

The **GSE** REPORT™

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Major Events

Chairman Frank introduces legislation to create a National Affordable Housing Trust Fund

- On June 28th, House Financial Services Committee chairman Barney Frank (D-MA) introduced the National Affordable Housing Trust Fund of 2007 (H.R. 2895), which would provide a funding vehicle insulated from Congress's annual appropriations process to support a wide range of affordable housing programs. Under H.R. 2895, the trust fund would finance grants, sustained by funding streams proposed under GSE regulatory reform (H.R. 1427) and FHA reform (H.R. 1852), to local governments (60% of the funds), states and American Indian tribes for use in building low-income housing or to help low-income buyers make down-payments on their first home purchases. The chairman also suggested that other sources of funds could be identified to go into the trust fund. The measure would authorize a trust fund of approximately \$1 billion in its first year [dedicated for affordable housing in the hurricane-damaged Gulf Coast region] with a similar amount annually over a ten year period, said Frank. The goal of the fund is to produce, rehabilitate, or preserve 1.5 million housing units over the next decade. Under the proposal, all funding must benefit families at or below 80% of an area's median income, and 75% of the resources must go to families living below the higher of 30% of local median income or the national poverty level. The bill would require grant recipients to match at least half of the award but would allow other federal grants be allowed to meet this requirement. "We've long had an affordable-housing moratorium in this country," said Frank. "[This trust fund would] capture funds created by other housing programs" and use them to increase the supply of affordable housing. Other lawmakers attending the bill introduction ceremony included Representatives Maxine Waters (D-CA), chairman of the Financial Services Subcommittee on Housing and Community Opportunity; Jim Ramstad (R-MN); and Christopher Shays (R-CT). Frank remains confident that the GSE regulatory reform, FHA reform, and the Housing Trust legislation will become law. "I believe we can get this done later this year or early next year," said Frank.
- While there is strong support for the trust fund from low-income housing advocates as well as the NAACP, the National Association of Realtors, and the U.S. Conference of Mayors, the bill faces fervent opposition from some Republicans and the Bush Administration. Representative Judy Biggert (R-IL), the ranking Republican on the Financial Services Housing and Community Opportunity Subcommittee, said the trust fund could "threaten the solvency of the FHA fund." White House spokeswoman Emily Lawrimore said, "We do not support the creation of an expensive, stand-alone housing fund that would take funds away ultimately from other HUD programs designed to help low- and moderate-income families — essentially robbing Peter to pay Paul." (*Bureau of National Affairs*, Richard Cowden, 06/29/07; *American Banker*, Steven Sloan, 06/29/07; *CQ Today*, Libby George, 06/28/07)

- In a July 6th editorial in the *Atlanta Journal Constitution*, Lyle V. Harris wrote, “The promise of decent, safe and affordable housing for every citizen is not a right enshrined in the U.S. Constitution. But the compassionate impulse to provide quality shelter for those desperately in need is deeply woven into our national character—as well it should be. As with other domestic priorities, housing policy has gotten short shrift in recent years, but that situation may soon change. A new bill introduced in Congress last month could renew interest in the issue and hopefully propel it to the forefront of the 2008 presidential campaign. [H.R.] 2895, which has bipartisan support, would create a National Affordable Housing Trust Fund with the goal of producing, preserving or rehabilitating at least 1.5 million units of affordable housing in the next decade. ... In order to mitigate against market forces that can jeopardize our poorest citizens, local and national governments must play an active role. Congress can begin doing that, and thereby recognizing a collective commitment to provide a basic human need, by passing this bill. (*Atlanta Journal Constitution*, Lyle V. Harris, 07/06/07)

Fannie Mae and Freddie Mac were adequately capitalized on March 31 st
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- OFHEO classified Fannie Mae and Freddie Mac as “adequately capitalized” on March 31, 2007. Based upon an analysis of Fannie Mae’s estimated numbers at the end of the first quarter, OFHEO determined that the company’s adjusted core capital (\$42.3 billion) exceed the agency-directed capital requirement by \$3.9 billion and exceeded the statutory critical capital by \$27 billion. Fannie Mae’s surplus, as a percentage of the OFHEO-directed requirement decreased slightly to 10.2% from 10.9% at year-end 2006, reflecting the growth in the company’s MBS outstanding and the resulting increase in the capital requirement. “Although progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the first quarter of 2007, significant work remains before Fannie Mae becomes a timely financial filer and corrects its internal controls and operational weaknesses,” said OFHEO.
- OFHEO determined that Freddie Mac’s adjusted core capital (\$36.2 billion) exceeded the agency-directed capital requirement by \$2.0 billion and exceeded the statutory critical capital by \$22.8 billion. Freddie Mae’s surplus, as a percentage of the OFHEO-directed requirement decreased to 5.9% from 7.7% at year-end 2006, primarily due to growth in the company’s retained portfolio. “Although the filing of the First Quarter 2007 Financial Statements and Information Statement Supplement continues to demonstrate progress for Freddie Mac in returning to timely and accurate financial reporting, internal control and operational weaknesses remain evident,” said OFHEO. “Significant work remains before Freddie Mac becomes a timely filer and SEC registrant. (*OFHEO Press Release*, 06/28/07)

The gathering storm...

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Bear Stearns' bail-out of hedge fund heightens the market concern about the subprime
fallout

- Bear Stearns' dramatic decision to commit up to \$3.2 billion to one of two of its troubled hedge funds staves off the risk of the collapse of the fund, but poses the potential for rippling effects from the deteriorating subprime mortgage market. Bear's decision to inject money into its High-Grade Structured Credit Strategies Fund was triggered by Merrill Lynch's seizure of \$400 million in collateral from the fund. [Bear later announced that it made a \$1.6 billion secured loan to the High-Grade fund.] Bear's loan helped bring order to the market and facilitated the repayment of fund's loans made by other investment banks. The prospects for Bear's more highly leveraged fund, the High-Grade Structured Credit Strategies Enhancement Leverage Fund started in August 2006, remain in doubt. Together, Bear's funds once commanded investments of more than \$20 billion in complex debt instruments, mostly backed by subprime mortgages, and bets made by the funds that certain markets would fall. The Bear funds are run by Ralph Coiffi, 51, a 22 year veteran of the investment banking firm, who started the High-Grade Structured Credit Strategies Fund in March 2003 with investor capital of about \$600 million [\$40 million of which came from Bear and a group the company's executives] and borrowings of at least \$6 billion from a dozen Wall Street lenders. As a result of the deteriorating subprime mortgage market, Bear said that the funds had lost 6.75% of their value in April, which they later revised to 18% in June. The firm's troubles are far from over with SEC starting an informal inquiry into issues surrounding the Bear funds and how the industry values mortgage-related securities that the funds hold.

- Deterioration in CDO [collateralized debt obligation] values likely spurred Everquest Financial, a company formed by Bear Stearns that managed \$720 million of CDOs at the end of 2006, to withdraw its registration for a \$100 million public offering. Cioffi, the manager of the two troubled Bear funds, was also co-chief executive of Everquest, a Cayman Islands-registered business. In a note to clients, Portales Partners analyst Charles Peabody said that Everquest appeared to be an investment vehicle used in part “as a way for Bear Stearns to offload some its own mortgage exposure.” If Bear knew that the two funds were in trouble in May, why did they proceed with the Everquest filing, asked Peabody. A Wall Street source noted that damage to Bear Stearns reputation would have been much more serious if Bear had moved ahead with the IPO. “Bear is lucky it all blew up before the IPO,” the individual added.
- In an auction of \$800 million of the funds’ assets, Bear received bids of 80% to 95% of face value for about a quarter of the offering and elected to call off the auction. Merrill Lynch succeeded in auctioning off some of the funds’ assets for 90% to 95% of the face value of assets, but other assets didn’t sell at all—even at discounts of 50% or more. In the market place, recent bids for some low-quality CDOs have been approximately 60% of face value. *Grant’s Interest Rate Observer* estimates that a 3% to 5% decline as a whole would destroy the insurance of the equity tranche and threaten the ‘BBB’ slices of the CDO.
- Investors in the two Bear Stearns hedge funds will have to wait until July 16 to discover how much money they have lost on their investments. In a June 29th “Dear Investor,” Bear Stearns Asset Management Inc. said that the funds’ net asset values as of May 31 would be calculated “on or before July 16.” Bear also will make its best effort to calculate an estimate of the two funds’ June 30 values by the same time. According to the letter, “[The firm] has determined not to release an estimated NAV in the interim.”
- “You don’t have a clue what [the CDOs] true book value is,” said Richard Bove, an analyst with Punk, Ziegel & Co. John Devany, manager of United Capital Asset Management, which suspended redemptions from its Horizon funds, likened investing in the subprime sector to “dancing on a razorblade.” More hedge fund troubles are expected to surface in coming weeks, as funds report their second quarter performance to investors. As the value of existing collateral falls, the funds will likely face additional pressure from lenders to provide more collateral to secure their borrowings.
- Dan Freed, a senior writer at *Investment Dealer’s Digest*, said, “It’s a weird dynamic that the market has now. You used to have a small number of institutions taking a lot of risk. Now you take something that’s toxic and you divide it into a thousand pieces and you say, okay, well, it’s not toxic anymore. ...But if it’s toxic, isn’t it [still] toxic?” He added, “Wall Street creates all these increasingly sophisticated financial products, and no one really seems to understand them but the people involved in creating them. They assure everybody that everything’s going to be okay, and we are

forced to believe them.” (*Wall Street Journal*, Kate Kelly, 06/17/07; *Wall Street Journal*, E.S. Browning, 07/02/07; *Investors Business Daily*, Kirk Shinkle, 06/27/07; *Financial Times*, Saskia Scholtesin, 07/05/07; *Wall Street Journal*, Gregory Zuckerman and Ianthe Jeanne Dugan, 07/05/07; *Financial Times*, Charles Dumas, 06/27/07; *New York Times*, Julie Creswell, 06/28/07; *New York Times*, Gretchen Morgenson, 06/26/07; *Reuters*, Dan Wilchins and Walden Siew, 06/27/07; *Financial Times*, Ben White and David Wighton, 06/26/07)

Tip of the iceberg?

- In the July issue of *Investment Outlook*, William H. Gross, manager of the \$103 billion PIMCO Total Return Fund wrote, “AAA? You were wooed Mr. Moody’s and Mr. Poor’s by the makeup, those six-inch hooker heels and a `tramp stamp.’ Many of these good looking girls are not high-class assets worth 100 cents on the dollar. ... Those that point to a crisis averted and a return to normalcy are really looking for contagion in all the wrong places. Because the problem lies not in a Bear Stearns hedge fund that can be papered over with 100 cents on the dollar marks. The flaw resides in the Summerlin suburbs of Las Vegas, Nevada, in the extended city limits of Chicago headed west towards Rockford, and yes, the naked (and empty) rows of multistoried condos in Miami, Florida. The flaw, dear readers, lies in the homes that were financed with cheap and in some cases gratuitous money in 2004, 2005, and 2006. ... Mortgage payments are going up, up, and up... and so are delinquencies and defaults. A recent research piece by Bank of America estimates that approximately \$500 billion of adjustable rate mortgages are scheduled to reset skyward in 2007 by an average of over 200 basis points. 2008 holds even more surprises with nearly \$700 billion ARMS subject to reset, nearly [75%] of which are subprimes.
- **“...The right places to look for contagion are therefore not in the white-washed Bear Stearns hedge funds, but in the subprime resets to come and the ultimate effect they will have on the prices of homes – the collateral that’s so critical in this asset-backed, and therefore interest-sensitive financed-based economy of 2007 and beyond.** [Emphasis added.] If delinquencies lead to defaults and then to lower home prices, then we have problems and the potential for an extended [period]... Escalating delinquencies of course ultimately lead to escalating defaults. Currently 7% of subprime loans are in default. The percentage will grow and grow like a weed in your backyard tomato patch. ... The uncertain part is by how much. But look at it this way: using the current default rate of 7% (3-4% total losses), the holders of some BBB investment grade subprime-based CDOs will lose all of their moolah because of the significant leverage. No need to worry about fictitious 100 cents on the dollar marks here. One hundred percent of nothing equals nothing. If subprime total losses hit 10% then even some single-A tranches face the grim reaper. AAA’s? Folks the point is that there are hundreds of billions of dollars of this toxic waste and whether or not they’re in CDOs or Bear Stearns hedge funds matters only to the extent of the timing of the unwind.”

