

The **GSE** REPORT™

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Major Events

The Federal Reserve proposes rules to curb abusive mortgage lending practices

- The Federal Reserve has asked for public comment on expansive changes to Regulation Z [Truth in Lending] to protect consumers from unfair or deceptive home mortgage lending and advertising practices. The rule, which would be adopted under the Home Ownership and Equity Protective Act, includes four key protections for “higher-priced” mortgage loans secured by a consumer’s principal dwelling. Specifically, the central bank’s proposal would (1) prohibit creditors from engaging in pattern of extending credit without considering borrowers’ ability to repay the loan; (2) would require creditors to verify income and assets that they rely upon in making the loan; (3) would require creditors to establish escrow accounts for taxes and insurance, and would allow borrowers to opt out of the escrow after one year; and (4) would allow prepayment penalties only if certain conditions are met, including the condition that no penalty apply for at least sixty days before any possible payment increase. The rule defines higher-priced mortgages as (1) a first lien mortgage with an annual percentage rate that is three points or more above the yield on comparable Treasury notes; or (2) as a subordinate-lien mortgage with an APR exceeding the comparable Treasury rate by five points or more. In defining higher-priced mortgages, the Fed’s intention is to capture all subprime mortgages as well as many “Alt A” mortgages, according to Fed counsel Kathleen Ryan. In general, the higher priced mortgage provision exclude loans in the prime mortgage market.
- The proposed rule also proposes new protections which would apply to all loans secured by a consumer’s principal dwelling regardless of the loans APR. The protections include (1) prohibiting lenders from compensating mortgage brokers by making payments known as “yield-spread premiums” unless the broker previously entered into a written agreement with the consumer disclosing the broker’s total compensation and other facts; (2) prohibiting lenders and creditors from coercing a real estate appraiser to misstate a home’s value; and (3) prohibiting loan servicers from engaging in certain practices. [For example, servicers would be required to credit consumers’ loan payments as of the date of receipt and would have to provide a schedule of fees to a consumer upon request.]
- The proposed revisions to TILA’s advertising rules require additional information about rates, monthly payments, and other loan features. The revisions also would ban seven deceptive or misleading advertising practices, including representing that a rate or payment is “fixed” when it can change.
- Under the proposed rule, creditors would have to provide a good faith estimate of the loan costs, including a schedule of payments, within three days after a consumer applies for any mortgage loan secured by a consumer’s principal dwelling, such as a home improvement loan or a loan to refinance an existing loan. [Currently, early cost

estimates are only required for home-purchase loans.] In addition, consumers could not be charged any fee until after they receive the early disclosures, except a reasonable fee for obtaining the consumer's credit history. Under the proposal, consumers will have recourse to sue, if the lender breaks any of the provisions of this rule. While the proposal would apply to all subprime lenders, the Fed wouldn't be alone in enforcing it. A final rule would make it much easier for state attorneys general, the FTC, and private lawsuits to litigate lenders who violate the new policies.

- Federal Reserve Chairman Ben Bernanke said it took time for the central bank to write regulations that were balanced. He added, “[The rules] were carefully crafted with an eye toward deterring improper lending and advertising practices without unduly restricting mortgage credit availability.”
- Although the Fed's proposed rule was broader than expected, the proposal did “little” to change the entrenched views of lawmakers, who are calling for a far-reaching, reshaping of the mortgage industry. In less than two hours after the Fed released its proposal, Senate Banking Committee Chairman Chris Dodd (D-CT) said the rule was “a significant step backward.” In a press release, Dodd said, “The board weakened its earlier guidance on requiring an originator to fully analyze a borrower's ability to repay the mortgage at the fully indexed rate, the most fundamental measure of good lending. It raises serious questions as to whether the Federal Reserve is the appropriate institution to house consumer protection functions. This is a clear signal that legislation is necessary to help protect homeowners from abusive and predatory lending practices.” Dodd said he plans to “re-examine” mortgage reform legislation that he recently introduced, because he is now considering taking more power away from the Federal Reserve. Dodd's displeasure may also derail the hopes of Fed governor Randall Kroszner, who was renominated for a 14-year term in May by President Bush. Kroszner and two other nominees need Dodd's approval before facing a Senate confirmation vote.
- Representative Barney Frank (D-MA), chairman of the House Financial Services Committee, called the Fed's proposed rules “generally weak” and a confirmation that the Fed is not an effective consumer advocate. Frank said, “We now have confirmation of two facts we have known for some time: One, the Federal Reserve System is not a strong advocate for consumers, and two, there is no Santa Claus. People who are surprised by the one are presumably surprised by the other.” Frank said he “liked a lot” of Dodd's proposal for a mortgage reform bill. “It's better than what I was able to get through here; the question is what he can get through the Senate,” said Frank. “I'd love to go to conference with him on that bill.” Other lawmakers argued that while the Fed move was welcome, it came too late to avert passage of mortgage reform legislation. Representative Carolyn Maloney (D-NY) said, “We still need legislation to move. My regret is that [the Fed] did not come out with it earlier. We could have avoided this credit crunch.”
- Consumer advocates said that they will continue their push for stricter mortgage reform legislation on Capital Hill. Jim Carr, the COO of the National Community

Reinvestment Coalition, argued that the Fed was overly concerned about how the rules would affect mortgage lenders. “I don’t think the mortgage lending industry is going to fold up and close shop if you purge practices that have been proven year after year to be predatory to unsophisticated consumers,” said Carr. Michael Calhoun, president of the Center for Responsible Lending, said the Fed should have banned lenders from giving loans to home buyers who cannot afford to pay after their adjustable rates increase. Instead, its proposal merely prohibited them from “engaging in a pattern or practice” of selling such mortgages—language that is too vague and “riddled with loopholes,” said Calhoun.

- Mortgage industry associations expressed more support for the Fed’s proposal. “It sets some tough standards, but it appears to take a reasonable and balanced approach that we hope will be workable,” said Steve O’Connor, senior vice president of government affairs for the Mortgage Bankers Association. The American Financial Services Association called the Fed’s proposal “measured,” while the Independent Community Bankers Association called their proposal an “important step.” The American Bankers Association said that the Fed proposal “will make a significant difference in protecting mortgage borrowers and potential homeowners. However, the ABA expressed concern that parts of the Fed’s proposal were too rigid and “could make it harder for bankers to tailor products for their customers.” Wayne Abernathy, ABA’s executive director of regulatory affairs, said, “It touches on the mortgage lending process in so many different places and in so many ways that unless they’re careful they could really introduce some new rigidities into the system.” (*Federal Reserve Press Release*, 12/18/07; *Bureau of National Affairs*, Richard Cowden, 12/19/07; *Wall Street Journal*, Damian Paletta and James R. Hagerty, 12/19/07; *American Banker*, Steven Sloan, 12/19/07; *Washington Post*, David Cho, 12/19/07; *Washington Post*, 12/15/07; *CQ Today*, Benton Ives, 12/18/07; *Washington Post Online*, 12/19/07)
- In a December 21 article in *American Banker*, Ellen Seidman wrote, “With foreclosures reaching record levels and predictions for further trouble ahead, the Federal Reserve Board ...unanimously approved potentially sweeping changes to how mortgages are marketed, made, and serviced, especially in the nonprime market. ...The proposed revisions to regulations under the Truth in Lending Act are designed to realign relationships in the mortgage business, so borrower and lender are once again interested in the same result: a good mortgage. The rules, unlike guidelines bank regulators issued over the last 18 months, would apply to all mortgage lenders and other participants in the process (such as brokers, independent mortgage bankers, and appraisers), not just banks, thrifts, and credit unions. That the Fed has proposed them at all is both an indication of how bad the situation has become and a testament to new leadership at the central bank.”
- “[T]he Fed has not eliminated the need for legislation. There are areas the regulations have not touched, mostly because they are beyond the central bank’s authority. These include nationwide licensing, testing and registration of mortgage brokers; liability — beyond the initial creditor — for violations of standards;

requirements for pre-foreclosure counseling and modification attempts; and bankruptcy law changes to permit judges to modify home mortgage loans that are 'underwater.' And the Fed can't provide the money needed for substantial increases in housing counseling, assistance to communities in trouble because of the foreclosure crisis, or even the enforcement of its own proposal by states and the Federal Trade Commission — all essential if we're to minimize the damage the mortgage crisis still has in store for us. That's the job of Congress and state legislatures. What the Fed did ... is a major move in the right direction. But there's still so much more to do. (*American Banker*, Ellen Seidman, 12/21/07)

President Bush signs mortgage tax relief bill into law

- On December 20, President George W. Bush signed into law a mortgage relief bill (H.R. 3648), which provides a three-year exclusion from income for debt forgiven as a result of a mortgage foreclosure or renegotiation and a three-year extension of the private mortgage insurance deduction. The measure also provides a two-year grace period before widows and widowers lose the full \$500,000 exclusion that married couples have from capital gains. [Current law requires that the home be sold in the same year of the spouse's death to qualify for the full exclusion.] The \$1.153 billion bill will be "paid for" with new penalties for failing to file S corporation or partnership tax returns and a shift in the amount of corporate estimated tax payments due in 2012.
- Bush said the legislation "will help hardworking Americans take steps to avoid foreclosure during a period of uncertainty in the housing market." He added, "The [law] will increase the incentive for borrowers and lenders to work together to refinance loans--and it will allow American families to secure lower mortgage payments without facing higher taxes." Bush also called on Congress to send him legislation that would allow state and local governments to issue tax-exempt bonds for refinancing existing home loans. (*Bureau of National Affairs*, Heather M. Rothman, 12/21/07; *CQ Today*, Richard Rubin, 12/18/07)

Fannie and Freddie were "adequately capitalized" for the third quarter, says OFHEO

- Fannie Mae and Freddie Mac were "adequately capitalized" through the third quarter, according to OFHEO. The regulator said that on September 30th Fannie Mae had a 5.9% surplus above the OFHEO-directed capital requirement, while Freddie Mac's surplus was 1.7% above the requirement. The GSEs' capital levels were down from the prior quarter "primarily due to credit and market-related stresses on income," said OFHEO.
- "The OFHEO announcement should be taken at face value and the implication is at least through the third quarter the losses on their portfolios did not push them beneath the capital requirement," said Charles Lieberman, chief investment officer for

Advisors Capital Management LLC. “The interesting question is: Will OFHEO do anything about the incremental 30 percent capital requirement above and beyond the normal capital requirement that was installed as punishment for their problems in accounting several years ago?” Lieberman also noted that the GSEs’ excess capital at the third quarter, coupled with the GSEs’ \$13 billion of capital raised in the fourth quarter, provides the GSEs a cushion for future losses. “They have some incremental room to take some write-offs for the fourth quarter that was provided by the preferred [stock offerings],” added Lieberman. (*Reuters*, 12/27/07)

Fannie Mae and Freddie Mac

Debate continues over the subprime crisis:

President Bush urges Congress to act quickly to stabilize the mortgage market

Senate Banking Committee Chairman Chris Dodd returns to work on Capitol Hill after withdrawing from the 2008 presidential campaign

Democrats ramp up the rhetoric on the subprime crisis

Former Federal Reserve Chairman Greenspan joins the call for the federal government to provide homeowners financial help to avoid foreclosure

Subprime crisis a hot topic on the presidential campaign trail

Democrats may commit *real* mortgage fraud

National effort needed to convert “material amount” of housing stock into rental housing

President Bush urges Congress to act quickly to stabilize the mortgage market

- Facing criticism that his administration has not done enough to stave off mortgage foreclosures, President George W. Bush said he will push Congress “to act quickly” on proposals he supports to help subprime borrowers. Specifically, the President will renew his calls for Congress to pass FHA reform legislation, which would liberalize the loan program’s guidelines by lowering down payment requirements, would increase the cap on loans eligible for FHA insurance, and would lower origination fees, among other things. The administration is also calling on Congress to temporarily allow states and local governments to issue tax-exempt municipal bonds to subsidize the cost of mortgage refinancing for subprime loans. According to *The*

Bond Buyer, Treasury officials have told lawmakers that the administration would also like to see the dollar cap on the amount of tax-free munis that can be issued by states and local municipalities raised by \$15 billion over three years. The administration has also said it will support a temporary increase in the conforming loan limit for Fannie Mae and Freddie Mac, if lawmakers will pass GSE regulatory reform legislation.

