

The **GSE** REPORT™

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Major Events

Fannie Mae and Freddie Mac lose more than \$6 billion in the fourth quarter:

Fannie Mae's posts \$3.6 billion loss for the fourth quarter –
triple the estimates of Wall Street analysts

Freddie Mac posts a \$2.5 billion loss for the fourth quarter—
more than 60% higher than analysts' estimates

OFHEO removes its restrictions on the GSEs' growth effective March 1st

Fannie and Freddie may have further to fall

Fannie Mae's and Freddie Mac's alchemy

Fannie Mae's posts \$3.6 billion loss for the fourth quarter –triple the losses projected by Wall Street analysts

- Fannie Mae posted a \$3.55 billion loss for the fourth quarter (\$3.80 a share), triple analysts' estimates for the period of \$1.20 average estimates of 12 analysts in a Bloomberg survey. For FY2007, Fannie reported a \$2.05 billion loss (\$2.63 loss per share), compared to a \$4.1 billion profit (\$3.65 a share) for FY2006. During the fourth quarter, the company's credit-related expenses soared to \$3 billion from \$326 million in the same period for 2006. While Fannie's 8.6% growth in revenues was driven by a 26.4% increase in guaranty fee income, CEO Daniel Mudd said that the company's enhanced guaranty business "has been far outweighed by the negative financial impacts of rising mortgage defaults, falling home prices, and extraordinary disruptions in the credit markets." In its investor summary, Fannie Mae said that its 2007 results "accurately reflect the most severe housing dislocation in decades. ...Our primary focus is protecting our capital, mitigating losses, and taking steps to emerge from the crisis on solid footing." In a conference call with investors, Mudd added, "The housing conditions are serious and they've gotten worse since our last projection in November. The overall economic outlook has dimmed, credit is tighter, home sales have stalled as buyers wait for prices to bottom out ...and prices have fallen quickly in a number of states." Mudd said that he sees no need to raise additional capital and reiterated that "protecting and conserving" the company's current capital is his top priority. In response to analysts' questions, Mudd acknowledged that responding to the kind of crisis that is now gripping the housing market "is something we are chartered to do," but added that it was a lower priority for Fannie Mae at this time.

- Fannie Mae said that deterioration in mortgage market is expected to accelerate this year, as rising foreclosures send credit costs soaring. The company raised its estimates of credit losses for 2008 from a range of 11 basis points to 15 basis points from its previous estimate of 8 basis points to 10 basis points—an increase of 37.5% and 50%, respectively. The company also projects average peak-to-trough declines in home prices of 13% to 17% before the market rebounds, compared to its earlier estimate of 10% to 12%.
- At December 31, 2007, Fannie Mae had total exposure of \$54.1 billion in subprime loans and \$350.6 billion in Alt-A loans. Fannie’s 2007 audited results included \$160 million of write-downs in values of MBS collateralized by subprime mortgages, but **excluded \$3.3 billion in unrealized losses on securities backed by subprime and non-conventional mortgages.** [Emphasis added.] In its Form 10K for FY2007, Fannie wrote, “We have not recognized other-than-temporary impairment with respect to these securities because we believe it is probable we will collect all of the contractual amounts due and we currently have the intent and ability to hold these securities until they recover their value or until maturity. As market conditions continue to evolve, however, the fair value of these securities could decline further.”
- At December 31, 2007, Fannie Mae’s counterparty exposure included (1) \$104.1 billion of primary and pool mortgage insurance by mortgage insurers (seven counterparties provide 99% of the coverage; four companies AA or higher rated and three companies AA- rated); (2) lenders with risk-sharing for single-family loans with full or partial recourse having an estimated unpaid principal balance [UPB] of \$43.7 billion (45% of counterparties investment grade based upon the lower of S&P, Moody’s and Fitch Rating); (3) lenders with risk-sharing for multifamily loans with full or partial recourse having an estimated UPB of \$128.3 billion; and (4) financial guarantors of \$11.8 billion on securities held in investment portfolio or guaranteed.
- Moody’s Investors Service placed Fannie Mae’s B+ Bank Financial Strength Rating (BFSR) on review for possible downgrade, and affirmed Fannie Mae’s Aaa senior debt, Prime- 1 short-term debt, Aa2 subordinated debt, and Aa3 preferred stock ratings with “Stable” outlooks. Moody’s rating action follows the company’s announcement of its \$3.6 billion loss for fourth quarter of FY2007. The rating agency said, “This loss exceeded our expectations and represents a significant deterioration of surplus regulatory capital which stood at \$3.9 billion at December 31, 2007 (based on the required 30% surplus to the statutory minimum).” Moody’s expects Fannie to record sizable losses during the first half of 2008 and possibly a net loss for the year due to the continued deterioration in the residential mortgage sector. Moody’s concerns regarding Fannie Mae’s capital position is partially mitigated by the announcement by OFHEO that it will discuss with Fannie Mae (and Freddie Mac) the gradual decreasing of the current required 30% surplus to the statutory minimum. (*Info-Prod Strategic Business Information*, 02/28/08)
- “I expect it’s only the beginning,” said Joshua Rosner, the managing director of Graham Fisher & Co. Fannie Mae has lost more than half of its market value during

the past 12 months, as the housing market deteriorated. In a report to clients, Morgan Stanley analysts concluded that the risk of a capital shortfall is greater than it previously appeared, raising the risk of a dilutive equity offering. Prior to Fannie Mae's earnings release, analysts for Goldman Sachs Group and Merrill Lynch changed their recommendations from "hold" to "sell" over concerns that falling house prices will restrict the company's earnings. Paul Miller, an analyst with Friedman Billings Ramsey & Co., projects Fannie's credit losses to rise to range of 15 basis points to 25 basis points in 2008 and 2009. Miller said that Fannie's need to preserve capital in a deteriorating housing market will inhibit the company's growth in 2008. "For me to get very comfortable in recommending this stock, I'd like to see something above \$15 billion in capital raising," he said. On February 25th, Miller lowered Fannie Mae's rating from "market perform" to "underperform."

- After Fannie's earnings release, the cost of credit-default swaps tied to its bonds rose 9 basis points to 87 basis points on February 27th. The cost of protecting Fannie Mae bonds from default have doubled this year. (*Wall Street Journal*, James R. Hagerty and Andrew Edwards, 02/28/08; *Washington Post*, David S. Hilzenrath, 02/28/08; *Form 10K*, Federal National Mortgage Association, 02/27/08; *Fannie Mae 2007 10-K Investor Summary*, 02/27/08; *Reuters*, Al Yoon, 02/27/08; *Bloomberg*, James Tyson, 02/27/08; *InfoProd Research*, 02/28/08; *Reuters*, Al Yoon, 02/26/08)
- *Bloomberg News*' Jonathan Weil noted, "The \$35.8 billion of [Fannie Mae's] shareholder equity at fair value consisted of \$20.5 billion of common shareholder equity and \$15.3 billion of preferred shareholder equity [on December 31, 2007]. A year earlier, by comparison, the fair value of Fannie's common equity was \$34.7 billion, while the fair value of the preferred was \$9 billion. This is a fancy way of saying that the common shareholders are losing control of the company, fast." (*Bloomberg News*, Jonathan Weil, 02/28/08)

Freddie Mac posts a \$2.5 billion loss for the fourth quarter—more than 60% higher than analysts' estimates

- On February 28, Freddie Mac announced that it lost \$2.5 billion in the fourth quarter of 2007 (\$3.97 per share loss), compared with net income of \$401 million (\$0.73 per share), a year earlier. Freddie's loss exceeded analysts' forecast of \$2.34 per share (by those polled by Thomson Financial) by 69.7%. The company also announced changes in the way the GSE accounts for its obligations to compensate holders of MBS for the costs of defaults. Without these changes, Freddie Mac's loss would have been 48% higher—a loss totaling \$3.7 billion for the quarter. The company's quarterly results reflect approximately \$800 million from marking the value of its expected future guarantee income to market and \$2.3 billion in losses on derivative contracts used to hedge against interest rate risk [which tend to vary widely from quarter to quarter]. Credit-related expenses, including provisions for credit losses and costs of selling REO, totaled \$912 million for the quarter. The GSE's total credit losses were \$236 million for the fourth quarter and \$499 million for FY2007. Freddie

said it expects losses to increase to \$2.2 billion for FY2008 and \$2.9 billion for FY2009. For FY2007, Freddie Mac reported a \$3.1 billion loss (\$5.37 per share) compared with a profit of \$2.3 billion (\$3.00 a share) for FY2006.

- Richard Syron, Freddie Mac's chairman and CEO, said "[We're] extremely cautious as we enter 2008. If the economy weakens substantially from here ...it will have a further negative effect on homeowners across the country and drive credit costs higher." Syron added, "This is a very ugly situation we're in,"—and Freddie assumes that home prices have fallen only a third as far as they are going to fall. The company now assumes that the average home price will decline about 15% from the peaks and bottom out in 2009 or 2010, said Buddy Pizsel, the company's CFO. Previously, the company had projected an 11% drop in home prices. Pizsel introduced a new alternative financial measure to analysts—adjusted operating income—to measure Freddie Mac's performance. Citigroup analyst Bradley Ball expressed skepticism to Pizsel during the investor conference call saying, "Just at a glance, it looks like you're essentially eliminating ...all the stuff that's bad and keeping all the stuff that's good." Pizsel responded that Freddie committed to making the change in 2006 and was not trying to make financial results look better.
- Freddie Mac also announced that its board of directors has formed a special committee to investigate allegations of mismanagement by the company's directors, senior officers, and outside auditors. According to the company's 2007 Annual Report, "In late 2007, the Board of Directors received two letters from purported shareholders of Freddie Mac alleging corporate mismanagement and breaches of fiduciary duty in connection with the company's risk management. One letter demands that the Board commence an independent investigation into the alleged conduct, institute legal proceedings to recover damages from the responsible individuals, and implement corporate governance initiatives to ensure that the alleged problems do not recur. The other letter demands that Freddie Mac commence legal proceedings to recover damages from responsible Board members, senior officers, Freddie Mac's outside auditors, and other parties who allegedly aided or abetted the improper conduct. The Board of Directors formed a special committee to investigate the purported shareholders' allegations." In an email, company spokeswoman Sharon J. McHale wrote, "The formation of a special committee to look into a derivative demand letter from a purported shareholder is actually a pro forma action on the part of a corporation to determine whether or not there is any validity to an allegation." (*Washington Post*, David S. Hilzenrath, 02/29/08; *Wall Street Journal*, James R. Hagerty and Aparajita Saha-Bubna, *Freddie Mac Annual Report*, 2007;)
- On February 29th, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' senior unsecured debt ratings on Freddie Mac with a stable outlook. S&P also affirmed the 'AA-' rating on the risk-to-the-government, subordinated debt, and preferred stock ratings on Freddie Mac and said that the outlook remains negative. "The ratings on Freddie Mac's senior unsecured debt reflect the company's very strong business franchise, its status as a [GSE], and under our government-related criteria, its status as a public policy institution and its key role regarding liquidity in

the U.S. mortgage capital markets. The ratings also reflect the implicit U.S. government support of these securities, as it relates to Freddie Mac's charter and governing legislation," said S&P's credit analyst Victoria Wagner. S&P's negative outlook on the risk to the government, subordinated debt, and preferred stock ratings on Freddie Mac is based on a lower earnings outlook for 2008 and its effect to Freddie Mac's capital position. Wagner wrote, "During this time, we expect credit-related expenses for Freddie Mac to approach an all-time high. The current level of plus 90-day past due loans ended the year at only 65 basis points, (bps), and net-charge-offs (NCOs) for the year were \$495 million or 3 bps. However, in fourth quarter 2007, annualized credit losses were higher at 5.4 bps. Freddie Mac's forecast for 2008 indicates total credit losses will reach \$2.2 billion or 12 bps. For 2009, Freddie Mac is forecasting NCOs of \$2.9 billion or 14 bps. At year-end 2007, the ending loan-loss reserve reached \$2.8 billion, which equates to 1.5 years' worth of coverage for expected NCOs. ...Now that credit-related expenses are fast approaching a new peak for Freddie Mac, its core earnings capacity to withstand the higher credit costs for 2008 is significantly lower, given the narrowing of its net interest margin and higher operating expenses. The level of capital commitment to support the core business, regardless of any change in the status of the regulatory imposed 30%, remains a key rating issue. ...These ratings will remain under pressure if quarterly GAAP earnings volatility remains high and if losses increase significantly above the 2007 level. Alternatively, if earnings volatility diminishes, the outlook could revert to stable." (*Standard & Poor's Press Release, 02/29/08*)

- *Bloomberg* reporter Jonathan Weil noted that Freddie Mac "reported a surge in its capital levels yesterday [February 28th]." Weil added, "As it turns out, most of the company's new surplus came from accounting maneuvers that make you wonder. [Freddie] ...said it had \$38.9 billion of core capital as of Jan. 1, up 12 percent since the end of September. That was \$4.5 billion more than the minimum required by Freddie's government regulator. As recently as Nov. 30, Freddie's capital had fallen below its minimum requirement, forcing the company to sell \$6 billion of preferred stock in December."
- "The curious part is how Freddie came to acquire most of its newfound cushion. A little more than half of it, or \$2.3 billion, came as the result of purely optional accounting changes. Nothing changed in true business terms. To the unsuspecting reader, however, Freddie looks stronger. The \$2.3 billion in question consists of two parts. The first was a \$1.3 billion capital boost that resulted from changes Freddie made during the fourth quarter in the way it accounts for mortgage guarantees. While the timing may look suspect, this has at least the veneer of defensibility, because it brings Freddie's practices in line with those at sister mortgage investor Fannie Mae. The other \$1 billion boost looks more gimmicky. It resulted from [Freddie's] voluntary adoption of new accounting rules, called [FASB] 159, in a way that let Freddie pick and choose which financial assets and liabilities it wished to start measuring at fair value on a recurring basis, rather than at historical cost. ... During a conference call yesterday, the company's chief financial officer, Buddy Pizsel, suggested the magnitude of the gain came as something of a surprise to Freddie.