- To death and taxes you can add this to your list of inevitabilities: the subprime crisis is not an isolated event and it won't be contained by a few days of headlines in *The New York Times*. And it will not remain confined to a neat little Petri dish in some mad financial derivative scientist's laboratory. Ultimately through capital market arbitrage it will affect risk spreads in markets completely divorced from U.S. housing. What has the Brazilian Real to do with U.S. subprimes? Nothing except many of the same bets are held in hedge funds that by prudence or necessity will reduce their risk budgets to stay afloat. And the U.S. economy? Of course it will be affected. Consumption will be reduced to say nothing of new home construction over the next 12-18 months. After all, attractive subprime pricing has been key to the housing market's success in recent years. Now that has disappeared. Importantly, as well, and this point is neglected by most pundits, **the willingness to extend credit in other areas – high yield, bank loans, and even certain segments of the AAA asset-backed commercial paper market should feel the cooling Arctic winds of a liquidity constriction.** [Emphasis added.]
- “If not taken too far – and there is no hint yet of a true ‘crisis’ – these developments may be just what the Fed has been looking for: easy credit becoming less easy; excessive liquidity returning to more rational levels. Still, PIMCO looks for the Fed to issue an insurance policy in the form of lower Fed Funds at some point over the next 6 months. ...We still believe in strong global growth, but...as we also suggested...that the U.S. housing downturn will affect growth and short-term yields over the next year or so. We remain consistent and resolute. Contagion? Maybe, but you won't be finding it at ‘99.9%’ pure Bear Stearns. Look for it instead, in the subprimely financed homes of Las Vegas, Rockford, Illinois, and Miami, Florida. This problem – aided and abetted by Wall Street – ultimately resides in America's heartland, with millions and millions of overpriced homes and asset-backed collateral with a different address – Main Street.” (*Investment Outlook*, William H. Gross, June 2007)
- “If there is contagion, the problem certain has sufficient scale to become a financial event,” said Dominic Konstam, head of interest rate strategy at Credit Suisse. David Ader, strategist at RBS Greenwich Capital said, “The CDO worries have progressed to the regulatory level. Although it is unclear which firms will be directly impacted by the investigation, one thing does logically follow, this month/quarter-end will see a push toward accurate marks on these assets given the increased regulatory scrutiny.” John Davidson, president of PartnerRe Asset Management in Greenwich, CT, said, “The issue with subprime could be far-reaching. The week has been focused on what's going on at Bear Stearns. The thought was that this could affect the housing market, the consumer and the overall economy.” (*Financial Times*, Michael Mackenzie and Jeremy Grant, 06/27/07; *Washington Post*, 07/01/07)
- According to a Bank of America analyst, the collapse of the Bear Stearns funds “could be the tipping point of a broader fallout from subprime mortgage credit deterioration. ...The large volume of subprime ARMs scheduled to reset at higher ratee in ‘07 and ‘08 will pressure already-stretched borrowers,” which will result in

higher foreclosure rates on these loans. (*Bloomberg News*, Sebastian Boyd and Will Edwards, 06/22/07)

- In a recent research report, a team of Deutsche Bank AG analysts led by Mustafa Chowdhury, wrote, “There is likely to be news around quarter end of more hedge funds that need to recognize large losses, possibly forcing liquidation of the funds.” The analysts concluded that total losses probably will range from \$70 billion to \$90 billion. (*American Banker*, 07/03/07)

Who’s left holding the bag?

- According to Bear Stearns, asset managers bought 22% of the equity tranches of CDOs in 2006, followed by insurance companies (19%), pension funds (18%), and hedge funds (10%). (*Jubak’s Journal*, Jim Jubak, 06/29/07)
- Mike Shedlock adds, “But the bagholders go far beyond the obvious. Everyone that owns a house and has seen property taxes skyrocket is a bagholder of sorts. That is close to 70% of the population. ...What about cities and municipalities foolishly banking on forever rising real estate prices and budgeting for exactly that by investing in a bunch of wasteful projects with money already down the drain? Expect to see some major cutbacks in services (canceled projects and job losses) as a result. But that money already raised via bonds has to be paid back somehow, doesn’t it? Who’s holding the bag there? Taxpayers of course. In short, bagholders are everywhere you look.” (*Mish’s Global Economic Trend Analysis*, Mike Shedlock, 07/04/07)
- Jim Rogers, co-founder of the Quantum hedge fund with billionaire George Soros, said, “Financial companies, stock brokers, investment bankers—I am short. I am short financial services companies, mainly in America. I am short Fannie Mae. ...The problems with the housing market have a long way to go in the United States. Probably more so than in any other country. But the excesses in the world economy are on Wall Street: investment bankers. Those guys are making vast fortunes, that’s not the way the world works.” (*Reuters*, Jan Dahinten, 07/05/07)
- In the *Wall Street Journal*, Steven Rattner, managing partner of the private investment firm Quadrangle Group, LLC, wrote, “The bigger -- and harder -- question is whether the correction [in the credit market] will trigger the economic equivalent of a multi-car crash, in which the initial losses incur large enough damages to sufficiently slow spending enough to bring on recession, much like what happened during the telecom meltdown a half-dozen years ago. But we have little choice but to sit back and watch this car accident happen. It would have been a mistake to dispatch the Federal Reserve to deflate the dot-com mania or the housing bubble. And it would be a mistake now for the Fed to rescue imprudent high-yield lenders. They have to learn the hard way. Hopefully, not too many innocent bystanders will share their pain.” (*Wall Street Journal*, Steven Rattner, 06/18/07)

House Financial Services Committee schedules hearings on hedge funds' risk

- The House Financial Services Committee will hold a hearing on July 11 on hedge funds and systemic risk. The hearing will focus on how the President's Working Group on Financial Markets "monitor systemic risk related to hedge funds and how that process might be improved." Witnesses at the hearing will include Federal Reserve Board Governor Kevin M. Warsh, Treasury Under Secretary for Domestic Finance Robert Steel; Erik R. Sirri, the SEC's director of the Division of Market Regulation; and Jim Overdahl, chief economist at the Commodity Futures Trading Commission.
- On July 11th, the House Oversight and Reform Committee, chaired by Representative Dennis Kucinich (D-OH), also will hold a hearing on hedge funds, which may generate more pointed questions. In a CNBC interview, Kucinich said, "When you have this huge amount of capital that is unregulated, there is a potential that investors could end up losing mightily because no one asks." He added, "We're going to be asking the questions about should hedge funds be more tightly regulated and what are the issues involved if they are?" (*Dow Jones Newswires*, Siobhan Hughes, 07/06/07; *Bureau of National Affairs*, 07/06/07)
- Today, hedge funds control more than \$2 trillion worth of assets and are responsible for more than a third of the stock trades. "To a great degree they're unregulated and hardly understood or not understood at all," said James Grant, publisher of *Grant's Interest Rate Observer*. Recent trouble with Bear Stearns's hedge funds, which sent the Dow Jones Industrial averages down 279 points and prompted an SEC investigation, has raised concerns in Washington and on Wall Street about how dependent the financial system has become on hedge funds and the level of systemic risk the funds may pose. It is difficult for even top economists to assess these issues, since many hedge funds do not disclose much about their trading activities and many funds operate off shore. Even for U.S.-based funds, no federal agency is empowered to regulate and oversee the hedge funds' activities. Some are concerned that the biggest hedge funds run the risk of putting the entire financial system at risk. "There's been a fundamental change in the debt markets that I don't think people appreciate yet," said Richard Bookstaber, a former hedge fund manager. "I don't think anybody knows how much leverage a particular [group] of hedge funds is using or how much leverage has grown. ... We are running the risk of making the markets more levered and more complex so that something can go wrong all of a sudden." (*Washington Post*, David Cho, 07/04/07)
- Federal Reserve chairman Ben Bernanke will deliver the Fed's semi-annual Monetary Policy Report to Congress on July 18th before the House Financial Services Committee and July 19th before the Senate Banking Committee. Both committees are expected to question Bernanke about the deteriorating subprime mortgage market and

ramifications for hedge funds and other investors, as well as the general economy. (*Wall Street Journal's Online's Economics Blog*, Greg Ip, 07/05/07)

Economy is strong enough to withstand collateral damage from subprime market

- Robert Steel, the Treasury's undersecretary for domestic finance, said that concerns that the near failure of the Bear Stearns funds might spark a financial crisis are unfounded. "We don't see any situation here that seems to be systemic or challenging," said Steel. "This is something that's being worked through in all the right ways." He added that the economy was strong enough to withstand collateral damage caused by losses incurred by these funds in the subprime mortgage market. "The economy is quite strong and in good form," said Steel. (*Bloomberg News*, Peter Cook and Rich Miller, 06/28/07)
- At a Euromoney conference in London on June 25th, Freddie Mac treasurer Timothy Bitsberger called the subprime slump "severe, but contained." He added, "If I have to worry, it's about market psychology." Bitsberger said the housing market may further deteriorate if there's an "over-reaction" by the regulators. The fallout could increase if investors and hedge funds rush to unwind their positions, since the market's "financial infrastructure" is "untested" because of the rapid growth of the CDO market in recent years. Bitsberger said the CDO market "is still relatively young and relatively new and we've still yet to see a shakeout." He added, "The jury's still out as to how this will play out. I don't want to say that we're in untested waters but it does scare a lot, it does become a bigger issue among many more hedge funds." Bitsberger said that the extent of the losses will also hinge on ratings companies. "There's a lot of dependency on the ability of the rating agencies to make objective judgments [of the risks backing the bonds]," he said. "I wouldn't be surprised to potentially see a re-rating of these securities." (*New York Times*, Gretchen Morgenson, 07/01/07; *Bloomberg News*, Neil Unmack and John Glover, 06/26/07; *Reuters*, 06/25/07)

Federal financial regulatory agencies issue the final Statement on Subprime Mortgage Lending

- The federal bank, thrift and credit union regulators issued final guidelines aimed at improving the underwriting standards for subprime mortgage loans. The new guidelines require federally-regulated financial institutions to underwrite loans based upon a borrower's ability to make payments at the highest possible rate that can be charged on the loan, rather than the low introductory rate. Many of the provisions are similar to the regulators' proposed guidance released in March with two significant differences. First, lenders should collect as much information to verify income and obtain copies of other documents proving a borrower has the capacity to repay the loan, except in very limited circumstances. Also, the guidelines direct lenders to allow borrowers to refinance adjustable-rate mortgages at least 60 days before the loan resets without assessing prepayment penalties. "The guidance on adjustable-rate mortgages underscores that the Federal Reserve and other banking regulators expect

lenders to make sure subprime borrowers not only can afford their monthly payments while they introductory rate is in effect but also after the interest rate resets,” said Federal Reserve Board Governor Randall Kroszner. The guidelines do not apply to state-licensed lenders, who are not supervised by a federal banking, thrift or credit union regulator.

