

The **GSE** REPORT™

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Major Events

The 110th Congress addresses GSE regulatory reform:

House Financial Services Committee chairman Frank introduces H.R. 1427 with the compromise language with Treasury largely “intact”

Treasury Department endorses “well-crafted” H.R. 1427

House Financial Services Committee holds hearings on H.R. 1427

House Financial Services Committee Chairman Frank introduces H.R. 1427 with the compromise language with Treasury largely intact

- On March 9, House Financial Services Committee chairman Barney Frank (D-MA) introduced The Federal Housing Finance Reform Act (H.R. 1427) to restructure the regulatory system for Fannie Mae, Freddie Mac, and the FHLBs. The legislation, co-sponsored by Representatives Richard Baker (R-LA), [Chairman of the Congressional Black Caucus] Mel Watt (D-NC) and Gary Miller (R-CA), reflects largely an agreement worked out between Frank and Treasury Secretary Henry Paulson in late 2006, which provides the newly-created GSE regulator the authority to control potentially risky growth of the GSEs’ investment portfolios for safety and soundness concerns and compliance with the GSEs’ missions, while not establishing hard-and-fast asset thresholds. The bill also includes a provision authorizing the regulator to temporarily increase a GSE’s minimum capital requirements if the company presents safety and soundness concerns, consistent with the original Treasury-Frank compromise language. The capital provision does not force the regulator to determine if conditions exist “to the extent originally required to support the temporary increase,” a provision proposed by Freddie Mac. The bill includes a product approval provision, which requires the GSEs to provide prior notice to they offer new products and provides that the regulator act on requests to introduce new products within 30 days after allowing the companies a 30-day notice and comment period.
- H.R. 1427 alters how Fannie Mae and Freddie Mac would contribute to an affordable housing fund. The bill contains an AH provision which assesses 1.2 basis points of Fannie Mae’s and Freddie Mac’s average mortgage assets, including whole loans, MBS, and loans that have been securitized and sold into the secondary market. This change was proposed by OFHEO, which concluded that the GSEs’ mortgage portfolios would be a more stable source of funds than the companies’ (volatile) profitability. According to the proposal, the AH fund would be subject to a five-year sunset. Approximately 75% of the AH fund would be targeted specifically for affordable housing activities, including single-family homes and rental units, and to

public infrastructure that supports housing. The remaining 25% of the fund would go to the federal government to defray costs associated with the program, thus making the bill budget neutral. Frank has been adamant that the first year's funding from the program be dedicated to helping rebuild the Gulf Coast region, which was devastated by hurricanes in 2005. The bill allocates 75% of the first year's AH funds to Louisiana and remaining 25% to Mississippi. Thereafter, the AH fund would be allocated according to a formula to be developed by HUD to distribute to the state housing authorities in the 50 states and District of Columbia.

- H.R. 1427 also contains a provision that would lift the conforming loan limit that Fannie Mae and Freddie Mac are authorized to purchase in high cost markets to the lesser of 150% of the national loan limit of \$417,000 or the median cost for that geographic area.
- Much of the bill reflects language of the GSE regulatory reform bill (H.R. 1461) passed by the House in 2005, along with the many of the changes brokered late in 2006 with Treasury senior officials. Frank rejected calls by Freddie Mac to restrict the powers of the new GSE regulator with regard to its control over capital, mortgage portfolios, and new products in H.R. 1427. Over recent weeks, Freddie began an aggressive lobbying campaign to make changes to the bill and circulated a six-page document to lawmakers which outlined how the bill should be changed. In January speech, Freddie Mac chairman and CEO Richard Syron argued that the restrictive GSE legislation could damage the housing market. "This is a serious defeat for Fannie and Freddie in a place where they should reasonably have expected a sympathetic reception," said AEI fellow Peter Wallison. "It is still only a proposal, however, and I expect that the GSEs will work like demons between now and markup to bring their troops—on both sides of the aisle—into line." Some GSE reform proponents said they were pleased to see any movement in a GSE reform bill that has stalled many times over the past few years. "It's a compromise between several parties from a variety of perspectives from the most hawkish to the most dovish," said MBA vice president Erick Gustafson. "[Frank's] effort is to keep this intact. The fact that he rejected the changes [proposed by Freddie Mac] is probably more of an effort to maintain the integrity of the compromise."
- Frank hopes to move H.R. 1427 rapidly through the Committee, following hearings before the GSE subcommittee on March 12th and the full panel on March 15th, markup of the bill on March 28th and a vote by the full House in April. The legislation received key support from two senior GOP committee members: Representatives Richard H. Baker (R-LA), the second-ranking minority member, and Gary G. Miller (R-CA). In a statement, Baker said, "I'm encouraged knowing that the legislation we introduced...represents the culmination of eight years of painstaking consensus-building and a solid foundation for bipartisan negotiation, improvement, and—hopefully at long last—action." Baker warned against efforts by the GSEs and their supporters to weaken certain measures of H.R. 1427. "The provisions of safety and soundness, minimum capital requirements in particular, are quite strong, and we simply must make sure they are maintained through the legislative process." (*Dow*

Jones Newswires, Damian Paletta, 03/08/07; *CQ Today*, Michael R. Crittenden, 03/09/07; *American Banker*, Steven Sloan, 03/12/07; *House Financial Services Committee Press Release*, 03/09/07)

Treasury Department endorses “well-crafted” H.R. 1427

- On March 9th, H.R. 1427 received broad endorsement from the Treasury Department, signaling that the compromise reached between Frank and senior Treasury officials has held, despite calls from other government and industry officials to alter significant sections of the bill. “Chairman Frank has introduced a bill that will significantly improve the supervision of the GSEs,” said Treasury under secretary for domestic finance Robert K. Steel. “This legislation creates a strong regulator, with authorities that are commensurate with other financial regulators’ powers, to ensure that the housing finance system remains vibrant.” Steel added, “On balance, this is a well-crafted bill.” Steel acknowledged that several issues, such as the creation of the affordable housing fund and the proposed increase of the GSEs’ conforming loan limit in high cost real estate market, remain unresolved. Steel said he looks forward to continued talks on these issues. (*Dow Jones Newswires*, Damian Paletta, 03/09/07)

House Financial Services Committee holds hearings held on H.R. 1427

- In testimony before the House Financial Services Committee on March 15th, Freddie Mac president and CEO Richard Syron and Fannie Mae president Daniel Mudd invoked the upheaval in the subprime mortgage market as reason for lawmakers to be cautious about subjecting the GSEs to stricter regulation, as proposed in H.R. 1427. Syron testified that the legislation could not only hurt Fannie Mae and Freddie Mac, but also would damage the already weakened housing market if the bill significantly restructures the GSEs’ business model. “We support strengthening [GSE] oversight, but not at the cost of crippling our ability to compete in the marketplace,” said Syron. “We remain concerned that this legislation will not only shrink the size of the GSEs, but also the very strong, safe, consumer-focused mortgage market that we serve. ...In this time of relative weakness in the U.S. housing market, over engineering the GSE model of housing finance, including requiring capital in excess of actual risks, may lead to further market weakness, high mortgage rates for borrowers, and the diminished supply of long-term fixed-rate financing.” Syron urged lawmakers to balance the complexities of the GSEs’ missions to that of their business model. “The ‘awkward reality’ [is that]—GSE regulatory reform is a delicate balancing act. Policymakers and regulators must solve a complex equation that strikes appropriate balances and trade-offs,” said Syron. He urged the lawmakers to provide “greater clarity and direction” in the GSE bill given the companies’ concerns about how some provisions “will be understood, interpreted and ultimately implemented” which could possibly “impair” the GSEs’ financial viability. Specifically, Syron and Mudd pointed to concerns about the bill’s provisions concerning the proposed GSE regulator’s power to adjust the companies’ minimum and risk-based capital levels, to

restrict the size of the GSEs' portfolios, and to approve the GSEs' products. Syron stressed that the bill's provision allowing the regulator to constrain the GSEs' retained portfolios would give the companies "little or no ability to provide market support for mortgages."