‘While we originally estimated that FAS 159 would have little to no impact on our capital position, the significant interest rate move we experienced in late 2007 created a one-time adoption adjustment upwards of \$1 billion in our core capital,’ Pizsel said.”

- “[T]he better gauge of the companies’ performance is the amount by which the fair values of their net assets declined, because almost all the items on their balance sheets are financial assets or liabilities. Viewed this way, Freddie lost \$24.7 billion last year, including \$17 billion during the fourth quarter. Those figures exclude the effect of capital transactions, such as stock sales and repurchases.
- “It should surprise no one if Freddie needs to tap the capital markets again. Under generally accepted accounting principles, it showed \$26.7 billion of shareholder equity at Dec. 31, a measure that’s less generous than the government’s core capital metric. That consisted of \$14.1 billion attributable to preferred shareholders and \$12.6 billion attributable to common.”
- “Judging by the company’s fair-value balance sheet, though, Freddie’s net assets were worth just \$12.6 billion, only \$300 million of which was attributable to common shareholders. So, if you own Freddie’s common stock, and you believe the fair values, your equity pretty much has been wiped out.”
- “Freddie’s common stock is down 62 percent over the past year. Yet at yesterday’s close [February 28th] of \$24.49, the company still has a \$15.8 billion market capitalization. That’s about 53 times the fair value of the net assets attributable to common holders. Those investors had better be hoping for a rebound in the values on Freddie’s balance sheet. If it doesn’t come soon, they may well be toast. (*Bloomberg News*, Jonathan Weil, 02/29/08)

OFHEO removes its restrictions on the GSEs’ growth effective March 1st

- In recognition of the progress made by both Fannie Mae and Freddie Mac in remediation of their respective financial reporting, operational and control weaknesses that led to multi-year financial restatements, OFHEO will remove the portfolio growth caps for both GSEs on March 1st. OFHEO director James B. Lockhart III noted that the companies’ timely publishing of their audited financial statements for FY2007 was an important milestone in their remediation efforts.
- In a statement, Lockhart also addressed the GSEs’ excess capital requirements. The Director said, “Since [consent] agreements reached in early 2004 [with Fannie and Freddie], OFHEO has had an ongoing requirement on each Enterprise to maintain a capital level at least 30 percent above the statutory minimum capital requirement because of the financial and operational uncertainties associated with their past problems. In retrospect, this OFHEO-directed capital requirement, coupled with their

large preferred stock offerings means that they are in a much better capital position to deal with today's difficult and volatile market conditions and their significant losses.”

- “As each Enterprise nears the lifting of its Consent Order, OFHEO will discuss with its management the gradual decreasing of the current 30 percent OFHEO-directed capital requirement. The approach and timing of this decrease will also include consideration of the financial condition of the company, its overall risk profile, and current market conditions. It will also include consideration of the importance of the Enterprises remaining soundly capitalized to fulfill their important public purpose and the recent temporary expansion of their mission.” (*OFHEO News Release*, 02/27/08)
- In an interview with the *New York Times*, Lockhart said, “We have to be very careful in this market not to do too much.” adding that he wouldn't begin to consider further changes until April at the earliest. “This capital has served them extremely well over the last nine months,” said Lockhart. In recent Senate testimony, Lockhart said he would be “much more comfortable” easing the GSEs' capital requirements if lawmakers passed long-stalled GSE regulatory reform legislation.
- Senator Charles Schumer (D-NY) praised the agency's lifting of the mortgage caps, but said OFHEO should have gone farther. “This is a long overdue step, but ... just as important is OFHEO's willingness to ease the capital surcharge requirements that continue to hamstring the GSEs,” said Schumer. “OFHEO should announce a plan to lift that surcharge immediately.”
- Industry observers, however, do not expect Lockhart to move that quickly. “OFHEO has plenty of room to support an argument that it would be unsafe to take the surplus off in the near term,” said Joshua Rosner, a managing director for Graham Fisher & Co. “Unless [the GSEs] are relieved of the capital surplus requirements, doesn't it remain generally more expensive to grow the portfolio than guarantee loans?” Douglas A. Dachille, CEO of First Principles Capital Management, said that neither lifting the GSEs' portfolio caps nor easing their capital requirement would make much difference to borrowers. In a report to clients, Dachille compared those steps to “handing out air freshener to homeowners who live next to a landfill.”
- In an interview with *American Banker*, Barclays Capital analyst Rajiv Setia said that for Freddie and Fannie “the issue ... is capital”—not the investment portfolio caps, since the GSEs could have expanded their portfolios by \$30 billion to \$40 billion under the existing caps. Setia said, “They chose not to do so, because their capital is being depleted very, very quickly. They're not really going to be adding assets here anytime soon, and the regulators, I don't think, given the marks and the fair value implications, are going to be in a hurry [to loosen capital requirements],” despite “tremendous” political pressure. (*American Banker*, Harry Terris, 02/29/08)
- In his February 27th testimony before Congress, Federal Reserve chairman Ben Bernanke urged Fannie Mae and Freddie Mac to raise more capital, if needed, so they can provide more guarantees on home loans. “We'd encourage them to raise capital

to allow them to do more,” said Bernanke. (*Washington Post*, David S. Hilzenrath, 02/28/08; *American Banker*, Rob Blackwell, 02/28/08; *New York Times*, Vikas Bajaj, 02/28/08; *American Banker*, Harry Terris, 02/29/08; *Wall Street Journal*, James R. Hagerly and Andrew Edwards, 02/28/08)

Fannie and Freddie may have further to fall

- In a February 29th article in the *Wall Street Journal*, Peter Eavis wrote, “...[C]losely followed measurements of capital in the fourth-quarter results show that Freddie increased its leverage—which calculates how many times assets exceed the company’s net worth—in the fourth quarter. That leaves the company more exposed than before to downturns in its business. And while Fannie’s leverage didn’t move much from the third to the fourth quarter, it remained at a level far above that of other financial institutions.”
- “A lack of capital could prompt dilutive stock issues from Fannie and Freddie, which operate under government charters. Fannie issued \$7 billion of preferred stock to bolster its capital in December and Freddie issued \$6 billion. This week, both companies said they had adequate capital at the end of the fourth quarter. But both noted that they may take actions to raise more capital if business turns out to be worse than expected. ‘We think the market will remain concerned that financial forces will undermine the highly leveraged [GSE] business model, possibly forcing another round of capital issuance to bolster their balance sheets,’ Merrill Lynch analyst Kenneth Bruce wrote in a recent research note. Last week, Mr. Bruce downgraded his ratings on Fannie and Freddie shares to ‘sell.’”
- “One indicator that analysts track to get an idea of leverage is a calculation Fannie and Freddie do of their net worth, taking the current market values of most of their assets and subtracting their liabilities. By that measure, Freddie looked a lot more risky at the end of the fourth quarter than it did at the end of the third. At the end of the fourth quarter, Freddie reported that its net worth was \$12.6 billion using market values, while its assets were worth \$800 billion, or 64 times more. This was up from 33 times at the end of the third quarter. The leap was due to big declines in the value of the mortgages it holds and an increase in expected losses for the mortgages they guarantee. Fannie’s leverage, using this metric, stayed at around 25 times from the third to fourth quarters. But Fannie’s leverage would have gone up if it hadn’t issued new preferred shares.”
- “The fair value approach has flaws, say analysts. For example, it can often reflect billions of dollars in losses that the companies may never actually close out and realize. Indeed, Freddie said this quarter that its net worth available to common shareholders was just \$300 million at the end of the fourth quarter, or a mere 45 cents a common share.”
- “Despite its vagaries, fair-value net worth is followed closely by [OFHEO]. Its views matter to investors because it has a big say on the adequacy of capital at Fannie and

Freddie and will influence the companies' capital-raising plans. In testimony before the Senate Banking Committee earlier this month, OFHEO's director, James B. Lockhart III, compared the fair value of net worth to Fannie and Freddie's total book of business, which combines the on-balance-sheet assets plus the mortgages that Freddie and Fannie have guaranteed. Under that calculation, Fannie's total book of business was 81 times its fair-value net worth at the end of the fourth quarter, and Freddie 167 times. This makes the companies' cushion for losses look even thinner. In an interview, Mr. Lockhart noted that this approach is just one of several ways to gauge capital, but he added that it shows that, 'a relatively small fluctuation in credit risk can have a significant impact on capital.'"

- "Because of flaws in the fair-value approach, some analysts think investors will focus more on book-value measured according to generally accepted accounting principles, or GAAP. This still makes Fannie highly leveraged at 20 times GAAP net worth and Freddie at 30 times at the end of last year. Using GAAP, the 20 largest U.S banks had much lower leverage of about 11 times, according to SNL Financial [Charlottesville, VA]."
- "If Fannie and Freddie raise capital to bring their leverage ratios closer to those of U.S. banks, it might allay concerns about safety and soundness. But it might make the companies less attractive to investors." (*Wall Street Journal*, Peter Eavis, 02/29/08)

Fannie Mae's and Freddie Mac's alchemy

- In a February 29th editorial, the *Wall Street Journal* wrote, "Both Fannie Mae and Freddie Mac lost lots of money last quarter and last year—and we mean *lots*. [Emphasis supplied.] If they continue losing money at current rates, in fact, they could find themselves below their mandatory capital requirements in another six months or so."
- "Fannie and Freddie think that the best way to deal with this problem is to allow them to leverage up even further by reducing those same capital requirements. Some on Capitol Hill, notably New York Democrat Chuck Schumer, agree. Like maxed-out consumers who were about to reach their credit limit, Fannie and Freddie already hit up investors for a cool \$13.8 billion in additional capital last quarter [of which more than 44% was lost by the GSEs during the fourth quarter]. But as they continue to lose money, their capital position remains tenuous."
- "So now, with the help of Senator Schumer and other friends on the Hill, they're trying to get their credit limits raised. Like political alchemists, they want to turn their losses into the gold of more profit-making opportunities. James Lockhart, the regulator responsible for Fannie and Freddie, gave them a bit of relief this week by eliminating caps on the size of their investment portfolios, and their stock prices jumped. Now the pressure is also on Mr. Lockhart to lower their capital

requirements, but nothing about their results suggests that Fannie and Freddie need more risk in their lives—or ours.”

- “The two government-sponsored mortgage giants lost \$6.1 billion between them in the fourth quarter. In both cases, the lion’s share of the reported losses came from losses on derivatives that the companies use to hedge their huge portfolios of mortgage-backed securities, or MBSs. Supposedly, we are to take some comfort from this. The companies contend that these are paper losses and that the price of derivatives can fluctuate from quarter to quarter or year to year. That’s true.”
- “But bear in mind why Fan and Fred buy these derivatives in the first place. Each of them has an MBS portfolio worth more than \$700 billion on its books. These portfolios are entirely separate from their original mandate, which was to buy mortgages from banks, package them into securities and sell them to investors with a guarantee. Both companies still do this too, of course, and the recent turmoil in the housing market has allowed them to greatly expand their market share in that business. But these days they make more money (on an ‘operating basis,’ at least) by holding mortgages or MBSs for their own account, or by buying MBSs on the open market and holding them.”
- “To do that, they borrow. A lot. In fact, almost every dollar they invest in MBSs is a dollar they borrow by issuing bonds. This they can do cheaply because of a market perception that, if loss comes to shove, Uncle Sam will make their creditors whole. The two companies then make money off the spread between their borrowing rates and the interest paid by the mortgage holder or the mortgage-backed security.”
- “To make sure that spread stays positive, and hence profitable, they then purchase interest-rate swaps and other derivatives to hedge their exposure to changes in interest rates. And in the fourth quarter in particular, Fannie and Freddie saw huge declines in the value of those derivatives as interest rates fell. It may be that those losses will never get realized or that the value of the derivatives will recover.”
- “But in the meantime, Fannie and Freddie continue to bleed capital. In the fourth quarter, Freddie raised \$6 billion and Fannie \$7.8 billion in preferred-stock offerings. And it’s a good thing they did, because without that capital last quarter’s losses would have put both companies below the minimum capital levels required by their regulator. Fannie’s capital base stands \$3.9 billion above the minimum, while Freddie has a cushion of \$3.5 billion.”
- “That doesn’t sound too, too bad, maybe. Except that Freddie is holding \$100 billion in subprime asset-backed securities in its portfolio while Fannie has \$74 billion or so. It wouldn’t take too much in the way of portfolio losses to wipe out those capital cushions. How likely are further write-downs? Well, 21% of Freddie’s \$100 billion in subprime assets are 60 days delinquent or more, and 40% of those securities on watch for downgrade.”

