

The **GSE** REPORT™

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Major Events

Subprime fallout...

FDIC Chairman, Ohio Governor and Iowa State Attorney General call on mortgage servicers to abrogate their contracts with investors by freezing mortgage rates

House Financial Services Chairman Frank introduces legislation and holds hearing on reforming mortgage lending practices

Senator Chuck Schumer leads charge to increase the GSEs' mortgage portfolio limits

Just "do something..."

A game of chicken?

Treasury Secretary Paulson outlines the role of government in the subprime crisis

House postpones vote on bankruptcy relief for subprime borrowers

Banks' plans for forming a super-SIV fund continue to evolve

Other notes of interest

FDIC chairman Bair, Ohio Governor and Iowa State Attorney General call on U.S. mortgage servicers to abrogate their contracts with investors by freezing mortgage rates

- In an October 19th editorial in the *New York Times*, Sheila C. Bair, chairman of the FDIC, wrote, "There have been many proposals to deal with the problems in the mortgage market. But the best place to begin is by looking at the poor lending standards and weak consumer protections at the root of the problem — in particular, the troubling loans called 2/28 and 3/27 subprime hybrids. They have starter interest rates of 7 percent or more for the first two or three years, and 'resets' that raise rates to as much as 12 percent, causing monthly payments to increase by at least 30 percent. When housing prices were rising, borrowers could sell or refinance their homes to pay off the loans before reset and avoid crippling monthly payments. But this year, as prices have dropped, more than \$150 billion in these loans have undergone reset, and an additional \$300 billion will do so before the end of 2008. Merrill Lynch estimates that if home prices decline by just 5 percent, a quarter of subprime loans may enter default, resulting in losses of almost \$150 billion."

- “A government bailout is not the answer. Bailouts erode market discipline, raising the likelihood of repeat episodes. And efforts to expand refinancing options will help only those borrowers who have enough equity to refinance.”
- “What happens to those who are unable to refinance and cannot afford the rate resets? Most of their loans are managed by firms called servicers. Typically, servicers sit back and wait for people to default, then foreclose and sell the properties. But in today’s troubled housing market widespread foreclosures will only maximize losses for servicers. Renegotiating terms loan by loan is too costly and time consuming. Servicers have modified only one percent of these mortgages that reset in early 2007.”
- “So subprime servicers should take a more standardized approach: restructure all 2/28 and 3/27 subprime hybrid loans for owner-occupied homes in cases where the borrower has been making timely payments but can’t afford the reset payments. Convert these to fixed-rate loans at the starter rate. This would be no bailout. These borrowers would still be required to make their monthly payments — at rates higher than what prime is today. Billions in savings would be generated by avoiding the administrative, legal, marketing and other costs of foreclosure, which can run to half or more of the loan amount. And avoiding foreclosure would protect neighboring properties and hasten the recovery of markets burdened by an excess supply of houses. The mortgage crisis is growing, and the mortgage industry has the ability to help solve much of it on its own. Subprime borrowers need a better deal — one that they can afford.” (*New York Times*, Sheila C. Bair, 10/19/07)
- In a speech at the National Policy Center, Bair said that the Treasury’s mortgage counseling initiative is “all well and good, but I think also servicers need to develop a systematic way of dealing with these loan resets. We don’t have any more time to ramp up on new programs or staff up. The problem is upon us now. These millions of loans are resetting now. It needs to be dealt with in a systematic way.” She added, “Going loan by loan, and trying to reunderwrite, and do a customized restructuring for each and every one is not going to work.” Bair comments underscored again the divide between FDIC and the Treasury Department on how to deal with the payment shock soon to be faced by approximately two million subprime borrowers. (*American Banker*, Joe Adler, 10/15/07)
- In an October 28th editorial, the *New York Times* wrote, “...Fortunately, the Federal Deposit Insurance Corporation has come up with such a solution [to rescue the economy from the worst effects of the housing bust.]. It has made a compelling case for freezing the introductory rates, typically 7 percent or 8 percent, on the most default-prone adjustable-rate loans. To qualify, a borrower would need to live in the home, be current in monthly payments and not yet have faced an increase in the loan’s rate. The plan would remove up to 1.75 million people from the ranks of future defaulters. And most of them will default, if faced with sharply higher rates. Helping those borrowers would free up money to resolve tougher cases: people who

are already delinquent and those who may not be able to afford a loan even if it is modified, and may need help finding alternative housing.”

- “A logical vehicle to further the F.D.I.C. plan is Hope Now, an alliance of lenders, loan servicers and investors formed this month to work on ways to avoid foreclosures, and recently endorsed by the Treasury. What is needed is high-level executive leadership to persuade the group to carry out the F.D.I.C. proposal, and as luck would have it, high-level executive leadership is the forte of the Treasury secretary, Henry Paulson Jr. There is little doubt that Mr. Paulson could achieve a melding of Hope Now and the F.D.I.C. plan. To date, the Treasury has seemed mostly concerned that moving forward in a big way on any front in this complex situation could have unintended consequences. But the consequences of doing nothing substantial are worse, including mass foreclosures that undermine the financial system and impede the markets’ recovery, possibly spawning a recession.”
- “Treasury’s leadership is also needed to cut through the arguments that have impeded forward momentum for too long. A typical reason for inaction is that loan modifications open the door to lawsuits, because it is impossible to alter a loan in a way that will benefit all of its investors. But federal regulators have issued guidelines clarifying those complex liability issues, which, if followed, would allow for widespread loan restructurings without fear of being sued. The F.D.I.C. has a good idea. Hope Now is a good idea too. Together, they could provide real hope.” (*New York Times*, 10/28/07)
- With up to 200,000 adjustable rate loans valued at \$14 billion scheduled to rest at higher rates in 2008 in Ohio, Governor Ted Strickland has called on lenders to be as flexible as possible in modifying subprime loan arrangements and avoid more home foreclosures. Under a proposed compact with the state, Ohio lenders and servicers would be required to submit a monthly report to the Department of Commerce documenting progress on restructured loans and any foreclosures. The compact would remain in effect until a 12-month average of foreclosure filings in Ohio declines for four consecutive months or until Dec. 31, 2010, whichever comes first. If lenders don’t agree to the plan, new legislation putting the compact into law would be an option, said the governor’s spokesman Keith Dailey. (*Associated Press*, 10/10/07)
- James Tierney, a former attorney general of Maine, is working with several current attorneys general on the subprime meltdown. [He also serves as head of the director of the National State Attorneys General Program at Columbia Law School.] In an interview with *Mortgage Insider*, Tierney said, “Attorneys general are approaching this looming [subprime mortgage foreclosure] crisis in a number of ways. Because much of the fraudulent behavior was perpetrated by individuals and companies that are no longer in business, it is difficult for the attorneys general to meet this problem solely by prosecuting fraud. For that reason, attorneys general are focusing on meeting with various members of the lending industry and pressuring them to modify existing loan agreements with individual consumers who are facing the loss of their

homes.” State attorneys general are now stepping up the legal pressure on the mortgage industry to restructure subprime loans to avoid foreclosure. Iowa Attorney General Tom Miller has organized a ten-state task force to meet with mortgage servicing companies and investors to find ways for them to modify more troubled subprime loans instead of foreclosing. Miller’s national effort is driven by the principle that borrowers, lenders, investors, and mortgage servicing companies all have an interest in avoiding foreclosure. “We are appealing to everyone’s enlightened self-interest,” said Miller.

- In an interview *MortgageWire*, Miller said that the state attorneys general will not take a back seat to the Treasury Department’s HopeNow initiative in working with and monitoring the top 10 subprime servicers and their loan modification activities. “We think the Hope Now initiative and our initiative are very complementary,” said Miller, adding that it’s important to have both local and federal people involved in the monitoring. In a letter to Miller, the Consumer Mortgage Coalition said that requiring servicers to work with both the Treasury and States’ initiatives will make them less effective. “We believe that by concentrating our efforts in the HopeNOW Alliance, we will be able to maximize the benefit for the citizens of your state,” wrote CMC executive director Anne Canfield. The top 10 servicers have agreed to work closely with a group of state AGs and banking regulators, Miller told *MortgageWire*. “None of them have indicated they are not going to honor their commitment,” he added. (*Mortgage Insider*, Mathew Padilla, 09/22/07; *Iowa Department of Justice Press Release*, 10/11/07; *MortgageWire*, 10/18/07)
- In *Mish’s Global Economic Trend Analysis*, Mike Shedlock wrote, “...Since when do [mortgage] *service providers* have the authority to reduce interest rates, allow delayed payments, or change loan terms in any way? ... Service providers generally get paid to service loans not make decisions. Yes they do have a stake in the matter, as the longer they service the loan the more they collect. But that typically is the extent of the contract because of obvious conflict of interest issues that would arise if the servicer could change the terms of the loan just to keep servicing it. Real World Example: Some random bank, big or small, makes a mortgage commitment. More often than not the loan is securitized (sold to investors like pension plans, foreign investors, life insurance companies etc). The originator may or may not service the loan but most often not. Typically the servicing is outsourced to an additional party. That party may again outsource it to someone else. Now the Fed [and FDIC chairman] is proposing some second, third or even fourth removed party that services the loan, make ‘loan modifications, defer payments, or a reduce principal.’ The idea is silly given the fact that the servicer may not have the slightest idea as to who owns the loan and likely has no ability (and should have no ability) to modify the terms of the loan because of conflict of interest issues...” (*Mish’s Global Economic Trend Analysis*, Mike Shedlock, 09/05/07)
- In the *Naked Capitalism*, Yves Smith wrote, “...By way of background, an Extreme Measure is a recommendation to take a radical and, upon examination, unworkable approach to a pressing problem. [The latest] Extreme Measures [related to] the US

housing crisis or the credit contraction ... comes from Sheila Bair, chairman of the FDIC, who proposed ...that mortgage servicers freeze all adjustable rate mortgages facing resets at their current rates... This may sound like an elegant solution, since it addresses the problem raised in the *Financial Times*..., namely, that mortgage servicers don't have the staff capacity (or a financial incentive) to renegotiate troubled mortgages, since it's a time-consuming, one-on-one process. Bair's suggestion is a one-size-fits-all approach that would presumably work in many cases."

- "In fact, many of these deals were so dodgy that they were underwater almost from the outset, so this remedy wouldn't be as effective as it might seem. As Dean Baker told us in his 'News Flash: The Problem With ARMs is Not Resets: Most of the news reporting on the subprime meltdown has focused on the problems that borrowers face when their loans reset from low teaser rates to much higher fixed rates. While this is a big issue for millions of borrowers, resetting subprimes are just a single wave in an ocean of bad mortgage debt. This can be seen from the fact that many of the subprimes were seriously delinquent or in foreclosure long before the mortgages reset to higher rates. In an analysis done early this year, the FDIC found that 10 percent of the subprime adjustable rate mortgages issued in 2006 were seriously delinquent (missed three or more payments) or in foreclosure within 10 months of issuance. Since no mortgages had reset at the 10-month point, clearly there were other problems. Either borrowers could not afford even the low teaser rates or they were defaulting because they realized that their homes were worth less than their mortgages. The latter problem will only get worse as house prices continue to decline in response to the glut of housing on the market (the inventory of unsold new homes is 50 percent above the previous record and the number of vacant ownership units is almost twice the previous peak) and tightening credit conditions curtailing demand.'"
- "Hhmm. Bair doesn't seem to know her own agency's data. But that's actually a minor problem, believe it or not. The real problem is that there is absolutely no way that her proposal could possibly be acted upon. The reason is simple. Mortgage servicers have no obligation to borrowers. Zero. Zip. Nada. They are the agents of the investors (technically, the agreement is with the legal entity that holds the mortgages). The only basis for them to do a loan modification is first, if it is permitted by the trust indenture (many restrict 'loss mitigation' mods, the kind that help borrowers) and second, only if it appears likely to improve returns to the investors. If a borrower is having trouble, modifying a loan may merely serve to forestall the inevitable. And in a deteriorating housing market, delay means a foreclosure sale at a lower price."
- "The [*Financial Times*] article notes that banking regulators can't require mortgage servicers to take those steps, but an industry consultant opined that they might do so to forestall legislation. Dream on. The servicing agreements are contracts governed by state law. The Feds can't willy nilly override them. To do so would raise fundamental federal/state law issues, which in turn would lead to years of court challenges."

- “Moreover, what is the basis for this intervention in private contracts? Essentially, this is a forced redistribution from investors to borrowers. Perhaps I am not thinking broadly enough, but I can’t recall a precedent for Congress enacting a law to redistribute the results of contracts executed between private parties. The only basis I know of for the government to take wealth from a private party (aside from taxation or seizure of property obtained by criminal means) is eminent domain, when the government seizes property for public use (although that notion has been strained by cases where real estate has been turned over to private parties for development).”
- “As much as I wish an idea like Bair’s could be put into practice, we need to recognize what it is: an expropriation of investor assets. As such, it will never happen. It faces way, way too many legal obstacles, as well as huge resistance from the securities industry and investor groups. **Anyone worried about the competitiveness of U.S. markets would be dead set against a move like this. Who would ever buy a U.S. security after it was established that the government could rewrite its terms?**” [Emphasis added.] (*Naked Capitalist*, Yves Smith, 10/05/07; *Beat the Press*, Dean Barker, 10/18/07)
- House Financial Services Committee chairman Barney Frank (D-MA) has scheduled a hearing on federal regulators’ efforts to get mortgage service companies to modify loans due to restate to higher interest rates. “We are trying to get the current [mortgage] holders to let people out from under mortgages they can’t possibly meet because foreclosure isn’t in anybody’s interest,” said Frank. This hearing will be held on Friday, November 2nd at 10:00 a.m. (*Associated Press*, 10/22/07; http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht110207.shtml)

House Financial Services Chairman Frank introduces legislation and holds hearing on reforming mortgage lending practices

- On October 22nd, House Financial Services Committee chairman Barney Frank introduced The Mortgage Reform and Anti-Predatory Lending Act of 2007 (H.R. 3915), that would require broad, industry-wide reforms in the ways in which mortgages are offered, securitized and supervised. The 66-page bill would create a national standard for mortgage originators and impose “assignee liability” on investment firms that purchase, repackage and sell mortgages in the secondary market. Under the bill, loan securitizers would not be liable for the loan if they provide borrowers a 90-day remedy, so the mortgage could be worked to conform to standards allowing the borrower a reasonable ability to repay the loan and providing him with a net tangible benefit. Securitizers could also receive a “safe harbor” from such liability by adopting a policy against purchasing questionable loans and conduct due diligence to scrub bad loans. Firms also would have to obtain representation and warranties from the seller that the loans are not predatory. “We believe [this bill] will diminish predatory lending while continuing to support a vigorous mortgage market,”

said Frank. “It creates a national standard for giving mortgages, originating mortgages, which will cover every mortgage originator.”