- During the hearing, Mudd addressed his concern about the regulator's ability to set minimum and risk-based capital levels, which would "adversely affect" the GSEs' ability to fulfill their missions. "The capital levels established by the Congress should be the norm, not the starting point," said Mudd. He also argued that Fannie Mae and Freddie Mac should be allowed to administer the affordable housing fund, as proposed in the Committee's bill [H.R. 1461] in the 109th Congress. "We believe GSEs should manage the fund," said Mudd. "I believe you want us to care about where [the money is distributed]." Frank responded that he could not argue with other lawmakers who feared that Fannie and Freddie would use the money to cultivate political support by funding projects in the districts of influential politicians. He added, the latest version of the bill takes the funds out of the GSEs' hands, which protects them from being "hit up" by members of Congress. Both executives stressed that Congress strike a "balance" of accomplishing the GSEs' chartered missions while not adversely impacting the companies' profitability, all while overseeing the "safety and soundness" of the companies. "The only issue I could raise as we go through this we continually aware that we have multi-missions and we are always balancing one against the other," said Syron. Mudd added, "It's both a mission and a business—both of these things have to be successful for either one to work."
- Judith A. Kennedy, president of the National Association of Affordable Housing Lenders, testified that Fannie and Freddie have been "AWOL" in CRA lending, while insured financial institutions had made more than \$300 billion in CRA loans (to customers earning 80% to 50% of the area's median income) in 2006 and nonprofits had financed more than \$70 billion of these loans. "So we could do much more if Fannie and Freddie were present in the market," said Kennedy. Because the GSEs have been reluctant to purchase loans from borrowers that do not meet certain standards, many customers have been forced to utilize nontraditional loans to fund their home mortgage, she added. "Unfortunately, we have learned that Fannie and Freddie have been the primary enablers of sub-prime lenders" through their purchases of ["AAA" tranches of] private-label MBS secured by subprime loans, said Kennedy.
- Ranking member Spencer Bachus (R-AL), along with other Republicans on the panel, voiced their opposition to the affordable housing fund provision proposed in the bill. Bachus said, "While I respect Chairman Frank's longstanding and sincere belief in the importance of creating this fund, I agree with [CBO] that the new assessments on the GSEs would inevitably be passed along to their customers in the form of higher fees, thereby raising the costs of purchasing a home or refinancing an existing mortgage. ...The proposed fund is extraneous to the task at hand: creating a world-class safety-and-soundness regulator for Fannie, Freddie and the [FHLBs]. Therefore, I must remain opposed to the inclusion of the affordable housing fund in the GSE reform bill." Representative Ed Royce (R-CA) said, "[A]s I said last year,

this fund is an experiment in socialism. We have a philosophical disagreement about this... This fund should not be included in legislation to improve the safety and soundness of GSEs. This is essentially a poison pill provision.” Royce noted that Federal Reserve Chairman Ben Bernanke’s suggestion that GSEs’ senior debt be limited to financing mortgages meeting affordable housing objectives was a better alternative which addressed both the systemic risk and affordable housing issues. “This would do much more in the area of affordable housing than the fund contained in H.R. 1427,” said Royce. Representative Judy Biggert (R-IL) voiced concern that the money would be wasted through bureaucracy. “I am concerned about the delivery because of what we have seen in Louisiana [in the distribution of aid to hurricane victims],” she said. Representative Randy Neugebauer (R-TX) said, “What this bill is going to do is raise the cost of housing for the American people.”

- In testimony before the panel, Treasury Under Secretary Robert K. Steel reiterated his agency’s support of H.R. 1427, but noted his agency’s reservations about the affordable housing fund and the provision to raise the conforming loan limits in high cost markets. Steel said the Treasury has “strong concerns” about the affordable housing fund, but will not oppose it, provided the fund would not be controlled by the GSEs themselves and it is capped and limited by a sunset provision. Frank asked Steel if he saw the proposed bill giving a new GSE regulator broad power to limit the companies’ investment portfolios. Steel responded that only concerns about the safe and sound operations of the GSEs should prompt the new regulator to cut the companies’ investments. “I think mission and safety and soundness capture everything,” said Steel. Frank responded, “What bothers me is the interpretation by some that additional factors could take you beyond mission and safety and soundness.” He added, “There is some ambiguity in the language. It may need that that needs to be made clearer.” Frank said conservative critics of the GSEs warn about systemic risks that the Fannie’s and Freddie’s pose to the overall economy, because they resent the benefits the companies derive from their government ties. “We disagree that there should be a power to deal with something defined as systemic risk over safety and soundness,” Frank added. He said he’s hopeful that Congress and the administration can reach a “common understanding of what we mean [by systemic risk].”
- OFHEO director James B. Lockhart, III also endorsed the bill, saying it presents a “balanced approach to needed statutory reform.” Lockhart told the Committee that his agency expects to release its annual report on the current condition of Fannie Mae and Freddie Mac in April. “Although the report will show that both still have problems that they are working to correct, I am hopeful that next year’s report will be more positive,” said Lockhart. “A key indicator to OFHEO of a successful remediation will be the timely filing of annual and quarterly financial statements with the [SEC] that have a clean audit opinion based upon a controls-based audit.”
- During the March 12th hearing of the Subcommittee on Capital Markets, Insurance and Government Sponsored Entities, representatives of the FHLB-Pittsburgh, the National Association of Realtors, and the Mortgage Bankers spoke favorably of H.R.

1427. “The Council [of FHLBs], which represents all 12 Federal Home Loan Banks, believes it is important to resolve the legislative uncertainty and is supportive of your efforts towards the creation of a strong independent regulator for the housing GSEs,” said John Price president of the FHLB-Pittsburgh. John Robbins, chairman of the Mortgage Bankers Association, said his group is “pleased with the bill” and “believes the GSEs need the flexibility to adjust their [investment] portfolios to changing conditions and marketplace needs.” Robbins cautioned, “MBA does not believe ‘jumbo loan’ borrowers need GSE funding. MBA is also concerned that such an expansion may make it more difficult for the GSEs to meet their affordable housing goals.” Thomas Stevens, a past president of the National Association of Realtors, said, “[The GSE reform] bill doesn’t over-regulate and it gives the regulator the authority to make proper adjustments [to the GSEs’ business practices].” Stevens added, “NAR supports regional adjustments to conforming loan limits for high-cost market areas as a matter of equity for American families in these markets.”

- In prepared testimony for the House Financial Services Committee’s March 15 hearing, Anne Canfield, executive vice president of the Consumer Mortgage Coalition, wrote, “H.R. 1427 makes some significant improvements to the supervisory framework of the GSEs, but does need to be strengthened in several important respects. ...[With regard to funding the GSE regulator,] H.R. 1427 would fund the new regulator (...the “Agency”) through assessments on the GSEs without regard to the Congressional appropriations process. However, the Agency’s authority to obtain prompt payment of assessments needed for effective supervision of a GSE is much more constrained than the authority of the federal bank regulators. ...For example, the Agency lacks express authority to go to court to enforce an order that the GSEs make timely payments. Given the public reports that GSEs have used the appropriations process in the past to pressure their regulator, the Agency needs to have express authority to issue an order for payment and then enforce it.”
- “[With regard to product approval,] [a]n effective process of new program approval is needed to assure that the GSEs use their government subsidies to focus on their core missions without being diverted to activities that may be more profitable but are of less public value or that might displace available private sector capital and resources. Currently, Fannie Mae and Freddie Mac may not undertake a new program without obtaining the prior approval of HUD. The statutory framework has a number of shortcomings: (1) the regulator must disapprove the new program within 30 days (plus a possible 15 day extension), or the program is deemed to have been approved; (2) HUD’s prior approval authority is limited to new programs, which are defined in the 1992 Act to mean mortgage programs; (3) the GSEs often contend that new activities do not constitute new programs subject to the prior approval requirement; and (4) the GSEs are not required to submit complete information before the 30-day clock begins to run.”
- “H.R. 1427 would require that the GSEs submit a written request for approval of a product. The request must describe the product in such form as the Agency requires. The Agency must publish notice and invite public comment regarding the proposed

new Product. If the Agency has not approved the new product within 30 days after the close of the 30-day comment period, the product will be deemed to be approved. If a GSE determines that any new activity, service, undertaking, or offering is not a product, it is required to provide notice to the Agency before commencing. The Agency must determine immediately whether the new activity, service, undertaking or offering relates to or involves a product. If the Agency notifies the GSE that it does involve a product, then the GSE must withdraw its request or submit a request for approval of the new product. The Agency may impose conditions in connection with the approval of any product.”

- “The GSEs would be able to continue to offer their automated underwriting systems (AUS) in existence on the enactment date of the legislation, including any upgrade to the technology, operating system, or software to operate the underwriting system. While this does not affect the Agency’s authority to review products or activities for safety and soundness, and consistency with the GSE’s statutory mission, it does greatly limit prior approval authority for mission-related reasons.”
- “[With regard to the regulator’s enforcement authority,] H.R. 1427 does improve the enforcement powers in current law. However, the bill continues to be significantly weaker than the statutory authority granted by law to the federal bank regulators. Of most importance, both H.R. 1427 and S. 190 would leave in place the limitations that currently apply to OFHEO in subtitle B of the 1992 Act, but not currently to the Federal Housing Finance Board or to the federal bank regulators. These limitations generally preclude OFHEO from requiring important corrective actions except if a GSE is undercapitalized. Capital is a lagging indicator; significant damage can occur before a GSE restates its books to account for the loss of capital...”
- With regard to principles for GSE Reform, Canfield wrote, “...The GSE conforming loan limit should not be raised to cover the so-called ‘high-cost’ areas. High income borrowers do not need the benefit of the two basis point subsidy the Federal Reserve Board has estimated the GSEs provide homebuyers. This proposal would benefit only a very narrow segment of wealthy borrowers and have a negative impact on affordability for the low and moderate-income consumers.”
- “...If an Affordable Housing Fund is established, it should be designed so that it is not a tax on consumers or lenders. The assessment should be levied on non-mortgage investments, as well as other assets, or it will give the GSEs an incentive to increase non-mortgage investments. In addition, the new regulator should be empowered to assure the proper use and administration of the funds. Finally, an advisory board of industry practitioners should be established to ensure that funds are distributed appropriately.” (*Testimony submitted by the Consumer Mortgage Coalition to the House Financial Services Committee, Anne C. Canfield, 03/15/07*)
- After the full Committee’s hearing on March 15th, Representative Paul Kanjorski (D-PA) told reporters, “Everyone is generally optimistic. We are going to move it

through the committee and through the House. The question is: what's going to happen in the Senate?"

