary, our fiduciary duties to our shareholders – as well as our housing mission – *oblige* us to have a view. The uncertainty for everyone has gone on too long, and speaking solely for myself, we need legislation, but we need to get it right.”
- “It’s not just the GSEs’ future that depends on appropriate legislation – which strengthens our oversight but also enables us to meet our expanding mission. The truth is, we are talking about the fundamental shape of the housing finance system in this country. And that has implications for the health of the Home Builders, the entire housing sector and our nation’s economy. I framed my discussion with you today in terms of the demographics of housing demand and the growing need for the GSEs. Because this is not about politics or spin or special pleading. It’s about what’s best for homeowners and for this country.”
- “This meeting [with the NAHB] is one of the most astute audiences I speak to every year. That’s why I trust you know the matters we are discussing here today are of profound interest to us both. And that together, we should act on them accordingly.”
(*Prepared remarks for Richard F. Syron, chairman and CEO, Freddie Mac, 02/08/07*)

<p>During this period of transition for the housing market, passage of GSE regulatory reform legislation is particularly important</p>
--

- In a February 12th speech to the ACB Real Estate Lending Conference, OFHEO director James B. Lockhart, III reiterated his call for passage GSE regulatory reform legislation to give his agency the tools it needs to promote a strong national housing finance system and ensure the safety and soundness of Fannie Mae and Freddie Mac. Lockhart said, “[The GSEs’] role in today’s housing market is particularly important. The housing market is currently in a state of transition. House price appreciation, as measured by OFHEO’s House Price Index (HPI), has decelerated dramatically from

the rates of the last few years. OFHEO's latest data suggest that house prices grew only 3.5 percent on an annualized basis from the second to the third quarter of 2006. This rate pales in comparison to the unsustainable quarterly rates of 17.7 percent and 14.5 percent we were seeing in 2004 and 2005. Virtually all other indicators suggest a far different landscape than we have seen in recent years: inventory levels are way up, housing starts are down, mortgage activity has declined, and mortgage delinquency rates are on the rise. As you know more than most, navigating these waters are difficult for even the best run companies."

- "The Enterprises, with their significant operational deficiencies, will be even more challenged. The growing uncertainty associated with future house price appreciation will make it difficult to manage credit, as well as market risk. We need a strong regulator to ensure that they are adequately managing their risks and to make certain their capital buffer is sufficient to weather market conditions. Although the Enterprises are not subject to the new, international banking capital rules, Basel II, it is instructive to compare their regulatory environment to the three pillars that Basel II uses. The three pillars are capital rules, regulatory strength and market discipline. ...[T]he capital rules and regulatory powers of OFHEO are weak compared to those of the bank regulators, and the debt markets provide very limited discipline because of their GSE status and the so-called 'implicit' Federal guarantee. The lack of market discipline relative to that faced by banks and other financial institutions makes capital and regulatory oversight of the GSEs even more important."
- "[GSE regulatory reform] legislation will give the new regulator the powers that it needs to prevent the Enterprises from growing out of control again. These Enterprises own or guarantee \$4.2 trillion of residential mortgages in the U.S.... If you total the [FHLBs] with Fannie Mae and Freddie Mac mortgage holdings and guarantees, they represent 46 percent of mortgage debt outstanding at the end of the third quarter 2006. In 2003, their market share peaked at nearly 54 percent. Despite the 3 year drop, which was caused by the Enterprises' problems, the GSEs still dominate the U.S. mortgage market. This dominance and the importance of the mortgage market to the American economy are key reasons why they need a strong regulator. The good news is that there is strong bipartisan support for reform legislation..."
- "...Presently, the Enterprises have low regulatory minimum capital requirements compared with other financial institutions. The 1992 Act that created OFHEO requires them to maintain stockholder's equity equal to 2.5 percent on assets and 0.45 percent on MBS outstanding. To be considered well-capitalized, banks must have 5 percent and hold significantly more "excess" capital than the Enterprises do. The Enterprises are now running at higher capital levels as OFHEO imposed a 30 percent capital surcharge on each due to their ongoing problems. They also have built a cushion on top of that, which is certainly more comfortable than the 2.5 percent level under present law. In addition, OFHEO's risk-based capital requirements have been too constrained by the 1992 law and are much lower than the minimum capital requirements. Risk-based capital should be based on the full array of Enterprise risks:

market, credit, and operational risk, as well as the risks they present to the overall financial markets. More flexibility to enhance capital requirements is a critical component of the future regulation of the Enterprises and would be more comparable to the authority banking regulators have in setting capital requirements.”

- “...Absence of market discipline has clearly contributed to unconstrained growth of both Enterprises’ portfolios. Over the past 15 years, mortgages outstanding tripled and yet the Enterprises’ portfolios grew ten-fold. The huge size of their portfolios is not required by their mission. Less than 30 percent of their portfolios contribute to meeting their affordable housing goals and over half of their portfolios are in their own MBS. If growth is not tied to their mission, the portfolios could pose increasing risk to financial markets.”
- “The regulator needs the flexibility to write a regulation based upon clear congressional guidance. While not perfect, I believe the compromise achieved near the end of the 2006 congressional session achieved that objective. It is designed to focus the portfolios tightly on their missions which include affordable housing, and stability and liquidity of the secondary market for residential mortgages. It also states that potential risks posed by their holdings should be considered by the regulator. A regulation would occur under a notice and comment rule-making, allowing all interested parties to comment on the proposed rule. An area to consider will be that largest pie slice, their MBS portfolios, which does not add to achieving affordable housing goals and yet create unnecessary market and operational risks. Many of these MBS could have been easily sold directly to the market. ...[T]he recent shrinkage of their portfolios, which was necessitated by their problems, was achieved by the run-off and sale of almost \$300 billion of their MBS. Despite this reduction, the MBS market has continued to strengthen.”
- “...There are other issues being discussed in the context of GSE reform. As you all know, an Affordable Housing Fund is a priority issue for House Financial Services Committee Chairman Frank. While managing the Fund is not a responsibility that OFHEO seeks, if it is in the legislation that passes, we will certainly do our best to implement the statute quickly. Issues of concern to the Administration – that the Fund not be controlled by the Enterprises, that it not be based directly on profits, and that there be a sunset – have moved in the right direction. Another question is whether there will be a cap on annual contributions. A last concern we have is that there should be tight controls around the Fund so that it is appropriately and effectively distributed.”
- The proposed Affordable Housing Goals address the need to equip the regulator with stronger enforcement powers – for mission oversight and safety and soundness. This is a crucial improvement as are the closer targeting of Enterprise activities to the low and moderate income families they are meant to serve, the better alignment of Enterprise goals with the Community Reinvestment Act goals, and the specific requirements for Enterprise purchase of mortgages for smaller multifamily projects.