- Presidential counselor Ed Gillespie told reporters that the White House is carefully eyeing economic data amid growing talk of a pending recession and has not taken off the table the idea of an economic stimulus package, which is being recommended by some leading economists. “We’ll do what we think is appropriate to foster economic growth,” said Gillespie. In an interview with *Reuters News Service*, Bush reiterated that he is weighing proposals for a new economic stimulus package, but no decisions are likely until his last State of the Union address to be delivered on January 28th. (*Bureau of National Affairs*, Nancy Ognanovich, 01/04/08; *Reuters*, Jeremy Pelofsky, 01/02/08; *Wall Street Journal*, John D. McKinnon, 01/02/08; *CNNMoney*, 01/04/08)
- On December 17th, Treasury Secretary Henry Paulson acknowledged that there is no “silver bullet” to solve the country’s credit market problems, but expressed optimism in the administration’s initiatives that are aimed to limit mortgage foreclosures, assist troubled borrowers, and restore market stability. “At a town hall meeting outside Orlando, FL, Paulson said, “The magic here is investors and servicers coming together to deal with an unprecedented situation so we don’t have perverse outcomes and so that we don’t have a market failure. The Treasury Secretary reiterated his support of temporarily raising the conforming loan limit for Fannie Mae and Freddie Mac in conjunction with passage of GSE regulatory reform. “From a public policy standpoint, (allowing Fannie and Freddie to securitize more expensive loans) flies against the affordable housing mission, but given the needs right now in this country, I see that as a good thing and would like to see that as part of a program where we reform the GSEs,” said Paulson, who hopes that Congress will pass reform legislation soon. “I want to be an optimist, but this is something that we need to look to Congress to get done,” he added. Paulson also said that he would support the idea of a one-page disclosure document for mortgage borrowers, which would make the customer’s commitment “very clear and understandable.” He also cautioned that lawmakers must be careful to consider how efforts to address the housing market turmoil might destabilize credit markets. “The last thing we want to do is [to] overreact and cut off credit to people who need it the most,” said Paulson. (*Dow Jones International News*, Damian Paletta, 12/17/07; *Dow Jones Newswires*, Damian Paletta, 12/17/07; *Dow Jones International News*, Damian Paletta, 12/17/07)

Senate Banking Committee Chairman Chris Dodd returns to work on Capitol Hill after withdrawing from the 2008 presidential campaign

- On January 4, Senate Banking Committee Chairman Chris Dodd (D-CT) abandoned his candidacy for the Democratic presidential race after placing sixth (in a field of

six) with 0.02% of the votes cast in the Iowa Caucus. For the first nine months of 2007, Dodd raised \$13.6 million for his presidential campaign (fifth among Democrats) with about \$5 million of his funds raised from financial, insurance, and real estate companies. Dodd's non-stop campaigning in Iowa meant a slower pace for his work on moving legislation through the Senate Banking Committee. (*Washington Post*, Shailagh Murray, 01/04/08; *Fox News*, 01/04/08; *Dow Jones Newswires*, Damian Paletta and Alex Frangos, 01/02/08)

- Dodd returns to Washington with a full slate of issues pending before the panel. Topping Dodd's list is sweeping FHA reform legislation, which has passed the House and Senate and now goes to conference committee for to resolve the major differences between the bills. While House conferees are expected to accept the Senate's one-year moratorium on risk-based premiums, the House is expected to push for an FHA loan limit higher than \$417,000. Other issues to be resolved include down payment requirements (zero in the House bill; 1.5% in the Senate bill); a prohibition of seller funded down payment assistance in the Senate bill; provisions which increase civil and criminal penalties to combat fraud (Senate version) and a forbearance of FHA's net worth; auditing requirements if the broker posts a surety bond of \$50,000 to \$100,000, based upon loan originations (House version); and a diversion of FHA revenue to an affordable housing trust fund (House version). According to *CQ Today*, the unresolved issues on FHA reform will result in a "contentious conference." The White House said it is strongly opposed to the House's trust fund language, as well as several other provisions in the House version. According to a White House statement, "Some concerns remain with both the Senate and House bills. We hope to work with Congress to resolve those concerns in a conference between the House and Senate. Congress should quickly send to the president's desk a bill he can sign to help homeowners." (*Dow Jones Newswires*, Damian Paletta, 01/04/08; *CQ Today*, Libby George, 12/14/07; *National Mortgage News*, Brian Collins, 13/31/07)
- Following the Fed's introduction of proposed changes to HOEPA to curb abusive lending, Dodd made it clear that the Fed's plan was a "significant step backward" and that his mortgage reform legislation must be enacted soon. Dodd's bill, which was introduced on December 12th, is more stringent than the House version that was passed in November and could face a "rockier" road in the Senate among Republicans. Dodd's bill would ban yield-spread premiums, prepayment penalties, and debt-to-income ratios above 45% for subprime or nontraditional loans. It also would effectively move a larger percentage of loans out of the market by expanding the definition of "high-cost" loans. Dodd's bill includes broad assignee liability for the trust that holds the mortgage note, which many lawmakers and bankers fear could damage the secondary market for mortgages. "It's awful," said Representative Tom Price (R-GA). "We suffered through that in Georgia. It literally shut down the secondary market, and we rapidly corrected it, thank goodness, but I don't know how one would correct it at the federal level. It doesn't make any sense to transfer the liability." While conventional wisdom on Capitol Hill opines that Dodd will have to scale back his bill to achieve passage in the Senate, it is clear that consumer advocates

expect him to stick to his guns and fight for strong mortgage reform. It is unclear how much support Dodd's bill has even among Democrats on the panel. Senator Tim Johnson (D-SD), one of four Democrats on the panel who has not signed up to co-sponsor the bill, said he hoped to work with Dodd on the subprime crisis "acting where appropriate [but] being mindful of the impact on the availability of credit."

- Senator Chuck Schumer (D-NY), who sits on the Senate Banking Committee, is lobbying for a seven-point plan to address the subprime crisis, which includes (1) about \$1 billion in federal funding for housing counselors; (2) a temporary 10% increase in Fannie Mae's and Freddie Mac's mortgage portfolios; (3) legislation to permit state and local governments to issue tax-exempt bonds for use in refinancing subprime mortgages; (4) changes in bankruptcy laws to permit judges to modify subprime mortgages; (5) anti-predatory lending legislation to prohibit steering; (6) changes in the rules for rating agencies which currently provide for their compensation by parties that benefit from a positive rating; and (7) improvements in mortgage disclosures, possibly including a one-page summary of all key mortgage disclosures. (*American Banker*, Stacy Kaper, 01/02/08; *CQ Today MIDDAY Update*, 01/04/08; *Bureau of National Affairs*, Richard Cowden, 12/20/07)

Democrats ramp up the rhetoric on the subprime crisis

- In a signal of the fast-changing nature of the political debate, former Clinton Treasury Secretary Lawrence Summers called for a \$50 billion to \$75 billion stimulus package with temporary universal tax rebates, extended unemployment insurance, and increased food-stamp benefits, if the national economy shows no sign of improvement by early 2008. Summers also criticized the Bush administration and Federal Reserve for not taking enough aggressive action to prevent a recession. At the same media event, Senator Chuck Schumer (D-NY) lambasted the administration – charging that the nation's economy "teeters on the edge of a recession ... and the Bush administration is just whistling into the wind." He added, "They seem to be unable to get the government moving quickly, decisively, and competently to address a serious economic crisis."
- Schumer also voiced unexpected criticism of Fannie Mae and Freddie Mac, accusing the GSEs of focusing too much attention on their shareholders and not enough on their housing mission. "Well, Fannie and Freddie, you're not just a private-sector company, and you can't keep putting your hat on and taking your hat off when you want," said Schumer. "If your only mission is to increase your shareholder's price, then don't take the government guarantee." Schumer, who has proposed legislation that would temporarily raise the GSEs' portfolio caps and allow them to purchase a combined \$150 billion in mortgages, said he wanted to direct these funds to people with subprime loans to prevent foreclosure. However, Fannie and Freddie didn't like this idea because it would be hard for the GSEs to make money, he said. "Some of us who have helped Fannie and Freddie in the past ought to jawbone them to do it," added Schumer. (*Washington Post*, Neil Irwin, 12/20/07; *Wall Street Journal*,

Damian Paletta and James Hagerty, 12/19/07; *Dow Jones International*, Damian Paletta, 12/19/07)