- At the Midwinter Conference, Senator Robert Bennett (R-UT) told attendees that there's a good chance the House and Senate will reach agreement on GSE regulatory reform. "With Secretary Paulson in the mix, the discussions have been more fruitful, and I think we'll get a bill," said Bennett, the second-ranking minority member of the Senate Banking Committee. But Kurt Pfofenhauer, MBA's senior vice president for government affairs, told the attendees that he believes that there's less than a "50-50" chance for passage of a GSE bill in the 110th Congress, adding "the odds are that it will never be passed." After the GSEs' resolve their accounting problems, Pfofenhauer said, "The whole issue fades away until there is another triggering event."
- In a research report, Stanford Group analyst Jaret Seiberg said that Senate opposition is likely to stall the GSE regulatory reform bill's progress, with Republican members on the Senate Banking Committee demanding a reduction in the GSEs' portfolios. "We fully expect [House Financial Services Committee chairman Barney] Frank to pass his bill out of committee this month and out of the full House next month," wrote Seiberg. "[However,] we caution against assuming House action improves the prospect for enactment. This is a relatively friendly bill for the enterprises, but it does not appear to be able to pass the Senate." (*American Banker*, Steven Sloan, 03/13/07; *National Journal's CongressDaily*, 03/13/07; *The Main Wire*, Margaret Chadbourn, 03/12/07; *MarketWatch*, Robert Schroeder, 03/12/07; *The Main Wire*, Margaret Chadbourn, 03/15/07; *Bureau of National Affairs*, Richard Cowden, 03/16/07; *Washington Post*, David S. Hilzenrath, 03/16/07; *Bloomberg*, James Tyson, 03/15/07; *CQ Today*, Michael R. Crittenden, 03/15/07; *Marketwatch*, Robert Schroeder, 03/15/07; *American Banker*, Steven Sloan, 03/16/07; *Dow Jones Newswires*, Damian Paletta, 03/16/07; *Dow Jones Newswires*, Damian Paletta, 03/15/07; *CongressDaily*, Bill Swindell, 03/15/07; *Reuters*, Patrick Rucker, 03/15/07; *National Mortgage News's MortgageWire*, 03/05/07)

Senate Banking Committee chairman Christopher Dodd outlines his priorities for GSE reform
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- In a March 7 statement, Senate Banking Committee chairman Christopher Dodd (D-CT) said, "In my view, there is broad agreement that we should create a new regulator to oversee Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. This new regulator must have a number of core powers in order to do its job effectively, and to be considered credible in the eyes of the public. These powers include: the ability to set both minimum and risk-based capital levels for the Enterprises; enhanced enforcement and prompt corrective action powers, including the authority to set and enforce prudential management and internal control standards; the ability to put a GSE into receivership; and authority over both safety and

soundness and mission. The goal in giving the new regulator this broad responsibility is to ensure a more coherent regulatory framework, better enforcement, and a more consistent, deeper, and more aggressive effort on affordable housing at all the GSEs. In addition, I believe that the new regulator must be politically independent and funded outside of the appropriations process. It is my hope that this shared consensus can be the basis for moving strong and effective legislation forward.” Dodd has indicated his committee would address GSE regulatory reform issue later in the fall. (*Senate Banking Committee Press Release, 03/07/07*)

Federal Reserve chairman Ben Bernanke urges Congress to tie the GSEs’ portfolios to their affordable housing mission

- In a March 6th speech to the Independent Community Bankers of America, Federal Reserve chairman Ben Bernanke urged lawmakers to tie Fannie Mae’s and Freddie Mac’s investment portfolios to affordable housing. Bernanke said, “...[A] standard for determining the public benefit of Fannie’s and Freddie’s portfolios seems readily available: Do the GSE portfolios support affordable housing? At the present time, Fannie and Freddie appear to fail this test. Indeed, by OFHEO’s estimation, less than 30 percent of the GSEs’ current portfolio holdings are oriented toward affordable housing...”
- “A straightforward means of anchoring the GSE portfolios to a clear public mission would be to require Fannie and Freddie to focus their portfolios almost exclusively on holdings of mortgages or mortgage-backed securities that support affordable housing. The evolution of mortgage markets since the GSEs were created strongly suggests that a concentration on affordable-housing products would provide the greatest public benefit. Markets for highly rated assets—including most residential mortgages and the pools of MBS backed by such mortgages—have become extremely deep and liquid, with more than \$25 trillion in outstanding instruments. These markets are international in scope, and market participants include thousands of banking organizations, insurance companies, pooled investment vehicles, institutional investors and, increasingly, foreign governmental authorities. Given the size and depth of the secondary market for most residential mortgages, the GSEs’ purchase and retention of highly rated mortgages and of their own MBS are unlikely to do much to enhance liquidity in the secondary markets for these assets or to promote affordable housing. On the other hand, the vast size of the market for highly rated assets greatly increases the potential for rapid growth of GSE portfolios and, consequently, systemic risk.”
- “In contrast, the market for affordable-housing products--particularly mortgages extended to households with below-median-income--is less deep and liquid than the broader market for residential mortgages. GSE portfolio purchases might add significant liquidity to the secondary markets for such assets, thereby reducing costs and increasing credit availability to prospective home purchasers. In addition,

increasing the presence of the GSEs in the market for affordable housing could help banks fulfill their CRA obligations by providing them with greater opportunities for securitizing such loans. In all, from a social perspective, focusing the GSE portfolios on affordable housing could provide benefits that might offset some of the risks that these more-targeted portfolios might pose to financial markets and to taxpayers. The key principle here is that the GSEs' senior debt-which investors view as government-backed-should be used only to finance assets (such as affordable-housing mortgages) that have, in the view of the Congress, a clear and measurable public benefit. Such an approach would set some functional limits on the size of the portfolios and on the range of assets that GSEs would be allowed to purchase, while preserving the ability of these companies to operate profitably.”

- “To be clear, I am not advocating a change in the exposure of GSEs to subprime loans. Orienting the GSEs’ portfolios more toward affordable housing is an approach which can succeed under the current GSE credit standards. Indeed, the credit risks associated with an affordable-housing portfolio need not be any greater than mortgage portfolios generally, so long as the GSEs continue to adhere to sound underwriting practices. Moreover, a renewal of the GSE affordable-housing mission might stimulate the development of innovative approaches to measuring and managing the credit risks associated with such mortgages. ... [T]he Federal Reserve Board believes that the GSEs’ investment portfolios should be firmly anchored to a measurable public purpose, such as the promotion of affordable housing. I believe that this approach provides a reasonable balance of social costs and benefits for the GSE portfolios. In particular, this approach would re-focus the GSEs on the affordable housing objectives given to them by the Congress.” (*US Fed News*, Remarks by Federal Reserve chairman Ben Bernanke, 03/06/07)
- House Financial Services chairman Barney Frank (D-MA) dismissed calls from the Federal Reserve to require GSEs to tie their investment portfolios to affordable housing. Frank told reporters, “No one in the housing field thinks that just by pushing them to... buy more mortgages without [a government] subsidy, that you will help low-income people. It just doesn’t work that way. You need the element of subsidy.” Senator Richard Shelby, minority leader of the Senate Banking Committee, said, “We [in Congress] should pay close attention to the issues [Chairman Bernanke] has identified regarding Fannie and Freddie. I share many of the concerns that the chairman raised in his speech today.” Shelby added, “While I realize that the make-up of the Committee has changed, Chairman Bernanke reminded us today that the risks and the problems associated with the GSEs have not. Should [the Committee] revisit GSE legislation this year, we would be well-advised to give great weight to the Fed’s unique perspective.” (*Dow Jones Newswires*, Damian Paletta, 03/07/07; *American Banker*, Joe Adler, 03/08/07)
- In a March 7th editorial, the *Wall Street Journal* wrote, “One duty of the Federal Reserve Chairman is steward of the U.S. financial system, so it’s good news that Ben Bernanke stepped up ...and put himself on record as favoring limits on Fannie Mae and Freddie Mac. Maybe his intervention will help prod Congress to stop protecting

the two mortgage giants from regulatory discipline. Readers of these columns know the incredible tale of Fan and Fred, the ‘government-sponsored enterprises’ that have grown like Topsy thanks to an implicit government subsidy and now pose a systemic risk to the entire financial system. Mr. Bernanke put it this way: ‘The perception of government backing allows Fannie and Freddie to borrow in open capital markets at an interest rate only slightly above that paid by the U.S. Treasury and below that paid by other private participants in mortgage markets.’ The companies use this subsidized pricing advantage to buy huge amounts of mortgage-based securities, or MBSs, and thus “can enjoy profits of an effectively unlimited scale.” Socialism can be a great business for the lucky few who game the political system.”