- “So, what in the world is Congress doing? Mr. Schumer cheered Wednesday when Mr. Lockhart lifted the caps on the companies’ portfolios. We guess he thinks that what we really need is more taxpayer exposure to the risk of a meltdown at Fan and Fred. Meanwhile, the reform bill passed by the House last year is stalled in the Senate Banking Committee, thanks in part to Democrats like Mr. Schumer. This is the bill that would strengthen the regulator’s power to make sure the two giants stay solvent.”
- “What Fannie and Freddie really need is a regulator with the clout to cut up their credit cards before they get into even deeper trouble—and take the rest of us along with them.” (*Wall Street Journal*, 02/29/08)
- On *Minyanville.com*, Todd Harrison wrote, “...I believe the potential that these companies [Fannie and Freddie] will eventually be nationalized is a much higher probability than most folks currently assign. The ‘when’ and ‘why’ remain to be seen, making the path that we take to get there entirely more important than the destination. The bottom line is this: If MBIA and Ambac are deemed too big to fail—which is inferred by the semantic socialization we’ve seen—Fannie and Freddie will be protected from up on high by the Prince of Darkness.”
(*www.Minyanville.com*, Todd Harrison, 02/28/08)

<p>Fannie Mae and Freddie Mac enter agreements with NY Attorney General Cuomo and OFHEO to establish new appraisal guidelines for loans they purchase</p>

- On March 3, Fannie Mae and Freddie Mac entered into cooperation agreements with New York Attorney General Andrew Cuomo and OFHEO, in which the GSEs agree to only buy loans from lenders that meet a new standards designed to ensure independent and reliable appraisals. Under the agreement, Fannie Mae and Freddie Mac will adopt the “New Home Valuation Protection Code” (“Code”), which sets new standards to ensure independent, reliable appraisals. Specifically, the Code establishes requirements governing appraisal selection, solicitation, compensation, conflicts of interest and corporate independence, among other reforms. Under the Code, mortgage brokers will be prohibited from selecting appraisers. Lenders will be prohibited from using “in-house” staff appraisers to conduct initial appraisals and appraisal management companies that they control. Beginning January 1, 2009, Fannie Mae and Freddie Mac will require that lenders represent and warrant that appraisals related to mortgage loans originated on or after January 1, 2009 conform to the Code or they will not be purchased.
- Fannie Mae and Freddie Mac also agreed to spend \$24 million for the creation the Independent Valuation Protection Institute (the “Institute”), an independent organization to implement and monitor the new appraisal standards and monitor the loans that the GSEs purchase. Specifically, the Institute will:

- Establish a complaint hotline for consumers nationwide to call if they believe the appraisal process has been tainted or if they have been harmed by appraisal fraud.
 - Serve as a contact for appraisers themselves if they believe their independence has been compromised. These complaints will be handled confidentially to protect appraisers from retaliation. The Institute will mediate complaints, or can forward them to the appropriate federal or state law enforcement agency or regulator.
 - Report publicly on its activities to the New York Attorney General and OFHEA on a bi-annual basis.
 - Appoint a Board of Directors which must be approved by both the New York Attorney General and OFHEO.
- “Today's agreement with Fannie Mae and Freddie Mac begins to set right what had gone so horribly wrong in the mortgage industry - rampant appraisal fraud,” said Cuomo. “The integrity of our mortgage system depends on independent appraisals. With this agreement, Fannie Mae and Freddie Mac have become leaders in transforming the mortgage industry. Now national banks have a clear choice: immediately adopt the new code and clean up appraisal fraud in the mortgage industry or stop doing business with Fannie Mae and Freddie Mac – it is that simple.”
 - “Accurate, independent appraisals are very important to ensuring the safety and soundness of Fannie Mae and Freddie Mac and the mortgage market,” said OFHEO Director James Lockhart. “OFHEO is committed to working closely with fellow regulators, the Attorney General, Fannie Mae, Freddie Mac, appraisers, lenders and other market participants to assure that the roll-out of the new code builds upon best practices, recognizes constructive comments to identify further refinements, and avoids unintended consequences.”
 - “We are pleased to work with regulators to do our part to ensure sound, accurate, independent and reliable appraisals,” Fannie Mae General Counsel Beth Wilkinson said. “As the nation’s leading purchaser of mortgage loans in the secondary market, Fannie Mae shares the interests of consumers in the integrity of the home valuation process, which is an important part of a well functioning market.”
 - “Accurate appraisals are fundamental to Freddie Mac's effective credit risk management - as evidenced by our leadership in quality control programs and assistance with criminal prosecutions of mortgage fraud. The Code of Conduct announced today enhances the independence and accuracy of the appraisal process. And it builds on our company's long-standing efforts to fight mortgage fraud by providing strong new protections for homebuyers, mortgage investors and the housing market. In addition, we look forward to working with the New York Attorney General, OFHEO, Fannie Mae and other mortgage market participants in launching the Independent Valuation Protection Institute. By funding the Institute, we are advancing the development and adoption of best practices in the appraisal

process,” said Freddie Mac Executive Vice President and General Counsel Robert Bostrom.

- Copies of the GSEs’ cooperation agreements and the Home Valuation Code of Conduct are available at www.oag.state.ny.us/press/2008/mar/mar3a_08.html. (*Press Release from the Office of Attorney General Andrew Cuomo, 03/03/08*)

Prospects for “quick” action on Senate housing stimulus plan fades, as cloture vote on S. 2636 fails

- By a vote of 48 to 46, Republican Senators voted down a move to invoke cloture on the Foreclosure Prevention Act (S. 2636) on February 28th, effectively ending chances for an early agreement on a housing stimulus package which the Bush administration had threatened to veto. The housing proposal includes a controversial proposal to rewrite bankruptcy laws, allowing bankruptcy judges to reduce the principal amount of the mortgage loan to the market value of the residence securing the loan and to slash interest rates for low-income homeowners, and provides \$4 billion to local communities to purchase abandoned properties and \$200 million for counseling services to subprime borrowers. Republicans argued that the bankruptcy provisions of S. 2636 would inflame the housing crisis and harm lenders and borrowers. Senator Mel Martinez (R-FL) argued that the bankruptcy provision would wreak havoc in the housing market and force the mortgage industry to recoup costs in other ways. “The bankruptcy provisions don’t have anything to do with the housing problem, and they’re going to raise interest rates,” said Martinez during floor debate. Minority Leader Mitch McConnell (R-KY) called the Democratic bill a “hastily concocted political exercise.” Shortly before the cloture vote, Senate Republicans introduced their own plan—the Home Ownership Manufacturing and Economic Growth Plan—which would include an extension of earlier tax cuts, expanding tax-exempt mortgage revenue bonds, and reducing excessive and “frivolous” litigation. The Senate is expected to resume debate on a housing stimulus package during the first week of March.
- In a press conference, Senate Majority Leader Harry Reid (D-NV) released a letter that he sent President Bush, saying that he was disappointed that the administration had threatened to veto S. 2636. Given the President’s concerns about the bill, Reid wrote that the bill had been modified to “allow judges to modify only subprime and adjustable-rate mortgages that already have been originated and provides creditors the ability to recoup lost mortgage principal after a modification, if and when the debtor resells.” Reid continued, “These changes were made to target the provision more directly at the loan products most prone to default as well as address concerns that closing the existing loophole for lenders would inject uncertainty into the mortgage markets or make credit less available.” At the press conference, Reid told reporters, “The big banks just won again, the mortgage bankers won again. The bankers on Wall Street and the big lenders are high-fiving tonight.” He added, “It becomes increasingly clear that the Republicans either have no interest in turning around our

sinking economy, or no ideas on how to do so.” Senator Richard Durbin (D-IL) said, “The same people who created this crisis in America... don’t want those people to have a chance to stay in their homes even if they can make the mortgage payments.”

- The banking industry has lobbied aggressively against S. 2636, arguing that if the bill gave bankruptcy judges the authority to modify residential mortgages, interest rates would rise for other borrowers and future investment in mortgage-backed securities would be curtailed. “Bankruptcy is not the answer for borrowers having a difficult time making their mortgages payments and it is gratifying to see enough senators recognize this fact,” said David G. Kittle, chairman-elect of the Mortgage Bankers Association. An industry representative said, “The only way we could support this package is if [the bankruptcy provision] is completely removed.”
- In a February 28th news conference, President Bush said, “The Senate bill would actually prolong the time it takes for the housing market to adjust and recover, and it would lead to higher interest rates.” Instead, the President urged Congress to extend indefinitely his 2001 and 2003 tax cuts, which expire at the end of 2010. (*New York Times*, Edmund L. Andrews, 02/29/08; *CQ Today*, Benton Ives, 02/28/08; *Wall Street Journal*, Damian Paletta, 02/29/08; *Bureau of National Affairs*, Richard Cowden, 02/29/08; *Washington Post*, Paul Kane, 02/29/08)
- In a February 26th editorial, the *Wall Street Journal* wrote, “Has Harry Reid realized that the just-enacted \$168 billion stimulus plan will do nothing to encourage economic growth? On the same day that President Bush signed the bill, February 13, the Senate Majority Leader introduced Son of Stimulus, with plans for a floor vote today. For this bill Mr. Reid decided to ignore the normal vetting of committee hearings and markups, and it shows. Democrats laud the \$200 million in the bill for credit counseling, but the actual language of the bill directs \$200 *billion* to something called the Neighborhood Reinvestment Corporation. We trust this error will be eliminated before Mr. Reid achieves Guinness fame for creating the world’s most expensive typo.”
- “The plan also borrows an idea from House Judiciary Chairman John Conyers to repeal a longstanding provision in bankruptcy law and allow judges to reduce the amount borrowers owe on their homes. Judges can do this now with credit-card debt—a big reason rates on credit cards are so much higher than those for mortgages. Allowing judges to rewrite the terms of mortgages is a tough sale even within Mr. Reid’s own party. The Congressional Budget Office, whose leadership is appointed by Democrats, warned in January that such a change could result in higher interest rates for homeowners and bigger caseloads in bankruptcy courts. Other non-libertarians in opposition include 16 House Democrats who sent a letter to Mr. Conyers last fall. They tried to talk him down from the ledge before he forced a December committee vote. And then there’s Supreme Court Justice John Paul Stevens, who noted in a 1993 case that the special treatment of mortgages was specifically intended to encourage lending to prospective homeowners.”

- “The bill also allows states to issue an additional \$10 billion in bonds to refinance subprime loans and allocates \$4 billion to rebuild abandoned and foreclosed properties in the states hardest hit by the housing downturn. This is a taxpayer-funded bailout that no one wants to call a bailout.”
- “Senators just returning from recess might use the few moments they’ll have before voting to consider who among their constituents actually benefits from this foray into mortgage finance. The roughly 35 million households currently renting their homes obviously do not. But a new study from Wharton professor Todd Sinai suggests that, even for homeowners, the answer depends on location, location and location. Examining recent proposals to help mortgage borrowers, Mr. Sinai finds that such ‘reforms’ invariably amount to a subsidy from all Americans to recipients concentrated in a few states, especially California. This is a winning formula in the House, where Speaker Nancy Pelosi can whip 51 of her Golden State colleagues, but a close look at the math may give Senators pause. Mr. Sinai adjusts for the size of each state market and finds that Californians are more than six times as likely to hold a subprime mortgage as residents of North Dakota. Arizonans are almost five times as likely as Vermonters to be subprime borrowers. If all politics is local—and make no mistake, this hastily-drafted bill is a political stunt designed to gain Senate seats in November—Senators might ask how costly Mr. Reid’s national solution will be for their constituents. Republicans are right to oppose it.” (*Wall Street Journal*, 02/26/08)

Affordable-housing trust fund dropped in conference negotiations on FHA reform
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- *CQ Today* reports that House and Senate negotiators have resolved the main stumbling block to FHA reform legislation by dropping the House provision which would create an affordable housing trust fund. With the elimination of the trust fund provision, only one sticking point remains—the FHA loan limits, which under the Senate provision allows FHA to insure loans up to \$417,000 in high-cost areas and the House bill increases the limit to \$700,000 in certain instances and allows the HUD Secretary the flexibility to increase different loan categories by as much as \$100,000 “if market conditions warrant.”
- House Financial Services Committee Chairman Barney Frank said, “We go forward with the bill with the affordable-housing fund neither established nor preempted in the future.” On February 29th, Frank met with Senator Christopher J. Dodd, (D-CT), the chairman of the Senate Banking, and their panels’ ranking Republicans — Representative Spencer Bachus (R-AL) and Senator Richard C. Shelby (R-AL). Frank said the meeting was “very productive” and he’s “optimistic that we’re going to get an FHA bill.” (*CQ Today*, Libby George and Phil Mattingly, 02/28/08)
- In testimony before Congress, Federal Reserve Chairman Ben Bernanke said that Congress could best help the subprime mortgage crisis by passing FHA reform which

would “provide a vehicle for financing some of these mortgages.” (*CQ Today Midday Update*, 02/27/08)

Fannie Mae and Freddie Mac

Will Congress bail out subprime borrowers?

Chairman Frank proposes a \$30 billion bailout for the subprime borrowers

Bush administration opposes *any* taxpayer-funded bailout for the housing crisis

Ivy League populism in the ‘08 Presidential campaign

Let the housing industry “find bottom”

Is homeownership the right thing for every household at every point in time?