- Frank’s bill would require brokers and lenders to adhere to a variety of requirements, including a uniform licensing standard and a mandate that they make full, complete and timely disclosures to consumers. While the bill does not require that the originator serve as a fiduciary agent of the borrower, it would prohibit mortgage originators from steering borrowers toward more expensive loans in order to receive higher compensation and would prohibit payment of bonuses known as “yield premium spreads.” The bill also would establish a floor for minimum state licensing and registration standards. If the states fail to enact the bill’s requirements, HUD would later issue rules for originators in those states to act solely in the best interest of the consumer. “We are going to set a federal minimum standard, but we are not going to pre-empt state laws beyond that,” said Frank, who sees his bill as a floor—not a ceiling. He added that while he wants states to go further in developing rules to govern lending standards, he plans to preempt state laws on assignee liability because allowing multiple states to go further would disrupt the secondary market. “There was a reasonable complaint that you could have a real patchwork [of assignee liability], and how would you package a security if you have different levels of liability,” said Frank. “The securitizer liability will be one uniform national standard.”
- The bill also would set minimum standards for mortgages in which borrowers would demonstrate that they have a “reasonable ability” to repay the loan. Under these standards, refinanced loans must “provide a net tangible benefit” to the borrower; escrow accounts must be included in the loan; and originators must make a good-faith effort to verify income. Federal banking regulators will jointly write mortgage rules which spell out the specifics in consultation with the FTC. The bill would prohibit prepayment penalties for subprime loans, as well as single-premium credit insurance and mandatory arbitration.
- Under the bill, the FDIC, the OCC, and the OTS would be responsible for writing the rules and implementing the law, in consultation with the FTC. Frank said he did not include the Federal Reserve in the rulemaking process because he has been unhappy over its supervisory performance under the 1994 Home Ownership and Equity Protection Act. “I frankly have not found this to be high on the Federal Reserve’s list,” Frank said. The bill also would increase the number of loans that would be covered under HOEPA by lowering the annual-percentage-rate trigger from 10% to 8% over comparable treasuries for first mortgages and decreasing the trigger for points and fees in the program from 8% to 5%.
- The mortgage industry has given Frank’s bill a “cool” reception. “We have serious concerns with certain aspects of the legislation,” said Floyd Stoner, an executive director at the American Bankers Association. “Some of our major concerns [about Frank’s bill] relate to increased regulatory burden for federally insured depository institutions, lack of a national standard and the impact on a bank’s ability to provide

products and services—all of which would increase costs and decrease choices for consumers.” Kurt Pfothenauer, the head of government affairs for the Mortgage Bankers Association, said, “We have a national mortgage market, and we need a national standard in order to protect consumers and in order to keep the costs of lending simple and low. When you’ve got one set of rules, you really eliminate picking winners and losers from various business models. You make it harder to gain in the regulatory system. You make it easier to educate consumers and more attractive for investors who can understand one set of rules.” He added, “The uniform consumer protection standard is the minimum we need in order to even consider getting behind this bill. It comes before the conversations about what’s in it.”

- Consumer groups said they could not support Frank’s bill if it preempted state laws, unless the Chairman toughened its standards. “Our feeling is if we are going to have a bill that preempts state law, that bar is pretty high in terms of what we would want to see. We would have to have pretty amazing protections in place for that to happen,” said Janis Bowdler, the National Council of La Raza’s senior housing policy analyst. “From what we’ve seen, I would not put preemption in this bill.”
- Jim Vogel, the executive vice president of research for FTN Financial Securities Corp., said it is hard to gauge exactly what would happen if the Frank’s [safe harbor provision] became law in a rapidly changing mortgage market. “The problem with all these kinds of discussions is that they are layered on top of the thought that the world that used to exist is going to continue to exist, and it’s all just radically changed,” said Vogel. “So now you are going to add a new set of regulations and thought processes on top of a world that’s already undergoing significant change, so you know what you hope will be the outcome, but faced with increased uncertainty — who knows?” (*American Banker*, Stacy Kaper, 10/24/07; *Bureau of National Affairs*, Thecla Fabian, 10/23/07; *American Banker*, Stacy Kaper, 10/22/07; *Los Angeles Times*, Jonathan Peterson, 10/23/07; Damian Paletta, *Dow Jones International News*; 10/22/07; *Congress Daily*, 10/22/07)
- On October 24, the House Financial Services Committee held an all day hearing on H.R. 3915, The Mortgage Reform and Anti-Predatory Lending Act of 2007, in which testimony was provided by regulators, consumer groups and industry representatives. In testimony before the committee, federal regulators cautioned lawmakers to take a balanced approach in adopting legislation in response to problems in the subprime mortgage market. Federal Reserve Board Governor Randall Kroszner said, “It is important that new laws carefully target lending abuses without unduly restraining responsible lending. Getting this balance right is particularly critical now, as many borrowers facing rate adjustments may need to refinance into more affordable loans.”
- Testimony offered by bank regulators illustrated just how complicated striking that right legislative balance might be. While Martin Gruenberg, vice chairman of the FDIC, supported the central thrust of H.R. 3915, including underwriting standards at the fully indexed rate, banning stated-income loans, setting new restrictions on

prepayment penalties, and establishing a “bright line” debt-to-income affordability test, Comptroller of the Currency John Dugan highlighted a series of reservations about the bill. H.R. 3915 would go beyond the federal regulatory standards for subprime mortgages and impose new “duty of care” requirements even in regard to prime loans, said Dugan. “While we support some of these broader standards, others raise significant questions or concerns that we hope will be addressed as the process goes forward,” he testified. Another area of concern for Dugan was the bill’s establishment of a national licensing and registration system covering all mortgage brokers and individual bank employees involved in mortgage origination. Dugan questioned whether such a new compliance burden “is, given existing bank regulations, worth the marginal benefit, especially for community banks.” While the bill’s enforcement mechanisms appear on the surface to be even-handed, in practice it would represent a greater burden for banks, he said. “Because of the existing enforcement provisions in federal banking law, application of the same set of bright-line standards for banks, brokers, and nonbanks in fact would expose banks and their employees to a much wider range of enforcement actions than would be the case for brokers and nonbanks,” said Dugan. Federal Reserve Board Governor Randall Kroszner expressed concerns about the impact that H.R. 3915 would have on the mortgage securitization market. “The securitization market is critical to making resources available to fund home purchases, and great care should be taken to assure that investors and securitization markets can quickly and accurately assess and mitigate the risks, including compliance risks of mortgages sold in this market,” said Kroszner.

- In testimony before the committee, representatives of the lending industry expressed its opposition to the bill. “We believe that HR 3915, as currently drafted, has fundamental flaws that need to be resolved,” said Kurt Pfothauer, MBA’s senior vice president for government affairs and public policy at the Mortgage Bankers Association. Specifically, lenders are concerned that the bill does not preempt most state laws; Instead, the bill would provide a federal minimum standard—the so-called regulatory floor—not a ceiling, said Pfothauer. The MBA also urged Chairman Frank to provide more flexibility in the safe harbors provision. “We strongly recommend that Congress carefully consider the potential impact of these safe harbor provisions before hard-wiring them into law,” said Pfothauer.
- As the hearing unfolded, GOP members voiced strong reservations about Frank’s bill. Representative Jeb Hensarling, (R-TX) said, “We want to dictate the terms of the subprime market ...but when you dictate the terms, you dry up the market.” He added, “Ultimately, we believe that fully informed consenting adults can figure out whether or not they can borrow or loan the money.” Representative Tom Price, (R-GA) said the bill is “a step in the wrong direction.” He added, “Under these proposals, Washington bureaucrats, not borrowers and lenders, will decide who is eligible to obtain a loan.” Representative Ed Royce (R-CA) voiced concern about the bill’s assignee liability provision, which would open up firms to too much legal jeopardy. “If assignee liability is improperly applied, players in the secondary market will simply reject the purchase of loans that expose them to potential liability which

cannot be determined or qualified,” said Royce. “The likely result of that will prevent many creditworthy borrowers from receiving financing and the credit crunch will spread even further.” Representative Spencer Bachus (R-AL) ranking member of the House Financial Services Committee, said, “Our goals should be to correct problems within the sub-prime market without choking off working Americans’ access to credit. This is an important issue, and we need to get it right.”

- Chairman Frank said he plans to markup the bill within two weeks. He noted that Representative Paul Kanjorski (D-PA) has introduced a bill requiring escrows for subprime loans, which may be incorporated into H.R. 3915. Frank emphasized that his initial bill will likely go through a number of changes as committee members weigh the need for reform against the concerns about the impact the bill may in restricting credit to borrowers. “I am also very much convinced that it will not be exactly what’s been introduced,” said Frank. “This is not an area where dogmatic certainty behooves anybody.” Frank said that House leaders will allot time for a House debate of the bill in mid-November.
- Movement of a similar bill in the Senate is less certain. Senate Banking Chairman Dodd has taken a slower approach on his anti-predatory lending bill, by only issuing an outline what he would like to incorporate into legislation. [Dodd’s outline does not include assignee liability.] Mortgage industry consultant and former HUD official Howard Glaser predicted that the bill’s fate could hinge on how much longer the housing slump persists and how the 2008 presidential candidates address the issue. “Democrats will blame the [Bush] administration for failing to anticipate or respond to the housing and mortgage problems,” said Glaser. “So the issue becomes partisan, and the bill gets stuck without bipartisan support.” (*Bureau of National Affairs*, Richard Cowden, 10/25/07; *Dow Jones Capital Markets*, Brian Blackstone and Damian Paletta, 10/24/07; *CongressDaily*, Bill Swindell, 10/24/07; *CQToday*, Benton Ives, 10/24/07; *Los Angeles Times*, Jonathan Peterson, 10/23/07; *MortgageWire*, 10/25/07)

Senator Schumer leads charge to increase the GSEs’ mortgage portfolio limits

- On October 16, House Financial Services chairman Barney Frank introduced a bill (H.R. 3838) to “temporarily increase the portfolio caps applicable to Freddie Mac and Fannie Mae, to provide the necessary financing to curb foreclosures by facilitating the refinancing of at-risk subprime borrowers into safe, affordable loans.” (US Fed News, 10/19/07)
- Senator Chuck Schumer (D-NY), chairman of the U.S. Congress Joint Economic Committee (JEC), released a report analyzing the greater financial impact of the subprime foreclosure boom. In a press release, Schumer said, “State by state, the economic costs from the subprime debacle are shockingly high. From New York to California, we are headed for billions in lost wealth, property values, and tax revenues. The current tidal wave of foreclosures will soon turn into a tsunami of

losses and debt for families and communities. The administration must act quickly to save financially-strapped families from drowning in this flood of subprime foreclosures.” Senator Amy Klobuchar (D-MN), said, “In the world of subprime lending, the chickens have come home to roost. If we are to contain the economic spillover effect of the subprime lending disaster, we must act now.” The JEC report concluded that (1) two million foreclosures of subprime mortgages will occur through 2008; (2) approximately \$71 billion in housing wealth will be destroyed through these foreclosures; (3) more than \$32 billion in housing wealth will be indirectly destroyed by the spillover effect of foreclosures on neighboring properties; (4) states will lose more than \$917 million in property tax revenue as a result of foreclosures; (5) the ten states with the greatest number of estimated foreclosures include California, Texas, Ohio, New York, Michigan, Texas, Illinois, Arizona, and Pennsylvania; (6) in addition to the economic losses on foreclosures, “a 10[%] decline in housing prices would lead to a \$2.3 trillion economic loss.” The report recommendations include (1) foreclosure counseling for subprime borrowers; (2) temporarily increasing the portfolio caps for Fannie Mae and Freddie Mac; (3) increasing the FHA’s ability to refinance subprime borrowers; (3) amending the bankruptcy code to protect families in foreclosure; (4) encouraging more loan modifications and refinancings; (5) waiving tax liability on forgiven debt in restructured loans; and (6) reforming mortgage lending and banning predatory lending practices. (*US Fed News*, 10/25/07)