- “Congress lets the duo play this game because the companies claim that their vast MBS portfolios help promote ‘affordable housing,’ and who doesn’t like that? But Mr. Bernanke also blew away that smokescreen by noting Fed research showing that these portfolios ‘appear to have no material effect on the cost or availability of residential mortgages.’ In order to buy those MBSs, the companies issue roughly equal amounts of debt, so the net result is a wash in supplying capital for mortgage finance. However, the companies keep piling up debt to buy those MBSs, growing them tenfold from 1990 through 2003. Today, the two have a combined total of \$5.2 trillion in debt and MBS obligations, which exceeds the entire \$4.9 trillion in publicly held U.S. government debt. We can hear our readers wondering why they can’t get in on a similar ‘business model.’”
- “Mr. Bernanke’s sensible recommendation is that Congress give Fan and Fred’s regulator the power to limit those MBS portfolios. He has other useful ideas, but his key point is that these MBS portfolios should be limited to a role that actually does promote affordable housing – that is, providing liquidity for ‘mortgages extended to households with below-median-income.’ This would mean less profit for Fannie and Fred but also less danger to taxpayers in case the duo guess wrong in the market and get into financial trouble. This is all so eminently sensible that it probably won’t happen. Democrats in Congress claim to want to help poor homeowners, but they seem only too happy to let Fannie and Freddie grow rich by investing in the higher-income mortgage market that is already liquid enough. They could better serve taxpayers and the poor if they took Mr. Bernanke’s counsel.” (*Wall Street Journal*, 03/07/07)

Fannie Mae and Freddie Mac

Reform bill unlikely to result in “dramatic cuts” to GSEs’ portfolios,
says OFHEO director Lockhart

- In a March 5th speech to American’s Community Bankers Government Affairs Conference, OFHEO director James B. Lockhart, III said, “It is unlikely that there would be ‘drastic reductions’ in [the GSEs’ mortgage] portfolios.” The new GSE regulator should not make cuts, “but rather a reallocation” of investments away from “some of their own” MBS and “more into” home loans and MBS sold by competitors. Lockhart added. “...[O]nce the [GSEs’] houses are in order, it is certainly possible that a mission-focused regulation would allow the portfolios to grow with the mortgage market. The proposed legislation instructs the agency to consider the size and growth of the market.”
- “...Market uncertainty is increasing, credit risks are growing, competitive pressures are increasing, and operational risks are abundant,” said Lockhart. “Mortgage delinquencies are rising. There are major concerns, in particular, with nontraditional and subprime loans.” He concluded, “It is time to move forward on [GSE] reform to ensure the safety and soundness of the housing GSEs and their full dedication to their important mission of supporting the mortgage market and especially affordable housing.” After the speech, Lockhart told reporters, “There certainly could be some changes in the [GSEs’] portfolios, not only in reallocation but some decrease in size. But it is not going to be as drastic as the point I was trying to make.” (*Prepared remarks by OFHEO director James B. Lockhart, III, 03/05/07; Dow Jones Newswires, Jeff Bater, 03/06/07; Bloomberg News, James B. Tyson, 03/05/07; Main Wire, Margaret Chadbourn, 03/06/07; American Banker, Steven Sloan, 03/06/07*)

GSEs’ affordable housing fund should reflect their objectives,
argues former Fannie Mae executive

- In a March 16th opinion editorial, Barry Zigas, the former president of the National Low Income Housing Coalition [from 1984 to 1993] and senior vice president of Fannie Mae National Community Lending Center [until 2006], wrote, “The House Financial Services Committee is poised to adopt an affordable housing fund for Fannie Mae and Freddie Mac as part of a broader revision of their congressional charters. It should do so without delay, but only by integrating the fund’s management within Fannie and Freddie can Congress maximize the money’s impact and create a modernized public mission for them.”
- “The idea of a fund paid for by a new assessment on the two companies has broad support. However, there is a persistent chorus of critics who are happy to slap a new surtax on the companies but loath to have them administer the fund it would finance.

They claim that Fannie and Freddie would use such a mandate to reward friends, punish enemies, and curry favor through a politically motivated award process. This canard is the WMD of the Fannie and Freddie debate. Congress is perfectly capable of designing a transparent selection process that eliminates politics from the allocation of funds. The bill the House passed in 2005 would have created just such a system. The [FHLBs] have operated a similar fund for nearly two decades without any complaints of political interference or bias. Those who want to divert the funds have other agendas in mind.”

- “A new affordable housing fund should capitalize on the central position of Fannie and Freddie in the mortgage finance system, their national scope and reach, and their natural strengths. It should push them into more innovation and market making in affordable housing. It should force them to learn new ways of doing business in new markets with new customers. A fund that would require both companies to use the allocations to leverage their core lending tools to meet high-priority housing and community development needs is the only proposal that would meet these tests.”
- “In 1992, Congress updated the companies’ charters to require systematic engagement to meet congressionally mandated housing goals. Both companies were forced to build new, sustainable businesses financing mortgages with very low down payments, and to borrowers with thin credit files or nontraditional credit, among other innovations. The gains for consumers, communities, and lenders were far greater than any levy would have produced. An integrated fund likewise would return much higher dividends than a surtax diverted to others. As private companies, Fannie and Freddie seek to maximize profits and returns to their shareholders. But Fannie and Freddie are private companies chartered with express public purposes and benefits.”
- “...But Congress should not buy their fear-mongering about the fund’s potential for political abuse, or arguments for dilutive distribution schemes. Instead, they should use this rare opportunity to redefine the public mission of Fannie and Freddie, to renew and increase their participation in solving America’s toughest housing problems.” (*American Banker*, Barry Zigas, 03/16/07)

“Framing” the size of the subprime mortgage crisis
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- In his March 12 testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, John Robbins, chairman of the Mortgage Bankers Association, described the size of the subprime mortgage crisis to the panel. On balance, there are approximately 50 million home loans in the United States of which 13.5%—or 6.75 million—are subprime mortgages. Robbins said, today slightly over 4% of subprime mortgages (270,000+) have entered foreclosure proceedings. In the modern era, Robbins said that the highest rate of all mortgages, including hybrid loans, going into foreclosure proceedings was 9.35% in 2000. Thanks to the industry’s mitigation techniques, approximately 50% of all subprime

mortgages entering into foreclosure proceedings go through the entire foreclosure process [versus 25% for all mortgage loans].

- Robbins pointed out that if the level of subprime mortgages going into foreclosure proceedings was to exceed the previous highest rate to say 10%, then approximately 5% of subprime mortgages would result in foreclosure and the remaining 95% of subprime borrowers would be successful homeowners. He reminded the panel that only 45% of subprime mortgages were made to borrowers who were buying their own home and many (if not most) of these individuals were unable to use traditional sources of mortgage loans.
- Robbins acknowledged that without question there were lenders in the marketplace marketing the subprime mortgage product and aggressively underwriting these loans to grow their market share. He noted that the market is “extraordinarily efficient” and has punished these lenders “severely if not totally” and that the aggressive features of these products have already been eliminated. (*Testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, MBA chairman John Robbins, 03/12/07*)
- During the Regional Conference of the Mortgage Bankers Association, Robbins accused certain consumer groups for “hyping” potential foreclosure numbers for subprime mortgages for political purposes. Specifically, Robbins pointed to the Center for Responsible Lending’s claim that two million subprime mortgages [approximately 19% to 20% of these mortgages] will result in foreclosure. Robbins also criticized Freddie Mac’s recent change in underwriting standards for 2/28 loans and 3/27 loans, which will require that loans be underwritten to the fully-indexed rate for loans the company purchases. Robbins argued that this change in underwriting, which goes into effect at the end of September, will create a disparity in the marketplace and adversely impact approximately \$1.1 trillion of mortgages, whose borrowers face interest rate resets this year. (*National Mortgage News’ MortgageWire, 03/14/07; Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners Executive Summary, Center for Responsible Lending, Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest, December 2006*)
- On March 13, several hundred ACORN members from across the country marched on the Mortgage Bankers Association to demand a one-year moratorium on “predatory mortgage loans” [which ACORN defines as adjustable rate loans that used the initial rate to qualify the borrower; stated income loans—also called “liar loans” according to the *New York Times*—that had no income verification; and loans that were made without escrows for taxes and insurance]. ACORN is also calling on lenders to change their practices regarding stated income and adjustable rate loans and follow the steps taken by Freddie Mac and recommended by federal regulators, in order to reduce the number of future loans resulting in foreclosure. (*Association of Community Organizations for Reform Now Press Release, 03/14/07; New York Times, Gretchen Morgenson, 03/11/07*)

