

The GSE REPORT™

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Major Events

The stimulus plan two-step on Capitol Hill:

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Senate adds election-year “goodies” to their stimulus package

Stimulus plan should be directed toward the stabilization of the housing market—
not consumption

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Chairman Dodd promises (again) to move GSE reform legislation through the Senate

Fannie Mae and Freddie Mac may face \$16 billion of losses in the fourth quarter

The “politics” of foreclosure

Short-sighted stimulus plan exposes the U.S. taxpayer to *terrible risk*

The House passes a stimulus package with a “temporary” increase for housing GSEs’ conforming loan limits

- By a vote of 385-35, the House of Representatives pass a \$146 billion package of tax rebates and business incentives designed to stimulate a sagging economy (H.R. 5140, the Recovery Rebates and Economic Stimulus for the American People Act of 2008) and called on the Senate to move forward with a version that would be acceptable to all members of Congress and the White House. “In short, this stimulus will put money in the hands of hard-working Americans to give them the help they need and, at the same time, stimulate the economy,” said House Majority Leader Steny Hoyer (D-MD). “I urge the Senate to act to produce a streamlined and focused stimulus package that is not loaded down with provisions that will either slow or undermine its passage and implementation.”
- Under H.R. 5140, most workers would receive rebate checks of \$600 for a sum of \$1,200 per couple plus \$300 per child. The bill limits eligibility for full payment to individuals with adjusted gross income of \$75,000 or less and \$150,000 for couples. Workers with at least \$3,000 in income in 2007 would receive \$300 plus \$300 per child. To encourage business spending, H.R. 5140 also provides for nearly \$45

billion in investment incentives to encourage business investments in new plants and equipment. The bill includes a provision that increases Fannie Mae's and Freddie Mac's conforming loan limit from \$417,000 to \$729,500, based upon median area prices, for mortgages originated between July 1, 2007 and December 31, 2008. The bill also increases the FHA conforming loan limit from \$367,000 to \$729,750 based upon median area prices, for mortgages for which the agency's credit approval is issued before December 31, 2008. A larger FHA modernization plan, which would have made permanent the increase in FHA-insured loans, was originally part of the stimulus package agreed to by House leadership and the White House. However, Treasury spokeswoman Jennifer Zuccarelli said those plans were pulled due to the last minute change of direction on the FHA legislation which caused confusion. Zuccarelli said Treasury Secretary Henry Paulson never thought that the agreement worked out with House Democrats extended beyond temporary increases in the FHA insurance cap and in the GSEs' conforming loan limit. Legislation reforming the FHA and regulatory reform for GSEs "should be completed as soon as possible on a separate track from the stimulus package," said Zuccarelli.

- In a statement, Paulson estimated that H.R. 5140 would create 500,000 more new jobs by the end of 2008 than would have otherwise been created. He commended House lawmakers on their quick action on the bill and asked Senate leaders to move just as quickly. "I am confident that Senate leaders understand that speed and simplicity are key to getting a bipartisan agreement enacted," said Paulson. "The time to act is now." (*Bureau of National Affairs*, Brett Ferguson and Nancy Ognanovich, 01/30/08; *Washington Post*, Jonathan Weisman, 01/30/08; *BusinessWeek*, Alan Zibel, 01/29/08)

Senate adds election-year "goodies" to their stimulus package

- The Senate, which did not participate in the Administration and House negotiations on H.R. 5140, developed its own stimulus proposal totaling \$157 billion. Democratic leaders used the stimulus package to reflect their economic priorities, to define their legislative agenda for the months ahead, and to bolster their case for electing a Democratic president and widen their party's majorities in Congress in the upcoming November election. In the Senate proposal, leadership proposed to increase benefits for the elderly and veterans; increase subsidies for low-income families' heating bills and other energy costs; include \$500 million for mortgage counseling for homeowners at risk of foreclosure; extend unemployment benefits, increase food stamp funding; and provide tax credits for alternative energy. To accommodate the added provisions of the stimulus proposals, the Senate version increased expenditures 7.5% (\$9 billion) above the House proposal and proposed lower tax rebates (\$500 to individuals and \$1,000 to couples, using a more expansive definition of qualifying income). [Over a two year period, the Senate version would cost more than \$190 billion—about \$30 billion more than the House package.]
- On January 31, Senate Republicans—backed solidly by the Bush administration—said they would block passage of the Democrats' stimulus package, leaving