Chairman Frank proposes a \$30 billion bailout for the subprime borrowers

- House Financial Services chairman Barney Frank (D-MA) called on Congress to make \$15 billion available to FHA for the agency’s use in buying and refinancing pools of subprime mortgages, along with \$20 billion to provide states assistance in repurchasing repossessed properties. Under Frank’s plan, the existing mortgage holder would be required to write down a mortgage loan to a level that the homeowner could afford. [This requirement would not apply to mortgages for second homes and investor-owned properties]. In an interview with *Financial Times*, Frank said that there is a “lot of support for this proposal in the House.” In the Senate, Senate Banking Committee chairman Chris Dodd called for \$20 billion in seed money to create a Homeownership Preservation Corporation, which would likely buy \$200 billion to \$400 billion of subprime mortgages at a discount. Frank said, “We can do it through an existing vehicle rather than a new vehicle,” noting that the logic behind both proposals are similar. Ultimately, the cost to the U.S. taxpayer would “probably” be about \$3 billion to \$4 billion. Frank also called for \$20 billion in loans to states, which could be used to buy and refurbish foreclosed homes and fund mortgage counseling services. He noted that “lesser efforts” to tackle the housing crisis “have not been very successful,” as the housing crisis is “getting worse, not better.” Frank added, “We’re talking about a terrible impact on society.”

- At a House Financial Services Committee hearing, Mark Zandi, chief economist at *Moody's Economy.com* told lawmakers that it would take about \$250 billion upfront to buy all 2 million nontraditional mortgages that were are expected to end up in foreclosure by the end of the decade. Frank said that “reality constraints” prevent this type of approach, given Congress’ pay-as-you-go spending rules.
- “We’re getting a lot of bailout pressures from different directions,” says Joseph Mason, Associate Professor at Lebow College of Business at Drexel University in Philadelphia. While it’s unclear how big a bailout will become, the likelihood of expanding rescue efforts is growing and it will pay to heed lessons of the past, said Mason. “The choice is very similar to disciplining a teenager,” he said. While infusions of federal money may serve an important purpose for the economy, the effectiveness of the bailout depends on setting limits as well as providing relief. If banks are insolvent and facing a long-term cash-flow problem, then short-term lending, such as the Federal Reserve’s recent infusion of liquidity, only prolongs the problem. Importantly, policymakers will have to make tough choices about whether bailouts are warranted. Mason argued that some institutions should be allowed to fail and any bailouts should match infusions of new capital with tight oversight to ensure that these new loans are “safe and sound” not high-risk. We learned during the Great Depression that this type of approach was successful, while “half measures ...are only a waste of money.” (*Financial Times*, Chris Bryant and Krishna Guha, 02/27/08; *The Wall Street Journal*, Damian Paletta, 02/27/08; *Associated Press*, 02/26/08; *The Christian Science Monitor*, Mark Tumbull, 02/27/08; *American Banker*, Stacy Kaper, 02/27/08)

Bush administration opposes any taxpayer-funded bailout for the housing crisis

- President George W. Bush and Treasury Secretary Henry Paulson voiced opposition to any kind of taxpayer-funded bailout to deal with the housing crisis. “We don’t support legislation that will reward lenders—you know, that will bail-out lenders,” said Bush, following a meeting with his economic advisors. In prepared remarks to the Economic Club of Chicago, Paulson said, “While some in Washington are proposing big interventions, most of the proposals I’ve seen would do more harm than good. I’m not interested in bailing out investors, lenders and speculators. ... Homeowners who gambled in the housing market and viewed their purchase as a short term investment may choose to walk away. Those who do this are nothing more than speculators, and they are not the focus of our efforts. I’m focused on solutions targeted at struggling homeowners who want to keep their homes.” In an interview with the *Wall Street Journal*, Paulson said, “I don’t think I’ve seen any scenario where the American taxpayer needs to be stepping in with taxpayer dollars.”(*New York Times*, Edmund L. Andrews, 02/29/08; *Bureau of National Affairs*, Michael Bologna, 02/29/08)
- Senior officials at Treasury, FDIC and HUD have expressed some interest in an OTS proposal that would help borrowers who are having trouble refinance their mortgages because their homes are worth less than they owe. Under the plan, borrowers would

be allowed to refinance into a FHA loan and the owner of the original loan would receive a “negative amortization certificate” (NAC) for the difference between the current loan balance and market value. Investors could choose to sell the NACs or retain the instruments until home values rebound. OTS director John Reich said, “With the decline in housing prices that’s taking place in this country, we are becoming increasingly aware that traditional refinancing is becoming very difficult as housing prices fall below mortgage balances. We are concerned this growing reality is encouraging increasing numbers of people to walk away from their homes.” Reich said that his agency is hoping to get other regulators’ support for this proposal, which is still under development. Treasury spokeswoman Jennifer Zuccarelli said, “Treasury is always open to hearing new ideas and we generally welcome innovative, market-based ideas to help struggling homeowners.” (*Bloomberg News*, John Brinsley and Alison Vekshin, 02/21/08; *American Banker*, Cheyenne Hopkins, 02/21/08; *Bureau of National Affairs*, Stephen Joyce, 02/26/08)

Let the housing industry “find bottom”

- In a February 27th *Wall Street Journal* Editorial, Holman W. Jenkins, Jr. wrote, “...Any debate about a housing bailout can be put aside—the bailout is underway, even in advance of specific plans being shopped around Washington by Bank of America to prop up home prices with direct subsidies to homeowners whose debt exceeds the value of their houses. No, the perverse effect won’t be a replay of the ‘30s, or even Japan’s decade of stagnation in the ‘90s, but the latter is your model, with a little inflation thrown in. The goal: avoid foreclosures and slow the fall of home prices to market-clearing levels.”
- “Notice that today’s bailout will be the opposite of the misnamed S&L bailout of the ‘80s. Then, only depositors, whose money was guaranteed under federal law, were bailed out. The federal government closed down thrifts, wiped out their shareholders, seized loan collateral and dumped it back on the market, even at fire sale prices. But this time, the liquidationist school has been routed—so named for Herbert Hoover’s Treasury secretary, Andrew Mellon, who said: ‘Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate. . . . It will purge the rottenness out of the system.’”
- “Making the hole even harder to climb out of in tough-love fashion, government policy itself played a big role in creating the bubble, on the bipartisan theory that homeownership begets ‘social stability.’ Like all good things, when converted to a slogan, this idea became our road to perdition. Charles Kindleberger, the late MIT economist who wrote the classic handbook *Manias, Panics, and Crashes*, noted as early as 2002 an emerging housing bubble. In an interview with this newspaper, he pointed a finger first of all at Fannie and Freddie, whose channeling of government-subsidized capital into the housing market helped turn housing into a leverageable, tradeable asset class. Result: The minting of new homes and home loans as speculative chits, which in turn has made housing more susceptible to the ups and downs of other speculative markets.”

- “So here’s the question: Do the people who would be bailed out want to be bailed out? Do they benefit from being bailed out? For starters, many homebuyers in the last two years were rank speculators, taking out zero-down subprime loans, then walking away when the bet didn’t pay off. A careful study of recent Massachusetts foreclosures by Federal Reserve Bank of Boston economists suggests that the key factor wasn’t an inability to pay, but an unwillingness to pay, once falling house prices made homeownership no longer a winning speculation. These people are already skipping out, because that’s their best option.”
- “Next up, what about the low-income homeowners who (unlike speculators) were the intended beneficiaries of homeownership expansion policies? Both President Clinton and President Bush championed such initiatives, and now 69% of households own their homes, up from 64% in 1992.”
- “Do the poorer households that were the targets of these initiatives actually benefit from homeownership? Carolina Katz Reid, then at the University of Washington, looked at the question systematically, using subjects who bought houses between 1977 and 1993. For most low-income households, homeownership proved a bad bet, even in a rising market. Mortgage costs ate up their incomes and tied them down in subpar neighborhoods with bad schools and inferior job opportunities. Their capital gains were subpar or nonexistent even if they managed to hold onto their houses for a decade. Lacking much income, they didn’t benefit from the mortgage-interest deduction.”
- “So much for subsidizing our way to greater ‘social stability’ by luring marginal borrowers into debt to own a home. The truth today is that politicians are rushing to prop up house prices not to rescue the poor from the ignominy of renting, but to get past the next election without affluent voters having to confront a realistic decline in the market value of their main assets. Most of these homeowners are still above-water in their home equity; though job changes or the prospect of job changes may make them sensitive to current market prices, many are not in need of selling.”
- “In the meantime, drawing out the correction prevents the market from finding a bottom. It prevents owners and shoppers alike from having confidence to judge what houses are worth. It bails out lenders and investors who incautiously or fraudulently financed home purchases for speculative buyers, which can only encourage more of the same behavior in the future.”
- “As piles of money shoveled out in the wake of 9/11 and Hurricane Katrina showed, even with untold trillions of dollars in unfunded entitlement liability hanging over the federal government, there is little resistance to contracting vast new liabilities whenever large numbers of voters are in distress, even if (as now) their own choices played a role. A more honest use of taxpayer money at least would be to buy up houses at foreclosure auctions and demolish them, especially in neighborhoods likely never to recover. The true fillip to ‘social stability’ right now would be to nip in the

bud the blighted, suburban slums of the future. (*Wall Street Journal*, Holman W. Jenkins, 02/27/08)

- In a February 7th white paper by Dr. Ronald D. Utt, Ph.D., a senior research fellow with The Heritage Foundation, wrote, "...A better approach [to addressing the subprime mortgage crisis] would be to encourage a return to more traditional underwriting practices that require borrowers to have an equity stake in their homes. The federal government should also link any mortgage assistance to an end to onerous local land use regulations that have caused much of the home price inflation in recent years." (*WebMemo No. 1802*, Ronald D. Utt, Ph.D., 02/07/08)

Ivy League populism in the '08 Presidential campaign

- In a February 21st article, Victor Davis Hanson wrote, "The rhetoric of Senators Barack Obama and Hillary Clinton about the sad state of America is reminiscent of the suspect populism of John Edwards, the millionaire lawyer who recently dropped out of the Democratic presidential race."
- "Barack Obama may have gone to exclusive private schools. He and his wife may both be lawyers who between them have earned four expensive Ivy League degrees. They may make about a million dollars a year, live in an expensive home and send their kids to prep school. But they are still apparently first-hand witnesses to how the American dream has gone sour. Two other Ivy League lawyers, Hillary and Bill, are multimillionaires who have found America to be a land of riches beyond most people's imaginations. But Hillary also talks of the tragic lost dream of America."
- "In these gloom-and-doom narratives by the well off, we less fortunate Americans are doing almost everything right, but still are not living as well as we deserve to be. And the common culprit is a government that is not doing enough good for us, and corporations that do too much bad to us."
- "In the new pessimistic indictment, the home mortgage meltdown has not occurred because too many speculative buyers were hoping to flip houses for quick profits. It had nothing to do with misguided attempts of government and lending institutions to put first-time buyers in homes through zero-down payments, interest-only loans, and subprime but adjustable mortgage rates - as part of liberal efforts to increase home ownership rates."
- "And there apparently are few Americans who unwisely borrowed against their homes a second and third time to remodel or purchase big-ticket consumer items - on the belief that their equity would always be rising faster than their debts. Nor are we to look at this downturn as part of a historical boom-and-bust cycle in the housing industry - the present low prices and non-performing loans the natural counter-response to the overpriced real estate of the last five years...."

- “As Senators Obama and Clinton try to outdo each other in blaming government for our lack of individual responsibility and promising solutions by raising taxes to give us more government, they offer little change and less hope.” (*RealClearPolitics.com*, Victor Davis Hanson, 02/21/08)
- According to a recent Congressional Research Service report, a federally mandated freeze on foreclosures, as proposed by Senator Hillary Clinton, could upset existing investment contracts and spark court challenges, demanding compensation from the government for damages. If enacted, such a bill could implicate rights protected under the U.S. Constitution, said David H. Carpenter, legislative attorney for the American Law Division, who authored the report. “Such a measure would modify existing contracts, which would result in the loss of property rights of some individuals in the mortgage market. For this reason, a foreclosure moratorium raises some constitutional concerns,” said Carpenter. Mortgage-backed securities investors would be the most likely to challenge the moratorium in court, claiming that a foreclosure moratorium amounts to a “taking” by the government that requires it to provide just compensation under the Fifth Amendment. (*Bureau of National Affairs*, R. Christian Bruce, 02/22/08)

Is homeownership the right thing for every household at every point in time?

- In Freddie Mac’s 2007 Annual Report, CEO Richard Syron wrote in his Message from the Chairman: “...The problems in the subprime market remind us of a longstanding truth that was nearly obscured during the last years of the long housing boom: not every family that wants to own a home is financially ready for homeownership. To understand why this is so, consider the subprime market, which can be roughly divided into three parts. The top group of subprime loans might have been eligible for prime credit, but for one reason or another ended up in the subprime category. A middle group of loans are legitimately in subprime, but should benefit from enhanced underwriting standards and more reasonable reset terms. Finally, a sizable bottom group of subprime loans may not have been repayable in any reasonable scenario unless home prices continued to escalate.”
- “I am an ardent proponent of the long-term benefits of homeownership. That also makes me an ardent opponent of practices that unduly raise the risk of foreclosure. We need to face the fact that, as a matter of both policy and attitude, our nation did not sufficiently question whether homeownership is the right thing for every household in America at every point in time. For most homeowners in the bottom group of subprime today, it may be better to be renters than homeowners at this point in the cycle. That’s how it was when many of us grew up.”
- “Accordingly, some of the housing stock that is now or soon will be facing the threat of foreclosure will likely need to be converted, at least temporarily, into rental housing. So it makes sense to undertake efforts that would enable at least some of the families that briefly owned the properties to stay in them under certain circumstances, whether as ordinary renters, or on some kind of innovative shared-equity, rent-to-own

or lease-to-buy basis. The specifics would have to be worked out as a matter of law and policy. But what's already clear is that the right kinds of creative solutions would be better than foreclosure — for lenders, families and neighborhoods alike.”