- In response to the crisis in the subprime mortgage market, Senator Christopher Dodd (D-CT), chairman of the Senate Banking Committee, said Congress may have to act quickly to protect subprime borrowers who are in danger of losing their homes to foreclosure over the next 18-months. “We may need to get some forbearance or something like that to give them a chance to work through their problems,” Dodd told reporters after making a speech to the National League of Cities. “Clearly, we are looking at what we can do to help out,” said Dodd, who is running for President. “We clearly want to look at that legislatively,” he added. Dodd acknowledged that such efforts could cost billions, but said those concerns must be weighed against the estimated \$164 billion of homeowners’ equity which is at risk through impending foreclosures. After saying he wanted to “get some forbearance” for delinquent subprime borrowers, the following day Dodd told reporters that he does not favor a federal government bailout for delinquent borrowers. “We’re not talking about bailouts—I don’t know where that language came from,” said Dodd. The Senate Banking Committee has scheduled a hearing, titled “Mortgage Market Turmoil: Causes and Consequences,” for March 22nd at 10:00 a.m. at which Dodd is expected to call federal regulators to Capitol Hill to testify on problems in the subprime industry. Dodd said, “That’s what made me angry here, that the regulators apparently have not been doing as good a job as they should have been doing. But we’ll know the answer to that question as we bring them before the committee.” On *Bloomberg News*, Dodd added, “Those who have taken advantage of the situation [in the subprime lending market] have been allowed to operate because regulators have not been good cops on the street.” The House Subcommittee on Financial Institutions and Consumer Credit has also scheduled a hearing on subprime and predatory lending on March 27th. (*National Mortgage News Online, March 17-18, 2007; Bureau of National Affairs, R. Christian Bruce and Rachel McTague, 03/14/07; American Banker, Stacy Kaper, 03/15/07; American Banker, Stacy Kaper, 03/09/07*)
- In a House Financial Services Committee hearing, HUD Secretary Alphonso Jackson said he has called on bankers to “go easy” on subprime mortgage borrowers who are having trouble making their mortgage payments. HUD also has asked Fannie Mae and Freddie Mac to look into possible steps that could be taken to assist troubled borrowers. “We’re doing everything in our power, our moral persuasion, to try to keep mortgage foreclosures from occurring,” said Jackson. “We don’t have the powers to dictate to them what they should do,” said Jackson. (*Washington Post, David Cho and Nell Henderson, 03/15/07; Wall Street Journal, Greg Hitt, Sarah Lueck and James R. Hagerty, 03/15/07*)
- As special interest groups and lawmakers began their push for solutions, banking industry representatives urged Congress not to be hasty in their reaction to the subprime industry’s problems. “[Congress] could actually make the situation worse” if lenders are forced to abandon certain types of mortgage loans which consumers may need to use to refinance their loans in a weak housing market, said Anne Canfield, executive director of the Consumer Mortgage Coalition. “The industry itself is self-correcting.” (*Wall Street Journal, Greg Hitt, Sarah Lueck, and James Hagerty, 03/15/07*)

- In an appearance on CNBC's *Kudlow & Company*, host Larry Kudlow interviewed Alex Pollack, a resident fellow at the American Enterprise Institute and former president of the Federal Home Loan Bank of Chicago. Kudlow asked, "Don't people have the right to make a mistake [by purchasing subprime mortgages]? Don't they [the lenders] have the right to go bankrupt, for heaven's sake?" Pollock responded, "They surely do on both sides of that equation. The lenders have a right to take a chance on a risky loan if they think it'll work, and the borrowers have the right to take a chance, they think they can own a house by taking on risky debt. And, of course, when that happens, sometimes you're going to get to the end of the cycle and there'll be a lot of mistakes, and then we'll get a bust like we got now. ...As you know, markets tend to overshoot upside and downside, but they've already reacted, are reacting now with tightening in every element of the subprime market. So we're going to get a liquidity squeeze." Kudlow asked, "Is today's situation in your opinion anything like it was in 1989 through 1992 where we really had a full-bore credit crunch?" Pollack responded, "Not--no. We don't have the broad spread credit crunch, and, of course, as you look over history, we get some kind of a--of a bust like this every decade or maybe more than once a decade, but this one, at the moment is in the subprime sector. The subprime mortgage sector had a boom, along with the house price boom, and it's now having a bust, and there is an interesting debate about whether that'll spread, whether that comes up the market to the so-called Alt-A intermediate credit level, which it may. At the moment it's pretty serious, but I want to come back to your point, if I can. If you want to have long-term growth, that is to say a trend line, where everybody is getting better off, you have to let people be free to make their own decisions. And when they're free to make their own decisions, sometimes you get booms and busts." (*CNBC's Kudlow and Company*, Alex Pollock, 03/12/07)
- In discussing the woes of the subprime mortgage companies that did well in the housing boom on CNBC, Countrywide Financial Corp's chairman and CEO Angelo Mozilo said, "You don't know who is swimming naked until the tide goes out." (*American Banker*, Marc Hochstein and Harry Terris, 03/15/07)

A unique viewpoint and voice of sanity
on how to handle the subprime mortgage market crisis

- In a March 16th article in the *American Banker*, Joseph A. Smith, the North Carolina Commissioner of Banks, wrote, “The ongoing stress test of the U.S. mortgage market, particularly its subprime sector, is a matter of concern to the financial sector and - given the importance of housing to our overall economy - the general public and policymakers. As the mortgage market works through this test, lenders, securities firms, regulators, mortgage firms, and legislative bodies have some decisions to make about how to respond. Such decisions will be best made if we think and speak clearly about the problem.”
- “First, we need to understand how we came to this pass. Advances in information and communications technology have revolutionized the mortgage market. Before the revolution, mortgages were made by depository institutions (generally savings and loans) that held the loans on their books. There was a unity of risk and reward. Today mortgages are made in a complex network, funded by capital markets, sold by an array of originators, and touched by many hands, such as servicers and securitizers.”
- “The revolution has brought with it a number of good things: a vast flow of liquidity into the mortgage market, increased availability of mortgage credit, and higher rates of homeownership. It also has brought moral hazard, as evidenced by the significant increases in fraud and foreclosures.”
- “Controls that were in place to govern the market have been overwhelmed by the requirements of a commission-driven origination system and a securitization machine built for volume. In a contest between the animal spirits of capitalism and the market’s control environment, the animal spirits of capitalism were a clear winner, particularly in the subprime sector.”
- “Market conditions have changed, and the stress test has begun. Default rates far exceed past experience, and the expectations of investors have soured. Changes in the yield curve and real estate values have reduced or eliminated refinancing as a prop to the market. A number of subprime originators have gone out of business, and the largest subprime lenders have undergone substantial capital adjustments. Because of risk dispersion through derivatives, it is not yet clear what the ultimate extent of the damage will be and who will feel it. Market participants are worried and for good reason.”
- “Before considering the next steps, it is important to limit or remove from the public discussion a number of concepts that are profoundly incorrect and misleading:”
 - “Regulators have clamped down. This statement is, at best, a distortion. Federal bank regulators, to their credit, have done what the market’s control environment

- should have done but did not do: pointing out that loans should be underwritten to give reasonable assurance of repayment. More importantly, companion guidance has been issued by state regulators of the mortgage brokers and non-bank lenders that originate the majority of the loans that feed the securitization market. High-income folks, who were the original market for nontraditional mortgages, need not fear this guidance; their ability to leverage their assets through sophisticated mortgage products remains unimpaired. Comparable loans to the unsophisticated and vulnerable will not be so easy to come by.”
- “The mortgage market is in a credit crunch. No, it is in a confidence crunch. The triumph of the animal spirits over the weak and ineffective controls imposed by capital markets has led to pain among those who bought or retained the risk of loss of the underlying loans. This pain has led to an understandable reluctance to allocate more money to the mortgage market until it returns to sanity.”
 - “Inhibiting the subprime market denies low- and moderate-income people the American Dream. This isn’t so. The American Dream is life, liberty, and the pursuit of happiness. Temporary shelter in a house you cannot afford is not happiness; it is a delusion. When subprime borrowers get the education they need, the opportunity to repair their credit through personal self-discipline and thrift, and mortgage products they can understand and afford, true happiness will be in view.”
 - “Having cleared the air, what do we do? First, we should let the stress test proceed to its conclusion and see how the market responds. **It would be best for government agencies and policymakers to let market participants recognize losses, reform their control mechanisms, internalize the lessons learned, and deal with the personnel who caused this mess.** [Emphasis added.] Market participants should do what they can to repair the damage that improvident lending has done to borrowers, as well as to neighborhoods and localities where foreclosures are rampant. If the market’s response is not satisfactory, legislators and regulators will need to step in to deal with it.”
 - “Second, we should continue to build a regulatory framework that will support the industry cleanup and restore investor confidence in the market. The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators are creating a coordinated national clearing house for the licensing of mortgage originators and a database to identify and track bad actors among originators. This effort is intended to facilitate the coordinated regulation of non-bank mortgage lenders and brokers that will give the industry a tool for self-regulation. The effort deserves support and time to work.”
 - “Finally, we should view the stress test as an opportunity to develop a principles-based regulatory scheme that reduces the paperwork associated with mortgage transactions and replaces it with understandable principles of conduct on which consumers and mortgage buyers may rely. The current morass of

mortgage-closing documentation is cumbersome, incomprehensible, and ineffective. If we try, the government and the mortgage industry can reform the lending process to be understandable, fair, and efficient.”