- Reaction to the regulators lending guidelines was somewhat muted, with trade group representatives repeating concerns that some borrowers would be left out of the housing market. “All regulatory actions come at a cost,” said Kurt Pfothauer, senior vice president with the Mortgage Bankers Association. “The bill for this one is going to be paid by people who would have qualified for a hybrid ARM under existing underwriting standards and who have paid their bills on time, or those already trapped in a hybrid ARM who will not be able to refinance because of this new guidance. I don’t know how many people that is, but it’s going to be a significant population.”
- Senate Banking Committee Chairman Chris Dodd (D-CT) said, “[This guidance gets] us part way to our final goal. We still have a considerable distance to travel. The Federal Reserve must take the guidance, strengthen its protections by requiring escrow accounts and limiting prepayment penalties, and turn it into regulation.” (*Dow Jones Newswires*, Damian Paletta, 06/29/07; *American Banker*, Joe Adler, 07/02/07)

Other notes of interest

- SEC Chairman Christopher Cox said his agency has undertaken about a dozen probes related to subprime mortgage loans and the CDO market. Cox told lawmakers that his staff has “about 12 open investigations into issues like these.” He added, “We see little systemic risk arising from liquidity issues [at Bear Stearns].” The agency’s investigation into the collapse of New Century, a subprime lender now in liquidation, has been elevated to formal status, providing the SEC subpoena power. (*Bloomberg News*, David Scheer and David Rosen, 06/26/07; *Reuters*, 07/05/07)
- In a June 15th letter sent by 11 Democrats to SEC chairman Christopher Cox, lawmakers asked the agency to clarify an accounting rule that may be preventing financial institutions from making loan modifications to help subprime borrowers. “A number of parties have brought to our attention that FAS 140, the accounting standard that guides securitizations, may not clearly state at what point a loan may be modified,” wrote the lawmakers. “The lack of clarity may be leading some institutions to withhold making some loan modifications that may benefit borrowers - - and bondholders -- for fear of being found in violation of FAS 140.” Given their concern about the rate of rising foreclosure rates, the Democrats requested a response as soon as possible. (*Reuters*, John Poirier, 06/19/07; *Dow Jones Newswires*, Damian Paletta, 06/20/07)

- This month, the House is expected to vote on a non-binding resolution, saying Congress senses that “government action” is needed to protect buyers from predatory loans, but does not explicitly say legislation is required. Such action from regulators or others should “enforce rules to eliminate unfair and deceptive practices” and “encourage lenders to evaluate a borrower’s ability to reasonably repay any mortgage.” The original resolution, authored by Representative Elijah Cummings (D-MD), calling for Congress to pass legislation enacting tougher standards for subprime mortgages, was scaled back after industry representatives expressed concerns with the language. (*American Banker*, Rob Blackwell, 06/27/07)
- Ohio Attorney General Marc Dann said he is building a case against rating agencies, based on the role he believes their ratings played in marketing riskier mortgage-backed securities. In an interview with *Fortune Magazine*, Dann said, “The ratings agencies cashed a check every time one of these subprime pools was created and an offering was made. [The agencies] continued to rate these things ‘AAA.’ [So they are] among the people who aided and abetted this continuing fraud.” In response, Moody’s argues that Dann’s charges are baseless. “We perform a very significant but extremely limited role in the credit markets. We issue reasoned, forward-looking opinions about credit risk,” said Fran Laserson, vice president of corporate communications at Moody’s. “Our opinions are objective and not tied to any recommendations to buy and sell.” Laserson also noted that while some securities have lost significant value, none have actually defaulted. (*Fortune Magazine*, Katie Benner and Adam Lashinsky, 07/05/07)
- Representatives Patrick McHenry (R-NC) and Al Green (D-TX) are drafting legislation to require mortgage lenders to provide borrowers a one-page disclosure form with key loan terms, three days before closing. “The bad news is that mortgage disclosure forms are becoming increasingly complex, convoluted, and cumbersome,” said McHenry. “There’s a real need for a simple document that breaks down lending terms.” (*American Banker*, Joe Adler, 06/18/07)
- Treasury Secretary Henry Paulson is launching an internal review of the regulatory overlap in the financial services sector, which will address such things as regulatory efficiency and the “ability to adapt to market participants’ constantly changing strategies.” Domestic undersecretary of finance Robert K. Steel said the project is “mission critical” because of the rise of private-equity capital pools, new debt instruments and the blurring of the lines between insurance, stocks, and other investment products marketed to the public. Recommendations from the review are expected early next year. (*Washington Post*, Carrie Johnson, 06/28/07)
- On June 20th, Federal Reserve chairman Ben Bernanke and Fed Governor Randall Kroszner met with three dozen members of ACORN (the Association of Community Organizations for Reform Now) for close to an hour. Activists said that Bernanke and Kroszner listened carefully to their views. “They didn’t give us any direct answers on what they were going to do. But they did say they would consider what

we were talking about,” said Fannie Brown, an ACORN board member from Oakland, CA. (*Los Angeles Times*, Jonathon Peterson, 07/21/07)

- NeighborhoodWorks American has teamed up with the Ad Council to produce public service announcements to alert troubled borrowers of a counseling hotline run by the Homeownership Preservation Foundation (HPF). The radio and print advertisements have been funded through \$1 million donations from several top financial services firms. Fannie Mae has provided \$5 million to the HPF to support the counseling efforts the ads are expected to generate. (*American Banker*, 07/02/07)
- The Pew Charitable Trust has awarded a \$1 million grant to the Center for Responsible Lending for promoting policies that curb abusive lending practices in the subprime mortgage market. Tobi Walker, an officer in Pew’s health and human services program, said the groups want to strengthen underwriting standards so that lenders are required to verify a borrower’s income and make sure the borrower is capable of repaying the mortgage at its full-indexed rate. (*Washington Post*, Dina ElBoghady and Nancy Trejos, 06/30/07)
- Washington Mutual Inc. has agreed to refinance or modify up to \$2 billion in subprime mortgage loans at discounted rates in an attempt to help homeowners avoid foreclosure. (*Dow Jones Newswires*, Monica M. Clark, 06/29/07)
- On June 29th, The Urban Institute Press published “*Subprime Mortgages: America’s Latest Boom and Bust*,” by economist Edward M. Gramlich. “The good news is that most of these [subprime] homeowners are building wealth, living in better neighborhoods, and participating in the American dream. The bad news is that a small but growing share is stretched thin,” said Gramlich, a senior fellow at the Urban Institute and former governor of the Federal Reserve Board. “They are vulnerable to the least shock, saving very little, contending with high levels of consumer debt, at the mercy of predatory lenders, being forced to sell their houses early, and often ending up in foreclosure.” The book (120 pages, ISBN 978-0-87766-739-1) is available from the Urban Institute Press for \$26.50. (*Ascribe Newswire*, 06/19/07)

Fannie Mae and Freddie Mac

As subprime bubbles, is GSE reform only sleeping or dead?

- As subprime anxieties plague the markets and Congress contemplates what actions, if any, should (or could) be taken to “ease” the deteriorating subprime sector, only time will tell if the Senate Banking Committee passes GSE regulatory reform legislation later this year. Committee Chairman Chris Dodd (D-CT), who has said he likes the House version of the bill [without being too specific], will determine if a GSE bill moves forward later this year. “[Senator Dodd] believes GSE reform is important,” said senator’s spokesman Marvin Fast. “He continues to seek to work in a bipartisan manner to address this matter in an appropriate, timely and constructive fashion.” While the chairman has said there is a need for a stronger GSE regulator and pledged his commitment to advancing affordable housing, the Committee has not taken up the matter this term, while Dodd remains busy campaigning for the 2008 presidential election and appears on Capitol Hill only sporadically. Assuming that Dodd will be reluctant to advance legislation that would make him few friends and possibly some new enemies, analysts have dismissed the chance of the Committee bringing GSE reform forward to the floor this summer. (*The Main Wire*, Margaret Chadbourn, 06/27/07)
- House Financial Services Committee chairman Barney Frank (D-MA) told reporters that he expects Congress will pass GSE regulatory reform this year. “I think at least the GSE bill will be done this year,” said Frank said. “I believe we will see some action in the Senate.” (*CongressDaily*, Bill Swindell, 06/29/07)
- Meanwhile, OFHEO director James B. Lockhart, III continues to push for passage of GSE regulatory reform legislation, which he says will strengthen the nation’s housing finance system. “There is a significant weakness [OFHEO has] compared to federal bank regulators. We do not have independent litigating authority. Everything has to be approved by Congress,” argued Lockhart at the Regulatory and Legislative Roundup at the MBA National Secondary Market Conference. “We can’t hire the people we need to oversee, yet Fannie and Freddie are spending millions of dollars to fix their problems. Full authority over capital is a critical piece.” From a macro perspective, the housing GSEs face a full range of risks, including market risk, credit risk and operational risk, which is why a stronger regulator for the GSEs is needed, said Lockhart. A single GSE regulator, which oversees Fannie Mae, Freddie Mac, and the FHLBs, would serve as a single regulatory voice focused on the health of the housing finance markets, he added. In a June 26th editorial in the *Washington Times*, Lockhart repeated his “call to action” for passage of GSE regulatory reform by Congress. (*Mortgage Line*, 06/28/07; *Washington Times*, James B. Lockhart, III, 06/26/07)

- Members of the Federal Housing Finance Board continue to disagree over the necessity and effectiveness of the House’s GSE regulatory reform bill, as it pertains to the FHLB System. Chairman Ronald Rosenfeld, a strong supporter of GSE reform, views the House bill as a “desirable” course of action which could help strengthen oversight of the GSEs. “The House took a good first step,” said Rosenfeld. “I hope the interest in the process continues in the Senate and in committee and we come out with a GSE reform bill. At the end of the day, the issues facing all of the GSEs relate to their role of having the American public as their client and a common regulatory environment best serves that role.” There isn’t “anything significantly negative” in the House bill that would take away from the FHLB System nor cause potential conflicts of interests if a new, single regulator is established, he added. Board member Alicia Castaneda said she “supports the administration’s GSE reform goal and the House efforts.” She noted, “What really matters most is the capability and accountability of the regulator.”
- However, Finance Board member Geoff Bacino strongly disagrees. “[The FHLBs] are distinctly different from Fannie and Freddie [and] there is no need to put everyone in one group,” Bacino argues. “If you combine everyone in one agency I think you’re looking at the possible demise of the Federal Home Loan Bank system. I don’t think they can survive in an arena with Fannie Mae and Freddie Mac.” Instead of drafting companion legislation to the House GSE reform bill, Bacino has urged Senators to introduce a separate bill called “The Federal Home Loan Bank Improvement Act” to clarify activities and functions of the Finance Board. Since the Finance Board already stands as “a world class regulator,” he argues that there is no reason for legislative reform and the measure he proposes would “resonate better” with the FHLBank system. Board member Allan Mendelowitz agrees with Bacino, saying, “As a regulator, we have every single conceivable legal authority to adequately monitor the Federal Home Loan Banks.” Without any “good reasons” to reform oversight of the FHLBs, there’s “no benefit to either the mission or the safety and soundness regulation to include all of the GSEs with a single regulator,” he argues. “I don’t see any upside and I see a lot of risk.” (*The Main Wire*, Margaret Chadborn, 07/03/07)

Fannie Mae [and Freddie Mac]: Another New Deal Monstrosity
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- In a July 2nd white paper published by the Ludwig Von Mises Institute, Karen DeCoster and Eric Englund wrote, “The shortcomings of Fannie Mae have been overlooked on the basis that Fannie plays a critical role in driving the housing sector, and thus the American economy. As Fannie goes, so goes the nation. Fannie means housing, and accordingly, Fannie is the conduit that takes one from ‘inequitable ownership’ to the American Dream. In a nation where equality is everything, and where advantage need not be earned, but only redistributed, how can anything be more virtuous?...”