- In a *New York Times* opinion editorial, Laura Tyson, the chairwoman of the Council of Economic Advisors from 1993 to 1995 [in the Clinton administration], wrote, “The economy faces a vicious downward spiral of foreclosures, declining property values and mounting losses on mortgage-backed securities and related financial assets. The resetting of interest rates on more than 2 million subprime loans will prompt a large number of foreclosures, perhaps a million a year in both 2008 and 2009. These huge waves of foreclosures will depress the price of residential real estate still further. Plummeting real estate values and escalating foreclosures will cause further losses on mortgage-related securities and will further burden American consumers already dealing with higher energy prices and substantial debt. Given the dampening effects of these developments on both consumption and investment spending, it is increasingly likely that the economy will slip into recession next year. The Federal Reserve should continue to cut interest rates and to experiment with new ways to pump liquidity into the financial system.”
- “The Bush administration’s plan for a voluntary freeze by lenders on interest-rate resets for a small fraction of subprime loans has been judged inadequate by the financial markets. Bolder measures — a temporary moratorium on foreclosures on subprime owner-occupied homes, a freeze on interest rate resets for subprime adjustable rate mortgages, and federal funds to help at-risk borrowers to stay in their homes and at-risk communities to reduce foreclosures — are required to contain the potential damage to the overall economy from the crisis in the housing and mortgage markets. (*New York Times*, Laura Tyson, 12/06/07)
- In a December 21st article in the *American Banker*, Eugene A. Ludwig, the comptroller of the currency from 1993 to 1998 during the Clinton administration, wrote, “...The government needs to intervene more directly to get the markets started again and to keep people from being forced out of their homes. In this regard, one part of the solution should be the establishment of a temporary government entity to purchase — at market — subprime, alt-A and other nontraditional prime mortgage products. Such an entity can be financed through the issuance of its own instruments guaranteed by the federal government. This entity would take a variety of measures not to foreclose on the mortgages it purchases, including a broad and permanent reset limitation on the nontraditional mortgage products it buys. Because this entity is in the market purchasing product, it would provide liquidity to the marketplace. But because it is buying at market or near market prices, it is harder to criticize it as merely a government bailout of those who took bets on bad loans. Furthermore, because it would be chartered to keep people in their homes wherever possible, with the power to adjust individual mortgage arrangements, it would play an essential role in avoiding the vicious circle that is beginning to spin because of the high level of foreclosures: foreclosures leading to fire sales, leading to lower real estate values, in turn leading to more foreclosures. There is some helpful analogy here to the Resolution Trust Corp., a temporary, government-created entity that helped us out of

the last real estate crisis, though engaged in rather different activities...” (*American Banker*, Eugene A. Ludwig, 12/21/07)

Former Federal Reserve Chairman Greenspan joins the call for the federal government to provide homeowners financial help to avoid foreclosure

- In a December 16th appearance on ABC’s *This Week*, former Federal Reserve Chairman Alan Greenspan suggested that a tax break or other form of government financial help for homeowners facing foreclosure would be the best “political fix” for the nation’s economy. Greenspan cautioned, however, against meddling with home prices or interest rates to address the severe housing slump. The former Fed chairman said, “It’s important to recognize there are very large groups of people that are in major distress, and having major difficulty in paying off their mortgages even when they’ve tried exceptionally hard. It’s important to help those people without affecting mortgage rates and without affecting the structure of markets. Cash is available, and we should use that in as large amounts as is necessary to solve the problems.” Specifically, cash from the government, asked ABC’s *This Week* host George Stephaopoulos. “Cash from the government, yes,” responded Greenspan. “In other words, if you are going to do that, it’s far less damaging to the economy to create a short-term fiscal problem — which we would — than to try to fix the prices of homes or interest rates. If you do that, it will drag this process out indefinitely.”
- Stephanopoulos asked, “You think infusing cash right now would work?” Greenspan replied, “I don’t know if it would work. But it would certainly help people — help their incomes, it would help their personal state — without affecting the structure of the way markets are behaving and the way the adjustment process is going on. “It is very critical that this thing reach a selling climax, if I may put it. In other words, exhaust itself. It’s only when markets are perceived to have exhausted themselves on the downside that they turn.” (*American Banker*, Steve Sloan, 12/18/07; *Associated Press*, 12/16/07)
- In response to Greenspan’s suggestions on how to help distressed homeowners, Treasury Secretary Henry Paulson, said, “I don’t think what we need is a big government bailout right now. I think what we need is to help the markets work the way they’re intended to work and avoid those foreclosures that are preventable.” On Fox Business Network, Paulson added, “There are a fair number of markets that are stable. I can’t undo the excesses of the last six years - housing prices rising at an unsustainable level, easy credit. When you have these kinds of excesses, it takes a while to work your way through it. I think the appropriate role for the government is to help the markets work and avoid market failures and avoid those foreclosures that are preventable.” (*Wall Street Journal’s Real Time Economics Blog*, Greg Ip, 12/17/07)
- Representative Paul Kanjorski (D-PA), who chairs the House Financial Services Capital Markets Subcommittee, said that former Federal Reserve Chairman Alan

Greenspan's recent call for the government to provide financial assistance to troubled subprime borrowers, coupled with the sudden \$500 billion of infusion from the European Central Bank into the financial system, are bellwethers that should not be ignored. "That should ring a bell of caution for us. Something must be up that we are not fully familiar with at this point or is anticipatory," said Kanjorski. "I get a little shiver up my spine to tell you the truth that we may not be seeing the true nature of the credit crunch and its impact on our economy, and particularly of the longer ramifications." The House needs to put a contingency plan in place quickly, so Congress is prepared to handle a financial disaster if necessary, argued Kanjorski. "We should start preparing for federal action now. ... It would be a mistake for us to do nothing and wait 'til things occur. As soon as we get back we should really call Greenspan and some of these people and start asking them the hard questions. ... 'Did you feel something out there that you haven't previously felt, and if so, what was it, and what can we do about it?' " (*American Banker*, Stacy Kaper, 01/02/08)

- In an American Enterprise Institute white paper, resident fellow Alex J. Pollock suggested that policymakers examine the history of the Home Owners' Loan Corporation (HOLC), Depression-era agency that purchased defaulted mortgages to prevent foreclosure, as part of Congress's current policy debate on the subprime mortgage crisis. From 1933 to 1937, HOLC made more than one million loans to refinance troubled mortgages, representing about 20% of all mortgage loans in the country. [Today, 20% of all mortgages would equal 10 million loans] As an at-risk lender, HOLC turned down approximately 46% of all applications with the largest number of loans made being collateralized by properties in Ohio, followed by Michigan [the two states with the highest default rate today]. HOLC ended up foreclosing on approximately 200,000 loans – or 20% of its loan portfolio—with losses averaging 33% of the agency's investment in these loans. "The fundamental idea was that the HOLC would acquire defaulted mortgages from lenders and investors, giving its bonds in exchange, and then refinancing the mortgages on more favorable and more sustainable terms," wrote Pollock. However, lenders had to recognize a loss on the principal of the mortgage due to a new appraisal and lower property value. After 18 years of operation, HOLC was liquidated and the government's initial \$200 million investment produced a modest return of \$14 million. "As the housing and mortgage bust of 2007 continues into 2008, the lessons of the HOLC again are relevant and well worth studying," wrote Pollock. The white paper is available at http://www.aei.org/publications/pubID.27293/pub_detail.asp. (*AEI Financial Services Outlook: Crisis Intervention in Housing Finance—The Home Owners' Loan Corporation*, Alex J. Pollock, December 2007)

Subprime crisis a hot topic on the presidential campaign trail

- In Ottumwa, Iowa, Senator Hillary Clinton (D-NY) outlined her plan to address the foreclosure crisis, which include a \$5 billion community support plan to help hard-hit communities and distressed homeowners, a 90-day foreclosure moratorium on certain subprime mortgages and a five-year freeze on monthly rates on subprime mortgages

or until they can be converted to affordable, fixed-rate loans. “We can’t have millions of people who are losing their homes or at risk of losing their homes,” said Clinton. “We’ve got to give them a chance to salvage this huge part of the American dream.” (*Wall Street Journal’s WashWire Blog*, Alex Frankgos, Amy Chozick and Elizabeth Holmes, 12/18/07)

- While campaigning in New Hampshire, Senator John McCain (R-AZ) suggested he’d tend toward a wait-and-see approach on government intervention during his unveiling of his major economic plan [which contained tax cuts and government spending reform]. During an interview with CNBC’s Larry Kudlow, McCain said, “I believe that government action is the last resort and not the first resort, and I’d like to see [Treasury Secretary Henry] Paulson’s plan at least have a chance.” (*Wall Street Journal’s WashWire Blog*, Alex Frankgos, Amy Chozick and Elizabeth Holmes, 12/18/07)
- During a campaign stop in mid-December in Savannah, GA, former Massachusetts Governor Mitt Romney, said. “I’m not in favor of a widespread government bailout.” He said he supports Paulson’s plan and emphasized that anything done in this area should be on “voluntary basis.” Romney added, “It would be done through the market system except in circumstances where homeowners had been defrauded in some way.” Later in the month, Romney pleaded with President Bush to stay on top of efforts to stem mortgage foreclosures and to return liquidity to the mortgage market. If things don’t improve, more might need to be done to save homeowners and revive the mortgage market, said Romney. “We may need to look for other tools to bring people together—[such as] cooperatives of mortgage servicing companies or investors coming together again with the interest of helping homeowners stay in their homes without having homes become foreclosed which has multiple negative impacts on the economy.” (*Wall Street Journal’s WashWire Blog*, Alex Frankgos, Amy Chozick and Elizabeth Holmes, 12/18/07; *Wall Street Journal’s WashWire Blog*, Alex Frankgos and Elizabeth Holmes, 12/31/07)
- In a January 3rd editorial, the Brussels newspaper *De Standaard* wrote, “American presidential elections are not ‘home affairs.’ American decisions have repercussions all over the globe. The American mortgage crisis affects banks in Europe. The insatiable American demand for oil makes the Arabian sheiks rich. The American refusal to care for the environment causes the North Pole ice to melt and coastal areas in Asia to flood. A weakened dollar and an immense budget deficit affect the global economy. Hence, the world should be given the right to vote. Because the current situation is a blatant case of taxation without representation, against which the Americans rebelled in 1776. But of course the world will not be allowed to vote. The best we can hope for is that the Americans choose a leader who is deeply aware of the U.S.’s responsibility, as a superpower, for the rest of mankind. The international community was able to limit America’s hegemony somewhat through organizations for international consultation, agreements and the corresponding judicial apparatus. But that system is in crisis, partly through the actions of the current American president.” (*De Standaard*, 01/03/08)

Democrats may commit *real* mortgage fraud

- In a December 16th op-ed in the *Chicago Tribune*, Steve Chapman wrote, “Nothing is more fun than doing noble deeds with someone else’s money, and right now Democrats are getting ready for a rollicking good time. Contemplating the subprime mortgage problem, with numerous borrowers unable to pay their debts, the party’s presidential candidates and congressional leaders have a simple solution: Fleece the lenders.”
- “The troubles arose because banks and finance firms offered mortgages to millions of people who, despite their imperfect credit histories, yearned to buy homes. The loans generally start out with a low interest rate that, after a couple of years, rises substantially. Some home buyers now discover that the reset payments are more than they can handle. On top of that, falling real estate prices mean some can’t recoup by selling, because the home is now worth less than the mortgage. This spectacle has brought forth recriminations from politicians who picture the lenders as James Bond villains, cackling at the chance to toss hard-working families out on the street. In fact, this course is almost as bad a deal for lenders as it is for borrowers. They typically lose up to half the value of the mortgage on foreclosures.”
- “From listening to the critics, you’d never guess that. Senator Barack Obama (D-IL) denounces ‘predatory lenders’ for ‘driving low-income families into financial ruin.’ Barney Frank (D-MA), who chairs the House Financial Services Committee, blames everything on an epidemic of ‘abusive lending.’ But lenders who made bad decisions are already paying the price. Many mortgage firms have gone bankrupt. And if these loans are so unconscionable, the question is not why the foreclosure rate is so high but why it’s so low. According to the Mortgage Bankers Association, less than 5 percent of subprime adjustable-rate mortgages are in the process of foreclosure. The vast majority of borrowers are making their payments, keeping their homes and asking no one for a bailout. Nor is it clear that soaring payments are the chief culprit. Foreclosures are most common in places where home prices are falling—such as California, Florida, Michigan and Ohio, which account for half of all foreclosures this year. Apparently many borrowers, seeing no point in paying off a \$200,000 debt for the privilege of owning a \$170,000 home, have elected to walk away from their obligations.”
- “The remedies urged by Hillary Rodham Clinton, John Edwards and the like include placing a moratorium on foreclosures, freezing teaser rates for five years or more, and forcing lenders to reduce loan amounts to reflect deflated home values. These options are conspicuous for a couple major defects. The first is that they punish lenders for the failings of borrowers. Why should someone who has kept the terms of a contract be penalized for the benefit of the party that didn’t? A lot of people took a calculated gamble on interest rates and home prices. Had they bet right, they’d be reaping the rewards. Since they bet wrong, they are entitled to bear the consequences.”