- In sharp contrast to the JEC findings, the GAO estimated the number of expected foreclosures in the United States at 1.1 million over the next six to seven years. In April, House Financial Services Committee chairman Barney Frank (D-MA) and ranking member Spencer Bachus (R-AL) asked the GAO to conduct this nonpartisan study to shed light on the scope and causes for the surge in mortgage foreclosures. The GAO’s findings do not fit the media template being spun by Democratic lawmakers. (*American Banker*, Stacy Kaper, 10/26/07; *American Banker*, Stacy Kaper, 10/16/07)
- In a conference call with the media, Schumer criticized Treasury Secretary Henry Paulson’s response to subprime crisis, saying the administration is acting “so slowly, haltingly” that it is “falling behind the crisis.” Schumer said, “The GSEs should be used in providing mortgage money. We’re not for a bailout. We’re for a workout [for homeowners facing foreclosure].” He added, “[Events] will force [the administration] to do more. The markets are still worried about the future.” (*Marketplace International*, John Shaw, 10/16/07)
- In a subsequent interview with the *Financial Times*, Schumer said that Treasury Secretary Hank Paulson has been “handcuffed” by President Bush in his handling of the subprime mortgage crisis. “Paulson is in ideological handcuffs,” said Schumer. “Everybody who studies this knows the government should be involved.” Congressional Democrats are pressing for Fannie Mae and Freddie Mac to be given a bigger role to play in helping struggling subprime borrowers who face foreclosure. To date, the Bush administration has opposed the Democrats’ proposal. “This is

serious and getting worse,” Schumer added. “Until the market sees somebody is in charge and making sure this doesn’t get out of hand they are going to continue to get spooked.” (*Financial Times*, Andrew Ward, 10/25/07)

- Senator Richard Shelby, ranking member of the Senate Banking Committee, has said that GSE portfolio legislation is not needed. Shelby spokesman Jonathan Graffeo said, “Rather than spending time discussing an unnecessary and potentially risky expansion of the GSEs’ portfolios, Senator Shelby believes that Congress should instead focus its attention on ensuring that the GSEs are employing all the tools presently at their disposal to help people stay in their homes.” (*CQ Today*, Benton Ives, 10/15/07)
- At the Mortgage Bankers Association convention in Boston, GSE executives said that their firms could be doing more to stabilize the U.S. housing industry if their mortgage caps were lifted. “Clearly, with no cap on the portfolio and no loan limit we could provide more liquidity,” said Patti Cook, Freddie Mac’s chief business officer. Thomas Lund, Fannie Mae’s EVP of single-family mortgage business, agreed, saying that he expects the cap and the capital surplus mandate to be lifted by the company’s regulator as early as the first quarter of 2008, when his firm can demonstrate to OFHEO that it has resolved operational issues that led to the limit. (*Reuters*, 10/15/07)
- While Fannie Mae and Freddie Mac have been lobbying to have their authority to buy more mortgages to help ease the credit crunch, recent information released for both companies show that they weren’t using the authority that they already possess to help troubled borrowers. In September, both companies reduced their mortgage-related investments, widening the gap between their holdings and the regulatory caps on those holdings. In fact, Freddie Mac sold more mortgage-related assets in September (\$19.1 billion) than during any other month in almost four years *and* reduced its commitments for future mortgage purchases. In September, Fannie Mae shrank its mortgage-related investments by \$5.1 billion. A company spokesman declined to answer the *Washington Post*’s questions about the GSE’s mortgage activities. Freddie Mac spokesman Michael Cosgrove said that its reduction in mortgage holdings was partly an effort to ensure that it has the required capital to absorb potential losses. “A lot of it is reflective of the value of the assets in the portfolio,” Cosgrove added. Freddie Mac has announced plans to release its third quarter earnings on November 20th. Industry analysts speculate that Freddie Mac may be selling assets in advance of potential write-downs of mortgage assets to shore up the company’s capital ratios. (*Washington Post*, David S. Hilzenrath, 10/27/07)
- An interview of Freddie Mac chief business officer Patti Cook in the October issue of *Mortgage Risk Magazine* illustrates her company’s approach to the subprime crisis. Cook said, “This year in February when we saw the [subprime] market beginning to come under some stress we said: ‘To provide some liquidity on the primary side, here’s the sort of subprime product we would buy and here’s the price we would buy it at.’ We’re just beginning to see origination practices come in line with that

guidance. So again we have seen a changing profile. Spreads are wider. Subprime is under pressure. ROEs look attractive. We can provide some liquidity. You might ask whether we are willing to rescue certain subprime borrowers at a substantial cost to shareholders. And the answer to that, probably, is no. While we may look at targeted programs that include some subsidy, we will not be the ones to provide a bailout for subprime loans that frankly shouldn't have been made. Today [Freddie's] charter is not in conflict with our shareholders. ...Our chairman and CEO, Dick Syron, a couple of months ago announced that we were prepared to buy \$20 billion in subprime in the foreseeable future. So far we've only done one trade and it was relatively small. The reason is that our customers haven't changed their infrastructure to underwrite to the standards as prescribed. As they come in line with our guidelines we would expect that volume to increase and hopefully meaningfully increase in 2008. It's a matter of getting the machinery adjusted..." (*MortgageRisk Magazine*, Rob Mannix, October 2007)

- In an October 22nd interview on CNBC, OFHEO Director James B. Lockhart, III said that Fannie Mae and Freddie Mac "already have significant flexibility" in their portfolios to provide substantial liquidity to the subprime mortgage market. "Between Freddie and Fannie, they are securitizing over \$100 billion a month. They are also seeing about \$30 billion a month in the run-off of their portfolios, and we actually gave them flexibility about a month ago that amounts to almost another \$10 billion a month. So they have more than enough flexibility within their current structure to provide liquidity to the subprime market in particular." Lockhart added, "They could do, without any changes, something like \$180 billion [of loans] over the next six months, and that's probably more than what's being reset over that period or pretty close to what's being reset. So it's hard to imagine that they would need to do more than that." Lockhart also said allowing the GSEs to make "jumbo" loans above the \$417,000 conforming loan limit could pose a new set of safety and soundness concerns for Fannie and Freddie. "We have significant safety and soundness concerns about their ongoing problems in risk management, controls, systems, and their inability to be timely reporters," he said. "So we think that they shouldn't take on significant new risks, especially ones like jumbo risk that they are not familiar with." The Director also noted that banks are beginning to lend again in the jumbo market. "My view is that a lot of liquidity has come back," said Lockhart. (*Reuters*, 10/22/07; *FXStreet.com*, Pete Kasperowicz, 10/23/07; *Dow Jones International News*, Damian Paletta, 10/22/07)
- In an October 18th speech before the Exchequer Club, David Nason, the Treasury's assistant secretary for financial institutions said, "Unfortunately, the legislative focus now seems to be on lifting the retained portfolio caps put in place by OFHEO. "This is an unfortunate development." Instead, Nason argued that decision affecting the safety and soundness of Fannie Mae and Freddie Mac should be left to its regulator, OFHEO. He also brushed off calls for legislative efforts to reform the bankruptcy laws. "Tinkering with bankruptcy is something that is fraught with some peril," Nason said. "It was a long process to get the bankruptcy legislation through

Congress, and I'm not sure reopening that is something that is going to produce near-term results." (*American Banker*, Cheyenne Hopkins, 10/18/07)

Just "do something..."

- In an October 23rd editorial, the *Wall Street Journal* wrote, "So determined are [Representative] Barney Frank and [Senator] Chuck Schumer to 'do something' about subprime mortgages that they have come up with a proposal that is unnecessary, will do little to help distressed borrowers, and would increase the risk to taxpayers from Fannie Mae and Freddie Mac. Other than that, it's a fabulous idea."
- "Their proposal is to temporarily lift the caps currently in place on the companies' portfolios of mortgage-backed securities by 10%, or about \$140 billion. Fannie and Freddie are then supposed to use that head room to underwrite mortgage refinancings. This is supposed to help distressed borrowers, with 85% of the cash, or some \$125 billion, going into subprime loans. Of course, Fannie and Freddie don't need bigger portfolios to do this, assuming they want to. Fan and Fred don't make loans. They are forbidden from doing so. What they do instead is buy mortgages from banks, bundle them into securities and resell those mortgage-backed securities to investors. This is supposed to drive mortgage interest rates down by adding liquidity to the market."
- "But just securitizing mortgages doesn't require Fan or Fred ever to hold a mortgage on the books for longer than it takes to package and resell it. Fan and Fred hold mortgages in portfolio for an entirely different reason. Their ultra-low, government-subsidized borrowing costs allow them to borrow money cheaply and use the proceeds to buy up mortgage-backed securities to make money on the interest-rate spread. This has little or no effect on the mortgage market or interest rates, but it's great for Fan and Fred's profits."
- "If the companies wanted to underwrite risky subprime loans, they could do it today by adjusting their underwriting standards in consultation with their regulator, [OFHEO]. They don't do that because those loans are, well, risky. Moreover, they are barred by their charters from underwriting any loan with more than an 80% loan-to-value ratio, a fact that the Schumer-Frank bill wouldn't change. This alone would prevent them from riding to the rescue of the borrowers most at risk of foreclosure."
- "Fannie and Freddie have been pushing for an increase in the portfolio caps since the debt markets went haywire this summer. But even they may be given pause by the terms proposed by Messrs. Frank and Schumer. Even if they had the appetite to refinance \$125 billion worth of subprime loans, finding candidates for that much borrowing would prove difficult. So the companies would probably smile, accept the Frank-Schumer terms for now, and then lobby to have the subprime restrictions lifted once the mortgage crisis passes."

- “Finally, ordering [OFHEO] to lift caps imposed in response to multibillion-dollar accounting frauds at both firms doesn’t exactly send a strong message about the need for the duo to clean up their acts. At a time when Mr. Frank claims to want to strengthen the regulator’s powers, this bill would have the opposite effect by showing that [OFHEO] can and will be pushed around by Congress for purposes of political atmospherics.”
- We’ll concede that in at least one respect this proposal is valuable. It illustrates the kind of ill-considered, counterproductive lawmaking that is so typical when politicians are looking to ‘do something.’ (*Wall Street Journal*, 10/23/07)

A game of chicken?

- In *Naked Capitalism*, Yves Smith wrote, “...Now before you decide this [debate over increasing the GSEs’ mortgage caps] is all D.C. gamesmanship, concerns about Fannie and Freddie are valid. Professor James Hamilton in a presentation at the Fed’s Jackson Hole conference in August said a run on Freddie and Fannie was possible, and the best way to forestall it was to restrict growth of their balance sheets:
 - ‘[Hamilton wrote:] Outstanding mortgage debt grew 50% more than [U.S. nominal GDP], raising the debt/GDP ratio from about 0.5 to 0.8. Mortgage-backed securities guaranteed by Fannie and Freddie grew 75% faster than GDP, while mortgages held outright by the two GSEs increased 150% more than GDP. The share of all mortgages held outright by Fannie and Freddie grew from 4.7% in 1990 to 12.9% in 2006, which includes \$170 billion in subprime AAA-rated private label securities. The fraction had been as high as 20.5% in 2002-3. It is hard to escape the inference that expansion of the role of the GSEs may have had something to do with the expansion of mortgage debt.’
 - ‘This acquisition of mortgages was enabled by issuance of debt by the GSEs which currently amounts to about \$1.5 trillion. Investors were willing to lend this money to Fannie and Freddie at terms more favorable than are available to other private companies, despite the fact that the net equity of the enterprises-- about \$70 billion last year-- represents only 5% of their debt and only 1.5% of their combined debt plus mortgage guarantees. If I knew why investors were so willing to lend to the GSEs at such favorable terms, I think we’d have at least part of the answer to the puzzle.’
 - ‘And I think the obvious answer is that investors were happy to lend to the GSEs because they thought that, despite the absence of explicit government guarantees, in practice the government would never allow them to default. And which part of the government is supposed to ensure this, exactly? The Federal Reserve comes to mind. I’m thinking that there exists a time path for short term interest rates that would guarantee a degree of real estate inflation such that the GSEs would not default. The creditors may have reasoned, “the Fed would never allow aggregate

conditions to come to a point where Fannie or Freddie actually default.” And the Fed says, “oh yes we would.” And the market says, “oh no you wouldn’t.”

- ‘It’s a game of chicken. And one thing that’s very clear to me is that this is not a game that the Fed wants to play, because the risk-takers are holding the ace card, which is the fact that, truth be told, the Fed does not want to see the GSEs default. None of us do. That would be an event with significant macroeconomic externalities that the Fed is very much committed to avoid.’
- ‘While I think that preserving the solvency of the GSEs is a legitimate goal for policy, it is equally clear to me that the correct instrument with which to achieve this goal is not the manipulation of short-term interest rates, but instead stronger regulatory supervision of the type sought by OFHEO Director James Lockhart, specifically, controlling the rate of growth of the GSEs’ assets and liabilities, and making sure the net equity is sufficient to ensure that it’s the owners, and not the rest of us, who are absorbing any risks. So here’s my key recommendation-- any institution that is deemed to be “too big to fail” should be subject to capital controls that assure an adequate net equity cushion.’ [Hamilton’s full presentation is available at http://dss.ucsd.edu/~jhamilto/jdh_comments.html.]
- Smith continues, “So let’s return to the general complaint that Schumer made, that Paulson ought to be doing more. I am at a loss to understand what that could be. ...[T]he best, in fact, only viable solution is good old fashioned workouts, which have to be evaluated, structured, and negotiated case by case with borrowers. Fiat solutions of the sort suggested by Shelia Bair of the FDIC are not only impossible to implement from a legal standpoint, but also wildly impractical. They will have the effect of keeping too many otherwise dead borrowers on life support for too long, and by ripping apart the terms of tons of mortgage securitizations, would destroy the willingness of investors to buy that sort of paper for at least a generation.”
- “The Treasury has very limited powers, far fewer than the Fed, and its main role in this mess is via its agencies OFHEO and the [OCC]. By all account, the OCC did a better job than the Fed at keeping an eye on subprime issuance by regulated banks and watching out for predatory lending. The most useful role Paulson could play is by giving his input and support to regulation to prevent future subprime-type disasters. But my impression is that Paulson, like his masters, is opposed to greater borrower protection and tougher rules for securitizations.” (*Naked Capitalist*, Yves Smith, 10/26/07)

Treasury Secretary Paulson outlines the role of government in the subprime crisis

- In an October 16th speech at the Georgetown University Law Center, Treasury Secretary Henry M. Paulson, Jr. discussed the role that government should be taking in the subprime mortgage market and the steps that the Bush administration has taken to date. Paulson noted that the administration’s immediate concern is to help

struggling borrowers whose primary residence is at risk of foreclosure. “I have no interest in bailing out lenders or property speculators,” said Paulson. “Still, we must recognize the very real harms to families affected by the housing downturn.”