- “The American retail mortgage market is a dynamic, creative, and efficient source of funds for an essential public purpose: homeownership. The market’s recent stress test is an opportunity to streamline, simplify, and improve it. This stress test, like other crises, is an opportunity in working clothes.” (*American Banker*, Joseph A. Smith, Jr., 03/16/07)

GSEs take the credit risk out of their investors’ investment decision

- During a roadshow in Hong Kong, Freddie Mac executive vice president Patricia Cook said that Asian investors’ interests in MBS has grown, while their concerns about problems in the subprime segment of the U.S. mortgage market have focused on the implications for the national economy rather than credit quality of the securities. “Those [in] that area investing in our securities don’t need to worry about the direction of the U.S. housing market because that’s what government-sponsored Freddie Mac handles. We take that credit risk out of their investment decision.” (*The Standard* [China], Winnie Pang, 03/05/07)

Florida’s residential real estate market may be more at risk than rest of the country due to its overstock of spec units

- During a March 12th question and answer session with senior executives of a equipment leasing and finance, Fannie Mae president Daniel Mudd said, “The one [state] that worries me is actually here [the State of Florida], where you have an awful lot of spec building. And it was built for spec, in a lot of cases, to be investor properties flipped into condos. They’re not going to flip into condos; ...they will turn into rental units. If they turn into rental units, in order to get them rented out, rents will have to drop. And when those rents drop, it means people say, ‘Geeze, I can rent this place for \$300...a month or I can get a mortgage at \$1,000 a month.’ And then home prices will start to come down. Florida’s got a ways to work through.”
- Mudd also mentioned southern California, the Northeast and parts of Michigan as potential problem areas. Mudd said, “We have kind of a heat map of the country, a map of the 50 states. And there are algorithms and data pulls that go all the way down to the zip code level and then they feed up. And the nature of the algorithm turns out, historically, that if the growth in appreciation exceeds and outstrips the neighboring areas, they are subject to a downfall. So if you blip out of that algorithm, your area turns red on my map.” While southern California and the Northeast are “red” on Fannie Mae’s map, Mudd said, “[In these markets,] ...there is limited availability of land. You’re hemmed in by water; you’re hemmed in by zoning. There’s a relatively good economy, and I think they’ll work themselves out in a

graduated way.” Although problems in the auto manufacturing industry have resulted in slumping home prices in the Midwest, economic dislocations have been outpaced by falling income levels, said Mudd.

- When asked during the session about subprime lending, Mudd disputed statements that subprime loans amounted to predatory lending practices, but acknowledged that rate resets are a problem. He argued that subprime mortgage loans are here to stay. “My own view is there are subprime borrowers. If there’s not subprime lending, then subprime borrowers aren’t going to be able to buy a home, right? And there are a lot of people who are teachers, firefighters, ..whatever. The subprime market is full of people that you want in your community, right?” Mudd added, “I don’t think everybody should buy a home. Buying a home could be the worst thing for a lot of people who have, you know, volatile income, or whatever, and all of a sudden get into 30 years of fixed mortgage payments.” Mudd said.
- Lenders who face defaults from subprime mortgages have only themselves to blame, Mudd added. “At the end of the cycle, people get insane about chasing market share, and in order to keep their market share they don’t price their risk and they get sloppy about their underwriting. And these guys that are going down are paying the price for that.” Mudd acknowledged that unscrupulous lenders can take advantage of borrowers and can lock them into problem loans. “People are getting slipped [a document to sign] in and they don’t understand that, literally, their monthly payment with a reset can go from \$300... to a thousand bucks. And if you try to get out of that, by the way, you’ve got to pay us \$5,000.... Do they know that? No. They just want their damn keys. And that puts them at a very inequitable situation at origination. So, is it a problem? Yes, it’s a problem” (*Bureau of National Affairs*, Drew Douglas, 03/14/07)

Former House Financial Services Committee chairman Oxley joins Baker Hostetler
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- Michael G. Oxley, former chairman of the House Financial Services Committee, joined the Washington, DC office of Baker Hostetler, effective March 12th. Oxley will serve the firm’s clients and will develop his own public policy practice in the areas of corporate counseling, financial services and capital markets. Oxley, who will earn “upward of \$10 million” according to the *New York Post*, is bringing with him to the firm two long-term staffers: former chief of staff James Conzelman and press secretary Peggy Peterson. (*American Banker*, Stacy Kaper and Joe Adler, 03/12/07)
- On March 16th the Nasdaq Stock Market announced Oxley’s appointment as its non-executive vice chairman. He will work with Nasdaq’s listed companies and act as the Exchange’s Washington “presence” on public policy issues. (*Wall Street Journal*, Alistair MacDonald, 03/16/07)

Fannie Mae

In memoriam

- On February 23, Féde Lourdes Morales Marks passed away at Reston Hospital Center. Marks, 51, was formerly Fannie Mae's vice president of public policy for housing and community development, where she led the company's anti-predatory lending efforts, managed several information service groups, and ran the homebuyer education initiative. Following ten years of service at Fannie Mae, Morales retired in December 2006. Morales was also an active member of Fannie Mae's Hispanic Employee Networking Group, past president of the Hispanic Bar Association of the District of Columbia, a member of the board of directors Ayuda Inc., a nonprofit legal clinic for low-income Latinos and immigrants. Prior to her service with Fannie Mae, Morales served in the Clinton Administration as the deputy assistant secretary for financial institutions policy in the Treasury Department from 1992 to 1996. (*Washington Post*, Louie Estrada, 03/06/07)

Fannie Mae provides its largest credit facility commitment of \$725 million

- Collateral Real Estate Capital LLC (CREC), headquartered in Birmingham, AL, has provided a \$725 million credit commitment for senior housing, the largest transaction of its type financed by Fannie Mae. CREC has funded \$686 million of the commitment and Fannie Mae purchased the loan, secured by 25 senior facilities in six states. "Thanks to the strong partnership between Fannie Mae and [CREC], we were able to provide the largest credit facility commitment in Fannie Mae's history," said Heidi McKibben, Fannie Mae's vice president of multifamily production. CREC is one of the nation's largest privately held commercial real estate lending and mortgage banking firms. (*Birmingham News*, Sherri C. Goodman, 03/15/07)

Citibank purchases from Fannie Mae a \$676 million portfolio of low income housing tax credits

- Citibank, N.A. has purchased from Fannie Mae a portfolio of investments representing approximately \$676 million in federal Low Income Housing Tax Credits (LIHTC) for cash plus the assumption of Fannie Mae's capital obligations relating to the investments. The portfolio consisted of Fannie Mae's investments in 12 funds owning 382 LIHTC properties with a total of 31,050 units that provide rental housing for low-income households. (*PR Newswire*, 03/16/07)

Freddie Mac

Freddie Mac to announce its FY2006 earnings on March 23

- On March 23, Freddie Mac will release its quarterly and full-year results for the year ended December 31 before the market opening of the NYSE and will hold a investors conference call at 8:30 a.m. EDT on that date to discuss the results. (*Freddie Mac Press Release, 03/14/07*)

Freddie Mac chairman and CEO Syron says the GSE is “still in the process” of complying with an OFHEO order to split its top management positions

- In an interview with *American Banker*, Freddie Mac chairman and CEO Richard Syron said that his company is still in the process of complying with OFHEO’s order to separate its chairman and chief executive officer positions. “One of my responsibilities is to find a new CEO. We’re coming along in the process of that. After that happens, I would remain the executive chairman,” said Syron. Last November, OFHEO issued guidelines calling for the chairman and CEO positions at the GSEs to be separated. Syron continued to voice support for Freddie Mac’s COO Eugene McQuade to succeed him. He said, “Gene has done a terrific job. He’s brought a lot of discipline to the place. He has a deep understanding of the role and I think he’s the person.” If McQuade is not named CEO by September 1, his contract allows him to leave Freddie Mac with a generous severance package. (*American Banker, Cheyenne Hopkins, Steven Sloan, and Joe Adler, 03/05/07*)

Freddie Mac and Wachovia Multifamily issue \$5.6 million in forward commitments as part of HOPE VI revitalization project in Atlanta, GA

- Freddie Mac teamed with Wachovia Multifamily Capital to issue approximately \$5.6 million of forward commitments to fund two 30-year permanent loans for two multi-family buildings that are a part of the HOPE VI revitalization of an Atlanta, GA public housing property. The combined project costs for the two properties total \$36 million. (*Freddie Mac Press Release, 03/12/07*)