leadership little choice but to adopt a version of the cheaper, more streamlined plan approved by the House. Democratic leaders have postponed a showdown on the stimulus package until February 6th [after the Super Tuesday primary], concerned that the absence of Senators Hillary Clinton (D-NY) and Barack Obama (D-IL) could doom efforts to force changes to the House stimulus package. To highlight their policy differences with Republicans, the Senate leadership plans to hold votes on a series of rival stimulus bills and amendments. Democrats believe that two measures with the most bipartisan support—tax rebates for 20 million seniors and 250,000 disabled veterans [who don't qualify for rebates under the House bill] and low income housing assistance—will be passed by the Senate, which will force negotiations between the chambers. Even if the stimulus bill goes to conference, Senate leadership remains confident that a stimulus package will reach the president's desk his signature by Congress's self-imposed deadline of February 15

- “Republicans and Democrats [in the House] rose above politics and put the people and our economy first [in passing a bipartisan stimulus package],” said Senator Mitch McConnell (R-KY). “Then all eyes turned to the Senate. Would we put our individual interests aside, or would we throw the whole plan into jeopardy by loading it down with gifts for anybody who came calling? Apparently the temptation for giveaways was too great for some to resist. As soon as the bill hit the Senate, it started to look a lot like Christmas over here. You could almost hear Bing Crosby's voice” (*New York Times*, David Herszenhorn, 01/31/08; *Washington Post*, Jonathan Weisman, 02/01/08; *New York Times*, David Herszenhorn and Steven Lee Myers, 02/01/08)
- On January 23rd, the Congressional Budget Office projected 34% growth in fiscal year 2008 deficit to \$219 billion [1.5% of GDP], up from \$163 billion for FY2007. “A slowing economy this year will contribute to an increase in the deficit,” said the agency in its annual budget and economic outlook report to Congress. CBO's estimates do not include any stimulus package currently being considered by Congress. (*Wall Street Journal*, 01/24/08; *CQ Today*, David Clarke, 01/23/08)

Stimulus plan should be directed toward the stabilization of the housing market—not consumption

- In January 31st commentary in the *Washington Post*, William H. Gross, founder and chief investment officer for PIMCO, wrote, “...It seems to me that the U.S. economy requires a new orthodoxy, a redirection from consumption toward the stabilization of the housing market and an emphasis on infrastructure. America's economy is faltering because of an exhaustion of free-market capitalism that has mutated in recent years to something resembling a pyramid scheme. Our levered, derivative-based financial system, seemingly so ascendant after the dot-com madness that preceded it, has met its match with the subprime lending and poorly structured, opaque mortgage-backed securities of today's marketplace. The result has been a dangerous deflation in America's most important asset class—housing. Preventing

home prices from declining even further is job No. 1 for monetary and fiscal authorities.

- ...[T]he big problem with the proposed ‘stimulus’ is that it is really directed toward consumption, not toward the housing deflation that threatens the U.S. economy. Our economic problem today resembles the Japanese property market crisis of the 1990s. What’s needed is not just \$600 checks that will flow into Wal-Mart (and then to the Chinese) but an expanded Federal Housing Administration program offering below-market, 30-year mortgage refinancings with minimal down payments, which the private market and Bernanke cannot provide. Republican orthodoxy seems so intent on curtailing the past abuses of Fannie Mae and Freddie Mac that some politicians are looking past a government agency solution in their own back yard. Housing and our finance-based market mania got us into this mess. Housing and government-based financial solutions must begin to get us out of it.”
- “Ultimately, America’s economy will require more than a \$150 billion shot in the arm to resolve its slow-growth predicament. One hopes that Americans will come to recognize that a better direction for our economy will be neither tax-based nor consumption-oriented. We have followed that path to our detriment in recent years. If government is ascendant vis-à-vis the hegemony of the private market, then it must invest more wisely than its economic partner has. For now, however, to be effective, the right temporary fix requires additional focus on where the damage lies—and that is centered on our housing market deflation. (*Washington Post*, William H. Gross, 01/31/08)

OFHEO Director is “very disappointed” by Congress’s proposal to increase GSE conforming loan limits