- The administration has organized outreach efforts to distressed borrowers needs through the HopeNOW Alliance, which will coordinate efforts to reach out to more home owners to help them find affordable solutions. More steps need to be taken to make more affordable mortgage loan products. The President has called on Congress to pass FHA reform legislation. A revitalized FHA can provide troubled borrowers more affordable loan products. In addition, the President has called on Congress to pass tax relief, which will temporarily eliminate taxes on forgiven mortgage debt on primary residences, which will facilitate mortgage workouts. Paulson said, “Congress should enact these bills as soon as possible.”
- “The GSEs also have a role to play in making affordable mortgage products more widely available. It is their mission,” said Paulson. “The secondary market in GSE mortgage-backed securities is functioning well. The GSEs could increase the flow of mortgage capital to refinance subprime borrowers if they securitized a greater number of these mortgages. To accomplish this, the GSEs must work closely with their private mortgage insurance company partners in the development of new products. The GSEs have additional capacity to help more blemished-credit struggling homeowners and we are hopeful that they will step up to this challenge.”
- Paulson also outlined the public policy issues which need to be addressed to prevent some of the excesses and abuses that have occurred in the mortgage market over the past few years. The Secretary argued that such changes should be made in a “balanced and thoughtful way so as to avoid overreacting and introducing unintended consequences such as those that might shut off credit to able borrowers.” He argued that four key issues need to be addressed: mortgage disclosure, mortgage origination integrity; predatory lending; and assignee liability. Paulson said that the mortgage industry needs to develop simple, clear, and understandable mortgage disclosures that provides borrowers with adequate information to make informed decisions. Secondly, the Secretary said that a higher level of integrity must be developed in the mortgage origination process. “The development of a uniform national licensing, education and monitoring system for all mortgage brokers is worth considering,” said Paulson. With regard to predatory lending, homebuyers must not be subject to unfair and deceptive lending practices. “The Federal Reserve can inject greater uniformity and objective standards into the mortgage process, and I encourage them to do so,” he said. “...We need to strike a careful balance of providing adequate consumer protection without limiting overall credit availability or consumer choice, especially for those who most need that flexibility.”
- Lastly, the Secretary said, “The fourth issue that has garnered attention is whether greater liability should be imposed on securitizers and investors. In my view, this is not the answer to the problem. Imposing broad liability provisions on investors and securitizers would very likely generate significant unintended consequences. It

would potentially paralyze securitization, a process that has been extremely valuable in extending the availability of credit to millions of homeowners nationwide and lowering the cost of financing. Again, balance is critically important. Congress should proceed with extreme caution so as to avoid cutting off investment inflows to the housing market.” (*Treasury Department Press Release*, 10/16/07)

House postpones vote on bankruptcy relief for subprime borrowers

- On October 24th, lawmakers delayed a vote on bill, authored by Representative Brad Miller (D-NC), which would allow U.S. bankruptcy judges to erase billions of dollars in mortgage debt. The brakes are being applied by 16 “Blue Dog Democrats,” a coalition of conservative congressmen who argue that the bill is moving too fast and may be altering the bankruptcy code unnecessarily. In an October 16th letter to House Judiciary chairman John Conyers (D-MI) and Representative Linda Sanchez (D-CA), chairman of the subcommittee on commercial and administrative law, the Blue Dogs wrote, “We respectfully urge you to refrain from moving forward on legislation amending BAPCPA until additional data is available regarding its effects, until its regulatory implementation has been completed, and until the judicial branch has provided greater clarity with regard to the manner in which its provisions are to be interpreted and enforced.”
- In a separate October 16th letter to leadership, eight Republican members of the House Financial Services Committee, wrote, “We should slow the consideration of the Miller bill so that we can benefit from a more full understanding of potential solutions. At this point, consumers and our economy would be better served by a small delay in finding the right solution than acting on a hasty and ill-informed proposal.” The Republicans added, “At a time when the mortgage market is experiencing a serious credit crunch, passing this bankruptcy legislation will increase costs to consumers, further destabilize the mortgage market and hurt the overall economy. Mortgage originators will no longer be sure that the money they lend is truly secure. This uncertainty will require higher interest rates and larger down payments to offset the risk and will push many lenders out of making certain mortgages.”
- Industry representatives and banking companies, including Capital One Financial Corp., Citigroup Inc., JPMorgan Chase & Co., Fifth Third Bancorp, Wells Fargo & Co., and Washington Mutual Inc., have joined forces to oppose the Miller bill. In an October 23rd letter to Chairman Conyers, the group argued that the Miller bill would “decrease liquidity in the markets and increase the cost of owning a home.” (*American Banker*, Steven Sloan, 10/25/07)
- In a Letter to the Editor in the *American Banker*, Chris Stinebert, president and CEO of the American Financial Services Association, wrote, “...the American Financial Services Association and others in the industry have concerns about current efforts to reopen the Bankruptcy Code and give judges the authority to restructure mortgage loans for Chapter 13 filers — a move that will make it far more difficult to originate

or sell loans in the secondary market. If this legislation moves forward, it will have a negative effect on the ability of Americans to obtain mortgages or refinance at a time when maintaining market liquidity is critical.” (*American Banker*, Chris Stinebert, 10/26/07)

Banks’ plans for forming a super-SIV fund continue to evolve

- On October 19th, the *New York Times* reported that the \$75 billion superfund structured investment vehicle (super-SIV) announced by Citigroup, Bank of America and JPMorgan Chase is “struggling to get off the ground” days after its formation was announced by the consortium. While Citigroup, BofA and JPMorgan all back the plan, the group is still hammering out the details and regulators, who are aware of the discussions, say that they are out of the loop. While the group has set up a syndication process to allow other banks to participate in the fund, only Wachovia has publicly announced its plans to join. Executives at Merrill Lynch and Lehman Brothers have expressed an interest in joining, while Morgan Stanley executives have said that they would certainly “consider” participating. Other investors, such as Pimco and T. Rowe Price have balked at buying in, which has puzzled market participants. “Until we know the answers, it is tough to say just how much impact this is going to have,” said Christian Stracke, a CreditSights analyst.”[At this point,] it’s a big mess.”
- “This is just taking money from one pocket and putting it another, with admittedly slightly stronger credit backing,” said William H. Gross, Pimco’s chief investment officer. Gross said the situation reminded him of 1990s, when Japanese banks that refused to sell or write-off troubled loans at distressed prices and U.S. Treasury officials advised their Japanese counterparts in to move swiftly to liquidate their problem debts. Today, Treasury officials are doing the opposite, Gross pointed out. “They are refusing to liquidate assets at market levels, so the problem continues,” he said. “Let’s get this stuff out in the open and find out what the assets are worth.”
- During an appearance on CNBC, former Treasury Secretary John Snow said that while the super-SIV may prevent a fire sale of shaky debt, it may cause more problems by delaying inevitable losses. “We’ve got all this paper out in the system, and my inclination is to say, let’s accelerate the price discovery process on this paper,” said Snow. “We know that when you prop things up artificially—Japan ...[and thrift industry] in the United States—you get bigger adverse consequences.”
- “Continuing to mask transparency by means of rearranging risk without actually offloading or recognizing the true value of that risk is not going to help anyone,” said Joseph Mason, an associate professor of business at Drexel University and a former economist at the OCC.
- The Institute of International Finance (IIF), a committee of top international bankers, issued a statement warning that the super-SIV must be transparent in its pricing of

assets if it is to help restore market confidence. Josef Ackermann, CEO of Deutsche Bank and IIF's chairman, said that while the group welcomes market initiatives such as the superfund, the fund must use of "proper valuations," which will require financial institutions to "take the hits" in liquidating SIV assets. The group added that it was "also important to create the transparency needed to restore confidence."

- In defense of the super-SIV, Secretary Treasury Henry Paulson told *Financial Times*, "The concept is not to buy bad assets [that have credit problems]. The concept is for the end investors working with the banks to buy assets that are not credit impaired." By focusing on the "very best assets," the proposed fund would "accelerate the return of liquidity to parts of this market" for asset-backed commercial paper, said Paulson. "I cannot emphasize enough that this is market driven—100% market driven [with Treasury playing] a convening role and a facilitating role to help participants come together." He added that it should be possible to get the superfund up and running by the end of the year.
- Of the \$325 billion of assets held by SIVs, 44% are mortgage backed securities, 2% of which are in subprime mortgage bonds, and 11% in collateralized debt obligations, according to a September report by UBS AG. The balance of SIV assets consists of company bonds and other asset-backed debt. The lack of trading in MBS securities has made it almost impossible to determine a consensus value of many SIV holdings. On September 28th, the average net asset values of SIVs rated by Fitch fell to 73, down from 100 in July. Citigroup is the largest owner of SIVs, with seven pools totaling \$80 billion in securities, according to the company spokesman, Jon Diat. (*Financial Times*, Krishna Guha, 10/20/07; *Financial Times*, David Wighton and Krishna Guha, 10/21/07; *Reuters*, 10/26/07; *Financial Times*, David Wighton, Peter Thal Larsen, and Paul J. Davies, 10/18/07; *New York Times*, Eric Dash and Gretchen Morgenson, 10/19/07; *Naked Capitalism*, Yves Smith, 10/26/07)

Other notes of interest

- Senator Norm Coleman (R-MN) has introduced the Home Mortgage Emergency Act (HOME Act), which would allow homeowners who are 60 days late in the mortgage payments to withdraw penalty-free up to \$100,000 from the retirement accounts through 2009 for the purpose of refinancing into an affordable mortgage in order to avoid foreclosure. The bill restricts this benefit to joint tax filers with adjusted gross incomes of \$166,000 or less, or single filers with incomes of up to \$114,000. Only mortgages on single-family residences would be eligible. The HOME Act would allow for the withdrawal to be made penalty-free, so long as the it is paid back within three years. (*US Fed News*, 10/19/07; *Washington Post*, Kenneth R. Harney, 10/27/07)
- The House Energy and Commerce Committee is expected to approve H.R. 3526, which would allow the OCC and FDIC to write rules against deceptive financial practices. Currently, only the Federal Reserve, OCC and NCUA have that power.

The bill, sponsored by Representative Barney Frank (D-MA), was approved by a voice vote by the House Financial Services Committee on September 18th. H.R. 3526 was also referred to the House Energy and Commerce Committee, which has jurisdiction over commercial practices. House leadership expects the bill to move quickly to the House floor for a full vote. (*CQToday*, Benton Ives, 10/25/07)

- Representative Dennis Kucinich (D-OH), chairman of the House Government Oversight Subcommittee on Domestic Policy, questions if the limited scope of the Community Reinvestment Act may be responsible for the surging home foreclosures and has asked federal regulators to report back on the need to update the 1977 law. Under the Gramm-Leach-Bliley Act of 1999, new and closer ties between banks, securities firms, and insurers were allowed and affiliate loans were not automatically subject to CRA, he pointed out. “If banks are permitted to avoid compliance with the CRA and people can’t get the loans, they then get thrown into the clutches of subprime lenders—the most predatory of lenders out there—and then they’re going to get destroyed financially and lose their homes,” said Kucinich. “This loophole enables banks to move their assets to non-covered affiliates to reduce their CRA obligations. Has this legal loophole enabled a surging foreclosure crisis? And if this is indeed the case, has Congress allowed the CRA to become obsolete in certain respects?” (*Bureau of National Affairs*, R. Christian Bruce, 10/25/07)
- On October 25th, members of the Federal Reserve’s consumer advisory panel urged the board to ban prepayment penalties and other potentially abusive lending practices. “I urge you to take appropriate measures but not half measures,” said Carolyn Carter, an attorney with the National Consumer Law Center. “Half measures with hope won’t solve these problems.” A number of the council members urged the Fed to require lenders to make sure a borrower has the ability to repay a mortgage loan over the life of the loan, not just at the introductory interest rate. “There has to be a point where you are looking out at if these borrowers can sustain payment on their homes,” said Patricia Hasson, president of Consumer Credit Counseling Service of Delaware Valley Inc. Stella Adams, CEO of SJ Adams Consulting, urged the Fed to focus should be on “safe and sound” lending. “It is irresponsible for the market not to ensure that there can be the consummation of a contract entered into with a borrower,” said Adams. She also urged the Fed to limit or eliminate prepayment penalties. “You are punishing good credit behavior by locking people into the subprime market,” said Adams. (*Dow Jones Newswires*, Michael R. Crittenden, 10/25/07)
- On October 23rd, Countrywide Financial said it would begin calling borrowers to offer loan modifications and refinancing on \$16 billion of loans which are expected to reset by the end of 2008. Countrywide has enlisted the help of one of its harshest critics—the Boston-based non-profit Neighborhood Assistance Corp. of America (NACA)—to assist with the project. Countrywide will pay NACA a fee for every successful loan that results from their joint program. (*American Banker*, Harry Terris and William Launder, 10/25/07;