- “One lesson I hope we all absorb from last year’s experience is that housing finance alone cannot resolve all the housing affordability challenges facing our nation. To achieve lasting gains in affordability, advances in mortgage finance must be accompanied by changes affecting the supply side of the housing equation — such as in zoning, permitting, transportation and other policies. In sum, we need a change of perspective, emphasizing sustainable homeownership — homes that families can afford to buy and keep — over mere homebuying. Any other approach elevates statistics over human lives: the short-term satisfaction of telling ourselves the homeownership rate is increasing, when what really matters is the long-term strength of our families, our neighborhoods and our economy, as shown by the events of 2007.” (*Freddie Mac’s Annual Report*, Richard E. Syron, 2007)

NAHB urges Congress to pass GSE regulatory reform

- In response to Freddie Mac’s announced plans to impose higher fees and stricter downpayment requirements, Jerry Howard, EVP and CEO of National Association of Homebuilders, urged Congress to “quickly ...enact comprehensive reform of the housing government sponsored enterprises so that their mission responsibility can take precedence over their business interest.” (*NAHB Press Release*, 02/25/08)
- Freddie Mac said it will increase its prices further and add underwriting restrictions for mortgages that it guarantees due to “continued deterioration of credit quality and declining home values in most areas of the country.” Starting June 1st, Freddie will assess a 30-basis-point fee on loans which have a loan-to-value ratio exceeding 80% and the borrower has a credit score of less than 740. The company also said it will stop buying mortgages with LTV ratios higher than 97%, except for loans insured by FHA or the VA. In December, Fannie and Freddie announced additional 25 basis point fees due to deteriorating market conditions. (*American Banker*, Harry Terris, 02/27/08)

Fallout from the mortgage market

- Freddie Mac’s chairman and CEO Richard Syron said, “Today’s economy represents one of the most severe housing downturns in American history.” (*Financial Times*, Saskia Scholtes, 02/29/08)
- During the fourth quarter of 2007, OFHEO’s seasonally-adjusted purchase-only price index declined 1.3% relative to the third quarter of 2007. The decline was more than triple the 0.3% decline reported during the second and third quarters of last year. For

the year 2007, prices fell 0.3%, as the fourth quarter decline erased earlier price gains in the year. (*OFHEO Press Release*, 02/26/08)

- By the third quarter of 2007, total debt outstanding rose to \$13.6 trillion from \$7.2 trillion on January 1, 2002 for an annual growth rate of 10%. Mortgage borrowing more than doubled over this period. Today, one out of every seven dollars of each American's disposable income goes to paying down debt. (*Wall Street Journal*, Scott Patterson, 02/20/08)
- On January 31, 2007, approximately 2.3 million mortgage loans were delinquent and another 505,000 mortgages were in default, according to Moody's Economy.com, an economic research firm. (*Wall Street Journal*, Ruth Simon, 02/28/08)
- *MortgageWire* reported, "Defaults on mortgages backed by the nation's largest mortgage insurers reached a new high-water mark during January, according to data released Friday by the Mortgage Insurance Companies of America. Insured defaults reached 68,950 during the month, an increase of 31[%] from year-ago levels. ...MICA reported that January's cure rate fell to 51.4[%], the lowest monthly cure rate on record." (*Housing Wire*, Paul Jackson, 02/29/08)
- Nouriel Roubini, a professor of economics at New York University and chairman of the popular economics website Roubini Global Economics, warns of the forthcoming "jingle mail tsunami." Roubini wrote, "...[T]he most important first-order risk for financial markets derives from the likelihood that 10 million to 15 million households may walk away from their homes if—as likely—home prices fall *another* 10% in 2008 and further in 2009. When – in the summer of 2006 – [I] argued that this would be the worst housing US recession in the last 50 years and that home prices would fall – from their peak value – by 20% such predictions were taken as being nearly lunatic. Too bad that [I] ended up being too optimistic, not too pessimistic, about the severity of this housing recession. Indeed, this will end up to likely to be the worst housing recession in US history – not just in the last 50 years – and home prices may likely eventually fall by 30%, not [my] "optimistic" 20%. By now prices declines of the order of 20% are predicted by Goldman Sachs, Robert Shiller, MarketWatch chief economist Irwin Kellner and others; while Paul Krugman has suggested even a figure of 30%; and, according to Bob Shiller, in some markets home prices may fall by 40 to 50%. ...If house prices decline of the order of 20 to 30% nationally, 10 to 15 million households will end up in negative equity territory and will be likely to default on their homes and walk away from them. Then, the losses for the financial system from this massive default will be of the order of \$1 trillion to \$2 trillion, a multiple of the \$200 to \$400 billion of losses currently estimated for mortgage related securities." (*Nouriel Roubini's Global EconMonitor*, Nouriel Roubini, 02/19/08; *RGE Monitor*, Nouriel Roubini, 02/28/08)
- Fitch Ratings has put credit ratings of MGIC Investment Corp., Radian Inc., and PMI Group Inc. on watch for downgrades because of continued weakness in the U.S. mortgage markets. "Fitch believes a number of the major players in the industry will

need to raise significant additional equity in the near future or risk having their ratings downgraded,” said the agency. According to their analysis, the mortgage insurance industry isn’t likely to return to “healthy” levels of profitability until 2010. (*Dow Jones Newswires*, Kathy Shwiff, 02/25/08)

- Moody’s Investors Services said that it has downgraded Regions Financial Corp., Synovus Financial Corp., Trustmark Corp., Zions Bancorp., and Royal Bank of Canada’s RBC Centura Banks Inc., because of their exposure to commercial real estate and residential construction. “Recent trends bear out what we have been concerned with for some time — that sizable CRE loan concentrations increase the potential for asset quality and earnings volatility,” said Moody’s. “Those that are heavily concentrated in CRE not only face potential credit losses from an industry downturn, but they may also experience a material decline in revenue from the associated slowdown in demand.”
- Moody’s Investor Services said that downgrades of bond insurers could require banks and securities firms to increase reserves by between \$7 billion and \$10 billion. If the monoline business further deteriorates, banks may have to set aside \$20 billion to \$30 billion in reserves to cover counterparty risks, estimated Moody’s. About 20 banks and securities firms have roughly \$120 billion worth of hedges with financial guarantors on CDOs that contain asset-backed securities, said the agency. “We are currently evaluating these individual exposures to assess how institutions can absorb the additional counterparty reserves that might be required if one or more financial guarantors were downgraded,” said Moody’s. (*Dow Jones Newswires*, 02/19/08)
- February was one of the worst months for U.S. municipal bonds in more than four years, after collapsing demand for securities sent debt costs for states, cities and hospitals as high as 20%. The \$330 billion auction-rate market froze in February, after dealers stopped purchasing bonds when buyers failed to bid. The auction rate turmoil and slump in municipal bonds is one of the latest fallouts from the subprime mortgage crisis. (*Bloomberg News*, Jeremy R. Cooke, 02/29/08)
- According to the FDIC, banking industry earnings fell to its lowest level since the fourth quarter of 2001. For the fourth quarter of 2007, banks reported net income of \$5.8 billion, 83.5% less than banks’ earnings for the fourth quarter of 2006. On December 31, 2007, 76 banks with approximately \$22 billion in assets were classified as “problem” banks by the FDIC, a 16% increase from the 65 problem banks on September 30, 2007. Three banks failed during 2007—the first time that FDIC has had to handle bank failures since 2004. (*Dow Jones Newswires*, Michael R. Crittenden, 02/26/08)
- According to the Office of Thrift Supervision, the thrift industry posted a record \$5.2 billion fourth-quarter loss, a dramatic swing from the industry’s \$3.1 billion net income for the fourth quarter of 2006. OTS Director John Reich said that he expects that strain from the housing crisis will lead to increased failures of thrifts, but not among the larger companies. “This is not banking-and-thrift crisis part two,” said

Reich. “It’s a totally different environment, with strong capital, higher reserves.”
(*Wall Street Journal*, Damian Paletta, 02/21/08)

- In testimony before the Senate Banking Committee, Federal Reserve Chairman Ben Bernanke said, “There will probably be some bank failures. There are, for example, small banks ... that are heavily involved in real estate in locales where prices have fallen, and they’re going to be under pressure.” He didn’t elaborate as to how many banks could fold, but did indicate that the largest domestic institutions remain safe. (American Banker, Steven Sloan, 02/29/08)
- FDIC is adding staff to handle a possible increase in the number of failed financial institutions as the conditions in the housing and credit markets continue to deteriorate. FDIC spokesman Andrew Gray said the agency is bulking up “for preparedness purposes” the division which handles bank failures, which currently has 223 employees mostly based in Dallas. (*Wall Street Journal*, Damian Paletta, 02/26/08)

Please, God, Just One More Bubble

- In his annual letter to shareholders, Warren Buffet wrote, “...Some major financial institutions have, however, experienced staggering problems because they engaged in the ‘weakened lending practices’ I described in last year’s letter. John Stumpf, CEO of Wells Fargo, aptly dissected the recent behavior of many lenders: ‘It is interesting that the industry has invented new ways to lose money when the old ways seemed to work just fine.’ You may recall a 2003 Silicon Valley bumper sticker that implored, ‘Please, God, Just One More Bubble.’ Unfortunately, this wish was promptly granted, as just about all Americans came to believe that house prices would forever rise. That conviction made a borrower’s income and cash equity seem unimportant to lenders, who shoveled out money, confident that HPA – house price appreciation – would cure all problems. Today, our country is experiencing widespread pain because of that erroneous belief. As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked when the tide goes out – and what we are witnessing at some of our largest financial institutions is an ugly sight...” (*Letter to Shareholders of Berkshire Hathaway Inc.*, Warren E. Buffet, February 2008)

HUD expects to issue new jumbo loan limits by March 7

- According to sources, HUD said that it expects to issue the new jumbo loan limits for high cost markets for Fannie Mae, Freddie Mac and HUD by March 7th. (*MortgageWire*, 02/21/08)
- Only 15 counties (most in southern California) in the U.S. have a median house price high enough to qualify for the temporary maximum conforming loan limit called for

in the economic stimulus package, an indication that increased conforming loan limits may not help as many home buyers and refinancers as lawmakers had expected. While the National Association of Homebuilders had hoped that as many as 29 metropolitan areas would qualify for the new conforming loan limit of \$729,725, the trade group has concluded that fewer than ten markets will qualify. With just 15 counties qualifying, NAHB now says it's possible that only 1.5 million homes could qualify for revised loan limit—half of the trade group's original estimate. Freddie Mac's chairman and CEO Richard Syron has assured the NAHB's board of directors that "we will find a way to get this done" [to implement the higher conforming loan limits]. Fannie Mae CEO Daniel Mudd told the NAHB that his company is already working with lenders "to get them up to speed." NAHB officials also have expressed concern that OFHEO officials may drag their feet and delay approval of the GSEs' new loan products for higher-limit loans. In response, OFHEO Deputy Director Edward DeMarco said his agency is "committed" to carrying out the will of Congress, but stressed that the internal processes that must be undertaken are those of Fannie and Freddie—not OFHEO. (*Dow Jones Newswires*, Lew Sichelman, 02/20/08)

- At Reuters Housing Summit, Fannie Mae CEO Daniel Mudd said that the benefits to the U.S. housing market from the increase in the GSEs' conforming loan limits were "stunted" by the Securities Industry and Financial Markets Association's (SIFMA) decision to isolate jumbo mortgage from the main mortgage securities market. SIFMA's decision will require traders develop a new market, instead of adapting the current TBA market, which is prized for its liquidity, said Mudd. "We think that was the wrong decision [by SIFMA]", said Mudd. "A separate market is effectively going to have to be established and created for (jumbos.) As a result of that, the impact will take longer to be realized." A better alternative would have been to limit the amount of jumbos to be allowed in a TBA pool, he said. (*Reuters*, Al Yoon, 02/20/08)
- According to Paul Miller, an analyst with Friedman Billings Ramsey Group, the temporary extension of the conforming loan limit to \$729,750 will have little immediate impact on mortgage rates offered by the GSEs. In a recent report, Miller wrote, "that Fannie Mae and Freddie Mac [would likely] establish risk-based pricing depending on the loan characteristics and raise the guaranty fees on this product beyond that of the agency loans due to exposure to higher credit risk." He added it would take the GSEs some time to "establish an adequate risk-based pricing system" for these loans. Over the long term, however, the GSEs could pick up more of a share of the "very profitable" but risky jumbo market, wrote Miller. (*American Banker*, William Launder, 02/26/08)
- So what's the verdict on the government stimulus package? According to Tom Hutchinson with *Motley Fool*, "One could argue that these policies are useless and only good for giving political cover to politicians who need to make it appear that they've done something. However, this Fool thinks the government has actually done a pretty good job. It can't wave a magic wand and fix everything. The government isn't, nor should it be, in the business of bailing out the market. Politicians are,

however, in the business of setting the stage for an environment where the market can more easily bail itself out. That they've done. Good for them." (*Motley Fool*, Tom Hutchinson, 02/20/08)

The Russian government plans to invest reserve funds in international debt instruments, including those issued by Fannie and Freddie