- “In 2004, Fannie was caught cooking the books... The latest tally will have Fannie Mae restating its earnings to the tune of \$11 billion. Flagrant accounting errors go back to at least the 1990s, when the company was improperly deferring expenses in order to boost reported net income as it paid out huge bonuses to top executives. Upon being hit by the scandal in 2004, Fannie Mae stopped filing its financial statements with the SEC. ... The company plans to hold its shareholder meeting in December of this year, for the first time in three years.”
- “So here we have a company surrounded with much misconception in the financial markets and accused of deceit by its own government overseers. It has chunked away nearly 40% of its profits via restatements of its fraudulent financial statements for recent years. Certainly, then, we can predict the collapse of this mortgage giant due to (1) a lack of audited financials and thus no conveyance of reliable information to the public, (2) an accounting scandal that produced achievements which the OFHEO described as ‘illusions deliberately and systematically created by the Enterprise’s senior management with the aid of inappropriate accounting and improper earnings management,’ (3) and a collapsing business model in light of a bursting housing bubble, along with an imploding sub-prime mortgage market. Wait. Not so fast.”
- “Instead we witness a publicly traded company with four high-profile attributes: (1) Fannie Mae’s financial condition serves as a proxy for Congress’s oversight; (2) Fannie Mae’s ‘health’ serves as a proxy for the health of the housing market; (3) Fannie Mae’s stock price has an influence on one of the world’s most closely watched stock market indexes; (4) Leading up to the 2004 Presidential election, President Bush had an aggressive housing agenda to ‘...dismantle the barriers to homeownership’ ...with Fannie Mae playing a significant role in ‘financing’ this agenda — and perhaps garnering more than a few votes for Bush and those congressmen who hung on to the coattails of this agenda.” With mortgage defaults on the rise, a financial meltdown at Fannie Mae would certainly demonstrate that foreign policy wasn’t President Bush’s only major weakness, and it could prove embarrassing for members of Congress aspiring to move into the White House.”
- “Considering the four aforementioned attributes, and the fact that this GSE is deeply mired in scandal, Fannie Mae is no doubt being closely monitored by the Working Group on Financial Markets (a.k.a. the Plunge Protection Team — which reports directly to the President of the United States). Accordingly, we would take great pleasure in seeing Ben Bernanke, a member of the working group, asked the following questions — including the supporting commentary — the next time he appears in front of the House Committee on Financial Services.”
 - “After the collapse of the NASDAQ bubble in 2000, and after the shock of 9/11, the Federal Reserve came to believe that the United States was heading into a deep recession. As is typical of any central bank, the prescription to reinvigorate the economy entailed creating more money and granting more credit. By June of 2003, the Fed funds rate had been reduced to 1%. To be sure, this set America’s housing market ablaze. And this is exactly what the Federal Reserve desired

because it views housing as ‘...a key channel of monetary policy transmission.’ A strategic cog in the monetary transmission mechanism is Fannie Mae. In the four-year period from 2000 to 2003, Fannie Mae’s outstanding Mortgage-Backed Securities grew from \$706.7 billion to an astounding \$1.3 trillion. Moreover, its mortgage portfolio ballooned from \$607.7 billion to \$901.8 billion. With Fannie Mae financing one in every five home loans in the United States, didn’t it ever occur to the Federal Reserve that it should look into this financial institution’s accounting, management control, and credit quality systems? If this massive transmitter of money — Fannie Mae — was not up to the task of responsibly lending such vast quantities of money into existence, did it not occur to the Federal Reserve that it may have to clean up the mess it had a hand in making? Does the Federal Reserve have a plan to bail out the second largest financial institution in the United States?”

- “Since the Federal Reserve is so focused on consumer confidence and expectations, wouldn’t the share price of Fannie Mae’s common stock be of keen interest to the Federal Reserve and the Working Group on Financial Markets? After all, the Federal Reserve engineered the housing bubble, and the health of Fannie Mae may be viewed as a proxy for the health of America’s housing market. Interestingly enough, America’s housing market is experiencing a significant decline while Fannie Mae’s stock price has appreciated by about 50% from its 52-week low, and it recently hit its 52-week high. There seems to be a disconnect here, especially when factoring in rising interest rates and the meltdown in subprime mortgages. In light of this, does the working group exercise any influence on the price of Fannie Mae’s stock?”
- “On May 2, 2007, Fannie Mae filed its latest form 10-K with the SEC. One would assume that this 10-K contained Fannie Mae’s 12/31/06 audited financial statement. With Fannie Mae’s internal accounting nightmare, it turns out that this 10-K contains audited financial information as of 12/31/05. Management hopes to have the 12/31/06 audited financial statement available by next quarter. Since you have a PhD in economics, you must be cognizant of the fact that security analysis begins with examining a publicly held company’s fiscal year-end audited financial statement. Does it not strike you as odd that of the 16 Wall Street brokerage houses tracking this security, 9 had ‘buy’ recommendations, 5 were ‘neutral’ and 2 had ‘sell’ recommendations? Considering that the investment community has waited a couple of years to receive any kind of credible financial information, and that the 2006 audited financial statement is still not available, doesn’t it seem a bit unethical for any brokerage house (including Bank of America and Morgan Stanley) to recommend buying the stock of a company for which only stale audited financial data exists? Therefore, it begs the question as to what influence the Working Group on Financial Markets is exercising over the powerful Wall Street brokerage houses? Quite candidly, this smacks of a cozy relationship between certain powerful brokerage firms and the working group.”

- “The Chairman of the Securities and Exchange Commission also serves on the Working Group. Have you ever asked him why he hasn’t recommended that Fannie Mae’s stock be delisted from the New York Stock Exchange? After all, if any other publicly held company hadn’t provided an audited financial statement for fiscal-years 2004 and 2005 — until December 6, 2006 and May 2, 2007 respectively — wouldn’t such a company have been delisted long ago?”
- “Is the Working Group pressuring Standard & Poor’s to keep Fannie Mae in its prestigious S&P 500 Index? How else could Fannie’s presence in the S&P 500 Index be sustained?”
- “Fannie Mae is not a free-market entity, nor is it a private body that must compete on the same playing field as its competitors. Fannie Mae is representative of all that’s wrong with central planning institutions: it is a government-created conduit for carefully crafted financial and market socialism that the bureaucrats uphold for the purpose of propping up their fantasies for pandemic social engineering. There’s nothing ‘American’ about this dream. In the eyes of the Republic’s visionaries, this particular dream has turned into a nightmare. (*Ludwig von Mises Institute*, Fannie Mae: Another New Deal Monstrosity, Karen DeCoster and Eric Englund, 07/02/07)

Conforming loan limits may fall in 2008, if house prices drop

- OFHEO issued a proposed guidance that will allow for a reduction in the 2008 conforming loan limit if the Federal Housing Finance Board’s House Price Index (HPI) declines by 1% or more over the 12 months ending October 31, 2007. Given the downturn in the housing market, such a drop in house values is likely since the HPI has declined 2.3% through April. OFHEO wants to set the ground rules for the calculation of the conforming loan limit in advance to avoid uncertainty in the mortgage market. Under the proposed guidelines, a fractional decline in housing prices will be deferred one year and factored into the following year’s calculation of the conforming loan limit. Last year, OFHEO deferred making a conforming loan limit adjustment when the HPI declined by 0.16% over the 12 months ended October 2006; this decline will be added to OFHEO’s calculations this year. The public comment period for the proposed guidance ends July 19. (*US Fed News*, 06/25/07; *American Banker*, Steven Sloan, 06/21/07; *National Mortgage News*, Brian Collins, 06/25/07)

OFHEO’s studies conclude that investors perceive an implicit guarantee of the Fannie Mae’s and Freddie Mac’s subordinated debt
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- In a recently released working paper, OFHEO analyzes Fannie Mae’s and Freddie Mac’s subordinated debt programs and conclude that the GSEs’ debt programs suffer from a number of shortcomings. While the agency’s study finds that GSE subordinated debt is somewhat sensitive to GSE financial risk, signals from the bond

market were not as strong or immediate and tend to lag behind signals from the equity market. Further, the agency's statistical analysis suggests that investors perceive an implicit guarantee of GSE sub debt. The report concludes that the subordinated debt has contributed little to market discipline of Fannie Mae and Freddie Mac. New regulatory authorities, such as receivership authority, and other regulatory powers, such as ability to expand the GSEs' disclosure requirements, could impact investors' perception of their potential for loss and increase their incentive to monitor GSE risk and produce stronger signals for the subordinated debt market that could change the behavior of GSE managements and OFHEO. (*OFHEO Working Paper 07-3: Subordinated Debt Issuance by Fannie Mae and Freddie Mac*, Valerie L. Smith, June 2007)

- In a follow-up study, the agency analyzes how sub debt market signals have evolved as the perceptions of the risk of the two GSEs has changed following recent revelations of accounting errors and earnings misstatements. Graphically and through simple regression analysis, the report concludes that the behavior of the sub debt of the GSEs differs significantly from that of the sub debt of other large, regulated financial firms. The authors write, "In particular, both the sub debt and the senior debt of the GSEs are much more tightly linked to Treasury debt than are the debt issues of large commercial banks. In addition, the yields on senior and sub debt of the GSEs are much more highly correlated than is true for commercial banks. Finally, the debt yields, including sub debt yields, have tended to be positively rather than negatively correlated with the Enterprise's stock price..." Using a dynamic signal model, the study found "...no dynamic signal related to innovations in the yields on Enterprise debt or the returns to Enterprise common stock. That is, we find no evidence of a firm specific signal for either Enterprise that is shared by the sub debt, senior debt, and equity markets." And, using Chow breakpoint tests to assess whether the market behavior of sub debt yields has changed over time, those tests "show that the market behavior of sub debt yields has changed as negative information has emerged about the Enterprises' management and risks. However, the nature of the change has been to link sub debt yields more closely to Treasuries. That paradoxical development is consistent with investors having greater confidence that Fannie Mae and Freddie Mac or their federal regulator would reduce the Enterprises' default risks, with greater liquidity in the Enterprise sub debt market in recent years, or with greater confidence in the value of the implicit federal guarantee associated with Enterprise debt." (*OFHEO Working Paper 07-4: Signals from the Markets for Fannie Mae and Freddie Mac Subordinated Debt*, Robert N. Collender, Samantha Roberts, Valerie L. Smith, June 2007)

OFHEO white paper describes the differences
between the agency's and S&P/Case Shiller's house price indexes

- In a June 22nd white paper, OFHEO provided information on the ways in which the agency's House Price Indexes are calculated, which are constructed using the same methodology used by S&P/Case-Shiller in their index. The study concludes that it

appears that “OFHEO’s national index has broader geographic coverage than the S&P/Case-Shiller National Home Price Index. (NHPI)” According to the methodology materials for NHPI, the S&P/Case Shiller index does not include house price data from 13 states and has incomplete coverage in another 29 states. Further, OFHEO’s sales price data includes only homes that have conforming mortgages, while the NHPI sales prices are not restricted to houses with certain types of financing. The full report can be downloaded as a PDF file from the OFHEO website. (*A Note on the Differences between the OFHEO and S&P/Case-Shiller House Price Indexes*, Andrew Leventis, 06/22/07)

OFHEO issues its report on the mortgage markets and GSEs for 2006

- On June 25th, OFHEO released “Mortgage Markets and the Enterprises in 2006,” an annual research paper that reviews developments in the primary and secondary mortgage markets and the financial performance of government-sponsored enterprises Fannie Mae and Freddie Mac in 2006. “This report is part of OFHEO’s ongoing effort to enhance public understanding of the nation’s housing finance system,” said OFHEO Director James B. Lockhart. The report also provides updated historical data on the activities and performance of the GSEs, federally-established loan limits, mortgage interest rates, housing activity and information about home prices. The full report is available at: www.ofheo.gov/media/pdf/MortgageMarkets2006.pdf (*OFHEO Press Release*, 06/25/07)

President Bush nominates former Representative Jim Nussle (R-IA)
to serve as the director of OMB