- “I have talked a lot today about having a stronger regulator, but that is not just for the sake of having a stronger regulator. It is to ensure that the housing GSEs are strong and do an even better job of supporting the mortgage market in the U.S. As both Fannie Mae’s and Freddie Mac’s CEOs have told me, a stronger regulator will help restore their image in the marketplace. And, as I have told them, there is no point in having a strong regulator if the Enterprises are too weak to fulfill their missions. Therefore, the reforms should be directed to ensuring that Fannie Mae and Freddie Mac do a better job of fulfilling their missions while reducing unnecessary risk. After their remediation efforts are complete and legislative reforms including the capital and portfolio regulations are implemented, there is no reason why these two Enterprises could not produce a competitive rate of return on equity and grow with the mortgage market.”
- “A new, stronger and independent regulator with the powers similar to those of bank regulators is needed to oversee Fannie Mae, Freddie Mac and the Federal Home Loan Banks. All are important to our housing market, the economy and the American dream of homeownership. We have made much progress, but we need more tools. ...We all agree that the GSEs have a very important public mission of supporting affordable housing and helping to ensure the foundation of the nation’s housing finance system. The proposed legislation should ensure that they remain safe and sound and that they and the system remain strong.” (*Prepared remarks by James B. Lockhart, III, 02/12/07*)

FHLBs don’t fit the “yoke” of Fannie and Freddie in GSE reform debate

- In a February 9th article in the *American Banker*, Federal Housing Finance Board director Geoff Bacino argued that the inclusion of the FHLBs in the new regulatory agency for Fannie Mae and Freddie Mac is not good public policy. Bacino wrote, “The structure and operations of the [FHLBs] differ significantly from those of Fannie and Freddie. Simply throwing the functions of OFHEO and the Federal Housing Finance Board together would not improve the quality of the banks’ regulation. For evidence, look no further than the Department of Homeland Security. A ‘super’ agency sounds good; however, the practical limitations that occur often result in a deterioration of the agency’s performance.”
- “The problems that have confronted Fannie and Freddie are exclusive to those enterprises. They do not mirror concerns at the Federal Home Loan banks. Should it becomes necessary to address Home Loan bank issues, they should be handled in a separate bill that takes into account the unique nature of the Home Loan Bank System and their reform needs.
- “The [FHLBs] already have a regulator — the Federal Housing Finance Board. Though there has been a lack of continuity at the top of the agency (five chairpersons in eight years), the current board has demonstrated its ability to serve as a world-class regulator. I don’t like regulatory dictatorships. I am now serving on my second

multi-person federal financial regulatory agency. Democracy within regulatory agencies allows for differing views from members with varying backgrounds and perspectives gleaned from both business and government backgrounds. This process substantially improves the regulatory results.

- “The sheer size of Fannie and Freddie would dwarf the [FHLBs], and the focus of the new regulator would be almost entirely on Fannie and Freddie issues. Those affecting the Federal Home Loan Bank System would be delegated to a career deputy and his staff. The voices of the [FHLBs] would be muted under this scenario.”
- “There is a reason that previous proposals to merge the OTS, the OCC, the FDIC, the NCUA, and parts of the Federal Reserve System have failed — they didn’t make sense. Careful thought and consideration proved to be effective arguments against moving forward on these suggestions. The same should be true in this discussion of GSE reform.”
- “I believe in the mission and goals of the [FHLB] System. I do not agree with those who would like to eliminate or substantially curtail the housing finance function of the banks. The system is undergoing change and reform — and it will be stronger as a result of this reform. The system requires a full-time, multi-person board to oversee and enhance the housing finance mission the banks perform.” [In July 2006, President Bush appointed NCUA board member Bacino to the Finance Board.] (*American Banker*, Geoff Bacino, 02/09/07)

Financial Services Roundtable renews its call for passage of GSE reform legislation

- In a February 8th press briefing, John Dalton, president of the Financial Services Housing Policy Counsel, said establishing a solid, independent regulator for Fannie Mae, Freddie Mac, and the 12 FHLBs is a critical legislative objective for 2007. The GSEs’ current regulatory system is “broken,” said Dalton. “For the good of our economy and the protection of the housing market, it is imperative that GSE reform be passed in this session of Congress.” Given the compromise that the Secretary Treasury Secretary Henry Paulson and House Financial Services Committee chairman Barney Frank (D-MA) have reached, “we are very optimistic and very positive that we will get GSE reform in this Congress,” Dalton added. (*Bureau of National Affairs*, Richard Cowden, 02/09/07)

Activists rap Fannie and Freddie for buying subprime mortgage-backed securities

- In testimony before Senate Banking Committee, the Reverend Jessie Jackson, president and founder of the Rainbow PUSH Coalition, took Fannie and Freddie to task for purchasing subprime MBS and “profiting” from abusive lending practices. Jackson said that Fannie purchases subprime securities [particularly securities backed

by 2/28 ARMs] that “are stripping working-class people of their precious home equity... In short, Fannie Mae and other GSEs are doing through the back door what the law prohibits through the front door. This must change.” Martin Eakes, CEO of Center for Responsible Lending (CRL), argued that Fannie and Freddie are “supporting and condoning lenders who market abusive, high-risk loans” through their investments in senior tranches of subprime MBS. Eakes added that the GSEs should not get credit toward their AH goals “by investing in loans that generate massive foreclosures.” According to CRL, Fannie and Freddie purchased about 25% of the total subprime MBS sold during the nine months ended September 30, 2006.