- “It’s true that if lenders have committed fraud with phony information about their loans, they deserve to be separated from their ill-gotten gains. At the same time, honest ones shouldn’t be punished for offering creative terms just because the loans sometimes go bad. When we’re talking about faceless institutions, it may sound reasonable to confiscate a share of their assets. But there’s no reason to stop with these greedy usurers. Say I sell my home at a handsome premium to someone who, we now learn, has been victimized by a ‘predatory’ loan. Why should I benefit from the lending abuse? If the mortgage company has to sacrifice some of its profit so the buyer can avert eviction, why shouldn’t I have to turn over a portion of mine? Most of us would fail to see the justice in this humane act of redistribution.”
- “If the government imposes the punitive option, another problem will arise: Lenders will be far less willing to offer credit to people with flawed credit records. Even the Bush administration’s plan for mortgage companies to freeze rates on a small number of loans effectively warns lenders to steer clear of all but the soundest borrowers. As Yogi Berra might put it, if mortgage companies don’t want to do business with certain customers, nobody is going to stop them. The consequence of this approach is clear. We’d be robbing tomorrow’s subprime borrowers for the benefit of today’s. Of course, when it comes to proposed solutions, robbery seems to be the order of the day.” (*Chicago Sun*, Steve Chapman, 12/16/07)
- In a December 16th column, George Will wrote, “...Perhaps Washington’s intervention in the subprime problem reveals the tiny tip of an enormous new entitlement: People who voluntarily run a risk, betting that they will escape unscathed, are entitled to government-organized amelioration when they lose their bets. The costs of this entitlement will include new ambiguities in the concepts of contracts and private property.” (*Washington Post*, George Will, 12/16/07)

National effort needed to convert “material amount” of housing stock into rental housing

- During a question and answer session at a December 7th Goldman Sachs Financial Conference, Freddie Mac CEO Richard Syron commented on the challenges that must be addressed the subprime mortgage market in the coming year. Syron said, “...[I]f you take the subprime market, where there’s going to be a lot of heat—there is a lot of heat—there’s a good third of that that’s people who never should have been [in houses] in the first place. Now, let’s be honest with ourselves. We went crazy as a country with goals. We went crazy with a lot of other things. We at Fannie and Freddie contributed to this, with saying everybody’s got to have a house. Everybody [can] have a house. And the way this has to be resolved in the end is you do have a match between kind of units and people that need to live in them. But they may not be able to live in them as homeowners. So we’re going to have to find a way as a national effort to convert a lot of the stock of housing—not a lot, but a material amount of the stock of housing that is now held in shaky hands as owner-occupied and convert it to rental housing with someone else holding it with all kinds of mechanisms—maybe warrants and things for people. And I think that’s going to be a huge political challenge. And I think that challenge is going to hit late spring or early

summer 2008, which, as you say, is going to be a very interesting time.” (*Transcript of Dick Syron Remarks*, Fair Disclosure Wire, 12/27/07)

Tough to manage OFHEO with “one or two hands tied behind your back” says Lockhart

- In an interview with *American Banker*, OFHEO director James B. Lockhart, III finds himself thinking about the something he has tried to avoid—the future of his agency. “Hopefully it doesn’t have a future,” said Lockhart, who remains optimistic about the Senate passing GSE regulatory reform legislation early next year. “It’ll be very tough to manage this agency with one or two hands tied behind your back.”
- Lockhart is aware that Congress may not pass GSE legislation before Fannie and Freddie return to timely submission of financial reports. The director appears to be resigned to easing some constraints on the GSEs if Congress does not act. “At the end of February, assuming they’ve got their ... [financial reports] out on a timely manner and with clean opinions and there are not material weaknesses, it is certainly possible that we will lift the portfolio caps,” said Lockhart. “Without legislation, I’m very reluctant to lift the caps, ... but we have to live up to the agreements we made with the companies.” The director acknowledged that removing the caps may have limited effect in the short term, since the GSEs would need to raise capital to expand their mortgage holdings. Lockhart said, “The question does become, ‘Does that matter at this point, if they’re capital-constrained?’ I’m not sure.” Lockhart is much less willing to remove the GSEs’ 30% capital surplus requirement, which he said he will only discuss after the companies have brought their accounting up to date. “The first test to me is to get the financials out, and if they can’t get their financials out, there’s really no reason to have the conversation,” said Lockhart. “I’ve told the two companies we’ll look at the cap when they put out their financials in February, and at that point we’ll discuss what the tests are to get the 30% removed. ... Both companies would like the 30% removed, and in my view, it would be premature. They haven’t resolved all their operational problems, and until they do that, especially in this market, I don’t think it would be a very safe and sound thing to do. ... Frankly, they could have conserved capital better than they did, in my view, and we’ve told them that. That’s why they had to react so quickly and issue such a big amount of preferred [stock].”
- Lockhart defended the GSEs’ recent increase in fees on mortgages they purchase. “There’s a lot of risk in this marketplace, and that’s really related to the potential for bigger losses, and so from our standpoint as a safety and soundness regulator, we can’t say you shouldn’t raise your fees,” said Lockhart. “The problem is, everybody so underpriced their product for the last three or four years that you really don’t know what the right price is. ... I think they’re trying to reprice to get to the right risk level.”

- In hindsight, Lockhart said he was right to oppose Senator Chuck Schumer’s proposal this fall to temporarily raise the GSEs’ caps by 10% to improve the liquidity of the mortgage market. “My concern back in September and August when there was a lot of pressure to raise it 10% was, frankly, what happened—that there was a lot of credit risk out there that was going to start to be reflected and potentially hit their capital,” he said. “If we’d increased that 10%, that would have been a significant amount of additional capital they would have had to raise.” (*American Banker*, Steven Sloan, 12/21/07)

Today’s roadblocks to GSE regulatory reform

- According to *American Banker*, sources say the biggest stumbling blocks to passage of GSE reform center on disagreements on how far the GSE regulator can go in setting new capital requirements and the establishment of an affordable housing fund in the House bill. “The current battle is, of course, over this housing fund,” said Rep. Richard Baker (R-LA). “Whether you want to try to merely adjust the fund or whether you want to eliminate the fund, there are people — significant numbers of people — who have great concerns about the fund.”
- [Baker, who has fought for GSE regulatory reform for more than a decade, told reporters that he will decide soon whether to leave Congress to become the next president and CEO of the Managed Funds Association, a lobbying organization for the hedge fund industry. “I don't see these discussions taking weeks or months. I see it more as a matter of days," said Baker, who is serving his tenth term in Congress. If he accepts the position, Baker would resign from Congress to avoid a conflict of interest between the wide-ranging hedge fund industry and his position on the U.S. House Financial Services Committee and the Louisiana governor would set a special election to fill his seat. If he doesn't accept the job, Baker said he would run for re-election in the fall.]
- In an email to *American Banker*, a Freddie Mac spokesman wrote, “We remain concerned about how certain provisions of this [GSE reform] bill could be implemented in the current turbulent market — especially the possibility of capital requirements not tied to the actual risks of our assets, and business activity regulation that constrains our ability to respond quickly to a changing marketplace.”
- Jim Vogel, the head of fixed-income research at FTN Financial Capital Markets Corp, said, “You have three tensions that are ... unresolvable in 2008. You have shareholders that have been flattened. They would love to get their capital out and deploy it elsewhere. Any regulator would want them to keep as much capital as possible. Then you have this third group that want Fannie and Freddie to support their mission. Every time an intelligent mover has tried to find a way to compromise, somebody has cut off that compromise with a hard line on one of those three points.” Brian Gardner, a political analyst for KBW Inc.’s Keefe, Bruyette & Woods Inc., said, “The GSEs think they can wait this out for another year and get a bill more to

their liking with a more Democratic Senate and a Democratic president. Why not wait a little longer and get a better deal?” Wayne Abernathy, a former Treasury assistant secretary for financial institutions and now a top official at the American Bankers Association, said now might be the best, and last, chance to pass GSE regulatory reform. “What’s changed is that the Fannie and Freddie world is no longer as quiet as it was,” said Abernathy. “There is a new recognition that there is a new set of problems. In the past, it was accounting problems. Now they have financial problems.” (*American Banker*, Rob Blackwell, 12/28/07; *Associated Press*, 01/04/08)

GSEs face \$3.5 billion loss on their derivatives in the 4th quarter

- During the fourth quarter, Fannie Mae and Freddie Mac probably lost more than \$3.5 billion on derivatives used to hedge against interest rate changes, said analyst Jim Vogel, the head of agency debt research at FTN Financial. “While most of these ‘losses’ are accounting entries, not economic events, they still have a big headline impact,” wrote Vogel in a note to clients. During the third quarter, smaller losses on such derivatives combined with expenses for surging home loan delinquencies produced a record \$2.02 billion loss at Freddie Mac and a \$1.4 billion loss at Fannie Mae. (*Bloomberg News*, 01/03/07)

Industry representatives protest the GSEs’ tax on housing

- In letters to Fannie Mae and Freddie Mac, the Mortgage Bankers Association has objected to the companies’ increases in fees on mortgages. Kieran P. Quinn, chairman of the MBA, wrote, “[The] recent pricing changes will drive up the cost of homeownership for all borrowers. For borrowers on the margin, this additional charge may very well put the dream of homeownership out of reach.” Observers estimate that the GSEs’ up-front, 25-basis point fee that the Fannie and Freddie will begin collecting on loan amounts in March would roughly translate into a 6-basis-point increase in interest rates on conforming mortgages. The National Association of Home Builders has also protested the plan, calling it a “broad tax on homeownership” that will make it “more difficult for the housing market to regain its footing.” (*American Banker*, 12/20/07)
- On December 21st, the Manufactured Housing Institute announced its “vigorous” opposition to Freddie Mac’s announcement that, as of March 1, 2008, it will be charging an additional “delivery fee” of 50 basis points to lenders to purchase manufactured home mortgages—which will be added to the current penalty of 50 basis points that they already charge for manufactured home mortgages. These penalties applied specifically to manufactured housing are in addition to the recently announced 25 basis points charged for all mortgages. To make matters worse, the new announcement also adds yet another 50 basis points penalty for mortgages scored “A-minus” or lower by Freddie Mac (this includes the vast majority of manufactured

home mortgages)—bringing the total penalty for most manufactured housing loans to 175 basis points (or 1.75% of the loan balance). This will dramatically impact the affordability for manufactured homes secured by real estate.