Federal Home Loan Banks

The FHLB-Atlanta pays its former president \$850,000

- According to a filing with the SEC, the FHLB-Atlanta will pay \$850,000 to its former president and CEO, Raymond Christman, for severance and continued consulting work. Christmann, who resigned in January, will be paid a \$730,000 severance package, payable in four installments over a nine month period beginning in March, and \$120,000 for consulting work Christman will perform for the Bank. According to the *American Banker*, “The 56-year-old executive reportedly stepped down because he was unhappy with the direction of the Home Loan Bank System.” (*American Banker*, Steven Sloan, 03/09/07)

FHLB-San Francisco elects James Burr to the board directors

- The FHLB-San Francisco board of directors has selected James F. Burr to fill a vacant position on the Board, effective March 30, 2007. Burr, the EVP and Treasurer for World Savings Bank in Oakland, CA, fills the seat vacated by Michael Roster, who resigned effective February 5, 2007. (*FHLB-San Francisco Press Release*, 03/14/07)

FHLB-Cincinnati announces plans to “revive” its American Dream Homeownership Challenge

- The FHLB-Cincinnati has announced plans to resume funding its American Dream Homeownership Challenge, which helps households recover from natural disasters. The Bank said it will dedicate \$3 million to this voluntary program, which it suspended last year because of the Federal Housing Finance Board’s consideration of a proposed capital rule that would have required the Bank to raise at least \$109 million of retained earnings. (*American Banker*, Steven Sloan, 03/08/07)

Ginnie Mae

Subprime mortgage woes may revive FHA reform

- Rising problems for lenders and borrowers in the subprime mortgage market may bolster efforts to streamline the FHA program and make it a more attractive alternative to subprime lenders. On March 15, a coalition of community groups called upon the Bush administration and Congress to permit the FHA to refinance loans of defaulting subprime borrowers, who are in danger of losing their homes. John Taylor, president of the National Community Reinvestment Coalition [an advocacy group that promotes fair lending practices], said the agency wouldn't necessarily have to purchase the defaulted loans, but would act as guarantor or services of the loan. Taylor said, the majority of the loans would remain in private hands, but lenders would be more confident that they "own a loan that's being paid on instead of one they have to foreclose on." Senator Hillary Clinton (D-NY) told the NCRC that FHA lending limits should be increased in high cost areas and outlined a series of proposals aimed at increasing consumer protections. "This market is clearly broken, and if we don't fix it, it could threaten our entire housing market," she said.
- HUD Secretary Alfonso Jackson told a House panel that he is convinced that the best way to "cure" the serious problems in the subprime mortgage market is to pass FHA reform which will allow lower-income homebuyers to obtain safer, more affordable loans. "I am convinced that this is the best way to save [those homebuyers]." In testimony before a congressional panel, Federal Housing Commissioner Brian Montgomery said that FHA was able to keep 75,000 borrowers who went into default in their homes through various workouts in 2006. He estimates that approximately 60% of loans in default are able to remain in their homes through such workouts. As a result of the agency's workout efforts, the FHA's foreclosure rate was 2.19% in the fourth quarter, compared to 4.53% for subprime mortgages.
- In testimony before a Senate subcommittee on housing, the National Association of Realtors called on Congress to enact legislation allowing the FHA to "conform to the nation's mortgage environment and reflect the consumers' needs and demands." NAR spokeswoman Joanne Poole said, "Because the FHA has not changed with the times and has remained stagnant, a growing number of homebuyers are deciding to, or being forced to, use one of several types of nontraditional mortgages. It is not hard to imagine a lessening of those risky products and therefore a lowering in the rising number of mortgage delinquencies, if FHA had an effective alternative to offer them."
- If FHA reform is not passed by Congress, the agency will raise its mortgage insurance premiums, Federal Housing Commissioner Brian Montgomery told Senate appropriators. As a fallback position, the FHA commissioner testified that he will raise the FHA upfront premium from 150 basis points to 166 bps and its annual 50-bp

premium by a few basis points. Senator Christopher Bond (R-MO) said he is skeptical that the regulatory reforms will increase FHA revenues, and doubts that HUD could implement the reforms fast enough to avoid a premium increase in fiscal year 2008. “As you know, HUD does nothing quickly,” said Bond. MBA chairman John Robbins said the FHA could quickly regain a 10% market share if the reforms are passed, which would generate \$3 billion in new revenues. Senator Patty Murray (D-WA), chairman of the Senate HUD appropriations subcommittee, said, “We need to work to make sure the FHA is strong and effective,” but added she does not want the FHA to adopt risky subprime practices such as no-downpayment loans. (*Wall Street Journal*, Kemba J. Dunham, 03/16/07; PR Newswire, 03/15/07; *MortgageWire*, 03/15/07; *National Mortgage News Online*, March 17-18, 2007)

Farm Credit System / Farmer Mac

FCA issues guidance on nominating committee procedures for the FCS

- The FCA board of directors has approved revised procedures for the nominating committees for FCS banks and associations. The procedures reaffirm the requirements for impartiality in the nominating committee process; discuss the procedures for identifying and electing members to the nominating committee; explain the duties, responsibilities, and authorities of the nominating committee members; and review the permissible involvement of directors, officers, employees and agents with respect to the nominating committee and the director nomination process. (*US Fed News*, 03/08/07)

ICBA calls on Congress to make FCA “more independent and transparent”

- In March 12th testimony before the Committee on House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, The Independent Community Bankers of America president Mike Menzies said, “Since Congress is now debating significant regulatory reforms to the regulatory oversight of Fannie Mae, Freddie Mac and the [FHLBs], it is a good time to look at the oversight of another GSE, the Farm Credit System. Unlike the other GSEs under discussion, the Farm Credit System engages in direct retail banking activities, competing directly with community banks. We have seen the Farm Credit System engage in significant mission creep and it clearly needs a stronger regulator to ensure that it is adhering to its Congressionally-mandated mission. The regulator of the Farm Credit System must be made more independent and transparent, with enhanced risk assessment capabilities. The Farm Credit System is engaged in many of the complex financial transactions that the other GSEs engage in and the regulator must have the ability to ensure they are conducted in a safe and sound manner. The

[FHLBs], Fannie Mae and Freddie Mac now must register stock with the SEC, so too should the GSE Farm Credit System. ICBA has communicated these views to the House and Senate Agriculture Committees and strongly urged them to address these issues. This issue is especially important in a year such as this when Congress is considering renewal of the farm bill. We expect the Farm Credit System to attempt to expand into non-farm lending through this legislation. ICBA commends the leadership of this committee for your letter to the leadership of the Agriculture Committee highlighting this potential expansion into lending under the Financial Services Committee's jurisdiction. We will continue to work with you on this issue." (*CQ Congressional Testimony*, Statement of Mike Menzies Vice Chairman ICBA President, 03/12/07)

Farmer Mac reports net income of \$29.8 million for FY2006
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- Generated from a new-business volume of \$3 billion, Farmer Mac earned net income of \$29.8 million or \$2.68 per share for FY2006, down from \$47.0 million or \$4.09 per share in 2005. For the fourth quarter, Farmer Mac's net income totaled \$7.6 million (\$0.70 per share), compared with a net loss of \$11.9 million (\$1.04 per share) for the corresponding period 2005. "Farmer Mac's record business volume for 2006 was attributable principally to its marketing strategies focused on large, high-asset-quality program transactions, backed by increasing numbers of mortgage loans on farmers, ranchers, and rural homeowners," said Henry D. Edelman, Farmer Mac's president and CEO. "These transactions achieve greater protection for Farmer Mac against adverse credit performance, with commensurately lower compensation for the assumption of credit risk and administrative costs, resulting in projected risk-adjusted marginal returns on equity approximately equal to those of other Farmer Mac transactions." (*Freddie Mac Press Release*, 03/15/07)