- In an effort to curb predatory lending practices, Senate Banking ranking member Richard Shelby (R-AL) suggested that Congress require Fannie Mae and Freddie Mac to be more selective in the subprime mortgage loans they purchase. “[Fannie and Freddie could] do a lot more,” said Shelby. “They should. At end of the day we all know they are a government-sponsored enterprise, a GSE with the implicit guarantee of the taxpayer when they sell securities.” Shelby asked Jackson about the role that Fannie and Freddie play in curbing predatory lending. “It seems to me that’s not always a good one,” said Shelby. Jackson replied that the GSEs have a public mission to ensure that the mortgages it purchases also carry the ability for the borrowers to repay. “I think they must be challenged to honor their ability to repay [standard],” Jackson added.
- After the hearing, Senate Banking Committee chairman Chris Dodd (D-CT) told reporters, “I am a strong supporter of the GSEs, [but] that does not mean that they are immune from the kind of criticism raised here.” Dodd indicated that the GSEs’ purchases of subprime securities will be an issue addressed when the Committee drafts a GSE regulatory reform bill. “We will be looking at that when we talk about the legislation,” he said. (*National Journal’s CongressDaily*, Bill Swindell, 02/08/07; *National Mortgage News Online*, 02/07/07; *National Mortgage News*, Brian Collins, 02/12/07)

Fannie Mae

Fannie Mae plans to file its annual reports for 2005 and 2006 by year-end 2007

- In a speech at the Credit Suisse Financial Forum, Fannie Mae CFO Robert T. Blakely said that his company will file its 2005 and 2006 annual reports with the SEC by year-end. Blakely said, “I’d like today to provide new guidance on the timing of our 2006 10-K — specifically, we believe we will file our 2006 results and 10-K before the year is over.” He added, “We plan to file the 2005 10-K no later than the end of August of this year, and then the 2006 10-K before the end of the year.” Blakely said that the company continues to demonstrate its conservative and effective approach to managing the interest rate risk in mortgage assets it purchases, which “has been reflected in our portfolio’s duration gap, which has not exceeded plus or minus one month for over two years.”
- “The reclassification of our mortgage portfolio to available for sale, from hold to maturity, allowed us to enhance our portfolio strategy,” said Blakely. “We now both buy and sell based on pricing dynamics in the market, with a focus on maximizing total return over time—subject to our risk constraints.” On the funding side of the company, he said, “Demand for our debt is a cornerstone of our investment activities and a key determinant of our ability to maximize long-term fair value over time. We’ve continued to see consistently strong demand for our debt from domestic institutional investors. And, in recent years, we have seen a marked increase in demand for our debt from investors globally.”
- Fannie Mae’s 2007 priorities are focused on making the Company more competitive, said Blakely, who emphasized that increasing competitiveness isn’t just about running a company faster and better—but cheaper. “Bottom line, we want to run our business as efficiently as possible,” he said. “We’re focused on both identifying tactical, immediate opportunities to capture cost-saves, and on longer-term initiatives to help reduce normalized expenses going forward.” Blakely reiterated Fannie’s commitment to reduce planned operating expenses by \$200 million in 2007 with normalized operating expenses (excluding non-recurring costs associated with returning to timely financial reporting) expected to approximate \$2 billion.
- Thomas A. Lund, the company’s EVP of Single-Family Mortgage Business, told the audience, “We also see very solid growth opportunities for our Single-Family business this year, next year and for the long term. We expect growth in our MBS to be slightly higher than the growth of the mortgage market.” Fannie Mae’s Economic & Mortgage Market Analysis projects a 7% decline in new home sales; an 8% decline in existing home sales; 15% decline in single-family housing starts; and a 1% to 2%

decline in housing prices in 2007.

- Lund also told the audience that Fannie Mae is working on new structures that would allow the GSE to guarantee and securitize mortgages it likes [in terms of pricing and risk] and sell off the pieces it doesn't want to other investors. "We tested our first structure to transfer risk to other market participants who have a different view of risk than us," said Lund. "These structures will allow Fannie to serve its customers and participate in more transactions [and many products, such as subprime mortgages]." he said. Lund noted that Fannie started purchasing subprime loans from a "very limited" number of its lenders in 2006. "We began to dip our toe in the water of subprime whole loans to determine if we could bring value to that segment of the market," he said. Lund also indicated that Fannie wants to increase its involvement in the subprime market. (*Fannie Mae Press Release*, 02/08/07; *Credit Suisse Financial Forum Slide Presentation*, Bob Blakely and Tom Lund, 02/08/07; *MortgageWire*, 02/09/07)

Fannie Mae eager to restart its ADC loan purchase program

- Fannie Mae officials recently met with OFHEO to discuss their interest in restarting the company's controversial ADC loan purchase program and submitted to the regulator a "very thick document" addressing the agency's concerns and containing "first-rate, state-of-the-art policies and procedures" about their program, said Wayne Curtis, Fannie Mae's vice president the ADC and lender channel. While refusing to comment on the details of the guidelines, he said that they "adequately address the inconsistent and ill-conceived policies and procedures" that OFEHO was concerned about. "As soon as we get an OK from the director's office, we're going to get back in business," said Curtis said at the National Association of Home Builders' annual convention. "I'm hoping days, not weeks or months. ... I'm not going to speculate, but I feel really good about this. We're prepared to get back in this business." (*National Mortgage News*, Lew Sichelman, 02/12/07)