- President George W. Bush has nominated former Representative Jim Nussle (R-IA) to become the next director of OMB. Nussle will succeed Rob Portman, who will leave the agency in August and return home to Cincinnati to spend more time with his family. Nussle, who is expected to gain Senate confirmation for his post, chaired the House Budget Committee during the last six years of the lawmaker’s 16-year tenure in the chamber. Nussle, 46, ran unsuccessfully for governor in 2006. Most recently, he has served as Rudy Giuliani’s chief Iowa campaign consultant. “Jim’s name and knowledge command respect on Capitol Hill,” said Bush during a White House news conference. “And as OMB director, he will use his expertise about the budget process to ensure that the taxpayers’ money is spent with respect and with restraint.” The change at OMB comes at a time when Bush is confronting Democrats over their plans to spend \$23 billion more than the Administration requested for the 12 fiscal 2008 appropriations. (*Des Moines Register*, Thomas Beaumont and Jane Norman, 06/20/07; *CQ Today Midday Update*, 06/19/07)

American Bankers Association and America's Community Bankers
announce plans to merge by year-end

- The American Bankers Association and America's Community Bankers, the two leading banking trade groups, have agreed to merge which should be finalized by year-end. The new trade group, which will represent about 95% of the industry's assets, will retain the name American Bankers Association. Ed Yingling will remain the ABA's president and CEO and ACB's former president and CEO Diane Casey-Landry will serve as executive vice president and chief operating officer. (*Dow Jones Newswires*, Damian Paletta, 06/25/07)

Fannie Mae

Fannie Mae's mortgage portfolio surges 13.8% in May

- Fannie Mae's retained mortgage portfolio increased at an annualized 13.8% to \$718.3 billion in May, after shrinking by an annualized 3.7% in April. Year-to-date, the company's retained portfolio has declined at an annualized rate of 2.0%, after decreasing 0.4% in 2006. Gross mortgage portfolio growth was driven by purchases of \$21.8 billion, reflecting a widening of option-adjusted spreads during the May. The company's book of business grew at an annualized rate of 20% in May to \$2.642 trillion, driven by an annualized growth rate of 18.7% for Fannie Mae MBS and other guarantees [compared to 9.6% in April]. Net retained commitments rose to \$17.5 billion in May, up from \$11.7 billion in April. Fannie Mae's effective duration gap averaged zero months in May. The company's conventional single-family delinquency rate remained unchanged at 0.62% in April, while its multi-family serious delinquency rate increased one basis point to 0.10%. (*Fannie Mae Monthly Summary*, May 2007; *Reuters*, Julie Haviv, 06/25/07)

Fannie Mae to award \$6.5 million in bonuses to top executives,
as it offers early retirement to employees in effort to cut \$200 million in expenses

- Fannie Mae has announced it will pay out \$6.5 million in bonuses in common stock to its top executives for fiscal years 2005 and 2006, following an internal review of its senior officials to determine whether senior officials should be disqualified from participating in the performance share plan following its major accounting scandal. Under the plan, Fannie Mae will pay stock awards valued at \$1.9 million to Daniel Mudd, the company's CEO; \$1.7 million to Robert J. Levin, chief business officer; \$1.4 million to Michael J. Williams, chief operating officer; \$1.1 million to Peter S. Niculescu, executive vice president of capital markets; and \$233,198 to Thomas A. Lund, executive vice president of the single-family mortgage business. The company

said that the proposed payments are approximately half of what Fannie Mae's executives had initially qualified for in FY2005 and FY2006. Fannie Mae's board decided not to pay the company's executives \$44.4 million in bonuses for FY2003 and FY2004. OFHEO, which must approve the planned payments, has asked the company to provide additional data and analysis on its proposed incentive award payments and the board is responding to that request, said Corinne Russell, the agency's spokeswoman. (*Associated Press*, 06/21/07; *Washington Post*, David S. Hilzenrath, 06/22/07)

- Senators Chuck Hagel (R-NE), John Sununu (R-NH), Elizabeth Dole (R-NC) and Mel Martinez (R-FL) have asked Fannie Mae and OFHEO to provide additional details on the company's recent decision to award \$6.5 million in bonuses in common stock to senior management. The senators singled out Dan Mudd, who served as COO when the accounting scandal occurred and "worked against OFHEO's corporate governance regulations for Fannie in 2003 and tried to get other government agencies to side with Fannie in order to undermine OFHEO's effort." The lawmakers wrote, "Rewarding these actions is wrong and does not meet the bare minimum ethical standard for Government Sponsored Enterprise (GSE) governance and accountable management and oversight. It further weakens the safety and soundness of the GSE System. Congress chartered the GSEs to serve and promote a public mission, not to inappropriately fatten management bonuses." (*Correspondence to Stephen B. Ashley Chairman of Fannie Mae and the Honorable James B. Lockhart III, Director of OFHEO*, Senators Chuck Hagel, John Sununu, Elizabeth Dole, and Mel Martinez, 06/25/07)
- As part of the company's plans to reduce operating expenses by \$200 million, Fannie Mae is offering some of its employees the opportunity to retire early in order to reduce its work force by several hundred by year-end. In March 2006, the company had approximately 6,500 employees. "The company is offering some employees who meet certain age and tenure criteria the opportunity to volunteer to retire early," said Fannie Mae spokesman Brian Faith. "We anticipate that ... the company will have several hundred fewer full-time employees at the end of the year." (*Associated Press*, Marcy Gordon, 06/19/07; *Washington Business Journal*, Neil Adler, 06/20/07)

Litigation news

- In a new law suit, former Fannie Mae chairman and CEO Franklin D. Raines has argued that OFHEO has no authority to delay his receipt of a \$3.9 million stock award. Raines is seeking release of 58,812 shares, worth \$3.9 million on July 5th. [In a separate filing, former chief financial officer J. Timothy Howard is seeking release of 7,823 shares worth \$523,124.] In court filings, Raines's lawyers argued that OFHEO's efforts to temporarily block payments contradicts previous court decisions which ruled that OFHEO could not informally freeze payments to former Freddie Mac executives. OFHEO's lawyers have argued that Fannie Mae has entered into agreements which the regulator that give the agency authority over executive

compensation. A federal judge has scheduled a hearing on the question for July 16th. (*Washington Post*, David S. Hilzenrath, 07/06/07)

- Separately, legal counsel for Raines is charging OFHEO with withholding documents that may show a deliberate attempt by the regulator to drive down Fannie Mae's stock. According to the court filing, "[OFHEO] continues to guard jealously against the disclosure of information. [OFHEO is denying access] presumably for fear that the integrity of its own public statements will be called into serious question." Specifically, Raines wants the agency to hand over documents related to a report published by HUD's inspector general. According to the report, the inspector general said OFHEO was "a divided organization" and that at least one agency employee was concerned about "unethical" behavior in its dealings with Fannie Mae. According to a court filing, OFHEO has provided Raines and Howard with 455,385 pages of documents and spent more than \$1 million to comply with two court orders prompted by prior subpoenas from the executives. (*Bloomberg News*, James Tyson, 06/19/07)
- A Fannie Mae shareholder has filed a new shareholder derivative lawsuit against Goldman Sachs, alleging involvement by Goldman in the GSE's accounting scandal. The suit accuses the investment banking firm of aiding and abetting Fannie Mae executives in arranging deals which allowed the company to shift \$107 million in earnings into future years without proper disclosure. The claims are substantially identical to those in a previous shareholder derivative lawsuit, which was voluntarily dropped last year, and a class action filed against Goldman in 2006. The class action suit was dropped in May, after a judge ruled that there was no evidence that the investment banking company had prepared any of the GSE's misleading financial statements or had knowledge of them in advance. (*Dow Jones Newswires*, Ed Welsch, 07/03/07)
- In a media interview, Ohio Attorney General Marc Dann said that Fannie Mae investors should be entitled to about \$10 billion in compensation for losses stemming from the company's accounting scandal – roughly double the \$5.3 billion spend by the company on administrative expenses in 2005 and 2006, largely to fix internal accounting controls. In September 2004, the company's stock traded above \$77 a share, but fell below \$42 a share by October 2005 when the company's accounting irregularities came to light. "It was not until the fall of 2005 that people had an actual sense of the magnitude of the restatement," said Dann, who represents two Ohio pension funds that are lead plaintiffs in shareholder lawsuits against Fannie Mae. (*Bloomberg News*, 06/22/07)

Fannie Mae alumni news

- The National Community Reinvestment Coalition has appointed James H. Carr to serve as the organization's chief operating officer. Previously, Carr was as senior vice president for financial innovation, planning and research at the Fannie Mae Foundation and vice president for housing research at Fannie Mae. Before joining

Fannie, he served as assistant director for tax policy with the U.S. Senate Budget Committee and was a research associate with the Center for Urban Policy Research at Rutgers University. (*National Mortgage News*, 06/18/07)

- According to Mark Ambinder in *Atlantic Online*, “For more than a decade, perhaps no Democrat in Washington better exemplified the city’s political-corporate-cultural elite than James A. Johnson, the former head of Fannie Mae. Johnson, according to two Democrats, including one with direct knowledge of the decision, will support Senator Barack Obama’s presidential campaign. Mr. Johnson did not respond to e-mails and a telephone calling seeking his confirmation or a comment. He is famously reluctant to speak to the press, which is one reason why he has become a trusted adviser to so many politicians. ...His resume spans the elite axis of the entrepreneurial, the artistic, and the political. He was CEO of Fannie Mae before that job became controversial, has served as chairman of the Kennedy Center, and was a senior aide to Walter Mondale before settling into life as vice chairman of Perseus, LLC, one of those big private equity banks in DC.” (*Atlantic Online*, Mark Ambinder, 06/19/07)

Fannie Mae invests \$424 million in the Gulf Coast region

- Jay Ryan, Fannie Mae’s vice president for tax-advantaged equity, said the company has established five low-income housing tax credit (LIHTC) funds totaling \$375 million, which are dedicated to serving housing in Louisiana, Alabama, and Mississippi. The GSE’s fund manager partners include Raymond James Tax Credit Funds, Inc., The Richman Group Affordable Housing Corp., and Boston Capital. In aggregate, Fannie Mae has invested about \$424 million in LIHTC investments in the Gulf region, said Ryan, who declined to specify how much Fannie plans to invest overall in LIHTCs this year. (*Affordable Housing Finance*, Donna Kimura, July 2007)

Fannie Mae adjusts the dividend rate for its variable-rate, non-cumulative preferred stock
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- In accordance with the terms of the Series O Preferred stock, Fannie Mae has adjusted the dividend rate of the issue to 7.515% per annum, which will be in effect from and including June 30, 2007 to, but excluding, September 30, 2007. Fifty million shares with a stated value of \$50.00 per share were issued and are currently outstanding. (*Fannie Mae Press Release*, 06/28/07)

Freddie Mac

Freddie Mac's May mortgage portfolio grew 3.8%

- Freddie Mac's retained mortgage portfolio grew by an annualized rate of 3.8% in May to \$711.4 billion after shrinking 8.8% (annualized) in April. Year-to-date, the company's retained mortgage portfolio has grown 2.6% after declining 0.9% in fiscal year 2006 to \$704.0 billion. Non agency, non Freddie Mac issues were the main component of Freddie Mac's portfolio growth in May, rising by \$7.46 billion while Freddie Mac MBS purchases decreased, said RBS Greenwich analyst Margaret Kerins. The company estimates that its retained mortgage portfolio under GAAP was approximately \$705.4 billion, well below OFHEO's mortgage cap of \$724.5 billion for June 30. According to industry analysts, Freddie Mac's mortgage holdings could increase further in coming months and remain within growth restraints established by OFHEO, because mortgage assets have become more profitable to buy following a big sell-off in assets in June. "As we've said in the past, monthly activity is volatile and may produce portfolio growth rates that will vary substantially from month to month," said Michael Cosgrove, Freddie Mac spokesman. In May, Freddie Mac entered \$17.1 billion of retained portfolio mortgage purchase agreements in May, up from \$14.7 billion the prior month, and issued \$40.6 billion of securities, the highest level in the past 12 months, said Cosgrove. In April, the company's single-family delinquency rate declined one basis point to 49 basis points. Freddie Mac's duration gap averaged 0 months, unchanged from April. (*Freddie Mac's Monthly Volume Summary*, May 2007; *Reuters*, Lynn Adler, 06/22/07)