- “Freddie Mac’s tax on homeownership unjustly penalizes tens of thousands of manufactured home buyers,” stated MHI President and CEO Gail Cardwell. “MHI and its affiliated state associations will vigorously oppose this homeownership tax by reaching out to Members of Congress to combat Freddie Mac’s unsubstantiated penalties. Freddie Mac already incorporates a risk premium for manufactured housing in its existing underwriting process. This additional charge does not accurately reflect risk and comes at a point in time when Freddie Mac should be providing liquidity to the marketplace and accepting a lower return to promote affordability, in accordance with its public mission and charter.” (*PR Newswire*, 12/21/07)
- At a December 7th Goldman Sachs Financial Conference, Freddie Mac chairman and CEO Richard Syron responded to a question about why the GSEs’ increased the costs of mortgages. Syron said, “Look, at the end of the day, at least in the short run, economics is a zero sum gain. ...I think most people would agree ...that we’re returning to rational prices. The credit for everything, just about, was priced too loosely around the globe. So you have to get back to rational pricing. Our originators were not thrilled by the price increase. We didn’t hear an enormous amount of screaming back. And I think that’s because they realize—Look, last week, we hurt our common shareholders by cutting the dividend—two weeks ago—by cutting the dividend in half. We went out and we raised with that \$6 billion in preferred because we had capital concerns. The way you get capital—The way you want to get capital over the long run is by generating earnings, and we just plain weren’t generating enough earnings on the basis of the prices that we were charging, particularly in the current risk environment. And we have three responsibilities—liquidity, stability, affordability. But we’re a publicly chartered company that has shareholders. So I don’t have the right, nor would I want the right, nor do I intend to be in a situation where we say we won’t do what’s right for the shareholders in order to subsidize some other market. We’re just not going to do it. And we did what any other business would have done in this environment. And I think, quite honestly, I believe that the GSEs are necessary for the health of the U.S. mortgage market in the long term, and I think that requires healthy GSEs. And I think healthy GSEs required a price increase. (*Transcript of Dick Syron Remarks*, Fair Disclosure Wire, 12/27/07)

<p>Bipartisan group of senators introduce legislation to establish the National Affordable Housing Trust Fund</p>

- On December 19, Senators John Kerry (D-MA), Olympia Snow (R-ME), Bernie Sanders (I-VT), Pete Domenci (R-NM) and Charles Schumer (D-NY) introduced the a bill in the Senate which would create the National Affordable Housing Trust Fund to provide a steady source of “off-budget” federal support primarily for the

construction and rehabilitation of rental housing units. (*Bureau of National Affairs*, Richard Cowden, 12/21/07)

Federal agency debt increased nearly 20% in 2007

- Federal agency debt issuance increased nearly 20% to \$820 billion in 2007 from \$686.2 billion in 2006. Short-term debt issuance was boosted by unusually heavy FHLB System advances during the credit crisis in the fall. According to RBS Greenwich Capital analyst Margaret Kerins, FHLB Advances increased more than \$200 billion in 2007, compared to an average rise of \$34 billion during the prior five years. Analysts expected agency debt could continue to grow in 2008, particularly if the regulatory caps on Fannie Mae and Freddie Mac are lifted by OFHEO. However, net supply growth should stay contained in 2008 with the GSEs' excess capital still restrained and market conditions remaining volatile, said Kerins. "While some of the increase in capital [at Fannie and Freddie] due to the recent issuance of preferred stock may support growth, we expect that the majority is needed to prepare for a deteriorating mortgage market and increasing credit exposures," she added. (*Reuters*, Lynn Adler, 12/31/07)

OFHEO announces the appointment of Myrtle S. Habersham as Associate Director of the agency's new Office of Management Planning

- On December 21, OFHEO director James B. Lockhart, III announced the appointment of Myrtle S. Habersham as Associate Director of the Office of Management Planning. Habersham will be responsible for overseeing and coordinating strategic planning, implementation of the president's Management Agenda, facilities management, physical security and all aspects of emergency preparedness and continuity of operations planning (COOP) for OFHEO. She will also serve as OFHEO's first Performance Improvement Officer, a new position required by an Executive Order of the President. For nearly four decades, Habersham served at the Social Security Administration and the Department of Health and Human Services (DHHS) including serving most recently as SSA's Chief Strategic Officer and prior to that, Regional Commissioner for two of SSA's largest regions, Atlanta and Chicago. She also served as the Inspector General for the Atlanta region. Ms. Habersham is a three-time recipient of the Presidential Rank Award as well as numerous SSA and DHHS awards. (*OFHEO Press Release*, 12/21/07)

Fannie Mae

Fannie Mae's mortgage portfolio falls at a 15.6% annualized rate in November

- In November, Fannie Mae's retained mortgage portfolio fell at an annualized rate of 15.6% to \$722.0 billion from \$732.3 billion in October. At month end, Fannie Mae's net retained commitments were (\$4.5 billion). The company's mortgage-backed securities and other guarantees rose at a compound annualized rate of 21.1% during the month with Fannie's MBS issuances totaling \$62.6 billion during November. The GSE's Conventional Single-Family Serious Delinquency Rate rose five basis points in October to 0.83% (the latest data available), while its Multifamily Serious Delinquency Rate fell one basis point to 0.07% in October. Fannie Mae's effective duration gap averaged plus one month in November. (*Fannie Mae's Monthly Summary*, November 2007; *Associated Press*, 12/21/07)

Moody's lowers Fannie Mae's BFSR outlook to negative

- Moody's Investors Service has revised the outlook on Fannie Mae's 'B+' bank financial strength rating to negative on its view that the GSE's 2008 profitability will be modest or even negative due to rising credit costs and the deteriorating mortgage market that Fannie Mae is likely to face. The rating agency also affirmed the firm's debt ratings including 'Aaa' senior debt, 'Prime-1' short-term, 'Aa2' subordinated debt and 'Aa3' preferred stock ratings with a stable outlook. Moody's noted that Fannie Mae has sufficient capital levels to meet all regulatory requirements even under a severe deterioration in the housing market. (*CNNMoney.com*, 12/20/07)

Bush is the devil and he *made* me do it...

- In the *American Thinker*, Thomas Lifson wrote, "Bush is the devil and the devil made me do it. That seems to be the gist of the argument being presented by [former Fannie Mae chairman and CEO] Franklin Raines, to explain his fall from grace. Readers may recall that Raines was an extraordinary success story: son of black janitors, Harvard undergrad and law degrees, Rhodes Scholar, investment banker, White House official under Bill Clinton and then richly-remunerated head of quasi-public Fannie Mae... It all came crashing down about him when it was revealed that certain, ahem, accounting irregularities overstated earnings by billions, and inflated the bonus payments received by Raines. He received more than \$90 million from 1998 to 2003, including more than \$50 million in bonuses tied to the company hitting earnings targets, according to [OFHEO], which is suing him to recover some of these funds. He also faces a huge potential liability from shareholder lawsuits."

- “But now, according to *CNN Money*: ‘The former chief executive officer of Fannie Mae says the Bush administration helped orchestrate an accounting scandal that cost him his job and that he wants to use White House documents to defend himself in a shareholder lawsuit. Franklin Raines ...argues in court documents that the Bush administration felt the government-chartered agency wielded too much power in the mortgage industry. His attorneys say the White House pushed regulators to weaken Fannie Mae and triggered a \$6 billion accounting scandal.’”
- “So he’s a victim, forced to accept tens of millions of dollars in compensation based on dubious accounting results of his company’s earnings. Greed had nothing to do with it. He’s just a public-spirited liberal. A fishing expedition into White House files is just the thing to demonstrate the evil outside forces which bear the real responsibility for his management of his company. Right. A babe in the woods Rhodes Scholar, tricked by what the left still regards as the dumbest president in history.” (*American Thinker*, Thomas Lifson, 12/22/07)
- On December 20, U.S. District Court Judge Richard J. Leon quashed Raines’ efforts to subpoena records from the White House for use in his defense against lawsuits accusing him and the company of securities fraud. The judge noted that many of Raines’s assertions were based on analysts and newspaper reports. “Press reports have no value in this [court] room [because they] might not be worth the paper they’re printed on,” said Leon. The judge said that he was not convinced that a search of White House records would turn up evidence relevant to the case, but told Raines’s attorney, Kevin M. Downey, that he could try to revive his White House subpoena if he finds stronger proof for his theory. “Leave the chicken in the oven. Let it cook a little longer. See what you come up with,” said Leon from the bench. The judge said he was influenced by a letter to a member of Congress written by OFHEO director James B. Lockhart, III, who wrote that his agency’s officials had not encountered any White House interference. (*Dow Jones International News*, Damian Paletta, 12/20/07; *Washington Post*, David S. Hilzenrath, 12/21/07)
- Separately, Raines has asked a judge to fine OFHEO at least \$10,000 a day for failing to provide documents related to Fannie Mae’s \$6.3 billion of overstatement of earnings. The filing escalates a 17-month fight between Fannie Mae’s former chairman and CEO and OFHEO, over charges that Raines and other company executives used improper reserves and deferred expenses to hit earnings targets, which triggered management’s bonuses. (*WashBiz Blog*, Terri Rugar, 12/28/07)

Fannie Mae streamlines its multifamily underwriting
in hopes of minimizing the red tape and maximizing the lenders’ flexibility