- In other news at Countrywide, the thrift reported a loss of \$1.2 billion for the third quarter, after booking approximately \$3 billion in credit-related impacts on October 25th. Countrywide's overall loan delinquency rate rose to 7.12% from 4.55% a year earlier. Conventional loan delinquencies rose to 4.41% at September 30th (from 2.57% a year earlier), while delinquencies on prime home-equity loans increased to 5.76% (from 2.52%) and subprime delinquencies rose to 29.1% (from 18.3%). The thrift said its first loss in 25 years will be short-lived, predicting that it will return to profitability in the fourth quarter. The thrift also announced that Henry Cisneros, who served as HUD Secretary during the Clinton administration, has stepped down from its board of directors. (*Wall Street Journal*, Lingling Wei, 10/26/07; *CNNMoney*, Chris Isidore, 10/26/07)
- The meltdown in the mortgage market during the third quarter has hammered the profitability of a wide array of companies in the financial services sector. Merrill Lynch reported a \$7.9 billion charge against its third quarter earnings to write-down the value of its mortgage investments. Bank of America reported a 32% decline in its third quarter earnings and announced its plans to close the bank's wholesale mortgage business and lay-off 3,000 employees. Washington Mutual reported a steeper-than-expected decline in earnings and warned that it is bracing for more difficulties ahead in the distressed housing market. Wachovia reported 10% decline in its third quarter profits, resulting from the bank's \$1.3 billion losses and writedowns related to turmoil in the credit market. According to the *Wall Street Journal*, "damage across Wall Street [related to the subprime mortgage market and related turmoil in the credit markets] has topped \$23 billion" to date. (*CNNMoney.com*, Chris Isidore, 10/26/07; *Wall Street Journal*, Randall Smith, 10/29/07)
- Connecticut's attorney general Richard Blumenthal has subpoenaed Standard & Poor's, Moody's Investor Services and Fitch Ratings Service to determine if the credit-rating agencies are using their dominant position to unfairly raise prices or exclude competitors in violation of Connecticut's antitrust laws. Blumenthal said, "My investigation seeks to determine whether credit-rating agencies may be exploiting their dominant positions to unfairly raise prices or exclude competitors. Assuring debt ratings are honest and untainted is vital to investors, companies and government." The focus of Blumenthal's investigation includes unsolicited ratings, notching [when raters allegedly threaten to downgrade an issuer's debt unless they get a contract to rate the issuer's entire debt pool], and the concept of exclusive contracts. "There are allegations that some raters conduct an unsolicited rating and then demand the issuer pay for it or face a possible poor rating," said Blumenthal. "[Exclusive contracts] may hinder competition by locking out other debt raters." In the *Naked Capitalist*, Yves Smith observes, "...So this is how oligopolies [credit agencies] are maintained—via extortion and threats..." (*Associated Press*, 10/26/07; *Wall Street Journal*, Rupini Bergstrom, 10/27/07; *Naked Capitalist*, Yves Smith, 10/27/07)
- In an interview with the *Wall Street Journal*, William Poole, president of the Federal Reserve Bank of St. Louis, said, "I think the big uncertainty right now has to do with the subprime paper: the extent to which there are owners that are potentially really

stressed and are going to be forced to sell, how strong are their positions, to what extent can they gain financing from other sources so that they don't have to dump assets. They may be convinced that this paper is worth 60 cents on the dollar and they don't want to be forced to sell it at 30 cents on the dollar. I really don't know very much about that, and I suspect that a lot of the people even who run these funds, whose businesses run these funds, don't know exactly where they stand on that and are out there trying to figure out what to do."

- Poole remains concerned about the potential for the subprime problems to spread into other parts of the economy, putting pressure on households that would hurt consumption, and the potential for greater contagion into corporate debt, with some companies already in doubt about whether they can finance projects. "If you look at spreads in the riskier side of corporate bonds, companies that have nothing whatsoever to do with housing have been affected," Poole said. "If that straightens itself out relatively quickly, there won't be any delay — or, say, minor delay — in the business investment that would be financed by obligations of that sort. But if that doesn't straighten out or if the problems deepen, then there are going to be companies forced to curtail or cancel projects that they thought were worth doing and ... would be profitable to do, and that is going to put downward pressure on aggregate demand and cause a general weakening in the economy and output and employment. That's not a forecast; that's a concern." (*Wall Street Real Time Economics Blog*, Sudeep Reddy, 10/22/07)

Fannie Mae and Freddie Mac

OFHEO holds the conforming loan limit at \$417,000 for 2008

- OFHEO director James B. Lockhart, III announced that the conforming loan limit establishing the maximum loan amount that can be purchased by Fannie Mae and Freddie Mac will remain at the 2006 and 2007 limit of \$417,000. OFHEO said that if the index used to calculate the conforming loan limit should rise in 2008, the amount of the increase would be reduced by 0.16% (the decline calculated in 2006). Lockhart also announced that OFHEO has transmitted to the *Federal Register* a revised Examination Guidance for the procedures related to the calculation of the conforming loan limit. The key provisions of the Guidance include provisions that (1) defer for one year a decreases in the limit; (2) require a cumulative total decrease of 3% before a decrease would be implemented; (3) determine that a loan is conforming at the time of origination to provide greater certainty for markets and asset securitization; and (4) round of conforming loan limits to the nearest \$100 for simplification. (*OFHEO Press Release*, 10/16/07)

Editorials urge passage of the national housing trust fund legislation

- In an October 15th editorial, the *New York Times* wrote, “The House took an important step toward easing the affordable housing crisis when it passed a bill that establishes a National Housing Trust Fund. A companion bill, which is expected to be introduced in the Senate soon, deserves to pass speedily into law.”
- “...Modeled on systems long employed by the states, the trust fund would be used to construct, rehabilitate and preserve 1.5 million units of housing over the next 10 years. Three-quarters of the money would be directed at extremely low-income families. The funds would be distributed to local jurisdictions that would award grants to entities that build and rehabilitate housing. The developing parties who receive the money would be required to set aside a proportionate number of units for low-income families. The idea is to create vibrant, mixed-income communities — instead of segregating the poor in isolated developments, as was often done in the past. The fund would require no new taxes. It would run on contributions made by the government-backed mortgage giants, Fannie Mae and Freddie Mac, and with money generated by the Federal Housing Administration, which insures mortgages.”
- “The trust fund bill passed with broad, bipartisan support in the House and deserves the same kind of support in the Senate.” (*New York Times*, 10/15/07)
- In an October 18th editorial in the *Washington Post*, David S. Broder wrote, “The House of Representatives, which has a penchant for spending time on issues such as the Armenian genocide of 1915, actually did something... It passed a bill to create an

Affordable Housing Trust Fund, a measure that, if it becomes law, will add 1.5 million badly needed units in the next decade.”

- “...If it is created, the new fund is expected to have between \$800 million and \$1 billion a year to distribute. The money would come from a 1.2 percent charge on the value of mortgages held by Fannie Mae and Freddie Mac, two government-chartered, privately owned financial agencies, and a similar contribution from the reserves of the Federal Housing Administration.”
- “Some Republicans argued that this is a backdoor way of taxing some home buyers to benefit others, but Frank insisted that no one’s mortgage payments would rise as a result of the bill. The other Republican objection was bureaucratic—an argument that this fund should be made part of another, smaller program already running at [HUD]. But the other program depends on annual appropriations, while this one would have an assured source of money not subject to the vagaries of the congressional budget process.”
- “...The bad news is that prospects for Senate action are uncertain, in part because Senator Chris Dodd of Connecticut, Frank’s counterpart on the Senate’s banking and housing committee, is preoccupied with his campaign for the Democratic presidential nomination. And the Bush administration has warned that the measure could face a presidential veto if it gets that far in anything like its present form. ...The bill creating the Housing Trust Fund passed 264 to 148—26 votes short of the maximum two-thirds majority needed to override a veto but with 23 members absent and uncounted.”
- “Housing is not a sexy issue for presidents or presidential candidates. The House action drew almost no newspaper coverage. But housing is as important to people as food and drink—and life itself. Will the Senate act? Will the president recant? I will keep reporting this story.” (*Washington Post*, David S. Broder, 10/18/07)
- In an October 18th editorial in *The Atlanta Journal-Constitution*, Lyle V. Harris wrote, “Left to their own devices, most private housing developers usually avoid building the kind of homes that low-income Americans can comfortably afford. The profit margins just aren’t attractive enough. Hoping to balance that lopsided dynamic and respond to a legitimate need, the House of Representatives ...passed a bill with bipartisan support to create a National Affordable Housing Trust Fund that would be used to build, rehabilitate or preserve 1.5 million units of below-market rate housing in the next decade.”
- “...Among the goals of the trust fund is to create mixed-income communities where blue- and white-collar workers --- as well as people of different racial and ethnic backgrounds --- have an opportunity to live in close proximity if they choose to do so. As Atlanta’s population grows and changes, fostering diverse communities will require a rare level of collaboration between public housing agencies, private sector developers and nonprofit housing advocates.”

- “While cynics may condemn such efforts as ‘social engineering,’ the U.S. Senate is urged to approve the trust fund as a fiscally prudent and morally defensible method of providing good, low-cost housing for Americans who need it most.” (*The Atlanta Journal-Constitution*, Lyle V. Harris, 10/18/07)

Everything’s relative

- According to *MortgageRisk Magazine*, “Kenneth Posner, an analyst at Morgan Stanley in New York, says: ‘In many respects [Fannie and Freddie] have emerged already as winners [in today’s mortgage market]. Appreciation for their mission and their business model is probably on the rise again.’” He cautions, however, that “both Freddie Mac and ...Fannie Mae remain vulnerable to a substantial downturn in house prices – something that looks increasingly likely. Right now winning is a relative concept.” (*MortgageRisk Magazine*, Rob Mannix, October 2007)
- On October 22, Lehman Brothers lowered its target price 16.3% on Fannie Mae from \$80 down to \$67 and lowered its target price on Freddie Mac 20% from \$75 down to \$60. While the GSEs’ credit losses should be relatively low relative to the banking sector, Fannie and Freddie will not be immune to rising credit costs, which should limit earnings growth, said Lehman Brothers analyst Bruce Harting in a note to clients. (*Reuters*, 10/22/07)

Capitol Hill notes

- Representative Kevin McCarthy (R-CA) has joined the House Financial Services Committee, succeeding Representative Paul Gilmore (R-OH) who passed away in September. McCarthy was also assigned to the financial institutions and consumer credit, housing and community opportunity, and oversight and investigations subcommittees. (*American Banker*, Cheyenne Hopkins and Joe Adler, 10/15/07)
- According to the *Sioux Falls Argus Leader*, Senator Tim Johnson (D-SD) is hiring top level campaign staff, signaling that he plans to run for a third term in the Senate. Johnson has tapped Steve Harding, “a veteran Democratic Party operative known best for running the successful effort to unseat Senator George Allen in Virginia and running Mark Warner’s successful gubernatorial campaign in Virginia.” Johnson also has obtained campaign office space and hired additional campaign staff. The *Argus Leader* also notes, “Johnson now has \$2 million cash on hand for his campaign.” Johnson serves as a member of the Senate Banking Committee. (*CQ Today Midday Update*, 10/19/07)
- Representative Chris Shays (R-CT) has announced that he plans to stand for re-election in 2008. “I am eager to run again,” said Shays. “I’m loving my job.” In

September, Shays publicly stated that he would not seek re-election if there were any chance that Republican leaders would pass him over to serve as his party's ranking member of the House Oversight and Government Reform Committee, in the event that Representative Tom Davis (R-VA) should leave the House. "Tom may come back. He may not," said Shays. "My view from day one is that if Tom leaves I want to make sure I am next in line and not passed over. I have no fear that will happen. I met with all the leadership, one-on-one, and the steering committee and I have almost unanimous support." Shays also sits on the House Financial Services Committee. (*Connecticut Post*, Peter Urban, 10/25/07)

Fannie Mae

SEC sends more than \$356 million to investors “harmed” by Fannie Mae financial fraud

- On October 19, the SEC sent checks totaling more than \$356 million to investors who were harmed by financial fraud at Fannie Mae which occurred between 1998 and 2005. In May 2006, Fannie Mae settled an SEC civil injunctive action, alleging that the company issued materially false and misleading financial statements in filings with the SEC. Final judgment was entered against the company in August 2006 and Fannie Mae paid fines of approximately \$356 million in resolution of the SEC’s claims. The \$356,128,500 distributed to Fannie Mae shareholders represents the entirety of the money Fannie Mae paid to settle the SEC’s charges, plus interest. (*Bureau of National Affairs*, 10/22/07)

Fannie Mae’s retained mortgage portfolio shrinks an annualized 8% in September

- Fannie Mae’s retained mortgage shrank at an annualized rate of 8% in September to \$723.8 billion. Fannie’s retained portfolio was \$11.2 billion below OFHEO’s regulatory cap of \$735 billion on September 30, 2007. During the month, company’s total book of business grew 13.3%, driven by growth in Fannie Mae mortgage-backed securities and other guarantees. Fannie Mae’s continued strong issuance of Fannie Mae MBS, which totaled \$58.4 billion in September, was partially offset by loan liquidations. In August (the latest data available), the company’s single-family serious delinquency rate rose three basis points to 0.71%, while its multifamily serious delinquency rate fell four basis points to 0.06%. Fannie Mae’s effective duration GAP averaged zero months, unchanged from August. (*Fannie Mae Monthly Volume Summary*, 10/26/07)

John C. Sites, Jr. elected to Fannie Mae’s board

- Fannie Mae’s board of directors has elected John C. Sites Jr. to serve on the board and on its Housing and Community Finance and Risk Policy and Capital Committees. Sites is the ninth new director elected to the company’s board since 2004. Sites, 55, is a consultant to Wexford Capital, LLC, an investment firm based in Greenwich, Conn., that manages hedge funds and private-equity funds, and is also a General Partner of Rock Creek Partners II, Ltd., a private equity fund. Previously, Sites worked for Bear Stearns, where he established the mortgage department and was an executive vice president and member of the board. During his 14 year tenure, Sites served on the firm’s executive and compensation committees, and was co-head of the firm’s taxable fixed income group, including the U.S. Treasury Department, capital markets, corporate bond department, municipal bond, preferred stock and distressed and high yield departments. In addition, he oversaw the investment banking

department with respect to financial institutions, and was also responsible for the asset management division. “John’s broad financial and mortgage market background will be important assets for the company and our shareholders,” said board chairman Stephen B. Ashley. “He will be an important addition to our Board and to Fannie Mae as the company executes on its business strategy and plan during this critical time in the housing market.” (*PRNewswire*, 10/26/07)