- In a January 24th statement, OFHEO Director James B. Lockhart, III said, “We are very disappointed in the proposal to increase the conforming loan limit as we believe it is a mistake to do so in the absence of comprehensive GSE regulatory reform. To restore confidence in the markets we must ensure that the GSEs’ regulator has all the necessary safety and soundness tools. [On January 23rd,] Chairman Dodd talked about moving a GSE reform bill early this year. We are ready to work with him and the Senate Banking Committee. We will also be working with Fannie Mae and Freddie Mac to ensure that any increase in the conforming loan limit moves through their rigorous new product approval process quickly and has appropriate risk management policies and capital in place.” (*OFHEO Press Release*, 01/24/08)
- In a January 29th interview, Lockhart said, “What worries me is [the GSEs] getting into the jumbo market because there are different risks. There’s a reasonable chance there will be a real wave of refinancings, which will grow the demand pretty significantly and could actually change the overall risk profile of these companies. ...Our concern is these two companies are stretched very thin at the moment.” Lockhart made it clear that even if the GSEs are able to securitize and guarantee

jumbo mortgages, the 30% capital surcharge at both companies would remain. “It’s certainly adding more risk and capital is there to support the risk,” said Lockhart. “I can tell you capital is king in this kind of market and certainly we’d be very reluctant to see them go down to the minimum capital rules.” (*American Banker*, Steven Sloan, 01/30/0/)

- Lockhart’s concerns were shared by a number of newspapers’ editorial boards. In a January 25th editorial, the *Wall Street Journal* wrote, “...As for Fannie and Freddie, the troubled mortgage giants will be allowed to raise the limit on loans they can buy to \$625,000 from \$417,000. The loan limit for [FHA] will rise even higher, to \$725,000 from \$362,000. The feds are thus extending implicit and explicit federal loan subsidies to a far larger pool of mortgage borrowers. This means that Congress and the White House will be providing mortgage subsidies to some of the same people they consider too ‘rich’ to receive tax relief. Go figure. ‘I got run down by a bipartisan steamroller,’ said Treasury Secretary Hank Paulson, in explaining the new housing limits. This means Fannie and Freddie now have a political blessing to expand their market share, despite their ferocious resistance to tighter regulation after their multi-billion-dollar accounting frauds. Perhaps the best that can be said of these Beltway antics is that they won’t do much harm – the housing credit guarantees aside. Americans lucky enough to qualify should enjoy this little windfall while they can, because the politicians are already planning to take it all back next year. After they’re re-elected.” (*Wall Street Journal*, 01/25/08)
- In a January 30th editorial, the *Washington Post* wrote, “...Allowing Fannie and Freddie to buy up and securitize large numbers of ‘jumbo’ loans would prop up prices in [high cost markets]. But it would also transfer these loans’ elevated risk to the companies, whose ultimate guarantor is the federal taxpayer. Does a Fannie-Freddie collapse seem farfetched? Well, they have been losing money lately and are subject to increased capital requirements because of past accounting scandals. They have no experience with ‘jumbo’ loans. And bolstering expensive residential real estate is hardly consistent with the companies’ statutory mission to promote affordable housing. ...We are told that the increased loan limit would lapse in a year or so. Don’t be too sure: What politician will want to take away this lucrative benefit a year from now? Steamroller or not, someone in the Senate needs to stop it.” (*Washington Post*, 01/30/08)
- In a January 29th editorial, the *Seattle Post-Intelligencer* wrote, “...[Under the stimulus plan], Fannie Mae and Freddie Mac, would be allowed to buy loans larger than \$417,000. That would seem a way to promote more home buying again -- especially in higher-priced markets such as Seattle. Except (and this is a big except) where will Fannie Mae and Freddie Mac get the additional capital to increase their loan portfolios? [OFHEO] is opposed to the measure unless it includes broader reform. Freddie Mac recently announced a loss of \$5.5 billion over the next couple of years from bad loans and the two lenders have debts or mortgage guarantees of nearly \$5 trillion—money leveraged with little cash. A serious injection of funds

might be the smarter bet. Make no mistake: This simple, quick, fix [e.g., the stimulus plan] includes an extraordinarily risky venture. (*Seattle Post-Intelligencer*, 01/29/08)