Judge rules against former Fannie Mae executives' push for February hearing on OFHEO's charges

- Administrative Law Judge William B. Moran has ruled against the request made by Fannie Mae's former chairman and CEO Franklin D. Raines, former CFO J. Timothy Howard, and former controller Leanne Spencer for a February 16th public hearing on OFHEO's 101 administrative charges against them. In a February 7 hearing, Moran said beginning a hearing on February 16th "would be nothing short of an absurdity." He added, "In that respect, I do view that assertion [as] specious and disingenuous [given the millions of documents that the defendants are seeking from OFHEO for use in their defense]. It's not a fair argument to make ... Only a low-scale, small-claims action could reasonably be expected to begin within the timeframe that respondents have suggested." Citing a Supreme Court decision in another case,

Moran said the statute required a scheduling conference within 60 days of the filing of the charges – not the evidentiary hearing, as the defendants’ counsel had argued. Moran’s ruling could defer the conclusion of the case until 2008.

- Raines’ attorney, David S. Krakoff, a partner at Mayer, Brown, Rowe & Maw LLP, said that defendants’ legal counsel weren’t trying to be disingenuous, but instead were hoping to speed up the public hearing, because OFHEO director James B. Lockhart had already made public statements about their clients that they believed were inappropriate. “We’re ready to go, as simple as that,” said Krakoff. “What’s really behind OFHEO’s position is that they are not ready to go.” While the defendants are trying to move the case to a federal court, all parties are required to continue the proceedings in the administrative court for now. In the “next few days,” the parties are expected to agree on a specific date to begin the formal administrative hearing.
- During the hearing, OFHEO deputy general counsel David A. Felt said, “The director has not made a decision [on] whether or not to recuse himself [from the hearing].” In a filing with the court in response to Raines’ request that the court bar Lockhart from the lawsuit, OFHEO argued that the agency’s director has the authority to review and overturn the findings of the administrative judge handling the case and that Lockhart would be “required to recuse himself only if he will be impervious to evidence contrary to his earlier views.” According to the filing, the defendants “cannot plausibly show that the impact of alleged prejudgment by [Lockhart] would escape effective appellate review. ...[Their] petitions are premature.” Moreover, the defendants haven’t shown that Lockhart’s views toward the case are set in stone, said OFHEO. “In determining whether an agency member has abused his discretion in declining to recuse himself it is necessary to conclude that his mind is irrevocably closed.” While the judge did not issue a decision on whether Lockhart should recuse himself, Moran said that he could be a fair and impartial judge and the OFHEO director could “willy nilly ignore” a judge’s findings. (*Dow Jones Newswires*, Damian Paletta, 02/07/07; *Bloomberg News*, James Tyson, 02/12/07; *Washington Post*, Damian Paletta, 02/07/07)
- Raines’ legal counsel and OFHEO have reach an agreement, giving the defendant access to thousands of documents that he claims refutes the agency’s charges that Raines overstated the company’s earnings to receive \$84 million in bonuses. On February 6, Raines and OFHEO “reached agreement with regard to OFHEO’s privilege log and its assertion of the examination privilege,” enabling it to withhold documents, said Raines in a court filing. “[Raines] reserves the right to challenge the confidentiality designations of specific documents produced in by OFHEO.” In this filing, Raines also withdrew his request asking the U.S. District Court to find OFHEO in contempt of court for not explaining why the agency withheld papers gathered during its examination of Fannie Mae. According to the court filing, “OFHEO has agreed to produce all responsive documents previously withheld.” On December 12, the agency denied Raines access to 3,300 papers, citing privilege and provided the defendant 179,134 papers out of a pool of more than 21 million documents related to

the GSE. (*Bloomberg News*, James Tyson, 02/09/07)

Goldman Sachs dropped as defendant in Fannie Mae lawsuit

- Goldman Sachs has been dropped as a defendant in a shareholder derivative lawsuit against Fannie Mae. The investment bank has recently moved to have the court dismiss their firm in a separate class action suit. (*Associated Press*, 02/06/07)

Fannie Mae financed \$34.3 billion in multi-family rental housing in 2006

- In 2006, Fannie Mae financed \$34.3 billion in multi-family rental housing through lender partners and investments in Low Income Housing Tax Credits with its syndication partners. According to the GSE, DUS lenders delivered \$20.4 billion or about 59% of its multifamily originations. Fannie invested \$2.2 billion in senior housing in 2006. Approximately 90% of the multi-family units financed by Fannie Mae in 2006 are affordable for families at or below the median incomes in their communities, while 58% of the units served low and very-low income markets. (*Commercial Property News*, 02/05/07)

Freddie Mac

Freddie Mac closed a record \$28.8 billion in multifamily loans in 2006

- In 2006, Freddie Mac closed a record \$28.8 billion in new multifamily business transactions in 2006, a 10% increase over the 2005 volume of \$26.2 billion. The company's multifamily originations included approximately \$1.2 billion in targeted affordable housing products which financed approximately 478,000 affordable housing units. Freddie's 2006 multifamily originations generated over \$12 billion through Freddie Mac's flow programs; over \$2 billion through its structured programs, including more than \$360 million in targeted affordable housing products and \$1.4 billion in commercial mortgage-backed securities small-loans volume; approximately \$1.5 billion in seniors housing mortgages related to the flow program; \$500 million in low-income housing tax-credit investments; and over \$14 billion in CMBS activity, excluding small-loans volume. (*Freddie Mac Press Release, 02/05/07*)

CRO Magazine ranks Freddie Mac ranks 28th in "100 Best Corporate Citizens"