- One of Fannie Mae’s competitive strengths in the multifamily market has been its delegated underwriting program, in which the company delegated credit decisions to lenders who agreed to retain some of the risk. Over the years, the DU program guidelines have become so complicated that lenders often had to obtain on average

five or six waivers from Fannie Mae for each loan. With competitive and risk considerations in mind, Fannie Mae overhauled the DU program to restore the lenders' authority and allow the GSE to focus its attention on vetting the riskiest loans. The program's new guidelines, which trimmed the DUS lender manual down from 400 to 50 pages, will no longer require lenders to go to Fannie Mae for things like appraisals, engineering, and replacement reserves. Michele Evans, Fannie Mae's vice president of multifamily corporate affairs, said that these changes should cut the average number of exceptions from five or six per loan to one. Evans said that today, only 30% of DUS loans are delegated in full to lenders. After the new guidelines are widely adopted, Evans hopes that percentage will rise to 80% with the remaining 20% of loans being the most "aggressively underwritten" by Fannie. Evans emphasized that the loans underwritten by Fannie will include those with debt service coverage below 115% and "anything to do with borrower credit." Fannie's revisions are not intended to create "lightened [underwriting] standards," insisted Evans. "Quite the contrary, we want to home in on what is the greater risk." (*American Banker*, William Launder, 12/26/07)

Freddie Mac

Freddie Mac's retained portfolio shrinks to two-year low

- Freddie Mac's retained mortgage portfolio shrank for a third straight month in November to \$701.4 billion, its lowest level in two years. The company's portfolio contracted \$1.8 billion in November for a 3.1% annualized rate. FTN Financial analyst Jim Vogel cautioned that Freddie Mac's portfolio, which generates the lion's share of its profits, would fall again in December. "Without fairly aggressive cash settlement purchases in the first two weeks of December, Freddie Mac's December 31 cash portfolio is very likely to fall below \$700 billion," said Vogel in a note to clients.
- In November, Freddie Mac's mortgage bond business grew at an annualized rate of 12.3% to nearly \$1.7 trillion. Delinquencies on single-family home loans guaranteed by Freddie Mac increased 3 basis points to 0.54% percent in October from 0.51% in September, while defaults on loans that have been "credit enhanced" rose to 1.40% in October from 1.34% in September. A company spokeswoman said that Freddie has not quantified its exposure to bond insurers. Freddie Mac also reported a duration gap of zero months in November, unchanged from the previous month. (*Reuters*, Al Yoon, 12/20/07; *Freddie Mac's Monthly Volume Summary*, November 2007)

Won't Freddie's expected credit losses erode the capital that it just raised?

- During a question and answer session at the Goldman Sachs' Financial Conference on December 7th, an audience member asked Freddie Mac's CFO Buddy Pizel, "[I]f [your] expectations [for Freddie's credit losses] play out, wouldn't you essentially erode the new capital that you just raised?" Pizel responded, "Well, you think about the timing in which this is going to emerge. And I said that we're trying to take some actions, because the big way that the credit emerged in the third quarter was on these marks. **And some of the marks and some of the accounting we're trying to get out of because we don't think it's representative of where, ultimately, the credit will come from and the way it should be emerging in the numbers.** [Emphasis added.] So, you're right. We said that we're expecting defaults in the \$10 to \$12 billion range overall. We've taken \$4.5 billion through the first three quarters. So we're basically halfway there. We're assuming we're going to take the rest over the next couple years. But, remember, we're getting earnings. So there's retained portfolio earnings, there's the fees that we're earning on top of that. We've announced the fee increases. There's going to be reduction in the G&A. So there's a lot of other sources of profits that contribute to what the overall P&L outcome is going to be. (*Transcript of Dick Syron Remarks*, Fair Disclosure Wire, 12/27/07)

Freddie Mac surpasses its \$20 billion commitment to fund
“consumer-friendly” subprime mortgages

- According to Freddie Mac’s corporate citizenship highlights, the company “surpassed its commitment to buy \$20 billion in more consumer-friendly subprime mortgages. As part of its pledge, Freddie Mac introduced SafeStep Mortgages, which are designed to give subprime borrowers more sustainable mortgage options.” The company also noted that “[d]uring the first ten months of 2007, Freddie Mac and its servicers enabled 43,622 borrowers to avoid foreclosure. In the majority of cases, the borrowers were able to stay in their homes through a repayment plan, a loan modification or a forbearance.” (<http://www.freddiemac.com/>)

Freddie Mac’s debt rose to highest level in more than three years

- In December, Freddie Mac’s debt outstanding rose \$30 billion to \$774.5 billion, the highest level in the last three and half years. The company’s short-term borrowing drove the increase, climbing \$34.8 billion to \$199.4 billion in December. According to FNT Financial analyst Jim Vogel, the sharp increase in Freddie Mac’s debt in December may reflect “heavy” buying for the portfolio, in part to meet annual regulatory goals tied to the amount of low-income housing that the company finances. John Radwanski, Freddie Mac’s vice president of debt funding, said the company ended up with such a sharp increase in short-term debt partly because it retired longer-term callable debt as interest rates fell. “Callable debt comes off the books a lot faster than it comes on the books,” said Radwanski. Investors also were demanding less of a premium over benchmarks on Freddie Mac’s short-term debt than on its long-term debt, he added. “From an economic standpoint, it also made a lot of sense for us to take advantage of that.” (*Bloomberg*, Jody Shenn, 01/02/08)

Freddie Mac securitizes Centerline Capital’s \$2.8 billion housing bond portfolio

- Centerline Capital Group has announced the completion of a securitization of the company’s \$2.8 billion tax-exempt affordable housing bond portfolio through Freddie Mac’s affordable housing bond portfolio for multifamily homes. The transaction, which was secured by 275 properties in 31 states and the District of Columbia, is one of Freddie Mac’s largest multi-family transactions. In this transaction, Freddie Mac guarantees the senior securities issued through its tax-exempt bond securitization program with Centerline Capital, which holds the subordinate securities in its own portfolio and services the underlying loans. “Our ongoing servicing arrangement creates a fund management structure for the bond portfolio similar to other funds,” said Centerline’s president and CEO Marc D. Schnitzer. Since 2005, Centerline has worked closely with Freddie as the sole lender permitted to fully underwrite and originate loans through the Targeted Affordable Housing Seller/Servicer program. To date, Centerline has invested more than \$350

million with Freddie Mac through their delegated underwriting program. [Centerline is the only lender that has full underwriting authority under Freddie's Delegated Underwriting for Targeted Affordable Housing program, while six lenders have received some delegated authority under this program] (*American Banker*, William Lauder, 01/03/07; *BusinessWire*, 01/02/08; *BusinessWire*, 12/26/07)

Freddie Mac provides \$198 million of financing for purchase of eight apartment properties in five states
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- Freddie Mac has purchased a \$198 million pool of crossed-collateralized, cross-defaulted mortgages from Capmark Finance, Inc. Freddie Mac put together a flexible financing solution for Capri Capital Partners, LLC for the acquisition of the Capri Apartments, which consisted of eight properties and 2,224 units in Florida, Texas, Colorado, Nevada, and California. The borrower also benefited from using the enhanced Freddie Mac Interest-Only Fixed-Rate Mortgage product. "We took the deal from under seller application to approval and commitment in less than three weeks," said Richard Martinez, Freddie Mac Central Region managing director. (*Freddie Mac Press Release*, 12/31/07)

Federal Home Loan Banks

U.S. Senate unanimously confirms Mendelowitz
to serve on the Federal Housing Finance Board

- On December 19, the U.S. Senate voted unanimously to confirm Dr. Allan I. Mendelowitz to serve another term on the Federal Housing Finance Board. On October 18, President Bush reappointed Mendelowitz, a Democrat, to a seven year term that expires on February 27, 2014. Prior to joining the Finance Board, Mendelowitz served as executive vice president of the Export-Import Bank of the United States, responsible for overseeing all of the Bank's programs and operations. From 1981-1995, he had a distinguished career with GAO, where he served as managing director of International Trade, Finance and Economic Competitiveness. (*Federal Housing Finance Board Press Release, 12/20/07; American Banker, Steven Sloan, 12/26/07*)

FHLBs emerge as vital source of liquidity for the U.S. banking system

- In an interview with *Financial Times*, Federal Housing Finance Board chairman Ronald Rosenfeld said that the FHLB System has access to an unlimited amount of money that the Banks can lend to support the mortgage finance industry as long as investors are willing to keep on buying its debt at moderate prices. "I do not think there is anything that sets a maximum amount of potential advances," said Rosenfeld. "If the market were to perceive some excess and therefore began to resist buying our securities that would obviously impose a limitation. I simply could not begin to quantify that nor do I see it coming in the near future."
- Since the onset of the credit crisis this summer, the FHLBs have emerged as a vital source of finance for mortgage lenders, lending at an unprecedented annualized rate of roughly three-quarters of a trillion dollars a year and issuing in November alone \$210 billion in debt. The Finance Board chairman said, however, that the FHLBs would not lend without limit to individual financial institutions. "At this time prudence would suggest that an individual bank does not go beyond a certain point with any particular member," said Rosenfeld. "I am sure that will continue to be a topic of discussion." On September 30, the three largest borrowers from the FHLB System were Citigroup, Countrywide and Washington Mutual.
- Rosenfeld said that the FHLBs are serving their original mission of providing a backstop source of liquidity when the normal private sources of finance dried up. "The role has not changed," said Rosenfeld. "The numbers have changed." The FHLBs provide an essential "safety buffer" for private markets, he added. "If the members of the system could obtain funds elsewhere at better prices or on better

terms they would do so.” The market liquidity required “an entity that has a greater purpose in life than just pure profit,” Rosenfeld added.

- While some top former economic officials worry about the massive expansion of GSE debt that is seen as carrying a government guarantee, Rosenfeld said, “I do not look at this in context personally of risk to the American taxpayer. I look at it more in the context of benefit to Americans. There is always a risk. But the reward in my opinion is enormously more significant than the risk.” The FHLB System is protected from credit risk by tough collateral rules and a requirement to post de facto margins. While the Finance Board is on “high alert” during this time of turmoil in the mortgage markets, Rosenfeld said there was no blanket prohibition on posting complex or illiquid securities as collateral for FHLBs’ loans. “Once we start saying we will not take something that is hard to value, it exacerbates liquidity problems in our system,” he added.
- The FHLBs’ investment portfolio consist of \$130 billion in mortgage-backed securities, which include “some” subprime loans. [The Finance Board’s staff estimates that the dollar-weighted exposure to securities backed by subprime loans is less than 10% of the private label MBS holdings.] “We believe after very extensive analysis that there is very minimal credit risk in the MBS held by the Banks,” said Rosenfeld. When asked what would happen to the FHLBs’ portfolios if house prices fell by 20% or 30% per cent, Rosenberg responded, “I do not know the answer—but I can tell you I do not want to hear the news.” (*Financial Times*, Kirshna Guha, 12/18/07)

FHLB-Indianapolis announces the \$100 million HomeRetain program to help its members relieve threat of foreclosure
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- The FHLB-Indianapolis has introduced the HomeRetain initiative to help member institutions assist mortgage borrowers who are facing foreclosure. The \$100 million program will be split among member institutions in Indiana and Michigan at the cost of funds plus a small administrative markup. Members can use these funds to modify or refinance mortgages for primary residences in any state in which they do business to homeowners who earn 115% or less of an area’s median income. Homeowners cannot take any cash out of the loan modification or refinancing. Also, the funds must be invested in a fixed rate mortgage product and the borrower(s) must complete an approved counseling program. No single Bank member can use more than \$15 million of the HomeRetain funds. (*American Banker*, Rob Blackwell, 12/31/07)