- In a January 29th editorial, the *Chicago Tribune* wrote, "...As for the higher loan limits for Fannie Mae and Freddie Mac, they could help to reassure mortgage lenders at a time when they are nervously pulling back. But they also increase the risks for two companies that Congress might feel compelled to rescue from any resulting default—at the expense of taxpayers. And after the reckless mortgage binge of recent years, it's probably a good thing for lenders to pull back a bit... (*Chicago Tribune*, 01/29/08)
- In a January 31st editorial, UK's *Financial Times* wrote, "Congress is breaking out its blunt instruments. A stimulus package just passed by the House of Representatives would allow Fannie Mae and Freddie Mac ...to buy jumbo mortgage loans valued at up to \$729,750 – well above the current \$417,000 limit. Such a move would unduly expand the mortgage giants' reach in exchange for potentially meager short-term benefits to the housing market. On the face of it, the government's efforts to boost jumbo loan liquidity are understandable. The spread between interest rates on jumbo loans and smaller loans that conform to Fannie and Freddie's standards has quadrupled to a full percentage point. Investors' limited appetite for jumbo loans has dulled the effects of the Federal Reserve's interest rate cuts. If Fannie and Freddie could buy and securitize those loans, it could stimulate lending in regions where homes are particularly costly."
- "The concept would be more palatable if Fannie and Freddie appeared well positioned to handle the extra risk. But the two agencies, created to stabilize the market, have hardly filled regulators with confidence. Both have recently emerged from accounting scandals, their balance sheets are opaque, and they already face billions of dollars in subprime losses. Politicians are clamoring for more oversight of the institutions, and a bill to overhaul them is treading water in Congress. It seems counter-intuitive now to let them slap more risk on their balance sheets, especially since any temporary loan limit increase could eventually become permanent."
- "Even if Fannie and Freddie are allowed to buy bigger mortgages, a resurgence in lending is not likely to occur until the homes used as collateral stop sinking in value. In any case, most jumbo loans issued in recent years were "interest only" loans that the agencies cannot guarantee. Fannie and Freddie's regulator opposes any move to raise loan limits without corresponding regulatory reform. Those concerns should not be swept under the rug." (*Financial Times*, 01/31/08)
- Friedman Billings' mortgage analyst Paul Miller said, "The real issue is that home prices are overvalued, and it gets uglier by the day. This [proposed increase in the conforming loan limit] might help on the margin, but it's not going to stop home prices from falling. It's not going to solve the problem, but it's a way for [Democrats] to get something through that they've wanted for a very long time." (*BusinessWeek*, Dawn Kopecki, 01/28/08)

Chairman Dodd promises (again) to move GSE reform legislation through the Senate

- Senate Banking Committee Chairman Chris Dodd (D-CT) said he plans to complete legislation to reform the regulation of Fannie Mae and Freddie Mac this year. At a January 25th meeting with Treasury Secretary Henry Paulson, Dodd said he made a commitment to move GSE regulatory reform legislation this year. His pledge came a day after the White House and House leadership agreed on a stimulus package, which included a provision to raise the GSEs' conforming loan limits. Previously, the Bush administration had resisted any move to raise the loan limits without enactment of GSE reform legislation. Dodd said that the one-year sunset provision keeps pressure for completion of a broader reform bill. Dodd has scheduled a February 7th hearing on GSE reform legislation and said he plans to hold a panel vote on the bill soon. "I'm an advocate of the GSEs," said Dodd. "We're going to get that bill done." (*Congressional Quarterly Online*, Benton Ives, 01/25/08; *American Banker*, Steven Sloan, Cheyenne Hopkins, and Barbara A. Rehm, 01/28/08)
- Senator Richard Shelby (R-AL), the Committee's ranking member, voiced concerns about raising the conforming loan limit without putting a stronger GSE regulator in place. He also is concerned that the GSEs would be providing "high-risk benefit" to the wealthiest Americans without sufficient consideration of the potential risks. Shelby spokesman Jonathan Graffeo said, "Senator Shelby believes that comprehensive and meaningful GSE reform remains necessary. He looks forward to working with Chairman Dodd in that effort." (*Congressional Quarterly Online*, Benton Ives, 01/25/08)
- In his January 28th State of the Union Address, President Bush took the rare step of pressing Congress to pass a GSE reform bill. "Tonight I ask you to pass legislation to reform Fannie Mae and Freddie Mac..." said Bush.
- "...[T]he initial reaction was this really dampens the prospects for GSE legislation, but on a second look, prospects may not be as bleak as everyone originally believed," said Keefe, Bruyette & Woods' political analyst Brian Gardner. "Despite the initial impact of 'Wow, this is a big deal,' I think people have settled in and realized that the companies will need additional capital to take advantage of the increased loan limit. Without a reform bill, I don't see ... [OFHEO] changing the capital surplus any time soon."
- Given the tight legislative calendar and division on the committee, some observers remain skeptical that lawmakers will pass a GSE bill. "In and of itself, [the increase in GSEs' conforming loan limits] hurts the chances of a bill," said Jim Vogel, the head of fixed income research at FTN Financial Capital Markets. "It does take away from the sense of urgency that may have been there otherwise. ... Without another big Fannie or Freddie or Federal Home Loan bank implosion, you don't have anything powerful on the let's-get-this-done side of the equation." (*American Banker*, Steven Sloan, 01/30/08)