Freddie Mac alumni news

- Janice Thomas has been named the chief financial officer for the National Housing Conference and its research affiliate the Center for Housing Policy. Previously, Thomas served as director of reporting and operations for the division of community relations and as controller for the Freddie Mac Foundation. From 2000 to 2002, she worked as planning, budgeting, control and accounting manager for the foundation's division of administration and corporate properties. (*National Mortgage News*, 06/18/07)

Federal Home Loan Banks

GAO says it's too soon to determine the potential impact of the Finance Board's excess stock rule on the FHLBs' affordable housing program

- In a June 22nd letter to Senator Kit Bond (R-MO), the GAO said that it was too soon to determine the potential impact of the Federal Housing Finance Board's excess stock rule might have on the FHLBs' affordable housing program (AHP). The agency noted that opponents to the rule have argued that such a provision would adversely impact the FHLBs' earnings and thereby reduce the Banks' contributions to their affordable housing programs. The GAO wrote, "Overall, [FHLB] and trade group officials we interviewed said it is too early to tell what the exact impact of the final rule on AHP will be. [FHLB] officials stated that it is too early to make an accurate assessment whether [FHLB] capital growth may decrease, by how much, and to what extent this could affect earnings and contributions to AHP. Trade group officials stated there has not been a noticeable impact on AHP subsidies for projects, but the situation could change based on what happens to the banks over time." (*Correspondence to the Honorable Christopher Bond, United States Government Accountability Office, 06/22/07*)

FHLBs announce second quarter dividends

- The FHLB-San Francisco's board of directors declared a second quarter dividend to be determined in accordance with the Bank's Retained Earnings and Dividends Policy. Based on information available to date, the Bank's dividend rate for the second quarter is projected to be approximately 5.06% annualized. (*FHLB-San Francisco Press Release, 06/28/07*)
- The board of directors for the FHLB-Dallas has declared a stock dividend for the second quarter at an annualized rate of 5.26%, which equates to the average effective federal funds rate for the first quarter of 2007. The board also announced that the Bank will repurchase the portion of their members' excess stock identified as surplus stock on (and effective) July 31st. [Surplus stock is defined as the amount of capital stock held by a member that exceeds 105% of its minimum investment requirement.] (*PrimeNewswire, 06/26/07*)
- The FHLB-Atlanta's board of directors has approved an annualized dividend rate of 6.0% for the second quarter, payable at the close of business July 2nd. (*PR Newswire US, 06/28/07*)

FHLB-Indianapolis names Milton Miller as president and CEO

- The FHLB-Indianapolis's board of directors has named the Bank's retired senior vice president and CFO Milton J. Miller II as President and CEO, effective July 16th. Miller will succeed Brian K. Fike, who has served as the Bank's interim president and CEO since December 2006. In 1978, Miller began his career at the bank, where he has held various positions until his appointment as CFO in 1985; he accepted early retirement from the Bank in December 2006. Chairman of the board Paul Clabuesch said, "Miller's extensive experience in the financial markets will be a tremendous asset as the bank continues to address the challenges of the evolving financial and mortgage product marketplace." (*PrimeNewswire*, 07/06/07)

FHLB-Dallas appoints Robert Oberg as its chief risk officer

- The FHLB-Dallas has named Robert C. Oberg as the Bank's senior vice president and Chief Risk Officer, responsible for the oversight of the Bank's credit, market, and operational risk functions. Oberg has 20 years of extensive financial services and risk management experience. Most recently he served as senior vice president and head of Global Credit Risk at GMAC Financial Services, responsible for developing, implementing and assessing the company's quantitative and qualitative credit risk. Prior to working for GMAC, Oberg was senior vice president and chief risk officer of First Financial Bancorp in Cincinnati, Ohio. He also held positions with SouthTrust Bank, Office of Thrift Supervision, and the Comptroller of the Currency. (*PrimeNewswire*, 07/03/07)

FHLB-Cincinnati introduces the HomeProtect Program
to help its members mitigate mortgage foreclosures

- The FHLB-Cincinnati will make available \$250 million in advances to member institutions at the FHLB's cost of funds through its Home Protect Program. Members can use these funds to help homeowners at risk of foreclosure to refinance their mortgages on more favorable terms. Under this program, mortgages can be made to homeowners earning 115% or less of an area's median income. Homeowners may not take any cash out of the refinancing and must complete an approved homeowner counseling program. HomeProtect funds are available to members on a secured basis only and are subject to the Bank's normal underwriting and collateral policies. Members may borrow funds under this program in amounts up to 2% of assets or a maximum of \$50 million per year. (*FHLB-Cincinnati Press Release*, 06/22/07)

Ginnie Mae

GAO urges caution on legislative “fixes” to FHA loan programs

- The GAO is urging FHA to move cautiously on major legislative proposals that would affect the agency’s mortgage insurance program and could affect demand for FHA loans, the cost and availability of insurance to borrowers and the program’s budgetary costs. GAO noted that recent changes at FHA, such as allowing higher performing lenders endorse and approve loans without prior FHA review and the agency’s adoption of conventional market appraisal requirements, have helped the agency modernize its insurance process and products. These GAO found that these administrative changes got good reviews from the FHA and mortgage industry officials interviewed by GAO. The report concluded that the changes have increased the efficiency of loan and insurance processing, “making FHA products more attractive and, therefore, more likely to be used.”
- While the FHA has proposed legislation that would grant the agency new flexibilities intended to help the agency’s address its challenges from competitors in the mortgage market, GAO said that if the changes are passed, they would likely affect borrower participation in the program, as well as the program’s budgetary costs. Using 2005 HMDA data, GAO estimated that the number of FHA-insured loans in 2005 could have been from 9% to 10% greater had the higher, proposed mortgage limits been in effect.
- While it is difficult to estimate the effect of introducing risk-based premiums for FHA, GAO concluded that risk-based premiums would drop premiums for lower risk borrowers and increase them for higher risk borrowers. In their analysis of the proposed risk-based premiums using FHA data for home purchase borrowers in 2005, about 43% of the borrowers would have paid the same or less; 37% would have paid more; and 20% would not have qualified [which consisted of borrowers with expected lifetime claim rates of more than 2.5 times greater than the average claim rate.]
- FHA’s legislative proposals also would impact the agency’s budget. Assuming the legislation were to pass, GAO urged caution in viewing FHA’s estimates that the loans it expects to insure in 2008 would result in negative subsidies of \$342 million, rather than requiring a \$143 million appropriation absent any program changes.
- GAO also expressed concern over FHA’s decision to rely on its mortgage scorecard and statistical models to estimate loan performance, rather than using piloting programs to mitigate risks of any zero-down-payment product it is authorized to offer. While FHA has improved its model forecasting ability, GAO found that the scorecard still does not include a number of important variables included in other mortgage institutions’ scorecards, such as the source of the down payment. GAO

said that FHA's legislative proposals also would introduce new risks and challenges for the agency. The proposal to lower down payment requirements is of particular concern to GAO "given the greater default risk of lower down payment loans, housing market conditions that could put borrowers with such loans in a negative equity position, and the difficulty of setting prices for new products whose risk may not be well understood." (*GAO Report 07-708: Modernization Proposals Would Have Program and Budget Implications and Require Continued Improvements in Risk Management*, 06/29/07; *Bureau of National Affairs*, Thecla Fabian, 07/06/07)

- In a second report, the GAO concluded that the decline in the FHA's market share from 19% in 1996 to 6% in 2005 is attributable to (1) the agency's product restrictions and lack of process improvements relative to conventional markets and their processes and (2) product innovations and expanded loan origination and funding channels in the conventional market, coupled with interest rate and house pricing changes. According to the report, FHA loans decreased among populations where it traditionally has had a strong presence, including minority borrowers and low- and moderate-income borrowers over the 1996-2005 period. (*GAO Report 07-645: Decline in the Agency's Market Share Was Associated with Product and Process Developments of Other Mortgage Participants*, 06/29/07)

House passes bill to increase FHA's assistance for mobile-home buyers

- On June 25, the House passed H.R. 2139, which would direct the FHA to insure 90% of a person's loan for purchasing or improving a mobile home and would increase the FHA insurance limit on mobile home loans to \$69,678 in 2008 and thereafter index the limit to inflation. FHA's current insurance limit is \$48,600. The measure would require FHA to increase borrowers' fees to offset the increased risk of losses from defaults. H.R. 2139 is identical to the bill passed by the House in the 109th Congress, but was never considered by the Senate. (*CQ Today*, 06/25/07)

International Mortgage Market

Falling interest rates “ignite” Brazil’s mortgage market

- According to *Latin Finance*, “Although they lack the tax incentives of the US system, and there is no real government sponsorship, continued macro-economic stability [in Brazil] is helping consumers get comfortable with real estate financing that is increasingly cheap and long-dated. ...Falling interest rates and longer tenors are igniting Brazil’s mortgage market. This will further stimulate capital markets activity. Brazilians are being offered more affordable options for purchasing houses than ever before. Mortgage volume will jump to about 31 billion reais in 2007, from 6.7 billion reais in 2003, according to Gafisa, the Brazilian residential property developer. Brazil is starting from a low base. The mortgage to GDP ratio is just 4%, compared to 11% in Mexico and 18% in Chile, according to GMAC-RFC. Marcos Levy, CEO of Brascan Residential Properties, a developer 60% owned by Brookfield Asset Management, contends the explosion in investment will be underpinned by four factors. First, properties provided as a guarantee for loans are now foreclosed on after three months of delinquent payments, versus five years in 2003. Brazilian rates are at record lows and are expected to continue falling, spurring investment. Third, tenors on mortgages have doubled to 20 years, from 10 years in 2002. Lastly, average expendable incomes are rising: a 4,000 real monthly wage is enough to pay installments on a 20-year 150,000 real loan, says Levy. Three years ago, a 7,000 real income was necessary to cover that amount, he says. There is no doubt mortgage volumes are headed north, but there is disagreement on the rate at which the pool will expand. By 2008, predicts Levy, Brazilian mortgages could surge to 26% of GDP, today measured at \$1.1 trillion. But Ademir Cossielo, executive director at Bradesco, says it would take 10 years for mortgages to make up a quarter of GDP...”
- “But market participants say lack of government sponsorship has, and will continue to hinder market growth. Besides disruptive regulation, Brazil lacks an institution like Mexico’s Sociedad Hipotecaria Federal, the government entity charged with fostering the development of primary and secondary mortgage markets through the issuance of credit and guarantees. Lenders are also starting to factor in pre-payment risk and adjust their pricing as rates continue to fall.”
- “On the supply side, real estate firms are finding ample opportunity to load up on cheap funds in the thriving capital markets. And bankers are getting excited about the potential for mortgage-backed securities, though a lack of secondary trade is an impediment. ...Debt financing is offered at a range of banks in Brazil. Bradesco, Itaú, Unibanco, HSBC, Santander and ABN AMRO are the most aggressive underwriters to Brazilian real estate, says Gafisa’s Carciolari. ‘Banks have realized there is a great opportunity in this sector,’ Carciolari says. ‘Competition among them is getting fierce.’ Still, the development of structured finance off the back of the mortgage boom is moving ahead slowly compared to markets like Mexico. ‘In

Brazil, we'll see continued dominance of the short term retail type of bond,' says Francisco Páez, associate director at Metlife Investments Latin America, which has operations in several different domestic markets. 'There's a tremendous potential in the mortgage sector, but I think that is something that is going to play out in the medium term.'" (*Latin Finance*, Luis Waldmann, June 2007)