- *Corporate Responsibility Officer Magazine's* annual survey of the "100 Best Corporate Citizens" in the United States recently ranked Freddie Mac in 28th place. In the annual survey [originally developed by *Business Ethics Magazine*], *CRO Magazine* compiled the list from more than 1,100 of the largest publicly traded companies in the U.S. and identified the top companies that excel at serving a variety of stakeholders well. "The 100 Best distinguish themselves from their peers at other large public companies by embracing higher standards – combining strong financial performance with responsible practices on environmental and social issues," said Michael Connor, Publisher and Editor of *CRO*. "We salute the 100 Best for their leadership roles in the field of corporate responsibility." (*Corporate Responsibility Officer Magazine, January-February 2007*)

Federal Home Loan Banks

FHLB-Atlanta agrees to pay interim CEO's consulting firm \$100,000 a month

- The FHLB-Atlanta plans to pay its interim CEO's consulting firm about \$100,000 a month while he runs the Bank. William Ott, president of PEAC Ventures Inc., a corporate advisory firm, became the Bank's interim CEO when its long-time president, Raymond Christman, stepped down suddenly. In an SEC filing, the Bank said it planned to pay PEAC Ventures an hourly rate equivalent to approximately \$100,000 a month for Ott's services. (*American Banker*, Steve Sloan, 02/07/07)
- The FHLB-Atlanta also announced the result of the Bank's 2006 director election to three year terms, commencing on January 1, 2007. B.K. Goodwin III and incumbent Russell Carothers, II will fill the two directorships designated by the Federal Housing Finance Board for the state of Alabama. Goodwin is president of FirstFed Bancorp Inc. and chairman, president and CEO of First Financial Bank, Bessemer, AL. Carothers is chairman and president, and CEO of The Citizens Bank of Winfield, Winfield, AL. Thomas H. Webber, III, vice president and chief financial officer for IDB-IIC Federal Credit Union, will fill the directorship designated by the Finance Board for the District of Columbia. Incumbent Thomas Johnson, vice chairman and executive vice president of First Community Bank, Lexington, S.C., will fill the directorship designated by the Finance Board for the state of South Carolina. (*MortgageLine*, 02/08/07)

FHLBs announce 4th quarter results

- The FHLB-San Francisco announced that its 2006 net income rose \$173 million or 47% to \$542 million, as a result of growth in net interest income and differences in fair value adjustments for respective periods. During 2006, the Bank's assets grew 21.3 billion or 10% to \$244.0 billion. Members increased their outstanding advances with the Bank by \$20.3 billion (13%) to \$183.7. The Bank's 2006 dividend rate was 5.41%, up 97 basis points from its 2005 dividend rate. (*FHLB-San Francisco Press Release*, 02/14/07)
- The FHLB-Pittsburgh reported net income of \$216.5 million for fiscal year 2006, an increase of \$24.7 million, or 12.9% compared to \$191.8 million for FY2005. The Bank's earnings increase was primarily driven by higher net interest income, which increased \$34.8 million or 11.2% due to impact of rising short-term interest rates on net non-interest bearing funds. On December 31, the Bank's assets totaled \$77.4 billion, an increase of \$4.5 billion or 6.1% from year-end 2005. During the year, the Bank's loans increased \$1.8 billion (or 3.9%) to \$49.3 billion, while its total capital increased \$0.3 billion (or 11.5%) to \$3.6 billion. "We are pleased with our 2006

financial performance, which reflects the continuing value our members place on advances and adds significantly to our support of affordable housing and community development in our region,” said John R. Price, the Bank’s president and CEO. “As we mark the 75th year of FHLB history, I believe our results, record earnings for FHLB-Pittsburgh, underscore the continuing relevance and importance of this Bank and the entire FHLB System.” (*BusinessWire*, 02/16/07)

- For fiscal year 2006, the FHLB-Cincinnati reported net income of \$253.1 million up 15.2% from 2005, which generated a return on equity of 6.7%. During the year, the Bank’s mission asset activity [consisting of credit services and mortgage purchase assets] grew 14% over the year with assets of \$56.9 billion. At December 31, the Bank’s assets totaled \$81.4 billion versus \$77.2 billion the prior year. The Bank’s capital stock (totaling \$3.7 billion) increased 4.4% from year-end 2005, while its regulatory capital stock decreased \$127.1 million or 3.2% during the year due to redemptions of excess non-member capital stock. (*FHLB-Cincinnati Press Release*, 02/09/07)

The FHLBs’ MPF Program forms partnership with USDA
--

- The FHLBs’ Mortgage Partnership Finance® Program has announced a new partnership with the USDA Rural Development program. Under this arrangement, approved FHLBs participating in the MPF Program can now purchase RHS Section 502 government-guaranteed loans from qualified members, including commercial banks, thrifts, credit unions, and insurance companies. The FHLBs of Chicago and Pittsburgh [the two Banks participating in the MPF Program] now have the ability to purchase these types of government loans from their members as a competitive alternative to the secondary market. Their members will retain the relationship with their borrowers and manage the credit risk of the loans they originate, while the FHLBs will manage the liquidity, interest rate, and prepayment risks associated with the loans. (*Mortgage Partnership Finance Press Release*, 02/06/07)