FHLBs announce dividends

- The FHLB-San Francisco announced that its fourth quarter dividend is projected to be 5.49% based upon an estimate of the Bank’s fourth quarter earnings. In accordance with the Bank’s Retained Earnings and Dividend Policy, the FHLB-San Francisco

expects to announce its fourth quarter operating results on February 14th and announce the fourth quarter dividends at that time. (*FHLB-San Francisco Press Release, 12/27/07*)

- The FHLB-Atlanta's board of directors has approved an annualized dividend rate of 6.0% for the fourth quarter, applicable to capital stock held from October 1, 2007 to December 31, 2007, payable at the close of business January 2. (*FHLB-Atlanta Press Release, 12/20/07*)

FHLB-Cincinnati announces promotion of Andrew Howell to serve as the Bank's COO

- The FHLB-Cincinnati's board of directors has approved the promotion of Andrew S. Howell to the newly created position of Executive Vice President and Chief Operating Officer, effective January 1, 2008. Howell, 46, previously served in several management positions at Huntington Bank, Bank One, and First National Bank of Cincinnati. In 1989, he joined the FHLB in the credit department. Earlier this year, Howell was named Executive Vice President, Mission Asset Activity, responsible for the Bank's credit services, mortgage purchase program and housing and community investments. (*FHLB-Cincinnati Press Release, 12/28/07*)

FHLB-Indianapolis announces the retirement of Brian Fike, SVP of member services

- The FHLB-Indianapolis has announced the retirement of Brian K. Fike, Senior Vice President – Member Services, effective February 29, 2008. Fike has voluntarily retired from banking to pursue other personal and professional interests. (*FHLB-Indianapolis Press Release, 01/04/08*)

International Mortgage Market

EU delays new rules on home lending

- In Europe, mortgage lenders won a delay in the promulgation of new marketing and refinancing rules after European Union regulators said that they needed more time to assess the market. In a December 18th policy paper, the regulators said that more time was needed before laws are proposed to open cross-border lending and cut prices for home loans. “Further analysis and consultation with stakeholders must take place before a final political assessment can be made on the most appropriate way forward,” concluded the regulators. The EU agency plans a series of reports in 2008 and may follow-up with proposed legislation addressing the mortgage market. Over the past two years, banking industry groups have urged the EU to slow down on a push for new requirements on the region’s \$8.3 trillion mortgage market. (*Bloomberg News*, 12/19/07)

Spain’s house of cards have started tumbling down

- *Financial Times* reports that Spanish property developers’ stocks have plunged in value due to their business models, which relied heavily on debt and are now struggling to service their debt. According to *FT*, “The problem in Spain is all the greater given that the country during the past five years or so has been building about 800,000 homes a year—that is the combined annual total of France, Britain and Germany. The Spanish building industry now expects the number to fall to about 450,000 a year until 2013. As a result, it also warns of some 400,000 job cuts in the sector that has accounted in the recent past for about 7.5 per cent of Spanish gross domestic product. As for house prices, these have increased by a whopping 280 per cent between 1997 and 2006 and are now starting to fall back for the first time in a decade. So it is not surprising the banks, themselves heavily exposed to the sector, are closing their credit taps. All this must worry the Zapatero administration acutely. Spain holds elections in March, which most people consider are too close to call. If the Socialist government is still claiming a short lead, it could easily be wiped out if Spain’s house of cards keeps tumbling down.” (*Financial Times*, Paul Betts, 01/03/07)

Farm Credit System / Farmer Mac

Farm Credit System: 0 for 3

- In the December issue of *Farm Credit Watch*, Bert Ely wrote, “Last Friday [December 14] , the FCS lost again as the Senate passed, 79 to 14, its version of the 2007 [\$286 billion] Farm Bill [with no Farm Credit System expansionist provisions]. Although a floor amendment to add some HORIZONS provisions to the Farm Bill was expected to be offered, it was not. The FCS has now struck out three times—when the HORIZONS provisions were dropped from the Farm Bill on the House floor, when the Senate Ag Committee did not plug any HORIZONS provisions into the Farm Bill, and when a HORIZONS amendment was not offered on the Senate floor.”
- [According to the December 21st *ABA Ag Banker*, “ABA and its state bankers association allies were unrelenting in their efforts to keep the Senate legislation free from FCS measures that would have expanded the system’s home mortgage and commercial lending authorities. Those efforts included numerous contacts with senators, two fall fly-ins of bankers and state association executives, and 38,000 letters of opposition from bankers and their employees...ABA will continue working to ensure that no FCS measures are included in the final legislation that emerges from a conference to reconcile the differences between the Senate and House bills”]
- Ely continued, “The HORIZONS battle is not over—one round remains. Because the House and Senate passed different versions of the 2007 Farm Bill, those differences must be reconciled in a conference committee comprised only of senior members of both Ag committees. Theoretically, the conference committee cannot add to the bill any provision not previously adopted by the House or the Senate. However, that rule is not always honored. Further, there are provisions in both Farm Bills which affect the FCS; those provisions could be used as the hook for adding HORIZONS provisions to the final version of the Farm Bill. Given the FCS’s strong support in both Ag committees, this is a very real threat. Bankers must continue expressing their opposition to HORIZONS until the 2007 Farm Bill goes to the President for his signature.” (*Bert Ely’s Farm Credit Watch*, Bert Ely, December 2007; *ABA AgBanker*, 12/21/07)

The ethanol turf war pits bankers against the FCS

- As President Bush signed the a bill requiring fuel producers to increase their use of ethanol fivefold over the next 15 years, the banking industry ramped up the rhetoric on who is best qualified to finance construction of ethanol plants with the release of a new study, commissioned by the American Bankers Association and the Independent Bankers of America. According to the study conducted by New Energy Finance, Ltd

(Alexandria, VA), commercial banks have provided more than \$8.4 billion—or roughly 55%—of the ethanol industry’s funding since 2004 versus the Farm Credit System’s 8% of the industry’s funding over the same period. The study finds that banks of all sizes have played a major role in growth of the ethanol industry by providing direct loans to farmer cooperatives and ethanol firms. Floyd Stoner, ABA’s executive director of congressional relations, said, “This study confirms what the ABA and the ICBA have argued for quite some time—that banks have enabled farmers to develop a new industry that lessens our dependence on imported oil.”

- Ethan Zindler, the study’s lead author, said the his firm’s findings were based on data amassed from approximately 100 ethanol financing deals, in which 56% of the financing came in the form of direct loans from commercial banks or from funds raised in initial public offerings that were underwritten by investment banks; 36% came from hedge funds or wealthy individuals [such as Microsoft co-founder Bill Gates] and the remaining 8% came from Farm Credit institutions. According to the study, the aggregate contributions for the ethanol financing deals totaled \$15 billion and could rise to \$22 billion, if most of the projects on the horizon come online. “The main thing to take away from the study is that funding comes from many different directions,” said Zindler.
- The new study was in response to the Farm Credit System’s advertisements in November in *Roll Call*, claiming that community banks do not have the lending capacity, expertise, or willingness to accept the risk of loans to the ethanol industry. “We wanted people on the Hill to get an overview of how the ethanol industry has been funded and the role banks have played in it,” said Mark Scanlan, agriculture and rural policy director for the ICBA. “Ethanol has not just been financed by Farm Credit,” he added. “Yet that’s the picture that they have tried to paint.” Part of the reason for the study was to dispel the FCS’s claims that community banks are not up to the task of funding the ethanol industry, said Scanlan.
- In a December 18th interview with *American Banker*, Ken Auer, the Farm Credit Council’s president and CEO, called the bankers’ study “a ham-handed attempt to demonstrate that the banking industry is supporting the ethanol industry.” He argued that the report lacks any hard evidence that community banks are financing the plants. Auer disputed the study’s findings, noting that the FCS made or committed to make \$4.2 billion of loans just in the first nine months of 2007. The bigger problem with the study is that the banking slice of the pie does not distinguish between national and international banks or large banks and community banks, thus failing to prove that community banks have the ability to take on the risk, added Auer.
- Meanwhile, demand for ethanol – and funding for the expansion of the ethanol industry— will only increase for the foreseeable future. The Senate and House farm bills include incentives such as loan guarantees and research-and-development tax credits to encourage increased ethanol production. Also, the 2007 Energy Bill, which President Bush recently signed into law, requires that fuel producers use 36 billion

gallons of ethanol by 2022, up from about 7 billion gallons today. (*ABA Ag Banker*, 12/21/07; *American Banker*, Robert Barba, 12/26/07)

Ethanol—the next bubble to burst?

- In the January/February 2008 issue of *Technology Review* published by MIT, David Rotman cautioned, “The irrational exuberance over ethanol that swept through the American corn belt over the last few years has given way to a dreary hangover, especially among those who invested heavily in the sprawling production facilities now dotting the rural landscape. It’s the Midwest’s version of the tech bubble, and in some ways, it is remarkably familiar: overeager investors enamored of a technology’s seemingly unlimited potential ignore what, at least in retrospect, are obvious economic realities.”
- “More than a hundred biofuel factories, clustered largely in the corn-growing states of Iowa, Minnesota, Illinois, Indiana, South Dakota, and Nebraska, will produce 6.4 billion gallons of ethanol this year, and another 74 facilities are under construction. Just 18 months ago, they were cash cows, churning out high-priced ethanol from low-priced corn, raising hopes of “energy independence” among politicians, and capturing the attention—and money—of venture capitalists from both the East and West Coasts.”
- “Now ethanol producers are struggling, and many are losing money. The price of a bushel of corn rose to record highs during the year, exceeding \$4.00 last winter before falling back to around \$3.50 in the summer, then rebounding this fall to near \$4.00 again. At the same time, ethanol prices plummeted as the market for the alternative fuel, which is still used mainly as an additive to gasoline, became saturated. In the face of these two trends, profit margins vanished.”
- “The doldrums of the ethanol market reflect the predictable boom-and-bust cycle of any commodity: high prices drive increased production, and soon the market is oversupplied, causing prices to crash. But the large-scale use of corn-derived ethanol as a transportation fuel has economic problems all its own. Even though crude oil is at near record prices, and companies that use ethanol in their gasoline receive a federal tax credit of 51 cents per gallon, ethanol struggles to compete economically. And with limited infrastructure in place to distribute and sell the biofuel, demand will remain uncertain for the foreseeable future.”
- “More alarming, the boom in ethanol production is driving up the price of food. Of the record 93 million acres of corn planted in the United States in 2007, about 20 percent went to ethanol. Since most of the rest is used to feed animals, the prices of beef, milk, poultry, and pork are all affected by increases in the cost of corn. The international Organization for Economic Coöperation and Development (OECD) recently warned that the ‘rapid growth of the biofuels industry’ could bring about

fundamental shifts in agricultural markets worldwide and could even ‘cause food shortages.’”