- The Russian Finance Ministry (RFM) will allow the country's Reserve Fund and National Welfare Fund to invest in debt instruments of 15 foreign government agencies. These agencies include Fannie Mae, Freddie Mac, the FHLBs, and the Farm Credit Banks, said RFM. On February 1st, Russia's Reserve Fund totaled \$125 billion and its National Welfare Fund amounted to \$32 billion. Each fund is supposed to invest 80% of their resources in sovereign debt, 10% in bonds of foreign agencies, and 5% in international financial organizations. (*Bureau of National Affairs*, Sergei Blagov, 02/22/08)
- On February 29th, Robert Reich, the former Secretary of Labor in the Clinton administration, wrote, "A delegation from the U.S. Treasury Department met recently with a few of the world's largest sovereign wealth funds. They want to avoid a political firestorm as more and more foreign investment makes its way into the U.S. economy. What's this all about, really?"
- "Over the past thirty years, the U.S. government has dismantled the system of regulation the nation instituted to prevent the sort of wild speculation that preceded the financial meltdown of the Great Depression. The last piece to fall was known as the Glass-Steag Act, a Depression-era firewall intended to separate banking from investment. In the 1990s, my cabinet colleague Bob Rubin joined Fed chair Alan Greenspan to get Congress to repeal Glass-Steagal."
- "Now we're witnessing another financial meltdown, also fueled by speculation. Hopefully this one is not as serious as the one that occurred in 1929. But it does require us to rethink the importance of sensible financial regulation. Perhaps the pendulum of financial deregulation has swung too far. Paradoxically, the primary response of governments—both here in the US and in other advanced nations whose financial markets are also frozen—isn't to rethink regulation. It's to subject financial institutions to government ownership. Recently the British government decided to take over the troubled mortgage lender Northern Rock. This was after the Bank of England was forced to give the firm emergency funding to avoid a run on the bank."
- "Well, you might say, that's Europe. They've been nationalizing companies for years. But the same trend is happening in the United States. The difference is that here it's not the US government that's taking over financial institutions. It's governments from Asia and the Middle East. Singapore recently paid \$4.4 billion for an ownership stake in Merrill Lynch. The Chinese bought a \$5 billion piece of Morgan Stanley. Abu Dubai is spending billions on other American financial

institutions. The list of foreign owners continues to lengthen, and the amount they're shelling out to buy American banks continues to grow."

- "As their balance sheets weaken, America's big financial houses are getting bailed out by selling out. It's only logical, from their viewpoint. American banks need the cash and oil-producing and East-Asian governments have it. Yet there's no end in sight for the credit crisis, and Middle Eastern and East Asian 'sovereign wealth funds' are in the process of owning a larger and larger portion of the global banking system. These funds are growing by more than a trillion dollars a year. At this rate, they'll BE the global banking system. The problem is, government ownership doesn't work. Governments are lousy at deciding where profits can be found. They're liable to make decisions based on politics rather than profits."
- "It's the biggest irony in financial history. Decades of U.S. government deregulation of Wall Street has reaped a whirlwind of irresponsible speculation. It's now ending in a financial meltdown that's being remedied by government ownership, with all the strings that come with government ownership. And it's not even OUR government that's holding the strings." (*Robert Reich's Blog*, 02/29/08)

Fannie Mae

Fannie Mae's retained mortgage portfolio declined 4.8% in January

- In January, Fannie Mae's retained portfolio declined at an annualized rate of 4.8% to \$720.985 billion. During the month, Fannie's MBS and Other Guarantees rose at a compound annualized rate of 11.1% with the company's MBS issuances totaling \$49.1 billion. Fannie's Single-Family Serious Delinquency Rate increased 8 basis points in December (latest data available) to 0.98 basis points, while its Multifamily Serious Delinquency Rate remained unchanged at 8 basis points. The company's effective duration gap averaged plus one month in January, down from plus two months in December. (*Fannie Mae's Monthly Volume Summary*, January 2007)
- Based upon Fannie Mae's securitization data from the company's Loan Performance database, Morgan Stanley analysts Kenneth A. Posner and Vivian Wei Wang noted that prime and Alta-A delinquencies continued to rise in January. As a result, the analysts expect Fannie's SF Serious Delinquency rate to rise to 1.22% in January. Morgan Stanley has rated Fannie Mae "Underweight" and maintains an industry view of "Cautious." (*Morgan Stanley Research of North America*, Kenneth A. Posner and Vivian Wei Wang, 02/26/08)

Ohio Attorney General Dann considers filing lawsuit against Fannie Mae

- Following a string of failed legal attempts to intervene in a series of foreclosure actions, Ohio Attorney General Marc Dann said he is refocusing his efforts on a series of broader legal initiatives and is considering filing lawsuits against Fannie Mae over investor disclosures. In late January, Dann filed a class action suit against Freddie Mac, alleging that the GSE failed to adequately disclose its subprime mortgage exposure. At the Reuters Housing Summit, Dann said, "It appears that [Fannie Mae] also failed to advise their shareholders of the extent of their subprime holdings." Speaking by telephone to the Reuters Summit, Fannie Mae CEO Daniel Mudd said he was unaware of Ohio's potential litigation, but was confident that his firm had made full disclosures. "We are believers in transparency and disclosure, and I certainly stand behind everything we've put out," said Mudd.
- Dann also said his office will subpoena 15 additional mortgage companies as a part of his investigation into lenders' practices during the housing boom. "We're going to issue our next wave of subpoenas in the next couple of weeks," he said. "We're working our way up the ladder." Ultimately, Dann wants to bring his mortgage fraud cases to a jury trial rather than seek settlements. "The only way to send a message to folks in this town [New York City] is by suing them," said Dann. "We've got to step up and hold them accountable. If I can get this case to a jury in Ohio, you can't fit enough zeros in the check." Dann told attendees that the eventual Democratic nominee [whether Hillary Clinton or Barack Obama] can tap into voter anger about

the housing crisis, and could lay much of the blame at the Republican Party's feet. (*Reuters*, Nick Zieminski, 02/20/08; *Reuters*, Martha Graybow, 02/20/08; *Housing Wire*, Paul Jackson, 02/20/08; *Reuters*, Joseph A. Giannone, Emily Chasan and Martha Graybow, 02/20/08)

Fannie Mae hires MBA's Douglas Duncan as its chief economist

- Fannie Mae has named Douglas Duncan to serve as vice president and chief economist, in charge of the firm's Economics and Mortgage Market Analysis Department within its Business Strategy Group. Previously, Duncan served as the Mortgage Bankers Association's chief economist and SVP since 2000. Duncan succeeds David Berson, Fannie's former chief economist, who accepted early retirement from the company in September and subsequently joined PMI Group to oversee market research. "Leaving MBA after 15 years is a tough decision given its prominence and influential position in the industry," Duncan said. "However, the opportunity at Fannie Mae is to join another influential firm at a critical time in the real estate finance markets. I look forward to making a positive contribution to the ability of Fannie Mae to support the housing markets." (*Reuters*, 02/26/08; *Fannie Mae Press Release*, 02/26/08)

In 2007, Fannie Mae spent \$5.6 million to lobby Congress

- Fannie Mae spent about \$5.7 million in 2007 to lobby Congress related to housing, lending and security legislation. According to the company's disclosure forms, Fannie spent \$2.9 million during the first six months of 2007 to lobby on legislation related to GSE regulatory reform, the regulation of secondary mortgage companies, data security, FHA reform, and creating an affordable housing trust. During the last six months of 2007, Fannie Mae spent a little more than \$2.7 million to lobby the federal government on legislation addressing the treatment of mortgages in bankruptcy and HUD appropriations. (*Associated Press*, 02/27/08)

"For far too long African-Americans have struggled at Fannie Mae"

- In anonymous letters sent to Fannie Mae CEO Daniel Mudd and chairman Stephen B. Ashley, employees said that minorities at the company are growing increasingly frustrated. "For far too long African-Americans have struggled at Fannie Mae," wrote one employee. In another letter sent in January, the employee wrote, "As more and more African-Americans leave ...hope is leaving the building as well. After receiving the first letter, Fannie Mae's management quickly called meetings with groups of African American and Hispanic employees to get their input on the company's climate. Stacey D. Stewart, the former head of the Fannie Mae Foundation which was closed down in 2007, recently updated the company's

diversity program and presented it to the board at its February meeting.

- In a recent meeting with *Washington Post* editors and reporters, Mudd said the company's accounting scandal, subsequent regulatory action and turmoil in the economy and housing market may have contributed to the employees' discontent. "We had other things to pay attention to, and I think we kind of took our eye off the ball," said Mudd. "I was disappointed that we sort of lost that." Mudd pointed out that Fannie Mae's diversity numbers have "held up pretty well and increased in a lot of areas." In 2007, nearly half of its employees were minorities and the proportion of mid-level minority employees has increased from 49% to 52% over the past three years. Today, 25% of Fannie Mae's high-level officers and directors are minorities, compared to the average among U.S. financial services companies of 15%, as reported to the EEOC. (*Washington Post*, Anita Huslin, 02/18/08)

<p>Fannie Mae introduces the HomeSaver Advance™ Mortgage to help delinquent borrowers</p>

- Fannie Mae has introduced HomeSaver Advance™ mortgage product, designed to help qualified borrowers bring delinquent mortgages current and keep their homes. With HomeSaver Advance, servicers can now offer an unsecured, personal loan that will enable a qualified borrower to cure the payment default on a mortgage loan that Fannie Mae owns or has securitized, with fewer up-front costs and generally in less time. "HomeSaver Advance will help Fannie Mae streamline its loss mitigation efforts and offer loan servicers a new way to cope with a delinquent loan," said Mike Quinn, Fannie Mae SVP for Single-Family Credit Risk Management. "Our research shows that most borrowers become delinquent because of a temporary life event or hardship. This loan can offer these borrowers another alternative, and help prevent a temporary setback from becoming a foreclosure."
- HomeSaver Advance will provide Fannie Mae with an enhanced ability to manage credit risk and conserve capital during the housing downturn. Fannie Mae anticipates that HomeSaver Advance will reduce the number of delinquent mortgage loans it purchases from its mortgage-backed securities trusts and the fair value losses it would record in connection with those purchases. HomeSaver Advance is being rolled out and should be available to all Fannie Mae Servicers by April 15, 2008. (*Fannie Mae Press Release*, 02/27/08)
- In the March 1st edition of *Wall Street Journal*, Richard Beales and Dwight Cass wrote, "Remember Ninja mortgages—no income, no job, no assets? And 'liar loans,' with no check of borrowers' stated incomes? Staid old Fannie Mae and Freddie Mac, the U.S. mortgage titans, were supposed to have shunned such subprime excesses. Maybe they did. But Fannie now seems to be going out on a similar lending limb. The company is offering borrowers who are behind with mortgage payments as much as \$15,000 each to clear their arrears. The money comes—get this—as **a 15-year unsecured personal loan, and 'verbal confirmation of financial capacity' is**

considered acceptable. [Emphasis added.] To be fair, there are a few other criteria. And it's billed as a way to help homeowners over a hump. But Fannie may benefit the most. For Fannie, the 'HomeSaver Advance' program should help reduce the need to modify mortgage loans formally, a complicated and expensive process, and to foreclose, a bad result all round. But as it happens, it will also reduce the number of delinquent loans Fannie buys back from the pools underlying mortgage-backed securities that it guarantees—and the related losses it would otherwise have to take.”

- “For borrowers, Fannie says, the program is a way to ‘bring delinquent mortgages current and keep their homes.’ That’s true, provided they can afford the regular payments on their mortgage and those on the new loan, which kick in after six months. That may be fine for borrowers in truly temporary difficulty. But longer term, it’s going to increase their debt burden.”
- “The program might also upset investors in the company’s MBS instruments. They like the idea that Fannie has to buy back troubled individual mortgages under certain conditions. If HomeSaver Advance makes formerly delinquent loans look pristine, even though the borrowers are actually still struggling, it undermines that comfort.”
- “Overall, it could be Fannie that stands to reap the clearest benefits, at least in the short term. The company isn’t saying how big the new program might get. But bruised shareholders—and U.S. taxpayers, who are implicitly on the hook—might wonder whether a collection of unsecured loans to demonstrably stretched borrowers could, before long, become a bit of a millstone.” (*Wall Street Journal*, Richard Beales and Dwight Cass, 03/01/08)

Freddie Mac

Freddie Mac's retained mortgage portfolio declines 6.5% in January

- In January, Freddie Mac's retained mortgage portfolio declined 6.5% to \$716.0 billion, while its total guaranteed PCs and structured securities issued increased at an annualized rate of 7.9% during the month. Freddie Mac's single-family delinquency rate increased 5 basis points to 65 basis points in December with non-credit enhanced delinquencies of 45 basis points (up 5 basis points) and credit enhanced delinquencies of 162 basis points (up 7 basis points). The company's duration gap averaged 0 months in January, unchanged from December. (*Freddie Mac Monthly Volume Summary*, January 2008)
- Based upon Freddie Mac's securitization data from the company's Loan Performance database, Morgan Stanley analysts Kenneth A. Posner and Vivian Wei Wang noted that prime and Alta-A delinquencies continued to rise in January. As a result, the analysts expect Freddie's SF Serious Delinquency rate to rise to 0.73% in January—an increase of 8 basis points. Morgan Stanley has rated Freddie Mac "Equal Weight" and maintains an industry view of "Cautious." (*Morgan Stanley Research of North America*, Kenneth A. Posner and Vivian Wei Wang, 02/26/08)

Freddie sets new record for multifamily business volume in 2007: \$45 billion

- In a February 4th speech to the Mortgage Bankers Association Commercial Real Estate Finance Conference, Mike May, Freddie Mac's SVP of Multifamily Sourcing, said that his company set a new record for business volume in 2007 of nearly \$45 billion, an increase of 50% from 2006 and nearly 66% from 2005. May noted that Freddie Mac helped "keep the multi-family markets open for business" during the credit crunch in which GSEs "became the sole, consistent provider of funds in the market." During 2008, he said Freddie Mac will (1) introduce new products with "new capital-markets execution" at the top of their list; (2) do more for affordable housing through a series of more flexible executions; (3) streamline the process through a new data delivery system; and (4) expand its capacity to process loans and simplify product information. (*Prepared Remarks for Mark May, Freddie Mac Senior Vice President of Multifamily Sourcing*, 02/04/08)

Merrill Lynch hires former Freddie Mac COO McQuade

- Merrill Lynch has hired Eugene McQuade, Freddie Mac's former COO, to serve as vice chairman and president of its U.S. banking operations, where he will oversee operations of Merrill Lynch Bank USA and Merrill Lynch Bank & Trust Co.