Ginnie Mae

HUD's top priority is to reform FHA

- HUD's "biggest priority in single-family housing" for the 2007 legislative year is reforming the FHA. "I think we're on solid ground with this legislation because of its broad bipartisan appeal," said FHA commissioner Brian Montgomery at the National Association of Home Builders annual convention. "With the new leadership, I think we have a great opportunity to push what could be perhaps one of the greatest pieces of bipartisan legislation of the 100th Congress." Montgomery said the three main sticking points to passage of the reform legislation include (1) fear that the proposed changes would end up hurting rather than helping home buyers; (2) concern that FHA is incapable of handling more complex programs; and (3) worry that the agency will take business away from the private sector. Montgomery stressed that FHA "has no plans" to loosen its eligibility criteria. "Our underwriting standards are designed to determine which borrowers represent an appropriate level of risk," he said. "That will not change." By moving to risk-based premiums, the FHA will be able to reach more lower-income borrowers at a substantially lower price than they are now paying for subprime loans. Concern that no-down payment loans would add another layer of risk that homebuyers will be unable to handle "is simply unfounded," he added, noting that 43% of last year's buyers didn't put up a down payment, even though many had the resources to do so. Montgomery also argued that his department is up to the task of implementing the proposed programs. "There should be no doubt we can manage our own programs," he said, adding that modernization will improve the agency's ability to manage risk. "There's no way we would or could supplant the activities of any private business," he said. "The FHA has a very specific and very critical role to play, and modernization is not intended to expand our reach beyond what is appropriate and necessary." (*National Mortgage News*, 02/12/07)
- According to GAO, FHA reform legislation would allow the FHA to set risk-based insurance premiums and reduce down-payment requirements, which means that HUD would have to "manage new risks and accurately estimate the cost of program changes." HUD deputy secretary Roy Bernardi told *National Mortgage News* that his agency is "ready" to manage those risks so that "less fortunate Americans" will have the opportunity to own a home. (*National Mortgage News Online*, Brian Collins, February 10-11, 2007)
- Although Montgomery didn't mention the possibility of FHA ADC loans to builders in his speech at the NAHB convention, former NAHB president Kent Conine said Montgomery was "intrigued" by the idea when they met recently in Washington. Conine said, "[The FHA commissioner] asked for a cost-benefit analysis. If we can show him how it would work and how it would benefit consumers, he said he would do a pilot." Although Montgomery "made no promises," Conine called the commissioner's willingness to entertain a proposal "good news." He added, "If we

can get our nose under the tent, sooner or later we can get a full-scale program.”
(*National Mortgage News Online*, Brian Collins, February 10-11, 2007)

Farm Credit System / Farmer Mac

NAR and NAHB voice support for expansion of mortgage lending authority for FCS

- The National Association of Realtors and the National Association of Home Builders are backing the Farm Credit System’s push for a provision to a broader farm bill that would allow the FCS to make home loans in communities with populations up to 50,000. Currently the FCS can only make home loans in towns with populations of 2,500 or less. In a joint letter to ranking members on the House and Senate Agriculture Committees, the NAR and NAHB urged Congress to expand the system’s lending authority, arguing that agricultural borrowers in towns with populations between 2,500 and 50,000 are unfairly prevented from borrowing from the system. “It is vital for those families in rural America who otherwise would be denied an opportunity to realize the American dream of homeownership because of a lack of readily available, reasonably priced credit,” said the groups. They urged the lawmakers to support “the long-overdue” increase in the population cap to 50,000 to enable FCA to serve an additional 5,800 towns located throughout America.
- Kenneth E. Auer, the president of the Farm Credit Council, said the goal is to update the Farm Credit Act and give the system the tools it needs to serve rural America. “We are not seeking to lend to anyone, any time, anywhere for anything,” he said. Auer said that NAR and NAHBs approached Farm Credit lenders, asking them to make loans in larger communities. “Both groups believe there is a need for additional competition in the rural credit markets,” he said.
- The NAR and NAHB, who called the move “long overdue,” are in essence endorsing a prominent provision of the Horizons Project, the FCS’s campaign to obtain a long list of increased authorities from Congress and FCA, said John Blanchfield, director of the ABA Center for Agricultural and Rural Banking. Raising the population cap to 50,000 would give the FCS access to wealthy metropolitan suburbs like McLean, VA and Potomac, MD,” he added.
- Mark K. Scanlan, the director of agricultural finance at the Independent Community Bankers of America, argued that commercial banks are already meeting credit needs in rural areas. Currently, 76.1% of households in non-metropolitan areas own their own home, compared with 66.3% of metropolitan households [according to data from the Department of Agriculture], argued Scanlan. “So for someone to suggest there is a lack of credit options in rural America borders on lunacy,” he added. Moreover, the Farm Credit System grew 14.3%, to \$154.7 billion of assets, at the end of fiscal 2006,

he said. “They’ve obviously got plenty of authority to grow their size and assets.”
(*American Banker*, Ben Jackson, 02/13/07; *ABA Ag Banker*, 02/16/07;
Correspondence to the Honorable Collin Peterson, National Association of Realtors
and National Association of Home Builders, 01/25/07)

ABA asks members to write letters in opposition of FCA’s proposed rule amending
criteria for entities eligible for financing by FCS institutions

- The American Bankers Association is asking bankers and their employees to send letters opposing the FCA’s proposed rule to amend the criteria used to determine entities eligible for financing by Farm Credit System institutions. According to the ABA-prepared comment letter, “The proposal is clearly part of the larger FCS [Horizons Project] agenda that seeks to radically transform the nature of business financing by the Farm Credit System. ...[R]ather than serving the farmers and ranchers who own the system, FCS lenders are seeking to finance investor-owned businesses [that] may be competing with those farmers and ranchers.” The letter urges FCA to withdraw the proposed rule, arguing that it is not in the best interests of the farmers and ranchers which FCS is intended to serve. By going online, bankers can send the ABA letter automatically to both the FCA and each banker’s member of Congress by entering their zip code and personal information. The deadline for submission of comment letters to FCA is February 26. (*ABA Ag Banker*, 02/16/07)

FCS reports net income of \$2.4 billion for fiscal year 2006

- The Farm Credit System reported combined net income of \$2.379 billion for the year ended December 31, 2006, an increase of \$283 million over the prior year’s earnings of \$2.096 billion. On December 31, FCS reported total assets of \$162.9 billion, net loans of \$122.7 billion, and total capital of \$24.4 billion. During the year, the System’s gross loans increased \$17.2 billion or 16.2%, due to increased loan demand throughout the System’s loan portfolio, as well as continued marketing efforts. Non-accrual loans totaled \$533 million as of December 31, 2006, representing 0.50% of the System’s loan portfolio, a decrease from 0.56% at December 31, 2005. “The System’s financial results were strong for 2006, continuing to be favorably impacted by the growth in the System’s loan and investment portfolios,” said Jamie B. Stewart, Jr., President and CEO of the Federal Farm Credit Banks Funding Corporation. “The System has enjoyed considerable success in attracting and retaining borrowers, while successfully managing the credit quality of the loan portfolio and maintaining a strong financial position.” (*Hoosier Ag Today with Gary Truitt*, Gary Truitt, 02/15/07; *BusinessWire*, 02/14/07)