Fannie Mae announces fourth quarter dividends

- Fannie Mae’s board of directors declared a fourth quarter dividend of \$0.50 per share to registered owners of its common stock at the close of business on October 31st, payable on November 26th. The board also declared dividend payments on its preferred stock in accordance with the terms of each issue. (*Fannie Mae Press Release*, 10/16/07)

ICBA renews its alliance with Fannie Mae

- The Independent Community Bankers of America has renewed and enhanced its five-year partnership with Fannie Mae. Under the new agreement, Fannie will provide enhanced delivery and services for bulk sales and reduce its licensing and transaction fees for Desktop Publisher. (*MortgageWire*, 10/24/07)

Alumni news

- NeighborWorks America has named James Ferris executive director of NeighborWorks Capital, the corporation’s newly formed real estate development financing arm. Previously, Ferris served as a senior director, national initiatives for the Fannie Mae Foundation since 2004. (*MortgageLine*, 10/17/07)

Hunton & Williams receives Fannie Mae’s Bridge Builder award

- Hunton & Williams LLP has received the inaugural Fannie Mae Bridge Builder award for the firm’s commitment to diversity. “We told our outside counsel last year that we would be issuing ‘report cards’ on their diversity performance,” said Beth Wilkinson, Fannie Mae’s general counsel. “Hunton & Williams was chosen for our Bridge Builder award because it has done an outstanding job promoting diversity.” (*CarolinaNewswire.com*, 10/16/07)

Fannie Mae invests \$3.4 million to help an area high school build athletic facilities

- Fannie Mae provided \$4.3 million to Ballou High School for building its athletic facilities, which included an artificial turf playing field, outdoor lighting, a renovated storage facility, new bathrooms, construction of a press box, and creation of a mobile concession stand. These funds were also used to purchase new uniforms for the school's football, soccer, and basketball teams. The funds were a portion of the \$10 million Fannie Mae has committed to contribute to the Washington, D.C. public school system. (*Washington Business Journal*, Erin Killian, 10/25/07)

Fannie Mae provides grant to American Red Cross
and mortgage relief to victims of California wildfires

- Fannie Mae has mortgage relief provisions in place for borrowers facing hardships as a result of the California wildfires that have caused widespread damage in several Southern California counties. Fannie Mae has provided \$150,000 in grants to American Red Cross chapters in Los Angeles, San Diego, and San Bernardino Counties for emergency shelter, food, and assistance to wildfire victims. Fannie also will match their employees' contributions to these Red Cross chapters through the end of the year. (*Fannie Mae Press Release*, 10/25/07)

Freddie Mac

Freddie Mac's retained mortgage portfolio shrank an annualized 1.2% in September

- In September Freddie Mac sharply shrank its retained mortgage portfolio by an annualized 31.2% to \$713.2 billion. This sharp decline trims the company's year-to-date portfolio growth to 1.7% from a YTD growth on 6% at the end of August. On September 30, Freddie's retained portfolio is remained \$21.8 billion below OFHEO's portfolio limit of \$735 billion. In September, Freddie Mac reported stepped-up sales, net of other activity, which contributed to the large portfolio drop. Freddie Mac's total mortgage portfolio grew by annualized rates of 23.3 percent in September, which was fueled by the GSE's 28.7% surge in its total issuance of mortgage-backed securities. The company's single-family delinquency rate for all loans increased 2 basis points to 46 basis points in August. In September, Freddie Mac's duration gap averaged zero months, unchanged from August. (*Freddie Mac Monthly Volume Summary*, 10/24/07; *Reuters*, Jody Shenn, 10/24/07)

OFHEO to the rescue (again)

- In *MortgageRisk Magazine*, Rob Mannix wrote, "Now, as the subprime turmoil unfolds, [Freddie Mac's] first piece of good fortune is that scrutiny from its regulator [OFHEO] encouraged a conservative approach to risk management precisely when the worst excesses of lax underwriting were at their height". (*MortgageRisk Magazine*, Rob Mannix, October 2007)

The Sergeant Schultz defense: "I know nothing..."

- On October 15th, former Freddie Mac chairman and CEO Leland C. Brendsel went to court to defend himself from charges by OFHEO that he participated in a scheme to distort the company's financial results and allowed the GSE to function without adequate computer systems and expertise. The regulator's legal counsel, Stephen E. Hart, urged the court to hold Brendsel responsible "for placing the financial integrity of Freddie Mac at risk" and asked that the defendant be held liable from more than \$1 billion of costs incurred by Freddie Mac in connection to its accounting restatement. Kevin M. Downey, attorney for Brendsel, argued in his opening statement that OFHEO's charges are false and the trial would present the former executive as "acting in good faith" and "trying to do the right thing." The trial-like proceeding before an administrative court is scheduled to unfold over the next 4 to 5 months
- Freddie Mac CEO Richard Syron, who appeared as OFHEO's first witness, told the court that there were "significant problems" with the company's internal controls when he joined the firm in 2004. Over the past four years, Freddie Mac essentially

had to rebuild its accounting and information technology systems, said Syron. Under questioning by Downey, Syron added, “I thought Freddie Mac was well capitalized and safe and sound.” (*Washington Post*, David Hilzenrath, 10/16/07; Marketplace, 10/15/07)

- During three days on the stand, Brendsel testified about the mundane aspects of his tenure with Freddie Mac. Brendsel, a former government economist and assistant professor of finance, told the court that he neither sent nor received email—and didn’t even use a computer. [His assistant filtered his incoming emails.] Brendsel said he often visited Freddie’s trading floor to catch up on events, since he didn’t have a news feed in his office. While he received a variety of internal reports, Brendsel said, “I typically depended on my staff to review them” to determine which needed his attention. (*Washington Post*, David Hilzenrath, 10/22/07)

Freddie Mac’s contingency planning

- At a recent Bank of America investors’ conference, Freddie Mac CFO Buddy Pizel said that Freddie Mac has added substantial new backup loan servicing capacity in case a big mortgage servicer fails. “We have backup plans to service roughly one million loans, which is a significant increase in our capacity,” said Pizel. In the event of potential market turmoil, Pizel added, “We have been spending a lot of time on counterparty risk, more than we ever have before.” Freddie Mac also is closely monitoring the mortgage insurance industry and doing “stress tests” to determine what might occur under various home value decline scenarios. [Approximately 20% of Freddie’s portfolio is credit enhanced.] (*National Mortgage News Daily Briefing-Weekend Edition*, Paul Muolo, October 27-28, 2007)

Freddie Mac launches two new mortgage products for the acquisition or rehabilitation of existing multi-family properties

- Freddie Mac has announced the launch of the Acquisition Upgrade MortgageSM, providing financing for cosmetic improvements, and the Acquisition Rehabilitation MortgageSM, providing more substantial improvements to reposition properties in their respective markets. These new products provide funds for both the purchase and upgrade or rehabilitation of the property in one first lien mortgage. “A lot of acquisition deals involve new owners/operators who want to renovate. Now, with one mortgage and one lender, a qualified borrower can obtain funds to both purchase and upgrade or rehabilitate an existing multifamily property, maximizing cash flow through upfront financing,” said Mitchell Kiffe, vice president of Multifamily Sourcing for Freddie Mac. “These new products are part of our strategy to better meet borrower needs and be more competitive in the marketplace.” (*Freddie Mac Press Release*, 10/16/07)

Freddie Mac announces investment of \$1.5 million
for a New Orleans home renovation fund

- Freddie Mac is investing \$1.5 million in a home renovation reserve fund, which will be matched by the Louisiana Housing Finance Agency and the City of New Orleans, to help remove obstacles—such as unexpected cost over-runs—to renovating hurricane-damaged homes. This aggregate infusion of \$4.5 million of capital is expected to jumpstart \$100 million in renovation mortgage activity over two years in selected neighborhoods in New Orleans and the City of Lake Charles with participating lenders Chase, Countrywide Home Loans and Standard Mortgage. Rebuild New Orleans is one of the largest collaborative efforts to establish scalable home renovations in specific neighborhoods. Freddie Mac’s announcement was made as more than 100 of the company’s employees from across the country kicked off a weeklong project to renovate homes in New Orleans’ Broadmoor neighborhood, one of four areas eligible to receive funds. (*PR Newswire*, 10/22/07)

Federal Home Loan Banks

FHLBs play critical role in restoring liquidity to the marketplace

- In an October 19th article in *American Banker*, John R. Price, president of the FHLB-Pittsburgh, noted that the role of the FHLBs during the recent liquidity crisis in the mortgage market was little noticed. Price wrote, “ ... These triple-A government-sponsored enterprises — organized as a cooperative for banks, thrifts, insurance companies, and credit unions — played their intended role as a provider of liquidity. As the Fed acted, the 12 Home Loan banks injected an additional \$163 billion of liquidity to calm the markets, in the form of loans to members ranging from small community banks to large commodity players. All told, 8,100 financial institutions own and can borrow from the Home Loan banks. ...The Home Loan banks were a major pacifying influence. They provided on-request funding of varying durations as other sources of liquidity dried up or became prohibitively expensive.”
- “...The Home Loan banks will continue to support members during rough seas in the mortgage markets. But crisis or not, they will also try ...to enable members to manage risk and make more effective decisions about utilizing the system’s credit products. They also hope to broaden the ways in which they can help communities meet their need for infrastructure. Modifying the Internal Revenue Code to allow Home Loan banks to wrap triple-A letters of credit around tax-exempt obligations of smaller issuers — municipalities, colleges, and health-care entities — is entirely consistent with their mission. To remain relevant, the Home Loan banks must define the most important ways in which they can help their members address new needs,

through their special status, access to global financial markets, and as steady, reliable friends.” (*American Banker*, John R. Price, 10/19/07)

FHLBs announce third quarter operating results

- The FHLB-San Francisco reported net income of \$135 million for the third quarter of 2007, down 3.6% from the third quarter of 2006. For the nine months ended September 30, the Bank reported net income of \$421 million, 8.8% above its net income reported for the first nine months of 2006. During the nine month period, the Bank’s total assets grew \$59.2 billion—or 24%— to \$304.2 billion on September 30, primarily due to growth in advances, which increased \$52.5 billion during the period. In addition, the Bank’s interest-bearing deposits in banks increased by \$4.9 billion, or 53%, to \$14.2 billion, and its held-to-maturity securities increased by \$1.4 billion, or 5%, to \$31.8 billion. The Bank’s third quarter dividend is 5.26% (annualized), compared to 5.54% (annualized) for the third quarter of 2006. (*FHLB-San Francisco Press Release*, 10/25/07)
- During the third quarter of 2007, the FHLB-New York’s total assets increased 25% to \$102.4 billion, up from \$81.7 billion at the end of 2006, while its advances increased 27% to \$75.1 billion, compared with \$59.0 billion on December 31, 2006. On September 30, 212 (71%) of the Bank’s member lenders had tapped the Bank’s liquidity window of last resort. The Bank reported net income of \$85.2 million for the third quarter, representing an 11% increase over the third quarter of 2006. As a result of the Bank’s robust earnings, the FHLB-New York has increased its third quarter dividend to an annualized 8.05% from 7.50% dividend paid in the second quarter. (*PR Newswire*, 10/18/07)
- The FHLB-Cincinnati reported its third quarter net income of \$107.8 million, an increase of 7.9% over the third quarter of 2006. The Bank’s net income for the nine months ended September 30 totaled \$202.4 million, an increase of 9.8% over the corresponding period in 2006. The Bank’s Mission Asset Activity, comprised of credit services and the mortgage purchase program, grew 21.1% during the first nine months of 2007, compared to year-end 2006. On September 30, the Bank reported total assets of \$86.6 billion and total capital of \$281.3 million. (*FHLB-Cincinnati Press Release*, 10/26/07)

The FHLB-Indianapolis announces its third quarter dividend

- On October 19, the FHLB-Indianapolis declared dividends on its B-1 and B-2 stocks at annualized dividend rates of 4.5% and 3.6%, respectively. (*PrimeNewswire*, 10/19/07)

FHLBs announce elections results and appointments to their boards

- The FHLB-Cincinnati's board of directors announced the election of a new director from Ohio and reappointment of two Tennessee directors who stood for election without opposition. Each director will serve a three-year term beginning January 1, 2008. Elected from Ohio was James R. DeRoberts, chairman of The Arlington Bank, a \$191 million-asset financial institution based in Upper Arlington, Ohio. DeRoberts will succeed James R. Powell, chairman and CEO, Liberty Savings Bank, FSB, Wilmington, Ohio, who is completing his third three-year term on the board, the maximum currently allowed by federal regulations. In Tennessee, William Y. Carroll, Sr., chairman of SmartBank, Pigeon Forge, Tennessee, returns for his third term on the board, and R. Stan Puckett, chairman and CEO, GreenBank, Greeneville, Tennessee, returns for his second term. (*PrimeNewswire*, 10/25/07)
- The FHLB-Des Moines' board of directors announced the election results for a new director from Missouri, North Dakota and Minnesota for three year terms beginning on January 1, 2008. The new directors include Joseph C. Stewart, III, CEO of Bank Star, headquartered in Pacific, MO; Eric Hardmeyer, president and CEO of the Bank of North Dakota, Bismarck, ND; and Michael J. Finley, president of Janesville State Bank, Janesville, MN. In addition, the Bank's board of directors elected Michael K. Gutttau, chairman and president of Treynor State Bank, Treynor, IA, to serve as chairman and Dale E. Oberkfell, president and COO of Reliance Bank, Frontenac, MI, to serve as vice chair. (*FHLB-Des Moines Press Release*, 10/26/07)
- The FHLB-Pittsburg announced that the Federal Housing Finance Board has appointed two directors to serve on the Bank's board of directors. Named were Walter D'Alessio, vice chairman of NorthMarq Capital in Philadelphia and chairman of the Philadelphia Industrial Development Corporation, and John Darr, currently the CEO and managing director of the FHLBanks Office of Finance, who also serves as a director of Manna, Inc., a District of Columbia-based low-income housing provider. Both were named to the board as Public Interest Directors, with Darr holding the sub-designation of Community Interest Director. D'Alessio and Darr will serve three-year terms that commence January 1, 2008 and expire December 31, 2010. (*FHLB-Pittsburgh Press Release*, 10/26/07)

The Independent Community Bankers Association forms task force on the FHLBs

- The Independent Community Bankers of America (ICBA) has formed a task force to examine emerging issues and organizational changes in the FHLB System. The task force will be comprised of ICBA bankers from each of the 12 FHLB districts and a representative from the trade group's state and regional partnerships. Dale Torpey, the president and chief executive officer of Federation Bank of Washington, Iowa, and a former chairman of the FHLB-Des Moines, has been named the task force's chairman. "Given the evolution of the banking system and capital markets, [the task

force] is the perfect conduit for community banks to discuss new ideas,” said ICBA’s chairman James Ghiglieri Jr. (*American Banker*, Cheyenne Hopkins, 10/19/07)

Ginnie Mae

The subprime FHA?