McQuade will report to Robert McCann, president of the firm's global wealth management, and will join that unit's executive committee. (*Reuters*, 02/25/08)

Freddie Mac and American Bankers Association extend their alliance for ABA members

- Freddie Mac and the American Bankers Association have extended their alliance and enhanced the product and service offering, in which ABA members are provided access to critical mortgage products. Technology tools, staff training and other important services. "Today's announcement with the ABA will accommodate its members' changing needs with a proven package of business services and residential financing options," said Iliana Ghanem, Freddie Mac vice president for regional and community lending. "We are proud of our relationship with the ABA and our commitment to provide its members with a higher level of support in today's challenging market." (*Freddie Mac Press Release*, 02/25/08)

Federal Home Loan Banks

FHLB System's lending "reckless"

- In testimony before the House Financial Services Committee, New York University economist Nouriel Roubini said, "The widespread use of the FHLB system to provide liquidity — but more clearly bail out insolvent mortgage lenders — has been outright reckless. Countrywide alone — the poster child of the last decade of reckless and predatory lending practices — received a \$51 billion loan from this semi-public system; in the absence of this public bailout Countrywide would have ended up where it should, i.e. into outright bankruptcy. And the largesse of the FHLB system does not stop at Countrywide. A system that usually provides a lending stock of about \$150 billion has forked out loans amounting to over \$750 billion in the last year with very little oversight of such staggering lending. The risk that this stealth bailout of many insolvent mortgage lenders will end up costing massive amounts of public money is now rising." (*Wall Street Journal's Real Time Economics Blog*, Greg Ip, 02/27/08)
- According to the FHLBanks Office of Finance, the FHLB System's advances increased 36.6% to \$875 billion during calendar year 2007, representing 68.7% of the Banks' total assets of \$1.274 trillion. The System's net income for FY2007 was \$2.8 billion, an 8.2% increase over the prior year. The Banks' aggregate capital increased 19.1% to \$54 billion on December 31, 2007, representing 4.24% of total assets. (*FHLBanks Office Of Finance Press Release*, 02/26/08; *American Banker*, Rob Blackwell, 02/27/08)

Two Finance Board directors urge Congress to drop the FHLBs from GSE regulatory reform

- In written testimony submitted to the Senate Banking Committee, Federal Housing Finance Board [Democratic] members Geoffrey S. Bacino and Dr. Allan I. Mendelowitz urged Congress not to include the FHLB System in GSE regulatory reform. The directors wrote, "On the matter of GSE regulatory reform, each one of us on the FHFBB holds his or her own views. No single member of the Board of Directors can speak for the agency. Hence, our views on GSE reform are our personal views. Stated simply, we oppose folding the regulation of the Federal Home Loan Banks into a single GSE regulator. The central issues at hand relate to the statutory powers of OFHEO, the regulator of Fannie Mae and Freddie Mac. Little if anything in the debate has any relevance to the Federal Home Loan Banks or FHFBB."
- "We see few if any potential benefits for the regulation of the Federal Home Loan Banks, from such a change, and we see significant downside risk. The regulatory regime and the activities of the Federal Home Loan Banks have little in common with the regulatory regime and activities of Fannie Mae and Freddie Mac, currently

regulated by OFHEO. Because the regulatory issues and challenges are so different (and the issues surrounding Fannie Mae and Freddie Mac are so much more visible), we fear that the quality of the regulatory oversight of the Federal Home Loan Banks' safety and soundness would suffer and the System's mission could be substantially diminished."

- "...By including the Federal Home Loan Bank System in this reform package, the Federal Home Loan Banks, in our view, are being held hostage by those who see the need to reform the regulation and business of the other two housing finance GSEs. There are good arguments for why OFHEO needs additional regulatory authorities. However, those arguments have no bearing on or relevance for the Federal Home Loan Banks and the Federal Housing Finance Board."
- "At this time of great difficulty in financial markets and housing finance, the Congress should move carefully to try to fix the current crisis, without disturbing those parts of the market and the regulatory structures that are working well. That is why we urge you to drop the Federal Housing Finance Board from any OFHEO /Freddie Mac and Fannie Mae reform bill. This is especially important because, no matter how valuable such a bill may be from the perspective of effective regulation of Freddie Mac and Fannie Mae, regulatory reform itself will make no contribution to repairing the current crisis in financial markets and housing finance. And, unnecessary changes hold the risk of making the situation worse." (*Statement for the Record of Geoffrey S. Bacino and Dr. Allan I. Mendelowitz, 02/07/08*)

FHLBs announce FY2007 results

- The FHLB-Des Moines' total assets increased 44% to \$60.8 billion during FY2007, as members' advances increased 84.9% to \$40.4 billion on December 31, 2007. The Bank's advance balance was the largest in its 75-year history. The Bank's net income totaled \$101.4 million for the year ended December 31, 2007, an increase of 13.5% over FY2006, while its retained earnings increased 5% to \$361.3 million at yearend. The FHLB-Indianapolis also announced a fourth quarter dividend annualized rate of 4.5%, payable on February 28th. (*FHLB-Indianapolis Press Release, 02/27/08*)
- FHLB-Atlanta reported total assets of \$189.7 billion on December 31, 2007, a 34.8% from year-end 2006. The Bank's growth was primarily a result of a 40.8% increase in advances during the period. The Bank's FY2007 net income was \$444.9 million, a 7.41% increase from its 2006 earnings, which resulted in a 6.47% return on equity. On December 31, 2007, the Bank's total capital was \$8.0 billion, an increase of \$1.8 billion, or 29.9% from year-end 2006. Based upon currently available information, the FHLB-Atlanta expects to pay an annualized dividend in the range of 6.00% to 6.50% for the quarter ending March 31, 2008. (*FHLB-Atlanta Press Release, 02/29/08*)

Federal Housing Finance Board approves changes to the FHLB-Seattle's capital structure

- On February 20, the Federal Housing Finance Board approved an amendment to the FHLB-Seattle's capital structure plan, which would increase the range of the Bank's stock purchase requirement from 4.5% to 6%. The Finance Board also approved an amendment that allows the Bank's unaffiliated members to transfer excess stock amongst themselves. The amendments are intended to provide the Bank more capital management flexibility. (*American Banker*, Steven Sloan, 02/22/08)

FHLBs' guarantees for small bonds needed to fund local community projects

- In an interview with *American Banker*, John Price, the FHLB-Pittsburgh's chief executive said, "The monoline [insurance companies'] hiccups [in the marketplace] have demonstrated that there is really a crying need [for credit enhancement], and therefore I think the perception is that the Federal Home Loan banks are the right institution to fill the void. Even from a conservative point of view that wants the private sector to do everything, you clearly have an unmet need, an inefficiently functioning market." Representative Sander Levin (D-MI), who introduced legislation that would allow the FHLBs to help community banks guarantee bonds, said the troubles with bond insurers underscore the bill's importance. "This legislation is more important than ever," said Levin. "Allowing the Federal Home Loan banks to issue letters of credit for tax-exempt municipal bonds would help restore stability to the municipal credit market, allowing communities to continue making critical investments and relieving some of the pressure on credit markets generally."
- However, a spokesman for Senator John Rockefeller (D-WV) who introduced the similar legislation in the Senate, said passage may be difficult. "Sen. Rockefeller has every intention of getting something done this year, but the reality is, given the fact that everyone's attention is on the presidential elections, and the fact that even getting the most non-controversial bill through the Senate takes 60 votes, this will be difficult," said the spokesman. That's good news for those who believe that the legislation simply allows the GSEs to chip away at another market dominated by the private sector. "Every time we mix government credit into the financial system, we create additional moral hazard, which means the next crisis will come sooner and be more severe," said AEI fellow Peter Wallison. "This proposal is particularly pernicious, since it will put the federal government behind local obligations. In a case like this, there is no natural limit to the number of local debt issuances, and no one but the federal taxpayer will bear any risk." Bob Mackin, the executive director of the Association of Financial Guaranty Insurers, said the FHLB bill "represents poor tax policy in that it would allow a double government subsidy by combining implied federal government support of the Federal Home Loan banks with the tax exemption of interest paid on municipal bonds. Further, the proposed amendment would effectively permit" the banks "to use their federal subsidies to enter a new line of

business that competitive private firms already serve.” (*American Banker*, Steven Sloan, 02/25/08)

FHLBs offer foreclosure prevention programs to their members

- The FHLBs of Indianapolis and Cincinnati are offering their members access to grants and advances to help them facilitate the refinancing of subprime mortgages into fixed-rate 30-year mortgages. The FHLB-San Francisco recently received approval from the Federal Housing Finance Board to start a \$10 million pilot program which would match grants of up to \$25,000 to facilitate refinancings of nontraditional and subprime adjustable rate mortgages. In its approval of the program, the Finance Board said that any loan being refinanced may not exceed the \$417,000 conforming loan limit. Under these grants, members could refinance mortgages that are underwater due to negative amortization or declining property values. These programs are being offered through the Banks’ affordable housing programs, which limits eligibility to low- and moderate-income homeowners. (*Mortgage Line*, Brian Collins, 02/22/08)

FHLB-Indianapolis announces two new board members

- The board of directors of the FHLB-Indianapolis has elected Paul D. Borja, EVP and CFO of Flagstar Bank, Troy, MI, to fill the unexpired director term [ending December 31, 2010] of Mark A. Hoppe. On February 19, 2008, the Federal Housing Finance Board announced the appointment of Elliot A. Spoon, Esq. to one of the two open appointed director positions on the Bank’s board for a term ending December 31, 2010. Spoon is Of Counsel with Jaffe, Raitt, Heuer & Weiss, PC, a law firm in Detroit, MI and also is a professor at Michigan State University DCL College of Law. (FHLB-Indianapolis Press Release, 02/22/08)

Farm Credit System / Farmer Mac

2008 Farm Bill remains in limbo

- In the February *Farm Credit Watch*, Bert Ely reports, “With just 17 days remaining until the 2002 Farm Bill expires on March 15, the pressure is growing on the Farm Bill conferees to resolve differences between the Senate- and House-passed versions of the 2008 Farm Bill. Conferees are those members of the House and Senate Agriculture Committees who serve on the ‘conference committee’ trying to resolve those differences to produce a Farm Bill ‘conference report.’ Key differences not yet resolved continue to be the total cost of the 2008 Farm Bill and limits on commodity payments to farmers.”
- “So far, the HORIZONS provisions [that] the FCS has been trying to get included in the Farm Bill have not yet surfaced for inclusion in the Farm Bill conference report, but anything is possible. One keen observer of the FCS expressed the hope that ‘nobody goes weak in the knees when it comes to blocking the HORIZONS project.’ The Farm Bill conferees need to keep in mind the January 15 letter ...that the leaders of the Senate Banking Committee and House Financial Services Committees sent to the leaders of the two Ag Committees essentially telling them not to include any HORIZONS provisions in the 2008 Farm Bill. That is not enough, though—bankers must continue to tell their senators and representatives ‘NO’ on including any HORIZONS provisions in the 2008 Farm Bill.” (*Bert Ely’s Farm Credit Watch*, Bert Ely, February 2008)
- *Congressional Quarterly* reports that the conference committee has spent weeks trying to come up with a funding mechanism to offset a five-year baseline cost of about \$280 billion. Senate and House negotiators have proposed a large number of funding proposals, including one that would impose new taxes on foreign companies working on American soil and another that would close loopholes in corporate tax shelters, but the White House has refused to accept any of the proposals or suggest other options and threatens to veto the legislation. Senate Agriculture Committee Chairman Tom Harkin, D-IA, said “They muse about this, they muse about that, but they don’t put anything on the table. They say they want a farm bill, but they won’t negotiate.” Senate Majority Leader Harry Reid (D-NV) and House Speaker Nancy Pelosi (D-CA) asked their negotiators to find a way to fund about \$10 billion in extra spending for the farm bill by Friday, February 29th. Senate Finance Chairman Max Baucus (D-MT) seemed unsure if the group can find those new offsets by the Friday deadline, but said, “We’re going to try.” Committee aides later conceded that chances are slim that congressional tax panels can come up with a revenue plan for bill. A Baucus aide said he’s still hard at work, “fully exploring the possibility of an agreement that will be good for farmers and that can become law.” (*Congressional Quarterly Midday Update*, 02/28/08; *Congressional Quarterly Midday Update*, 02/29/08)

- In a February 21st speech, U.S. Department of Agriculture Secretary Ed Schafer warned that U.S. farmers are in danger of not getting a new farm bill this year if Congress and the White House do not reach an agreement on spending and subsidy reform levels by March 15 [the expiration date of the 2002 farm bill extension]. If Congress and the administration cannot reach an agreement for a 2008 farm bill by mid-March, Schafer said it would not be difficult for Congress to issue another short-term extension while the details are settled. Schafer reiterated that the White House will not agree to a farm bill that goes more than \$6 billion over-budget and includes revenue-raising tax measures or budget gimmicks that mask spending. The Senate's farm bill version is \$12.5 billion to \$23.5 billion over-budget, depending on whether budget gimmicks are factored in, Schafer added. If Congress fails to pass the new farm bill, USDA Deputy Secretary Chuck Conner said U.S. farmers would lose improved government support for the U.S. ethanol and biofuels industry, agricultural exports and farm credit. (*Dow Jones Newswires*, Bill Tomson, 02/21/08)

Postal Service

President Bush nominates Nanci Langley to the Postal Regulatory Commission
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- President George W. Bush has nominated Nanci E. Langley of Virginia to serve as a Commissioner on the Postal Regulatory Commission for the remainder of a six-year term expiring November 11, 2012. Langley currently serves as Director of the Office of Public Affairs & Government Relations at the Postal Regulatory Commission. Previously, Langley served as Deputy Staff Director of the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia on the Senate Committee on Homeland Security and Governmental Affairs. (*White House Press Release*, 02/26/08)

The USPS names Ross Philo as its chief information officer
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- The Postal Service has named Ross Philo to serve as executive vice president and chief information officer for the agency. Previously, Philo was director of global energy solutions at Cisco Systems. (*Postcom.org*, 02/26/08)

How <i>can</i> snail mail survive?