FCA submits \$47.5 million budget for fiscal year 2008

- The Farm Credit Administration has submitted its Fiscal Year 2008 Budget (Proposed), requesting \$47.5 million for operations consisting of \$46.0 million in assessments from FCS institutions and \$1.48 million in other sources of funding. The budget request represents a 3.81% increase from the previous year, representing the only budget increase over the last three years. Personnel compensation comprises 62.6% of the budget (81.7% including employee benefits) with the balance (\$8.7 million) comprised by operating expenses such as other services and consulting (7.5% of the budget) and travel (6.2%). (*Farm Credit Administration Fiscal Year 2008 Budget (Proposed) and Performance Budget, 02/12/07*)

FCA proposes rule to amend priority claims for FCS member in liquidation

- On February 8, the FCA board of directors adopted a proposed rule to amend priority of claims regulations, governing the distribution of assets of a FCS member in liquidation. The proposed rule would provide the same priority of claims rights to Farm Credit banks if they made payments under a reallocation agreement to bondholders of a defaulting bank as they would receive if they made such payments under a joint and several call by FCA. This proposed rule would establish that the banks' payments would have the same priority, whether made under a joint and several call or under a contractual agreement among the banks. The contractual agreement would be subject to FCA's prior approval. The proposed rule also clarifies that, in receiverships of all types of System institutions, all claims of the same class or priority will receive payments on a pro rata basis if there are insufficient funds to pay the class of claims in full. The proposed rule will be published in the Federal Register for a 60-day comment period. (*US Fed News, 02/08/07*)

Farmer Mac and the CFC close a \$365 million transaction

- On February 15, Farmer Mac and the National Rural Utilities Cooperative Finance Corporation (CFC) announced the Corporation's sale of \$365 million of distribution cooperative mortgage loans and the purchase by Farmer Mac of the mortgage-backed securities representing beneficial ownership of those loans. [CFC is a privately owned, non-governmental organization that provides low-cost capital and state-of-the-art financial products to approximately 1,000 electric cooperatives that serve rural communities.]

Postal Service

USPS attributes its first quarter loss of \$2.7 billion to funding requirements of postal reform legislation

- During the first quarter of fiscal year 2007, which ended December 31, 2006, the Postal Service reported a \$2.7 billion loss due to the accelerated funding of retiree benefits mandated by postal reform legislation, which requires the agency to substantially fund its share of these benefits by 2017. Otherwise, the USPS would have reported a net income of \$1.2 billion from operations, in line with its financial plan for the period. Under the reform bill, the Postal Service must place \$5.4 billion in the new Postal Service Retiree Health Benefits Plan. The “relief” provided in the reform bill for the \$3.3 billion planned escrow payment and the reduction of \$1.5 billion in Civil Service Retirement Payments must be applied to the fund, which results in a net shortfall of \$600 million for fiscal year 2007. “It’s important to put this into perspective,” said H. Glen Walker, the Postal Service’s CFO. “Although this will have a multibillion-dollar impact on our reported financial results, the additional cash required is approximately \$600 million.”
- During the first quarter ended December 31st, the USPS’s revenue was \$19.7 billion, up 6.4% over the first quarter last year. Revenue growth was driven by a 2.3% rise in mail volume, driven largely by a 4.9% growth in standard mail volume. (*DMNews.com*, Melissa Campanelli, 02/13/07)

GAO’s assessment of challenges facing the USPS

- Although GAO has removed the USPS from its “high-risk” list given the agency’s success of reducing its debts and the recent enactment of postal reform legislation, the Postal Service continues to face significant challenges. According to GAO, the USPS’s challenges include, (1) generating sufficient revenue as First Class Mail volume declines and the changing mail mix provides less revenue contribution than First Class Mail; (2) controlling costs as compensation and benefit costs rise; (3) continuing work-hour reductions while maintaining service; (4) optimizing its infrastructure and work force to reduce costs and improve operational efficiency; and (5) providing reliable data to assess performance. “We plan to closely monitor these challenges to ensure that they are addressed,” said GAO. “We will also monitor the implementation of the postal reform legislation to determine how the results and impacts compare with legislative intentions.” (*DMNews.com*, Melissa Campanelli, 02/06/07)

NRLC's membership rejects tentative contract agreement with the USPS

- The National Rural Letter Carriers' Association membership rejected the tentative contract agreement that labor union management and the USPS had reached on December 8. The NRLC, which represents 66,000 career employees and 52,000 non-career employees, must now meet with the Postal Service management to decide how to proceed. (*DMNews.com*, Melissa Campanelli, 02/09/07)

Does the USPS's growing customer base hurt or help the agency?