Fannie Mae and Freddie Mac may face \$16 billion of losses in the fourth quarter

- On January 22, Credit Suisse analysts estimated that Fannie Mae and Freddie Mac may need to recognize an additional \$16 billion in losses on loans in the fourth quarter because of declines in the value of mortgage-backed securities collateralized by subprime mortgages. According to Credit Suisse analysts Moshe Orenbuch and Kerry Hueston, Fannie and Freddie have not yet been hurt by declines in the \$230 billion of non-agency mortgage-backed securities [secured by subprime mortgages]. With other financial companies already booking “other than temporary impairments” on these securities, Fannie Mae and Freddie Mac may need to follow suit, wrote Orenbuch and Hueston. “We believe that this will likely spur the GSEs’ regulator to compel similar actions,” they added. According to their estimates, Freddie Mac’s subprime securities may be worth \$8 to \$11 billion less than their current book value, while Fannie Mae’s bonds may be worth between \$2.5 million and \$5 billion less. The analysts’ estimates do not reflect the GSEs’ holding of securities collateralized by Alt-A mortgages or loans considered between subprime and prime (in terms of risk of default).
- On February 1st, Standard & Poor’s said that losses from mortgage-backed securities collateralized by subprime mortgages may exceed \$265 billion, as regional banks, credit unions, overseas financial institutions write down the value of their holdings. In response to rising mortgage delinquencies, S&P put on review the ratings of \$534 billion of securities tied to home loans made to people with poor credit. The downgrades may increase losses at European, Asian, and U.S. banks, credit unions, Fannie Mae, Freddie Mac, and the 12 FHLBs, said the credit rating agency. Anthony Davis, a Stifel Nicolaus’ banking analyst, said, “There’s a lack of confidence in the markets and this exacerbates that. This will have a chilling effect on the markets.” (*Bloomberg*, Jody Shenn and David Midenberg, 01/30/08; *Bloomberg News*, 01/31/08)

The “politics” of foreclosure

- In a February 2nd *New York Post* editorial, Michelle Malkin wrote, “Who says bipartisanship is dead? From President Bush to Hillary Clinton, Barack Obama and John Edwards, to Mitt Romney and John McCain, virtually everyone in Washington agrees: The government must Do Something to stop home foreclosures across the country. These leaders agree on the total presumption of homeowner innocence. The borrower-as-victim and lender-as-predator storylines are etched in stone. Can’t let reality get in the way of election-year pander-monium.”
- “Special guests at the State of the Union Address are usually extraordinary heroes, entrepreneurs or citizens who’ve gone above and beyond the call of duty. On Monday night, one of those guests was an Indiana woman whose claim to fame is that she called a 1-800 number and was assisted by the ‘Hope Now Alliance,’ a group Bush convened, which, according to him, ‘is helping many struggling homeowners

avoid foreclosure.’ Subprime victims are the new heroes. Welcome to the politics of foreclosure.”