- In a February 20th article in the *Tampa Tribune*, John Nash wrote, "...When a business is showing decreased gross income and/or net profit, simply raising the price

of its product or services will usually exacerbate the problem. The proper course of action is to reduce costs, and/or improve the product or services without raising prices. Our endangered U.S. Postal Service seems to have been unable to understand that basic concept. According to a recent news report, in the United States, first-class mail volume has dropped 7 percent since 2001. A 15 percent boost in bulk advertising and other discounted mailings has offset only some of the loss in revenue.

- Of course that is not the first, nor the only, setback for the USPS over the past 30 years: In fact, that has been the trend since just about the first moment when the USPS was allowed to manage itself — although “manage” in this instance may be the wrong term. As we’ve all surely noticed, it seems that the price of a first-class stamp has increased about 10 percent just about every year. The USPS has attempted to explain away that large jump in price as being due to “increased costs of doing business.”
- “You can see that they have thus been routinely violating the economic law presented at the beginning of this discussion. They seemed to get away with their thoughtless and risky economic policy for a few years, but with the advent of widespread popularity of e-mail and other Internet options, the postal service came up against a formidable competitor.”
- “...Central government has never, as far as I know, demonstrated any ability to efficiently and effectively manage anything; the postal service is clearly not an exception to that condemnation. It’s costs — driven primarily by unjustified and avoidable increases in labor — began driving away its first-class users, well before computers arrived on the general scene.”
- “When the public began to discover the convenience and economies associated with replacing the postal service with the Internet, and/or by using independent, express package delivery services, the writing was on the wall for the mismanaged USPS. I won’t attempt to predict what the next decade holds for the postal service; I doubt that they’ve given it much thought. But this much I’ll venture: We will see major — even traumatic — changes in their services, and, most probably, even some long overdue cost cutting.”
- “Of course, if the Democrats take control of the White House next year, the solution to the problem may well be to add to the income tax already unfairly and unjustly burdening the evil rich, while promising to use the new income to prop up the teetering foundation of the carelessly managed USPS.” (*Tampa Tribune*, John Nash, 02/20/08)

How <i>not</i> to run a business—or a GSE

- The Postal Service undercharged countries including China, India and Canada by \$3.4 million dollars because of errors in processing mail at John F. Kennedy

International Airport in New York, according to the Inspector General. The USPS may be able to recover about \$2.2 million (65%) of the amount owed, with the balance stemming from computer, billing and employee errors made in 2006 being too long ago to be recovered under law. “The Postal Service expects to recover the full amount listed some time next year,” said Postal Service spokesman Yvonne Yoerger. “The funds we can’t recover is money lost to the Postal Service that we are due.”

- The IG auditors found that the Postal Service’s JFK Airport facility made billing errors on 78% of the overseas mail received from October 1, 2006 to May 31, 2007 with about 39% of the mail originating from China. The JFK facility handles 60% of the agency’s overseas express mail entering the U.S. (*Bloomberg News*, Neil Roland, 02/25/08)

USPS launches 31-digit bar code to permit business customers to track their mail
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- The Postal Service is launching “Intelligent Mail,” a 31-digit bar code which will allow business customers to track their mail from drop-off to delivery . “Intelligent mail is like having a GPS system for mail,” said Postmaster General John E. Potter when he announced the project in 2007. Eleven of the bar code’s digits will show the destination zip code with the remaining 20 digits available for the businesses’ use to identify themselves and assign a unique number for the customer. (*Washington Post*, Stephen Barr, 02/18/08)

TVA

TVA increases wholesale electric rates by nearly 12%

- On February 20th, TVA announced that its wholesale electric rates will increase by nearly 12% on April 1, reflecting both the agency's base rate increase previously approved by its board of directors and its most recent quarterly fuel adjustment. The rate increase is TVA's largest one-time jump since the early 1980s. TVA spokesman John Moulton said the utility has lost most of its cheapest source of power — electricity generated from its 20 hydroelectric dams because of the lingering drought. "Persistent drought conditions across Tennessee and the resulting lack of hydro generation continue to negatively impact TVA," said Moulton. "The fuel cost adjustment is designed to go up and down every three months in accordance with TVA's fuel costs and that's what this increase reflects." (*Chattanooga Times Free Press*, Dave Flessner, 02/21/08)

TVA to buy former Enron natural-gas powered plant

- Six years after the collapse of Enron, TVA has agreed to pay \$55 million to Duke Energy Corp. for a former Enron natural-gas fired plant near Brownsville, TN. Enron was estimated to have spent about \$200 million for the 480-megawatt plant before filing for bankruptcy in late 2001. The transaction, which is subject to approval by the Federal Energy Regulatory Commission, is expected to close during the second quarter of 2008. "The acquisition of the Brownsville combustion turbine plant is another step in TVA's efforts to meet its customer needs with clean, cost effective generation" said Ron Hall, general manager of TVA's combustion turbines and distributed resources group. (*Associated Press*, 02/19/08; *WEBWIRE*, 02/18/08)

Clean, safe nuclear power is the answer to global warming

- In the February issue of *Imprimis* [published by Hillsdale College], William Tucker wrote, "...The U.S. currently gets 50 percent of its electricity from coal and 20 percent from nuclear reactors. Reversing these percentages should become a goal of both global warming advocates and anyone who wants to reduce America's dependence on foreign oil (the latter since a clean, expanded electrical grid could anchor a fleet of hydrogen or electric cars). Contrary to what some critics charge, this would not require massive subsidies or direct intervention by the government. Indeed, the nuclear industry has gone through an astounding revival over the past decade. The entire fleet of 103 reactors is up and running 90 percent of the time. Reactors are making money hand-over-fist—so much so that the attorney general of

Connecticut recently proposed a windfall profits tax on them! The industry is poised for new construction, with proposals for four new reactors submitted to the Nuclear Regulatory Commission and almost 30 waiting in the wings.”

- “The rest of the world is rapidly moving toward nuclear power. France, Russia and Japan are not only going ahead with their own nuclear programs, but selling their technology in the developing world. America, which once dominated this technology, is being left behind. The main culprit is public fear. Nuclear technology is regarded as an illegitimate child of the atomic bomb, a Faustian bargain, a blasphemous tinkering with nature. It is none of these. It is simply a natural outgrowth of our evolving understanding of the universe. The sun has been our prime source of energy throughout human history, but energy is also generated in the earth itself. It is time to avail ourselves of this clean, safe terrestrial energy.” (*Imprimis*, William Tucker, February 2008)

North Carolina’s lawsuit against TVA goes to trial on July 14 th

- On February 29, U.S. District Court Judge Lacy Thornburg ordered that North Carolina’s lawsuit against TVA go to the trial on July 14 in Asheville, NC. Thornburg said the trial is expected to last about three weeks, according to *The Asheville Citizen-Times*. In the lawsuit, North Carolina Attorney General Roy Cooper argues that TVA hasn’t taken strong enough steps to reduce emissions of sulfur dioxide, nitrogen oxides, mercury and soot from its 11 coal-fired power plants in Tennessee, Kentucky and Alabama and that the emissions are affected the health and well-being of the residents of western North Carolina. Cooper is asking the court to order the TVA to reduce emission levels at its plants to a level comparable with North Carolina’s 14 coal-fired power plants. (*Associated Press*, 02/29/08)

Water issue could be serious for TVA region – and the agency
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- In a February 24th editorial, the *Knoxville News Sentinel* wrote, “The drought’s not pretty, but even worse is what could be a looming fight over water. Instead of bickering, we propose planning and study.
- “The effects of the drought are well documented. The Tennessee Valley Authority reported a loss of \$17 million in the first quarter of the 2008 fiscal year, and the drought is one of the reasons. With little rain to replenish TVA’s depleted tributary lakes, the utility’s production of cheap hydroelectric power has been down. The utility has been forced to buy more expensive electricity from outside suppliers. According to TVA, rainfall from October through the end of January was 28 percent below normal, while the amount of water reaching the Tennessee River and its reservoirs was 67 percent below normal.”

- “The Tennessee River is one of Tennessee’s blessings - one of the factors that has made TVA so successful and one of the reasons water shortages have rarely been a problem in the state. Georgia, however, has not fared as well. In November, reports revealed that reservoirs in the Atlanta area were close enough to the bottom that the dirtier water that contained more bacteria was going to need more expensive purification. That same month, Georgia Gov. Sonny Perdue held a public prayer vigil for rain on the steps of the state Capitol. With water so critical, it’s not a surprise that Georgia is looking to Tennessee and the Tennessee River. Atlanta’s mayor has raised the idea of tapping the Tennessee River, but Gov. Phil Bredesen has cautioned against large transfers from the river. But the issue has caused TVA to begin formulating a board-level policy on interbasin water transfers from the Tennessee River system.”
- “The latest proposal - from Georgia - is a new look at the border between Tennessee and Georgia. The Georgia Legislature argues that an 1818 survey that drew the Georgia border one mile south of the river is flawed. The legislature wants to create a boundary line commission to resolve the dispute and give Georgia access to part of the river to ease Atlanta’s water shortages. Any change to the border would have to be approved by the legislatures in both states as well as Congress. Although the Georgia Legislature seems disposed to redraw the border, the Tennessee Legislature isn’t. ‘If they ever tried,’ said state Sen. Andy Berke, whose district includes Chattanooga, ‘the governor and me and everybody else would be waiting for them.’ Bredesen responded with a laugh, ‘We will protect our borders here in Tennessee.’ The Tennessee Legislature responded [February 20th] by denouncing the resolution by the Georgia Legislature that seeks to redraw the state line, and now our legislators are drafting a retort.”
- “Ignoring the water problem—and treating this latest suggestion from Georgia as a joke—won’t make it go away. It’s affecting Atlanta, and it’s affecting TVA. It may well affect Tennessee. Now is the time to take a serious look at our water resources and how they’re managed. A policy to share water might not harm Tennessee, but it’s impossible to know that without consideration and study. Atlanta, faced with the same dilemma years ago, apparently did nothing. Tom Kilgore, president and CEO of TVA, had this to say: ‘If Atlanta calls, I lived there when they were supposed to build six reservoirs around the city, and they built zero, so they’re starting with the wrong person.’ Tennessee can learn from Atlanta’s failures.”
- “We must start studying the issue while there is time to enact a plan and carry it out. The headwaters of the Tennessee River are right here in East Tennessee, and we don’t want to squander one of our most precious resources.” (*Knoxville News Sentinel*, 02/24/08)
- In a March 1st editorial, the *Toledo Blade* [OH] wrote, “...There are, after all, quite a number of people who live in that narrow strip north of the Georgia border, particularly in East Ridge, Tenn., and a slice of southern Chattanooga. The fact that they and their predecessors have been paying taxes and voting in Tennessee for 190 years has to count for something. As Tennessee state Rep. Henry Fincher, (D.,

Cookeville) told the *Associated Press*, ‘What this means as a practical matter is Georgia has pretty much lost this case heading out of the gate.’

- “Also, if the U.S. Supreme Court (where the dispute likely would end up) decided in Georgia’s favor, Atlanta still might never see a drop of the water because the Tennessee Valley Authority and the Army Corps of Engineers would probably have to sign off. Finally, surveys aren’t exact, conventions change over time, and techniques and equipment have improved over the last two centuries. A positive result for Georgia, therefore, could cast doubt on many state borders across the United States, perhaps including the U.S. border with Canada, and it hardly seems likely that the justices would want to open that can of worms.”
- “Georgia state Sen. David Shafer (R., Duluth), the resolution’s sponsor, says it’s a ‘serious effort to secure our border and begin a discussion of water sharing.’ It’s unclear whether his comment came before or after his colleagues began singing ‘This Land is My Land’ in the state Senate. In any event, we believe this idea should be flushed, provided Georgia can find the water to do it.” (*Toledo Blade*, 03/01/08)

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