- “All this comes at a time when the need for alternatives to petroleum-based transportation fuels is becoming urgent. At press time, the price of crude oil was near [\$100] a barrel. And worries about the impact of greenhouse-gas emissions from the roughly 142 billion gallons of gasoline used every year in the United States are deepening. Expanded use of biofuels is central to the federal government’s long-term energy strategy. In his State of the Union speech on January 23, 2007, President Bush set the goal of producing 35 billion gallons of renewable and alternative fuels by 2017, citing the need for independence from foreign oil. The U.S. Department of Energy has set the similar goal of replacing 30 percent of gasoline use with biofuel use by 2030. Hitting both targets, however, will require significant technological breakthroughs... While President Bush and other advocates of biofuels have often called for ethanol to be made from alternative feedstocks such as switchgrass—a plant native to the U.S. prairie states, where it grows widely—the required technology is, according to most estimates, at least four to five years from commercial viability. Meanwhile, advanced biological techniques for creating novel organisms that produce other biofuels, such as hydrocarbons, are still in the lab. So far, researchers are making quantities that wouldn’t even fill the tank of a large SUV.”
- “The economic woes and market limitations of corn ethanol are a painful reminder of the immense difficulties facing developers of new biofuels. ‘The bottom line is that you’re going to have to make fuel cheap,’ says Frances Arnold, a professor of chemical engineering and biochemistry at Caltech. ‘We can all make a little bit of something. But you have got to make a lot of it, and you have got to make it cheaply. The problem is so huge that your technology has to scale up and do it at a price that is competitive. Everyone is going to be competing on price alone...’” (*Technology Review*, David Rotman, January/February 2008)

FCS’s mission creep continues

- According to *Farm Credit Watch*, “...FCS, with the active encouragement of the Farm Credit Administration (FCA), is increasingly recasting loans it cannot lawfully make as securities, called ‘mission-related investments,’ or MRIs. Sometimes these securities are characterized as Rural America Bonds [RABs], [which] represent extensions of FCS credit to borrowers not eligible to borrow from the FCS... The amount of MRIs outstanding has grown rapidly, from \$1.94 billion at the end of 2005 to \$2.86 billion at the end of 2006 [for a 47% increase] to \$3.36 billion on September 30, 2007 [for a 17% increase]. The FCS has not disclosed any figures on the amount of outstanding MRIs prior to the end of 2005, which is a strong indication that MRIs were not very significant prior to 2006.”
- “MRIs outstanding will continue to grow rapidly for as long as the FCA looks the other way as FCS institutions continue to reach beyond the lending boundaries

Congress established in the Farm Credit Act. Congress should investigate the rapid growth in the FCS's off-farm lending, which has occurred during the tenure of FCA Chairman Nancy Pellett, focusing particular attention on MRIs as one means by which the FCS violates the Farm Credit Act." (*Bert Ely's Farm Credit Watch*, Bert Ely, December 2007)

Postal Service

Congress appropriates \$117.9 million for USPS

- In the Fiscal Year 2008 Omnibus Appropriations Act (H.R. 2764), Congress approved a \$117.9 million payment to the USPS to reimburse the agency for providing free mail for the blind, overseas voters, and the U.S. military. The appropriation also continues the \$49 million payment for the congressionally-mandated nonprofit mail subsidy, which had originally had been omitted from the House Appropriations bill. H.R. 2764 also instructs the USPS to prepare a staffing report for submission to Congress by May 2008, which addresses how the postal service "will ensure that postal customers receive the quality mail service that they expect and deserve." (*eNAPUS Legislative Political Bulletin*, 12/21/07)

The House of Representative's franking privilege cost taxpayers \$20 million in 2006

- In 2006, U.S. House members spent \$20.3 million in tax money to send nearly 116 million pieces of mail –many of them consisting of "glossy productions filled with flattering photos and lists of the latest roads and bridges the lawmaker has brought home to the district" according to the *Associated Press*. Mailings offered advice on a variety of topics, ranging from how to keep your car properly maintained in a newsletter from Representative Tim Murphy (R-PA) to tips on home improvements in a mailing from Representative David Dreier (R-CA). Former Representative Cynthia McKinney (D-GA) offered helpful advice to her constituents on voting. McKinney wrote, "Convicted felons can vote if 'your' prison sentence has been served, parole or probation completed and fines are paid." A dozen House members spent more than \$133,000 each to send 9.8 million pieces of mail for a total cost of \$1.8 million. (*Associated Press*, 12/27/07)
- In a December 5th analysis of congressional franking, the Congressional Research Service wrote, "...[R]estrictions on the use of the frank — who is entitled to frank mail, what is entitled to be franked, how much material can be sent, where the franked material can be sent, and when franked material can be sent — have been both tightened and loosened by Congress throughout history. This reflects a

normative ambiguity about the privilege, with Congress seeking to balance a democratic need for the franking privilege against charges of abuse, wastefulness, and incumbency protection.”

- “...Members of Congress continue to use the frank to communicate with constituents, despite the rise of alternative forms of mass communication. Although illegal use of the frank has been largely curtailed, contemporary critics of the privilege continue to voice concerns about wastefulness and incumbency protection. Recent proposed changes to the franking privilege reflect these concerns, seeking to reduce the overall volume of franked mail and the impact of mass mailings on elections, while maintaining the ability of Members to effectively communicate with constituents.”
(*CRS Report for Congress: Franking Privilege—Historical Development and Options for Change*, Congressional Research Service, 12/05/07)

Technology continues to erode the Postal Service’s business model

- Netflix, the DVD-by-mail company with more than 7 million customers, has struck a deal with a South Korean manufacturer, LG Electronics, to stream movies and other programming to the company’s high-definition televisions. This partnership extends Netflix’s novel feature, announced a year ago, which allows paying subscribers to watch more than 6,000 movies and television shows on its web site free. Through a myriad of devices, Netflix customers will soon be able to watch movies through downloads, thus eliminating the company’s distribution of movies via the U.S. postal service. (*New York Times*, Brad Stone, 01/03/08)
- The *Financial Times* and *Wall Street Journal* also are reporting that Fox and Apple have reached an agreement to set up a movie rental service via the Internet. Users of this service would be able to download a movie from the iTunes store at a cost of \$2.99 a month –cheaper than anything offered by mail or in video stores from Netflix or Blockbuster. According to *Courier Express*, and *Postal Blogspot*, “Now what does this mean for the Postal Service? ...While the new Fox - Apple agreement will not immediately affect volumes, the Postal Service could be a significant loser in this new technology. (*Courier Express*, and *Postal Blogspot*, 12/27/07)
- Another trend coming into vogue is sending holiday cards via the Internet. “Once seen as the tacky, last-minute substitute for pen and paper, e-cards have become more acceptable this holiday season, especially in the corporate world, where LinkedIn and Facebook have become popular places for sending holiday greetings,” according to the *New York Times*. As a result, many companies are embracing electronic greetings which are considered cheaper, “greener,” and more versatile. According to ComScore Media Metrix, 39.7 million people visited e-card sites in November, compared to 39.3 million in November 2006. (*New York Times*, Maria Aspan, 12/24/07)

- The National Wildlife Confederation, the Natural Resources Defense Council, and the Ecology Center has launched www.cataloguechoice.com, which provides consumers a free way to opt-out of receiving specific catalogues. Since the site's October 9th launch, more than 300,000 consumers have signed up for the service, each of who have declined on average to receive 12 titles – representing 3.6 million catalogues that consumers have asked retailers *not* to send them. The environmentalist groups behind the site plan to hold the retailers' feet to the fire long after the holiday frenzy. "We depend on the good faith of the merchants to honor these [do-not-mail] requests," says the website's chief executive Chuck Teller. "If they don't, we'll tell our members who is not honoring them." (*BusinessWeek*, Burt Helm, 12/20/07)

Mailboxes become a disappearing icon

- The big blue mailboxes that once dotted the corner of America's streets are fading away, almost as quickly as public pay phones. The postal service is removing mailboxes from street corners, as the result of declining mail volumes, weight restrictions (of up to 13-ounces) for items placed in a box, and safety concerns in a post-September 11th world which resulted in removal of all boxes that were not in the direct public. Every year, each mailbox is put through a "density test" to determine if it will remain in service, based upon the average number of pieces of mail that are placed in the box each day. (*Times-Union*, 12/26/07)

TVA

TVA to pay \$180 million to URS Corp. to expand its natural gas power generation

- TVA will pay up to \$180 million to URS Corp to help the agency design and build or renovate gas-fired power plants. Under the 30-month contract, URS will design and build a combined-cycle plant next to TVA's existing Lagoon Creek turbine plant in Haywood County, TN. TVA spokesman Gil Francis said the Lagoon Creek plant is scheduled to begin operation in 2010.
- TVA is planning further expansion of its gas power generation capabilities in 2008. In February, the utility plans to file a request to the Tennessee Department of Environment and Conservation for an air emissions permit to build a combined-cycle gas plant in Brownsville, TN. After securing regulatory approval for the plant, TVA plans to begin construction of 600-megawatt plant, which is scheduled for completion by June 2010. TVA also will consider buying or building at least one other gas-fired power plant during 2008. (*Chattanooga Times/Free Press*, 12/28/07)

Browns Ferry Unit 1 reactor's costs were 5% over budget

- TVA said that its restart of the Unit 1 reactor at its Browns Ferry nuclear plant was approximately \$90 million –or 5%--over its original \$1.8 billion budget. The unit was successfully restarted in May 2007, after a five-year effort to restart the moth-balled nuclear reactor, which was shut down in 1985 due to safety concerns. According to TVA's 2007 Annual Report, the overruns were caused in part by preparing the reactor for a power "uprate," which should allow it to generate up to 20% more power than its current 1,155 megawatts. (*Associated Press*, 12/17/07)

Conservation groups ask Supreme Court to reinstate their lawsuit against TVA

- The Sierra Club and the National Parks Conservation Association have filed a petition with the Supreme Court, asking that it review a decision by a lower court that dismissed a lawsuit accusing TVA of violating the Clean Air Act at its Colbert, AL plant. In 2001, the conservation groups sued TVA, alleging that it made major modifications to Unit 5 at Colbert Fossil in the early 1980s, which required the federal utility to install additional pollution control equipment. The suit also accused the utility of beginning construction on the modification project without proper permits from the EPA. In October 2007, the 11th Circuit Court of Appeals ruled that while it was illegal for TVA to begin work on the project without a permit, it was not illegal for the utility to operate the plant without one. The court also ruled that a five-year statute of limitations for filing a lawsuit against TVA had expired when the groups sued the utility. (*Times Daily* [Northwest AL], Dennis Sherer, 01/04/07)

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