- In an October 15th commentary in the *Wall Street Journal*, John Berlau wrote, “[B]efore the FHA’s loan spigots are opened up, a little due diligence by the political sector is in order. The FHA’s recent credit history shows it is far from the prudent institution it is said to be. By its own estimate, next year the agency expects to be in the red, paying out more for defaulted loans than borrowers pay to it in insurance premiums. ‘Because of adverse loan performance,’ the FHA states in its budget submission for 2008, ‘total costs exceed receipts on a present value basis, and therefore would require appropriations ...to continue operation.’”
- “The agency poses more than just a threat to taxpayers. The collapse of whole segments of the housing market can be traced to FHA-subsidized mortgage products. Despite its decreasing market share, the FHA appears to have played a significant role in the current mortgage ‘meltdown’ attributed to subprime loans.”
- “For the past three years, delinquency rates on the oh-so-safe mortgages insured by the FHA have consistently been higher than even those of the dreaded subprime mortgages. In the last quarter of 2006, for instance, the delinquency rate for subprimes had increased to 13.33% in the National Delinquency Survey compiled by the Mortgage Bankers Association. But in the FHA category, the rate had risen to 13.46%—‘a new record.’ Nationally, FHA-backed loans do have a lower foreclosure rate than subprimes do, but one that’s nearly twice as high as the rate for all mortgages. And in certain regions, FHA-insured loans account for a disproportionate share of mortgage woes.”
- “Take Colorado. For months the state has had one of the highest foreclosure rates in the nation, and a *Denver Post* investigation lays much of the blame on FHA products. ‘FHA program key in surge of foreclosures,’ stated the headline of the *Post* article. The newspaper found that while the FHA backed less than one-fifth of home loans in two Denver-area counties, the loans that were FHA-insured actually accounted for about a third of the counties’ foreclosures.”
- “FHA-insured loans have also been at the center of some of the worst excesses of the housing boom, including mortgage fraud, loans made without income verification, and property ‘flipping’ with inflated appraisals. Last month, in a case brought by

federal prosecutor Patrick Fitzgerald, a Rockford, IL, real-estate agent pleaded guilty to conspiring to defraud the U.S. government through the use of phony pay stubs and credit letters to obtain FHA loans for home-buying clients. Several similar schemes involving FHA-backed loans have been documented by congressional probes and newspapers such as the *Baltimore Sun*. GOP Senator Susan Collins of Maine, who supervised a 2001 Senate subcommittee investigation of mortgage fraud, said bluntly that ‘the federal government has essentially subsidized much of this fraud.’”

- “How could an agency with a reputation for being so conservative have made loans that turned out to be so problematic? Part of the answer rests in a foolish quest to compete with the private sector for ‘market share.’ In both the Clinton and Bush administrations, the FHA’s response to private alternatives for low-income borrowers was to aggressively compete with them – by making the agency’s own lending standards even more ‘subprime’ than those of the private sector. Since its inception in 1934, the FHA has required a down payment—originally 20%, but gradually whittled down to 3%—for a home loan. The down payment requirement was to help ensure that borrowers were responsible, even if they didn’t have perfect credit histories.”
- “But in 1997, home sellers and buyers started to get around this rule by donating money to foundations that provide down-payment assistance to buyers. Since the FHA does not count assistance from these foundations as a seller inducement -- as many non-FHA lenders do -- seller-funded charities can contribute virtually unlimited amounts to borrowers to cover down payments, closing costs and even FHA borrower insurance premiums. A recent paper by HUD researcher Austin Kelly notes that, since 2000, studies by HUD’s Office of Inspector General ‘have found that sales prices of homes using seller-funded nonprofits tend to reflect the assistance’ provided by the charities. In other words, the buyer’s assistance is frequently rolled into the home price, inflating the value of the home and leaving the FHA -- and ultimately the taxpayer -- holding the bag for a defaulted loan. And studies also indicate that the FHA will be picking up the tab at a higher level for these loans. In 2005, Congress’s Government Accountability Office found that FHA borrowers who received assistance from a seller-funded nonprofit were more than twice as likely to default as the agency’s borrowers who received no down-payment assistance. They were also more likely to default than borrowers with other types of assistance.”
- “Despite these trends, HUD Secretary Jackson’s biggest concern has appeared to be not the FHA’s solvency, but the government agency’s loss of business to the private sector. ‘I am absolutely emphatic about winning back our share of the market,’ he told the *Washington Post* in 2005. Looking at the agency’s dismal performance over the past few years, we can predict that, if the FHA racks up more ‘wins,’ taxpayers and low-income home buyers will likely be suffering the losses.”
- “It is important to note that the vast majority of home mortgages, FHA-backed or otherwise, are not in danger of foreclosure. Overly burdensome regulation of any type of lender would be counterproductive. But those concerned with the fiscal

health of the mortgage market and the U.S. Treasury should be emphatic in opposing the expansion of a government agency that added so much fuel to the current ‘meltdown.’” (*Wall Street Journal*, John Berlau, 10/15/07)

- In an October 20th Letter to the Editor in the *Wall Street Journal*, HUD Secretary Alphonso Jackson wrote, “John Berlau’s Oct. 15 commentary opposing FHA modernization ...is incorrect when he tries to pin the ‘worst excesses’ of subprime loans—such as unverified income levels—on the Federal Housing Administration. The FHA requires lenders to underwrite all loans and borrowers to document their credit history and income. Short-term ‘flipping’ of homes is also prohibited, contrary to his claims.”
- “Mr. Berlau conveniently omitted that the FHA, despite considerable opposition from special interests, has closed the loophole allowing seller-funded downpayment assistance. We agree that such loans have been a drag on the FHA’s portfolio for years. They are a financial shell game where the seller wins and too many homebuyers lose. Our rule puts an end to this type of self-serving, circular-financing arrangement and its harmful effects on homeowners and the housing market. By closing this loophole, the FHA will help prevent more people from being steered into a situation where they don’t understand the fine print and end up being foreclosed upon.”
- “A healthy FHA is good medicine for the ailing housing market. It is self-sustaining, costing taxpayers nothing, not ‘subsidized,’ as Mr. Berlau claims. It is safe, with a foreclosure rate half that of risky subprime mortgages. And it is sound, free of costly gimmicks such as “teaser” interest rates or prepayment penalties. It also offers mandatory loss mitigation, meaning that we will work with homebuyers if they get in trouble.”
- “But the FHA must be updated for the 21st century. Outdated loan and downpayment limits have priced the FHA out of high-cost markets such as California, which—not coincidentally—has been one of the states hardest-hit by the housing crunch. That’s why the House and the Senate Banking Committee each voted overwhelmingly to modernize the FHA. And it’s why President Bush recently launched FHASecure, which will expand the pool of homeowners able to choose a safe, affordable FHA loan into which they can refinance.”
- “The time to modernize the FHA is now. Low- and moderate-income borrowers desperately need an alternative to the riskier and more expensive subprime loans. A new FHA would also increase liquidity in the market place and help stem the overall credit crisis. The subprime market share explosion, from 8.5% in 2003 to 20% in 2005, was a major cause of the housing bubble. The FHA is part of the solution.” (*Wall Street Journal*, Alphonso Jackson, 10/20/07)
- At the Mortgage Bankers’ recent annual meeting, Steve Nadon, president and COO of H&R Block Inc.’s Option One Mortgage said that the FHA will be an integral part of

the subprime market in which his company once played a dominant role. “Over the next 24 months, or even 36 months, the subprime market is FHA,” said Nadon. “There’s no subprime [financing available anywhere else].” David Lowman, CEO of JPMorgan Chase & Co.’s global mortgage group, said, “I think FHA will play a huge role in the recovery of the market. I envision they will be in the double-digits, at 10 percent to 12 percent [up from a 2% market share in recent years].” (*Reuters*, Al Yoon, 10/15/07)

Ginnie Mae to create separate pools of FHASecure loans

- Effective December 1st, Ginnie Mae will create a separate pooling of FHASecure loans within the multiple-issuers pools under the Ginnie Mae II program. In August, President Bush launched the FHASecure loan program, which refinances delinquent adjustable-rate mortgages into FHA-insured loans when they become delinquent due to a rate reset. The program also refinances fixed-rate conventional loans with subordinated second liens in FHA-insured products. As of December 1st, Ginnie Mae said it would start guaranteeing FHASecure pools. (*Asset Securitization Report*, Paul Menchaca, 10/22/07; *MortgageWire*, 10/24/07)

Reverse mortgages “ripe” for securitization

- The growing number of reverse mortgage originations is making this product “ripe” for securitization, which will “revolutionize” the FHA’s HECM loan, said Arthur Axelson, a partner with Reed Smith LLP. Craig Corn, president of BNY Mortgage Co., said the Ginnie Mae program would increase liquidity for the product as well as increase the number of secondary-market investors, which presents “an incredible opportunity, but with that opportunity comes risks.” Ginnie Mae is launching the new product because its charge is to support government-insured products, said Theodore Foster, the agency’s senior vice president. While there is dramatic growth in the number of HECM originations, there is no standardized secondary-market take-out for the product, said Foster. Ginnie Mae’s goals include increasing availability of HECMs and creating a secondary market for them. (*MortgageWire*, 10/19/07)

International Mortgage Market

IMF says U.K.'s housing market at risk of steep downturn in home prices

- In *National Mortgage News*, Paul Muolo wrote, "...If you think the U.S. housing market has problems, get a load of what the International Monetary Fund said recently about the U.K. housing market. In its 'World Economic Outlook' report, the IMF said the U.K. is among the countries most at risk for a steep downturn in home prices, even more so than the U.S. Keep in mind that several U.S. investment banking houses have mortgage-related businesses in London. This should be interesting..." (*National Mortgage News Daily Briefing-Weekend Edition*, Paul Muolo, October 27-28, 2007)

Farm Credit System / Farmer Mac

Banking industry lobbies to block provision to farm bill that would expand the FCS

- Banking lobbyists are ramping up their efforts to prevent the Senate Agriculture Committee from including a provision allowing the Farm Credit System to expand its lending authority in the 2007 Farm Bill. On September 19th, 30 bank groups sent a letter to lawmakers, outlining their opposition to any legislative attempt to expand the FCS. Bankers argue that the FCS wants to expand the system outside of its mission of helping local farmers in order to compete in mortgage and commercial lending.
- "The Farm Credit System is not satisfied to serve farmers and ranchers and wants Congress to allow it to finance projects that are owned by corporate entities," wrote the Independent Community Bankers Association in its letter to lawmakers. "These proposals do not target underserved markets, and there is no rationale for displacing the private sector from the rural marketplace in favor of a government-sponsored, tax-advantaged entity," ICBA senior legislative counsel Ike Jones said his group is concerned that members of the committee might be successful in persuading Agriculture Chairman Harkin to include language in a manager's amendment to the bill that would expand FCS's biofuel financing powers. [FCS institutions can loan money for biofuel projects in which farmers have a 50% ownership stake.] "We anticipate there will be an amendment. Where it is coming from, I don't know," said Jones. Agriculture Committee ranking member Saxby Chambliss (R-GA) and committee member Senator Patrick Leahy (D-VT), who have been FCS proponents, would likely support such a move, he added. "[FCS's] whole ploy is just to get something in the farm bill to get to conference," said Jones. (*National Journal's CongressDaily*, Bill Swindell, 10/23/07)