Farm Credit System / Farmer Mac

Farm bill containing HORIZONS provisions runs into trouble
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- Committee action on the 2007 Farm Bill, containing provisions from the FCS HORIZONS project which would expand the System's lending authorities, has been postponed until mid-July, due to disputes on the commodity title. In the event that Congress is unable to pass a farm bill during this session, an extension of the existing legislation will likely be passed. In the June issue of *Farm Credit Watch*, Bert Ely wrote, "Any delay in congressional action on the Farm Bill automatically will slow down congressional action on the bill's HORIZONS provisions, which will give bankers and others more time to educate Congress as to why there should be no expansion of the FCS's lending powers." (*Farm Credit Watch*, Bert Ely, June 2007)
- In a June 25th letter to Senate Agriculture Committee chairman Tom Harkin (D-IA) and ranking member Saxby Chambliss (R-GA), Senator Chuck Hagel (R-NE) told the lawmakers that he opposes efforts to expand the Farm Credit System charter in the 2007 Farm Bill. "I ask that you give careful scrutiny to the [FCS's] proposed Horizons Project, which would significantly expand FCS's lending authority well beyond [its] current mission," wrote Hagel. "We must thoroughly and comprehensively assess the current state of the FCS and ask the critical tough questions to ensure that the FCS's mission is being served.Congress must not ... hastily rush to expand the FCS's charter." (*Correspondence to Senators Tom Harkin and Saxby Chambliss*, Senator Chuck Hagel, 06/21/07)
- In a June 22nd letter to Senate Agriculture Committee chairman Tom Harkin (D-IA) and ranking member Saxby Chambliss (R-GA), the American Bankers Association, American Institute of Certified Public Accountants, America's Community Bankers, Financial Services Roundtable, Independent Community Bankers of America, Independent Insurance Agents & Brokers of America, and Mortgage Bankers Association voiced strong opposition to draft provisions in the 2007 Farm Bill that would expand the Farm Credit System's off-farm lending authority. The groups wrote, "The subcommittee's language tilts the competitive playing field against tax-paying financial services providers, while moving the system's mission further from the farm ..." They added, "The FCS should leverage its government-granted privileges in the service of farmers and ranchers, not in the service of its own

ambitions. The broad new powers being sought by the FCS are not about making more agricultural loans or even new agricultural loans. Instead, these powers facilitate the System's desire to move broadly into commercial lending, reduce the System's focus on lending to farmers and ranchers, and expand its mortgage lending authority in direct competition with private mortgage lenders and government housing programs. (*Correspondence to Senators Tom Harkin and Saxby Chambliss, the American Bankers Association, American Institute of Certified Public Accountants, America's Community Bankers, Financial Services Roundtable, Independent Community Bankers of America, Independent Insurance Agents & Brokers of America, and Mortgage Bankers Association, 06/22/07*)

FCS expands its definition of "moderately priced" dwellings

- In the June issue of *Farm Credit Watch*, Bert Ely notes, "The FCS has been making a major push in its HORIZONS initiative to increase the size of towns where it can finance 'moderate-priced' dwellings. There has been substantial confusion, though, as to what 'moderate-priced' means, so on April 10 the FCA issued an Informational Memorandum clarifying the meaning of this term. Bottom line: A 'moderate-priced' home today can have a market value of \$500,000, or even higher. That is far more than what many would consider to be a moderate-priced rural home. The FCA considers a home to be moderately priced if (1) its value does not exceed a limit set by Farmer Mac for mortgage securities it will guarantee or (2) the home is valued at or below the 75th percentile of house values in the area where the home is located."
- "The Farmer Mac option is fairly clear -- it is the maximum value for a home, 'excluding the value of the land on which it sits,' whose mortgage can collateralize Farmer Mac-guaranteed securities. That maximum in 2007 is \$247,184. However, the underlying land can equal the value of the house, which means the value of the house and land can go as high as \$494,368. Therefore, assuming an 80% loan-to-value (LTV) ratio, the FCS can originate mortgages of almost \$400,000 on half-million dollar homes. Those are hardly moderately priced rural homes."
- "The other option, the 75th percentile limit, can be bent sufficiently to push the value of an FCS-financed home well above \$500,000. The FCA states that 'in some situations it may be appropriate' to 'use the Conforming Loan Limit [CLL] to identify moderately priced housing values.' For 2007, the CLL is \$417,000. Assuming an 80% LTV, a \$521,000 home would be moderately priced. However, it is clear from the Memorandum that moderate-priced can mean homes well above \$500,000 in value, particularly in areas near large cities: 'Specifically, we [the FCA] encourage [FCS] institutions to develop housing programs that help creditworthy individuals of all income levels ...to purchase homes in rural areas.' [Emphasis supplied]."
- "According to the FCA, '[T]he 75th percentile is merely the point where values are deemed by the regulation to be moderately priced. [FCS] institutions may finance existing or planned rural housing that exceeds the 75th percentile of housing values in

a rural area if they determine that the housing in question is moderately priced for the rural area where it is located.’ [Emphasis supplied]. Despite a warning that the area in question cannot be ‘too small of an area, such as a subdivision,’ a creative FCS association could easily specify an area that is not ‘too small’ but large enough to encompass homes with values well beyond the 75th percentile over a larger area.” (*Farm Credit Watch*, Bert Ely, June 2007)

America’s commercial banks continue to meet the credit needs of the country’s farmers

- The *ABA Ag Banker* reports, “The banking industry continues to meet the increasing credit needs of rural America by providing the majority of loans in the agricultural marketplace, according to ABA’s annual Farm Bank Performance report. Banks, which are serving young, beginning, small and part-time farmers, have \$28.7 billion in small agricultural loans under \$100,000 on their books, the study said. The study also found that agricultural loans at the nation’s 2,362 farm banks grew 8 percent to \$49.1 billion in 2006, and such banks held \$237.3 billion in assets, up 7.3 percent from 2005. (*ABA Ag Banker*, 07/02/07)

Farm Credit System continues to push the envelope

- In the June *Farm Credit Watch*, Bert Ely wrote, “FCS institutions are getting bolder in making clearly illegal loans while their regulator, the Farm Credit Administration ...looks the other way. Recently, a Texas FCS association made a \$665,500 loan secured only by a nursing home in a central-Texas city. While the deed of trust (which I have reviewed) makes no mention of the nursing home, aerial photos clearly show a substantial structure on this 3.6 acre property. Although a nursing home is not the type residential property the FCS can lend on, the FCS cannot even justify the loan on that basis since the nursing home is located in a city with a population exceeding 2,500, the population limit for cities and towns where the FCS can lend on ‘single-family moderate-priced dwellings.’ What is absolutely astounding is the deed of trust’s clear misrepresentation of the use of property, for it states that the ‘Grantor [of the mortgage] covenants and warrants that the Property will be used principally for agricultural, farming, or aquacultural purposes...’ Perhaps that language is intended to mislead an FCA examiner reviewing the association’s loan files, but a sharp examiner should question whether that ‘farmland’ is worth \$182,000 per acre.” (*Farm Credit Watch*, Bert Ely, June 2007)
- In a June 28th press release, Cameron Family Glass Packaging announced the official ground breaking for its \$109 million, “eco-friendly” glass manufacturing facility in Port of Kalama, WA, which will manufacture glass exclusively for the wine industry. Financing of the project was provided by 42 North Structured Finance, Inc.; **Northwest Farm Credit Services, PCA**; Cowlitz Bank, **CoBank, ACB**; Sterling Savings Bank; **First Pioneer Farm Credit, ACA**; **Farm Credit Services of the**

Mountain Plains, FLCA; and Medley Capital LLC. [Emphasis added.] (*PR Newswire*, 06/28/07)

Farm Credit recognizes the leadership of Senator Chuck Grassley (R-IA) and Representative Stephanie Herseth Sandlin (R-SD)

- Senator Chuck Grassley (R-IA) and Representative Stephanie Herseth Sandlin (R-SD) were awarded AgriBank’s District Farm Credit Council’s Distinguished Service Award in recognition of their leadership regarding issues facing the Farm Credit System, as well as agriculture and rural America. (*Sioux City Journal*, 06/24/07)

Postal Service

House of Representatives passes the 2008 financial services and general government appropriations – and eliminates a \$29 million payment to the USPS

- Despite urging from major mailing associations and the Postal Service, the House of Representatives omitted a \$29 million payment to the USPS from the 2008 Financial Services and General Government Appropriations bill. The debt stems from mail services provided by the USPS in the 1990s. In a letter to lawmakers, Postmaster General John Potter wrote, “Failure to fund this authorized appropriation places the remaining funds owed the Postal Service, already deferred by interest-free installments over a total of 42 years, at risk. According to generally accepted accounting principles under which the Postal Service operates, the Postal Service could be in the position of having to recognize the present value of the entire outstanding balance as a bad debt, with these costs being unfairly borne by current postage ratepayers.” (*DMNews.com*, Melissa Campanelli, 07/02/07)

The USPS Board of Governors votes to keep standard mail pricing

- During June 19th closed door session, the Postal Board of Governors voted to keep unchanged the rate increases for Standard Mail flats and Nonprofit Regular flats that went into effect May 15. After the Governors had asked the Postal Regulatory Commission (PRC) to reconsider some of the prices originally recommended for these mail categories, the PRC issued a “Second Opinion and Recommended Decision on Reconsideration” which established a transitional temporary rate reduction of 3 cents for all Standard Mail Regular flats and 2 cents for Standard Regular nonprofit flats. The PRC estimated its recommendation would reduce the

Postal Service's revenues by \$100 million. James C. Miller, chairman of the Board of Governors, wrote, "That amount of money is substantial and its financial effect cannot be discounted ... [D]espite our agreement that mitigation of rate shock is indeed a worthwhile objective, we are not inclined to approve the means recommended by the [PRC] to achieve this end." (*DMNews.com*, Melissa Campanelli, 06/20/07)

Postal Rate Commissioner Ruth Goldway urges
the Federal Trade Commission to "fully assert" its authority over the USPS

- In a July 2 letter to the Federal Trade Commission, Postal Rate Commissioner Ruth Goldway urged the agency to "fully assert their broad statutory responsibilities" to oversee the USPS given to it by the Postal Authorization and Enhancement Act. Goldway writes, "...the [Postal Rate Commission] cannot be—and is not expected to be—the sole watchdog of the monopoly [of the USPS]. The FTC must use its regulatory expertise and authority to review, and if appropriate, call into question actions of the Postal Services as the Service markets competitive products that may create unfair competition with private competitors... It is important as well for the FTC to review actions of the USPS in marketing its monopoly products... Just as private corporations need protection from a \$70 billion government monopoly, so do customers who rely on the Postal Service's brand yet are confused by the complexity of its product offerings and often overwhelmed by the difficulties of seeking redress through unresponsive and/or unavailable clerks, offices and telephone lines..." (*Correspondence to the Federal Trade Commission*, Postal Rate Commissioner Ruth Y. Goldway, 07/02/07)

Pressures keep mounting on the Postal Service's business model

- According to *eMarketer*, nearly 80 million U.S. adult Internet users will do some banking activity online in 2007, a 9.5% increase over the 73 million who did so last year. By the year 2011, *eMarketer* estimates there will be 101 million users. The publication notes that nearly 51 million people paid some of their bills online in 2006 and another 4 million will sign on in 2007, spurred in part by recent increases in postal rates. (*Investors Business Daily*, Doug Tsuruoka, 06/25/07)
- *San Francisco Gate* reports that Blue Cross of California (BCC) will charge thousands of customers a \$2 "service fee" to receive their bills in the mail. The fee affects the 820,000 BCC customers who receive coverage directly from the insurer through individual policies; at this point, the policy does not impact the company's 7.5 million of customers who are insured through an employer or some other organization. "Businesses costs don't stay stagnant, said BCC spokesman Nick Garcia. "There have been increases in postage and paper costs." BCC is not the only insurer charging a fee for bills sent by mail. Health Net (HN) charges its 100,000 California members with individual policies a fee of \$5 each for paper bills. "This is

to promote the efficiency of electronic payment methods,” said HN spokesman Brad Kieffer. (*San Francisco Gate*, David Lazarus, 07/01/07)