Postal Service

Postal rates set to increase May 14th

- The Postal Service’s Board of Governors (BOG) agreed to accept the recommendations of the Postal Regulatory Commission (PRC) regarding the pending rate case, which will increase the cost of a first-class stamp to \$0.41 effective May 14th. The BOG also approved the proposal to create “forever stamps,” which will always be valid for mailing regardless of postal rate increases. The BOG has asked the PRC to reconsider its rate proposals for standard mail flats (generally used for catalogs), Priority Mail flat-rate box, and surcharges for large items not sorted by machines is too high, which the BOG felt were too high. The BOG also voted to enact rate increases for newspapers and magazines on July 15th to provide mailers time to update their computer software for the new postage rates. (*Associated Press*, 03/19/07)
- In a letter to the USPS BOG, American Postal Workers Union President William Burrus wrote: “I am writing on behalf of the American Postal Workers Union, AFL-CIO (the APWU), to urge the Governors to approve the Recommended Decision of the Postal Regulatory Commission in Docket No. R2006-1 (hereinafter ‘Recommended Decision’). The APWU has participated actively in this rate proceeding as an intervenor. Our particular concern in this case is the manner in which discounts are established for workshared First Class mail. On that issue, the Recommended Decision is fundamentally correct and should be approved by the Governors.” (*Correspondence to the Board of Governors of the U.S. Postal Service*, William Burrus, President of the American Postal Workers Union, AFL-CIO, 03/08/07)
- In a March 9th editorial, the *Jackson Citizen Patriot* [Jackson, MI] wrote, “If, as we suspect, a new round of postal-rate increases is inevitable, it’s time for a reminder: Price and service. You can’t have one without the other. If patrons must pay more for postal delivery, let there be compensating improvements in delivery. It has only been a year since the last round of rate increases. In January 2006, the cost of a first-class stamp went up from 37 to 39 cents. Now, barely 14 months later, the Postal Regulatory Commission has proposed some new increases... Perhaps more of immediate interest, there is a rising tide of impatience with unsolicited mail. Postmaster General John E. Potter recently cited this as a reason to be cautious in raising rates. As of February, 10 states had introduced legislation providing for a do-not-mail registry similar to the federal do-not-call list. ...The postal service is dealing with a new clientele these days. Feisty enough to enact such laws, these customers are not in a rate-happy mood. Nor are we. For all the improvements to service that automation and centralization were to have brought, it is still not uncommon to see examples of letters sent from Point A in Jackson to Point B across town, taking days

to arrive. Service is the key. If it improves, a rate increase may be warranted. But year after year with the same old problems prompts us to dig in our heels and say ‘no way’ to yet another postal rate increase.” (*Jackson Citizen Patriot*, 03/09/07)

- The *Kansas City Star* noted, “Drip, drip, drip: For every penny increase in the price of mailing a letter, Americans will pay an additional \$800 million.” (*Kansas City Star*, Rick Montgomery, 03/11/07)

Postmaster General Potter warns that postal reform legislation will
“bring about a lot of change”

- In a March 1st speech, Postmaster General John E. Potter made it clear that he has some serious concerns about how the Postal Service will operate under the Postal Accountability Enhancement Act, signed into law by President Bush on December 20th. “What the law lays out for the Postal Service is not an easy lift by any stretch of the imagination,” said Potter during a panel discussion at American University’s seminar on postal reform. Three separate times Potter voiced his concerns about the difficulties that the Postal Reform will face under the new law. Potter added, “It’s a huge opportunity, but one that’s not easy. I’m not going to go into a lot of detail other than to say that this law is going to bring about a lot of change. He did not discuss what worries him about the new postal reform law. Potter also expressed concern about “do not mail list” legislation pending in ten state legislatures. (*Linn’s Stamp*, Bill McAllister, 03/15/07)

TVA

TVA Caucus holds its first session in the 110th Congress

- On March 5, the TVA Caucus received testimony from TVA chairman Bill Sansom and CEO Tom Kilgore concerning the agency’s strategic plans and current matters affecting the TVA region. Senator Lamar Alexander (R-TN), Caucus co-chairman, said, “There’s a lot that’s right about the TVA: its reliability, for example, and its willingness to be a pioneer in the area of nuclear power. Now we want to give the new board a chance to complete the development of a strategic plan that will assure low-cost, clean power for the next generation.” Sansom told the panel that TVA expects power demand to grow 2% annually. The agency is looking at additional power supplies, particularly nuclear which doesn’t generate the air pollution problems of coal-fired plans, to meet growing power demand. Representative Jim Cooper (D-TN) told the TVA executives, “It seems that we are essentially betting the future of TVA [on expanded nuclear power]. We have to make sure we succeed on this step

because so much is riding on it.” (*Knoxville News Sentinel*, Richard Powelson, 03/06/07; www.thechattanooga.com, 03/05/07)

Senators Bunning and McConnell propose bill to “hold TVA accountable”

- Senators Jim Bunning (R-KY) and Mitch McConnell (R-KY) have introduced the “Access to Competitive Power Act of 2007,” a bill that would allow Kentucky’s electric customers served by TVA to secure less expensive power from other electric suppliers. “All Kentuckians deserve to choose where they buy their power,” said Bunning. “This bill will not only give residents that choice, but it will also create a more competitive environment among Kentucky distributors and allow our businesses and residential consumers to keep more money in their pockets.” McConnell said, “Currently, Kentuckians are being held captive by TVA and are being forced to pay higher rates than those who receive power from other distributors. This is unacceptable, and needs to be changed. The bill ... will allow Kentuckians to have greater access to more affordable electricity. It’s time to hold TVA accountable.” The legislation would give the Federal Energy Regulatory Commission (FERC) the same jurisdiction in relation to TVA that FERC currently has over other public and private utilities throughout the country. This legislation also sets out some of the specific rights of customers who choose to leave TVA and those who want to stay in the system. Kentucky companies served by TVA currently cannot provide their customers with access to Kentucky’s inexpensive power because TVA has refused to provide basic transmission and interconnection services. Under existing law, Kentucky customers cannot go to FERC when they feel TVA is not providing necessary services or negotiating fairly. This legislation will give FERC the ability to review TVA contracts and hold them to the same reasonable standard that applies to other utilities. **The bill also requests that GAO conduct a comprehensive study on the privatization of TVA and analyze the agency’s debt level.** (*US Fed News*, 03/13/07)
- In a March 18th editorial in the *Cincinnati Post*, the paper’s Washington bureau chief Michael Collins wrote, “Kentucky Sens. Mitch McConnell and Jim Bunning ramped up the interstate quarrel this week when they filed a bill that would let Kentuckians who are served by the [TVA] buy more affordable power from other electric suppliers. McConnell and Bunning say Kentuckians are being held captive by the TVA because the utility refuses to provide basic transmission and connection services to other power distributors that want to leave the TVA system for cheaper power elsewhere. Their bill would let Kentucky distributors buy part of their power from the TVA and part from other producers without paying a large financial penalty. It also would place the TVA under the jurisdiction of the Federal Energy Regulatory Commission. Tennessee Senator Lamar Alexander was far from impressed with his fellow Republicans’ bill. He called the legislation ‘short-sighted and misdirected,’ argued it would raise electric rates for all TVA customers and said it would actually

deprive Kentuckians of a future option for reliable, low-cost power. ‘This legislation would effectively destroy TVA as we know it, putting it on a path toward deregulation, privatization and the sale of its assets,’ he declared. (*Cincinnati Post*, Michael Collins, 03/18/07)

Nuclear Regulatory Commission approves TVA’s request to increase
its Browns Ferry Unit 1 generating capacity

- On March 7, the U.S. Nuclear Regulatory Commission approved a power uprate of TVA’s Browns Ferry Unit 1, which if restarted this year as planned, would be the nation’s 104th operating reactor. The Commission approved a 5% increase for the reactor, which has been offline since 1985. In its approval of the uprate, the NRC said TVA must replace turbines and transformers at Unit 1 before increasing the power capacity from approximately 1100 MW to 1155 MW. Currently, 103 nuclear reactors operating in 31 states provide 20% of the nation’s electricity demand. (*UPI*, 03/07/07; *Nuclear Engineering International*, 03/07/07)
- With construction of the Browns Ferry Nuclear Unit 1 99% complete, the full restart of the unit nears, which will mark bringing the first nuclear unit online in more than a decade. (*Marketwatch*, Joe Govreau, 03/16/07)

TVA hires Duke Energy exec as its COO

- The TVA has hired William McCollum, Jr., a group executive and chief regulated generation officer with Duke Energy Corp. with 30 years experience in the energy services business, as its chief operating officer, effective May 1. In his new role with TVA, McCollum will direct the agency’s fossil-power, nuclear and river-system divisions. McCollum replaces William Orser, who has served as interim COO since September 2006. (*Charlotte Business Journal*, 03/13/07; *US Fed News*, 03/12/07)

TVA studies four office sites to serve as its headquarters in Chattanooga, TN

- TVA, the largest employer in Chattanooga, TN, is studying four local sites for possible new offices if the agency’s current landlord does not cut its rental rates, said Terrell Burkhart, TVA’s vice president of facilities management. Burkhart said TVA has signed an option for office space to be vacated downtown by BlueCross BlueShield of Tennessee and is studying sites near Chickamauga Dam and along South Broad Street for a possible new power headquarters. TVA also is continuing to negotiate with the owner of the Chattanooga Office Complex at 12th and Market Streets, where the agency’s operating divisions have been headquartered since 1986, said Burkhart. The agency’s current 25-year lease on its 1.05 million square-foot complex expires in 2011. Burkhart said TVA’s current facility is 40% bigger and its

lease is nearly twice as expensive as the agency wants or needs in the future. TVA is seeking 600,000 square feet of office space in Chattanooga to house more than 2,000 employees in its power headquarters. The agency is expected to pick among its four office options by this summer. (*Chattanooga Times Free Press*, Dave Flessner, 03/07/07)

TVA sells its biomass facility to Masada Resource Group

- TVA has selected Masada Resource Group, LLC to be the successful bidder to purchase the agency's biomass plant facilities and equipment located in Muscle Shoals, AL. (*Statewide News Network*, 03/12/07)

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