- In the October 18th edition of the *Newark Advocate* [OH], Leonard Hubert wrote, “Most Americans agree we must increase our nation’s energy independence by developing alternative fuel sources. But success relies on two critical factors: the availability of sufficient capital to meet the demands of the renewable energy industry, and a determination to encourage local ownership of production as a means of retaining economic benefits locally. Congress, now debating the 2007 Farm Bill, can help.”
- “There are tremendous opportunities in Ohio for farmers, rural communities and the agricultural business community. Of the 110 or so ethanol plants nationwide, six are in Ohio. According to the Renewable Fuels Association, Ohio ranks ninth nationwide in production capacity, but fourth in ethanol plant expansion and production...”
- “Governor Strickland and the Republican leadership are promoting legislation to accelerate the development and use of alternative fuels. The opportunity for Ohio to become a leader nationwide, however, is stifled in part because of the large amounts of capital required. That’s where the farm bill comes in. Most community banks don’t have sufficient capital to make loans for alternative fuel plants on their own. As a result, banks often team up with Farm Credit, the nation’s largest agricultural lender and a pioneer in financing the ethanol industry. Since Congress created Farm Credit in 1916 as a means of ensuring farmers would always have a lender on whom they could rely, regardless of weather and price fluctuations, the farmer-owned cooperative lender has focused on rural and agricultural needs.”
- “The problem is, Farm Credit’s ability to provide more funding to the renewable fuels industry is limited by antiquated eligibility criteria. In a nutshell, if you’re a farmer who wants to invest in, say, an ethanol plant, you can borrow from Farm Credit. But if you are not a farmer, you can’t—even if your ethanol plant is located on traditional farmland and surrounded by hundreds of acres of corn. As a result, even though the alternative fuels industry got its start among the farmer-owned cooperatives served by Farm Credit, outdated eligibility requirements make it difficult if not impossible for Farm Credit to make capital available to these projects. Congress has a chance, in the Farm Bill, to enable Farm Credit to make these loans.”
- “When rural towns are involved in ownership of renewable fuels facilities, they build a sustainable economic base on which to maintain their culture and quality of life. When farmers join with other investors to develop alternative fuels, they can finally shed their dependence on rollercoaster prices and their reliance on subsidies associated with commodity crops. Renewable fuels could reduce the U.S. trade deficit by billions. It makes sense to allow more local businesses to benefit from Farm Credit’s ability to help build a new economic security for our state and our nation.” (*Newark Advocate*, Leonard Hubert, 10/18/07)

- Today, almost all of the ethanol fuel made in the U.S. comes from the starch in corn grain. The Bush administration has proposed that biofuels replace at least 15% of the gasoline demand by 2017—approximately 35 billion gallons. If corn remains the primary source for biofuels, the administration’s 10-year goal would consume the *entire* U.S. corn crop.
- Mass production of corn uses more herbicides, insecticides, and synthetic fertilizer and causes more soil erosion than any other U.S. product. Corn ethanol yields only 1.5 times as much energy as is required to produce it, while sugar cane can yield eight times as much. Unfortunately, suitable land in Florida to grow sugar cane will not meet the country’s biofuels demand. (*Organic Gardening*, Greg Williams and Pat Williams, August-October 2007)
- According to a recent study by John Urbanchuk [a leading biofuel industry analyst], “The capital cost to meet the 36 billion gallon renewable fuels target by 2022 amounts to \$105.5 billion (2007 dollars).” The study also concludes that the typical ethanol plant requires investors to raise \$95 million before going to the credit markets and an additional \$130 million in debt to construct a plant. (*Farm Credit Council Press Release*, 10/25/07)
- According to BBC News, U.S. corn prices are up 80% or more today [*before* an even larger portion of the country’s corn crop is dedicated to the development of biofuels]. As a result, feed prices for livestock and food prices are spiraling upward. BBC News reports, “Now 129 plants are making ethanol, mostly in small towns dotting the American [midwest], and another 80 are under construction. ...Most ethanol plants are now farmer-owned co-ops [financed by the Farm Credit System]. ...Half the states in the U.S. have ethanol plants and it may soon be the leading producer in the world of this home-grown fuel—right up there with Brazil, which makes its fuel from sugar cane. ...The goal of the ethanol enthusiasts is to have farmers and foresters produce 25% of American energy by the year 2025. As it stands, the US now makes about six billion gallons of ethanol. It’s barely enough to replace a mere 4% of the nation’s gasoline consumption. And most of that is used in blends...”
- BBC News adds, “...[W]hile food prices remain high, ethanol prices are trending downward, off nearly 30% on the spot market since May. So, is this the beginning of the end of the big ethanol dream? Killed, just as it got going? Most farm economists say no—ethanol will find its place. Now, maybe it won’t replace all the imported oil—more than half of US consumption—and maybe it won’t save the planet. Such overstatements, critics believe, set ethanol up for a fall to begin with...” (*BBC News*, Tim Egan, 10/12/07)
- Jean Ziegler, the United Nations’ special rapporteur on the right to food, recently condemned the growing use of crops to produce biofuels as a replacement for petrol,

calling it a crime against humanity and arguing that the production of biofuels will bring result in more hunger worldwide. Noting that the growth in the production of biofuels has helped push the price of some crops to record levels, Ziegler complained that an ill-conceived dash to convert foodstuffs into fuel is a recipe for disaster. Ziegler is not alone in sounding this alarm. The IMF recently voiced concern that the increasing global reliance on grain as a source of fuel could have serious implications for the world's poor. (*BBC News*, Grant Ferrett, 10/27/07)

- According to the *Wall Street Journal*, "...On top of the 51 cent per gallon tax credit for this inefficient fuel, the Senate energy bill requires a doubling of ethanol production from corn, \$500 million in new direct payments to ethanol producers, and \$2 billion more for loan guarantees for new ethanol refineries." The *WSJ* also notes, "Energy bills moving through Congress tax oil companies and pass most of the \$25 billion or so in expected revenue to wind, solar and Midwestern biofuels companies, even though private venture capital for such fuels hit new peaks in 2005 and 2006. For 20 years, the feds have poured more than \$10 billion into this industry with little reduction in U.S. oil dependence." (*Wall Street Journal*, 10/23/07)
- At June 30, 2007, the Farm Credit System had \$1.668 billion in loans outstanding relating to biofuels products, representing 6.4% of the System's capital and 1.3% of net loans outstanding. The FCS has made an additional \$2.238 billion in loan commitments to extend credit to the industry, bring the System's total loan exposure to \$3.9 billion [representing 15% of FCS's capital and 3% of the System's net loans outstanding on June 30]. (*Farm Credit Council Press Release*, 10/25/07)

Farm Credit Systems' earnings up 11% for the first six months of 2007

- The Farm Credit System earned \$1.29 billion for the first six months of this year, up from \$1.16 billion in the same period of last year as a result of growth in the system's loan portfolio and a strong agricultural economy. Net interest income for the period increased by \$244 million to \$1.97 billion, as a result of the System's growth in average earning assets which totaled \$163.3 billion as of June 30. The System's net interest spread declined by six basis points during the first six months of this year from the prior-year period. The FCS recognized \$38 million in loan loss provisions for the six month period, up from \$14 million in the first half of 2006. On June 30, non-accrual loans totaled \$469 million, \$64 million lower than the non-accrual balance at year-end 2006. Loans that were 30 days or more delinquent comprised 0.44% of System loans at June 30, up from 0.40% one year earlier. (*National Mortgage News*, Ted Cornwell, 10/22/07)

Postal Service

USPS and National Rural Letter Carriers' Association enter binding arbitration

- According to Mailers Council executive Robert McLean, the National Rural Letter Carriers' Association and USPS began binding arbitration on October 29. The parties are planning to hold a series of meetings over a 20-day period in an effort to reach an employment agreement for the NRLCA members. (*Postcom.org*, 10/15/07)
- In other USPS postal union news, William Burrus was re-elected to a third term as president of the American Postal Workers Union. Burrus received more than 77% of the votes cast in balloting that ended on October 5th. (*Postcom.org*, 10/15/07)

Re-branding the USPS

- In an effort to “update” its image, the USPS is launching a “Today’s Mail” advertising campaign, utilizing print, online and direct mail outreach to customers. The Postal Service describes the theme as an invitation to consider the post office in a new light, “reflecting improvements in service and technology—like the Postal Service Web site.” Rod DeVar, manager for advertising and promotion at the Postal Service in Washington, said, “Our brand is changing, but customers were not viewing us as the more contemporary and competitive organization we are. We’ve kept coming out with new services to better serve customers, but when we’re talking to them, they say, ‘I didn’t know that’ or ‘I never would have expected that from the Postal Service.’”
- “We want to bring to the fore the products and services that get people excited,” said Mark Bellissimo, executive vice president and account director at Campbell-Ewald, which produced the Today’s Mail campaign. “[Because] Americans’ perceptions of the Postal Service tend to be rooted in their youth, we did find that a redefinition was needed, said Bellissimo. “The imagery of the past does cloud people’s visions of what the Postal Service can do today — and even tomorrow.” (*New York Times*, Stuart Elliott, 10/23/07)

Change of address forms facilitate identify theft

- According to the *Wall Street Journal*, “While identity thieves used a wide combination of methods, fewer than 20% of the crimes involved the Internet. The most frequently used non-technological method was the rerouting of mail through change of address cards.” (*Postcom.org*, 10/23/07)

Iowa Postal Workers Union enters the presidential fray

- Democrat John Edwards has received the endorsement of the 3,000-member Iowa Postal Workers Union, a statewide branch of the AFL-CIO affiliated with the American Postal Workers Union. (*Des Moines Register*, Tony Leys, 10/18/07)

TVA

TVA awards construction contract for completing nuclear reactor to Bechtel

- TVA has chosen Bechtel Power to lead the engineering, procurement and construction work for the completion of the Watts Bar 2 nuclear reactor. From the five firms invited to bid on the project, TVA received proposals from two firms, Bechtel and Shaw, Stone & Webster. The agency said it selected Bechtel's proposal, based upon the company's technical capability, overall value and pricing, and quality of proposed project team. In August, TVA's board unanimously approved completing Watts Bar 2 at an estimated cost of \$2.49 billion, which includes the Bechtel's proposal and other costs to complete the project and start up the unit. Work on the unit is scheduled to begin in July 2008 and be completed by late 2012. TVA expects Bechtel to employ about 1,000 workers during the first three years of the construction with employment peaking at 2,000 in 2011 and then taper off until 2013. After Watts Bar Unit 2 is complete, TVA will employ an additional 250 employees to operate the new reactor. (*Nuclear Engineering International Magazine*, 10/16/07; *Herald News* [Dayton, TN], John B. Carpenter, 10/24/07)

TVA accountability is imperative

- In *The Tennessean* [Nashville, TN], Stephen Smith wrote, "Senator Everett Dirksen's famous quote, 'A billion here, a billion there, pretty soon it adds up to real money' appears once again to describe the leadership of the [TVA]. The new board of directors, at the prodding of TVA's CEO Tom Kilgore, has jumped with both feet back into the nuclear construction business. Earlier this year, the small band of political appointees committed no less than \$2.5 billion dollars of Tennessee electric bill payers' money to an attempt at completing the troubled Watts Bar Unit 2 reactor in East Tennessee. Active construction on this stalled unit has not been attempted for over 20 years. No objective independent review was completed, no rigorous regulatory process, no serious public comment. Remember, this is \$2.5 billion — 'billion with a B' — public dollars."

- “This past month, TVA’s board again laid the foundation for a multi-billion dollar project by moving forward with seeking the construction and operating license for two new nuclear reactors at their Bellefonte site in north Alabama. The potential price tag is undisclosed, but estimates put the cost above \$5 billion. TVA did not involve the public in the decision-making process, nor did they provide any independent analysis that more nuclear plants are the least-cost option for electric bill payers. While the TVA board will claim, ‘no final decision has been made’ on this commitment, there is every indication that they are moving forward.”
- “Whatever your thoughts on the prudence of TVA, which has a \$24 billion debt, getting back into the nuclear construction business, we should all want to make sure that there is real accountability and transparency on how these decisions are being made. It is a fact that no other utility in the country could make these multi-billion dollar commitments with other people’s money without a much more rigorous process. All private utilities in the South must have senior management stand under oath before a regulatory agency called a public utilities commission and be subject to extensive public cross examination before being allowed to spend millions of dollars, let alone billions of dollars. Here in TVA land, a highly unusual structure is in place: The TVA Board of Directors also serves as its regulator. Yes, TVA’s board regulates its own decisions. Anyone who has been to a TVA board meeting will witness a good old boy, back slapping love fest as opposed to a thorough grilling of top executives on the rationale for spending ratepayers’ money. Because TVA is a federal agency, Congress has an oversight role here, but they have dropped the ball completely.”
- “Two weeks ago, the final appointment to the new TVA board appeared before a Senate committee that Senator Lamar Alexander serves on, but not a single tough question was asked. Could it be because Alexander has appointed a lot of his friends to the TVA board? So TVA is back in the nuclear construction business, our rates are going up and TVA debt will be going up. Are you feeling a little like a hen these days?” (*The Tennessean*, Stephen Smith, 10/20/07)

The drought tab for TVA: \$300 million
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- During fiscal year 2007 [which ended September 30th], rainfall was 66% of normal and runoff was 54% of normal in the TVA’s seven-state service area. The drought cost TVA about \$300 million in lost hydroelectric power generation, said TVA officials. (*The Knoxville News Sentinel*, 10/15/07)

The economics of TVA’s Green Power Switch program

- In 2000, TVA began its Green Power Switch program, which generates solar, wind and methane power that is sold to its customers at a premium. The utility has

invested just under \$13 million in capital investments, including \$3 million for solar panels (for 3 megawatts of power), \$4 million for three windmills (for 2 megawatts of power), and \$6 million to methane (for 8 megawatts of power). TVA also buys power from a private company, which operates 15 windmills in East Tennessee. [Jim Keiffer, TVA's vice president of marketing, said the utility's contract with the private contractor prohibits TVA from disclosing the cost per kilowatt hour of the windmills.] In general, Keiffer said, solar costs 40 to 60 cents per kilowatt hour, while wind costs 12 cents and methane costs 4 to 6 cents. TVA said that while it touts its solar and wind programs as being environmentally friendly, it's harder to promote methane as an affordable green source of energy because it is "literally stinky." While methane gas is half as expensive as TVA's windmills and a tenth the cost of solar generators, Keiffer said, "From a marketing viewpoint, it's hard to promote" Over the past 13 months, 1% of TVA's alternative energy came from solar panels, while 33% was generated by burning methane and 66% from wind turbines. Altogether, TVA's alternative energy sources produced 74.8 million kilowatt hours, which powered 4,730 homes during the 13 month period. [representing approximately 0.15% of the homes in TVA's service area]. (*Associated Press*, 10/22/07)

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