- The direct marketing industry is experiencing rapid consolidation among some of the most well known names in the catalog and publishing industries due to economic challenges in the business and changes in the fundamental structure of how business must be done. [Can declining mail volumes from the direct marketing industry be far behind?] (*DMNews.com*, Ed Mallin, 07/05/07)

Private mail contractors remain a bone of contention
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- “I think within the next six to eight months the Congress of the United States is going to decide an issue that’s going to determine whether or not we have a reliable, efficient postal service in the future,” said William H. Young, president of the National Association of Letter Carriers. “What I’m referring to is the decision that’s been made at the highest levels of the Postal Service to give all the new growth, and the new deliveries that are springing up, to private contractors,” he said. Young’s union is currently staging picket lines in New Jersey and Florida to protest the Postal Services’ uses of private contractors for mail delivery in urban and suburban areas.
- If the Postal Service is to survive, it will have to consider outsourcing more of its activities, argues Gene Del Polito, president of the American Association for Postal Commerce. “[It’s conceivable] that a postal system in the future could evolve into something which I would call the master contractor, where it maintains its government identity by the government being the master contractor but that it puts things out competitively on bid.... At the end of the day, what you need is a universal mail delivery system, you don’t need a universal mail delivery enterprise.”
- “The world is changing dramatically in terms of instant communications,” said William Burrus, president of the American Postal Workers Union. “We as a species have discovered the ability to have instant communications. That’s not consistent with hard copy. I would suspect that over time hard copy will play less and less of a role in our communications.”
- Tony Conway, president of the Alliance of Nonprofit Mailers, said he expects the Postal Service to “evolve, probably into more of a focus on the strength of the organization, which is its delivery network. That’s the heart and soul of the organization, no current private carrier can compete with it. [But] it may or may not be a government organization. The \$64,000 question is how to keep the delivery network affordable,” given the decline of first-class mail. He added, “The days of reckoning are coming sooner than people probably now appreciate.” With the Postal Service adding 2 million new delivery points every year, raising costs on a declining revenue base, “that’s not a pretty financial model,” said Conway.

- Del Polito said, “We’re already seeing signs that we’re at the point now where people are seriously measuring the effectiveness of mail against alternative mechanisms, such as e-mailing or retailing or telemarketing to your known customer base, shifting to direct response TV or any of the other channels that previously one would have looked at and said, ‘God, these are expensive venues.’ Now, all of a sudden, they’re looking at them and they’re saying, ‘Well, the cost of those venues are coming down but the cost of mail is going up.’ Sooner or later we’re probably going to have to make a decision as a nation as to whether or not the core services that are provided for free are going to be done the way that they are today, or whether they’re going to be offered in a more restricted capacity and in a more cost efficient capacity.”
(*Associated Press*, Randolph E. Schmid, 07/06/07; *Tampa Bay Business Journal*, 06/21/07; *PRNewswire*, 07/19/07)

<i>Only at the USPS</i>

- *Newsday* reports, “Babylon [NY] town officials got a boost in their battle against the construction of a new post office in Wyandanch when Senator Charles Schumer (D-NY) threw his weight behind the effort in court to delay the project. Residents have objected to the proposed design, which has bulletproof glass and barbed wire, saying it projects a fortress-like image that is counter to their efforts to revitalize the community. Town officials are asking Judge Leonard Wexler in U.S. District Court for a temporary stop to the \$4.7-million post office being built on Straight Path. Schumer said in a news release that the Postal Service was ‘ignoring the will and wishes of Wyandanch residents’ seeking to clean up the community’s image. ‘For the post office to thumb its nose at the [people of Wyandanch] is wrong,’ Schumer said, adding that he was hoping to ‘cut through the red tape’ and open up a dialogue between the two parties.”
- “...Town Supervisor Steve Bellone said outside court that talks with the post office don’t reflect the hamlet’s push for economic revival. ‘[The design] would be a huge setback,’ Bellone said. In addition to the bulletproof glass, the building would be set back off the street so as to not allow for development close by, Bellone said.”
- “Postal Service officials said precautions were necessary in Wyandanch, whose post office was robbed last year. They said the bulletproof glass was recommended by the Postal Inspection Service at facilities ‘where there is a security risk’ and that the barbed wire would only surround post office vehicles at night.”
- “However, Schumer said that the answer was to make the new postal facility ‘better and more hospitable.’ He added, ‘While creating a secure building is paramount, the Postal Service needs to ... erect a structure that is both smart and safe.’ The hearing continues on July 12.” (*Newsday*, Laura Albanese, 07/03/07)

TVA

President Bush appears at TVA's Browns Ferry Nuclear Plant to applaud the agency's restart of Unit 1

- On June 21, President George W. Bush toured TVA's Browns Ferry Nuclear Plant in Athens, AL and spoke to 250 local residents and agency workers. In his speech, Bush said, "The restart of Browns Ferry Unit Number 1 represents the first nuclear reactor to come online in the United States in more than a decade. This is a demonstration that one is capable of doing a job on time and on budget. And I congratulate you all for your hard work, and thank you for the contribution you're making to the United States of America. ...I thank all the employees who work at this plant. Thanks for what you're doing. Thanks for being skillful. Thanks for working hard. Thanks for helping the country..."
- "I believe that it is essential that we have a comprehensive energy policy to be able to deal with the challenges we're going to face in the 21st century, whether that be energy independence or economic security or good environmental policy. And at the core of such policy must be electricity generated from nuclear power. I'm also here to nudge Congress along. They're working on a bill that I hope that they can get to my desk, that is a good bill, a balanced bill, a reasonable approach to making sure we continue to be wise about how we use energy in the United States."
- "Nuclear power is affordable and it is reliable. Once a nuclear plant is constructed, fuel and operating costs are low. The cost of electricity from a nuclear power plant is stable. It is predictable. The cost of electricity from a plant like this doesn't fluctuate the way plants fired by natural gas can fluctuate. The flow of power is not intermittent like the wind. This is a reliable source of low-cost energy. We need nuclear power to play a greater role in our future. That's what I want to share with you and the American people, as we talk about a comprehensive energy strategy, a comprehensive energy plan, nuclear power has got to be a really important part of our future. Nuclear power is the only large-scale emissions-free power source that is currently able to meet the growing need for electricity. As our economy grows, with additional demands for power and electricity, nuclear power can handle those needs. In order to keep pace with our nuclear energy needs, experts believe it will be necessary to build an average of three new plants per year starting in 2015. In other words, it's one thing to talk about nuclear power; it's another thing to ... understand [that] the strategy [is] necessary."
- "So we are going to need three plants starting in 2015. And as we tackle climate change, it may be necessary to have even more plants. Here's the problem: Our country has not ordered a new nuclear power plant since the 1970s, partially as a result of constant litigation and overly complex regulations. So we're working to overcome those obstacles. I appreciate the fact that the TVA is making decisions to

move forward nuclear power. **It's time for our country to start building nuclear power plants again.** [Emphasis added.] That's what I want to share with you..." (Prepared remarks of President George W. Bush, The White House, 06/21/07)

- According to Scott Peterson, vice president for communications at the Nuclear Energy Institute, the United States currently has 104 commercial reactors which supply about 20% of the country's power. The Department of Energy projects a 45% growth in electricity demand by 2030, which will require that 35 to 50 new nuclear plants be built just to maintain nuclear's share of the energy market. "[Growing demand] has been the single biggest factor in companies looking at building large nuclear plants again," said Peterson. The 2005 energy bill passed by Congress provided subsidies for the construction of the first six nuclear plants, which the industry sees as a one-time "jump start" for building nuclear plants, said Peterson. "If we can't be competitive after those first few reactors, then companies will stop building them," he said. "No one is building nuclear plants because they have a religious belief in nuclear." New standardized plant designs will help the industry control costs by taking advantage of cheaper, offsite modular construction and allow plants to share parts and work crews. The new designs are also safer because they incorporate the lessons of Three Mile Island, which had a partial meltdown in 1979 after workers misread a valve and mistakenly thought cooling water was getting into the reactor. The reactor's new systems have fewer valves and less piping, relying primarily on gravity to deliver cooling water to the reactor, added Peterson. The industry has proven it can safely store its waste, and will be able to do so until Yucca Mountain is open, and has developed elaborate security for the nuclear plants to aimed to deal with various attack scenarios, said Peterson. (*Associated Press*, Jay Lindsay, 07/04/07)
- In a June 22 editorial, the *Decatur Daily* wrote, "The president of the United States doesn't come to town often so when he does, it's a big event. ... We are glad the president chose to highlight the progress the [TVA] is making in nuclear energy. He told a gathering at the three-unit plant that the nation must have more nuclear plants to keep up with demand and to cut greenhouse-gas emissions. The U.S. ... must build more nuclear plants if it is to wean itself from fossil fuels and not fall behind, but not at the expense of building them to fail-safe specifications. ... Safety, not speed, is of paramount importance. So is doing something about spent fuel. The president said that can be solved. It needs to be." (*Decatur Daily*, 06/22/07)
- *Associated Press* reports that three powerful lobbying forces—the automakers, utilities and coal industry—have confounded the Democrats' efforts to pass an energy bill in Congress. The GOP led an intense fight, on behalf of two of the country's largest coal burning utilities [the Atlanta, GA-based Southern Company and TVA], to block an amendment requiring utilities to generate 15% of their power from renewable energy sources. In letters to lawmakers, the utilities argued that the requirement couldn't be met without huge increases in the cost of electricity. Supporters of the amendment claim the utilities' argument is false. Bill Wicker, a spokesman for Senator Jeff Bingaman (D-NM), who sponsored the renewable energy amendment,

said that the Senator views promotion of renewable energy as a core ingredient of a new energy policy. If the GOP continues to block a vote on the amendment, their efforts could “unplug the whole bill,” said Wicker. Passage of the Senate bill has also been stymied by the auto manufacturers’ objections to a provision requiring increased fuel efficiency for new cars of 35 miles per gallon by 2020 and annual improvements of 4% thereafter. Auto and coal interests also have played havoc with passage of similar energy legislation in the House. (*Associated Press*, 06/18/07)

TVA’s completion of Watts Bar 2 reactor
“would have no significant environmental impact”

- TVA received 1,229 form letters, addressing concerns about nuclear power, radioactive waste and security, in opposition to the utility’s plans for building a second nuclear reactor at the Watts Bar station in Tennessee. TVA responded in a 160-page supplemental environmental impact statement, which concluded that “there is no significant environmental impact if TVA decides to complete construction and operate Unit Two at Watts Barr.” The agency also concluded that the facility’s use of water from the Tennessee River should have minimal impact on river temperature and water loss; that spend fuel storage onsite should not be a problem; security against terrorists has been upgraded at TVA nuclear plants; and the proposed site should cause no harm to wildlife or habitat. The report concluded that the proposed reactor would increase demand on local government services during construction of the project and recommended “a supplemental allocation” from TVA’s annual in-lieu-of taxes payment. TVA’s board of directors will make a decision on moving forward with construction of the new reactor at their August 1st meeting, at which time the board expects to receive a \$30 million feasibility study on the project. The utility’s construction permit is due to expire in 2008. Construction could start as early as 2008, if the board votes to proceed with the project. (*Associated Press*, Duncan Mansfield, 06/19/07; Nuclear Engineering International [Footh Kray, UK], 06/2./07)

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