- In an Institute for Research on the Economics of Taxation Congressional Advisory, the question is asked: Does the growing number of homes and businesses help or hurt the Postal Service? According to IRET, "Most private-sector businesses would be delighted to be able to count on a steady, moderate increase in customers year after year. The ...Postal Service, in contrast, complains that its rising customer base is a crushing financial burden. Can the Postal Service's attitude – so different from that found in the private sector – be right?"
- "The number of mailing addresses increases about 1.3% - 1.4% annually, with most of that due to the nation's growing population and the rest attributable to other factors such as higher incomes. Servicing the continuing influx of new home and business customers does have costs. The Postal Service must process more mail and deliver it to more addresses. On the positive side, the added homes and businesses raise mail volume, and that boosts the government enterprise's revenues. A realistic financial assessment of mailing address growth requires considering both the cost and revenue sides, and portraying them accurately. The Postal Service, however, exaggerates the costs while glossing over the revenues. Rick Merritt, who was Executive Director of Postal Watch, often pointed out that new delivery points have relatively low costs, in part because of the Postal Service's moratorium on to-the-door deliveries for new residences, and generate healthy revenues. Economists at the Postal Rate Commission also concluded that the annual cost of adding delivery points is relatively small."
- "The Postal Service is worried about slow growth in total mail volume and an actual decline in first class mail volume. New delivery points help counter those trends. Volume and revenue growth would be much weaker if not for the rising number of homes and businesses. Not every letter sent to or from a new address represents a net addition to the mail stream, but many do. Because delivery-point growth is self-financing, it would not be an excuse for future postal rate increases to exceed the cap that is a key feature of recently enacted legislation. The Postal Service should not try to garner sympathy by erroneously depicting added customers as a burden. They are an asset." (*IRET Congressional Advisory No. 219*, 02/15/07)

No junk mail bills proposed in three state legislatures
would have “dire consequences” for USPS

- Bills to create “no junk mail” lists have been introduced recently in state legislatures in Colorado, Washington and Texas to the dismay of the USPS. Opponents to the no junk mail lists say that many companies, including the Postal Service, will be hurt if such legislation is passed. For the USPS, the consequences could be dire. Massive layoffs would result if the Postal Service’s mail volume and revenues were to drop, said agency spokesman Al Desarro. “To me that’s an infringement on free speech and free business,” he added. In the state of Washington, National Association of Letter Carriers president William H. Young told state legislators that passage of a bill creating a “Do Not Mail” registry would be detrimental to the USPS, its workforce and the general public. In a letter to lawmakers, Young expressed his “fierce opposition” to the proposed legislation and argued that the proposal “could jeopardize the very future of the American postal system.” He added, “Elimination of a significant portion of advertising mail could be devastating. This ‘third class’ mail now constitutes more than 50% of all mail, and its loss could mean reductions in the current levels of service or, even worse, the collapse of all postal services.” (*MileHighNews.com*, Michael Rovito, 02/15/07; *KLTV-Channel 7* [Austin, TX], 02/05/07; *DMNews.com*, Melissa Campanelli, 02/12/07)

Bill proposed to extend the sale of the Breast Cancer Research Stamp

- On February 15, Senators Dianne Feinstein (D-CA) and Kay Bailey Hutchison (R-TX), along with a bipartisan coalition of 24 Senators, introduced a bill to extend the sale of the highly successful Breast Cancer Research Stamp for two additional years beyond its current expiration date of December 31, 2007. Since first going on sale in 1998, the Postal Service has sold more than 747 million stamps and raised \$53.76 million for breast cancer research. (*Association for Postal Commerce*, 02/15/07)

TVA

TVA's budget reduction plans will likely change
when agency passes its new strategic plan

- According to OMB's forecast, TVA expects to cut its debt by \$529 million this year and another \$553 million in 2008. These reductions would come on top of more than \$2.5 billion that the agency has cut from its long-term financial obligations since 1997, when its debt peaked at \$27.7 billion. As a result, the share of TVA's electricity bills which are used to pay the debt service has dropped nearly 60% over the last decade, reflecting TVA's lower level of debt, lower interest rates and higher revenues [generated by its 17% increase in rates in fiscal year 2006 to offset rising fuel expenses]. OMB noted that TVA's plans to reduce overall debt a third by 2016 could be revised by the agency's board of directors, which is in the process of adopting a new strategic plan. The board is expected to place less emphasis on reducing debt and more focus on adding more power generation and pollution controls in its new strategic plan which will be adopted this spring.
- In a December interview with the *Chattanooga Times Free Press*, TVA chairman Bill Sansom said he is more concerned about rates and reliability than the agency's balance sheet. "I don't think we are in too bad of shape, and I certainly don't get up every day worrying about paying down the debt," said Sansom. "We need to manage TVA in a way that ensures we have low-cost reliable power for the long term." The utility is considering spending more than \$7 billion to finish, rebuild and construct new nuclear power plants to gain more power generation, which its distributors may help finance in exchange for partial ownership interests in the generating assets. TVA also announced plans to install \$350 million in emissions-control equipment to reducing certain smokestack pollutants by as much as 95% at its John Sevier fossil plant.
- White House budget planners said TVA has improved its financial transparency by beginning to make quarterly financial reports under the regulation of the SEC. OMB repeated its call for the utility to register its debt with the SEC and for TVA's Office of Inspector General to be funded independently to help insure the IG independence. In response, TVA spokesman John Moulton said OMB's recommendations "will not help TVA or the bondholders." (*Knoxville News-Sentinel*, Andrew Eder, 02/06/07; *Durham Herald Sun*, 02/06/07; *Chattanooga Times Free Press*, Dave Flessner, 02/06/07; *Associated Press*, 02/14/07)

TVA announces first quarter results

- In the agency's first-ever 10Q filed with the SEC, TVA reported net income of \$51 million on sales of \$2.1 billion for the three months ended December 31, compared to a net loss of \$53 million for the same quarter a year ago. "Although our financial results for the first quarter compare favorably with results of the first quarter last year, our operating revenue and net income are lower than planned, primarily because of the mild weather and lower-than-expected hydro generation," said TVA president and CEO Tom Kilgore. As a result, TVA's power sales dropped 4.7% percent in the first quarter compared to the same period last year. The utility attributed its improved earnings to higher utility rates, which absorbed TVA's higher fuel costs. (*Memphis Business Journal*, 02/15/07, *US Fed News*, 02/15/07)

Canfield & Associates, Inc.
1401 H St., NW, Suite 560
Washington, DC 20005
Phone: (202) 661-2100
Fax: (202) 403-3924
www.canfieldassoc.com