- “Housing Czarina Hillary immediately jumped on the president’s address and on news that foreclosure rates skyrocketed 79 percent over the last year. She reiterated her call for ‘a 90-day foreclosure moratorium on subprime mortgages and a 5-year freeze in rates on subprime loans.’ Borrowers who knowingly bought more house than they could pay for have no place in Hillary’s world. ‘It is indisputable that brokers and mortgage companies lured families into mortgages that were designed to end in foreclosure,’ she stated in a *Denver Post* questionnaire this week.”
- “Continuing the theme of duped borrowers, Sen. Chuck Schumer is crusading for more federally subsidized ‘mortgage counseling.’ He wants \$200 million more, in addition to the \$180 million for ‘Housing Counseling Assistance’ that he helped stick into the omnibus spending bill last year. A significant portion of that will go to government-approved counselors affiliated with left-wing activist groups such as La Raza and ACORN. I certainly have sympathy for borrowers who may have been misled. But for every ‘predatory lender’ out there, you can find a predatory borrower. For every fraud-minded loan officer or mortgage broker, you can find a homeowner who secured financing and bought a home he knew he couldn’t afford with little money down and bogus or no income verification.”
- “Washington is silent about this reckless behavior, which it is encouraging both tacitly and explicitly. Now comes word from California that some of these homeowners Washington is rushing to rescue are simply walking away - abandoning their mortgage commitments and contractual obligations. Poof: ‘Foreclose me... I’ll live in the house for free for 12 months, and I’ll save my money and I’ll move on,” one homeowner blithely told *The Los Angeles Times* this week. The stigma of default is gone. Political rhetoric absolving borrowers of their responsibilities—and encouraging them to spend, spend, spend even more—has made it possible. And so has federal legislation intended to ‘help.’ The omnibus spending bill passed last year prevents the IRS from taxing mortgage forgiveness as income up to \$1 million for a two-year period.”
- “Finance blog *Calculated Risk* reported last week that increasing numbers of homeowners are walking away from their homes by choice. A Wachovia executive noted during a conference call that they are ‘people that have otherwise had the capacity to pay, but have basically just decided not to because they feel like they’ve lost equity, value in their properties.’ Some are bailing for cheaper homes in the same neighborhoods. There’s even a term that’s become popular over the last couple of years—‘Jingle Mail’—that describes when homeowners cut loose and mail in the keys to the bank. Ho, ho, ho.”
- “The true victims in this ‘crisis’ are those who paid for homes within their means and those who waited to enter the housing market. A reader in New York City wrote me last week: ‘My husband and I patiently sat back and watched while our friends made

a killing in real estate over the past six years. ...Now, after several years, we are ready to move to the 'burbs, and we feel it is responsible people like us who are going to get hurt by this mortgage mess. We're the ones who have to sit back and wait for housing prices to fall, while our government, looking to protect only the homeowners, keeps prices artificially high with bailout programs and artificially low interest rates. What about programs to help out renters who didn't make any money in this bubble because we were responsible? What about government intervention to lower the still-high housing prices so we aren't locked out of the market? A natural correction in the housing market is in order, but the government seems hellbent to prevent it from taking place. In the meantime, we are priced out of the market because we aren't willing to get in over our heads financially (unlike some of these revered homeowners).”

- “Sorry, responsible Americans. There’s no seat at the next State of the Union Address, or the next Hillary Rescue roundtable, for you.” (*New York Post*, Michelle Malkin, 02/02/08)

Short-sighted stimulus plan exposes U.S. taxpayer to *terrible risk*

- In a February 3rd *San Francisco Chronicle* editorial, San Mateo, CA attorney Sean Olender wrote, “Congress is about to sell us the biggest fraud in American history. It’s been highly touted as an economic stimulus bill that will help millions of Americans... But, as the old adage goes, nothing comes for free. As part of the bill, Congress is set to rush through an increase in the mortgage loan limits for Fannie Mae and Freddie Mac (and Federal Housing Administration insurance, too)—from \$417,000 to \$729,750—the first step toward a massive financial disaster in which taxpayers will end up paying through the nose.”
- “Here’s how we got to this point. Domestic and international investors hold hundreds of billions of dollars in bad debt, because U.S. investment houses sold them junk securities based on often fraudulent mortgages. Many of these mortgages were sold to unqualified buyers under terms that made widespread foreclosures a certainty once the housing market began to fall. Investment banks and bond rating agencies sat down and tried to figure out how to describe Americans with insufficient incomes and little for a down payment as great credit risks on loans too big for their incomes. The new rules focused on credit scores, because it was a good excuse to avoid looking at income and down payment, factors that would have restricted this moneymaking fiasco. Now, thanks to Congress, junk bond investors will be able to pawn off their bad debt to Fannie and Freddie, instead of suing the big investment houses for ripping them off. This shift will certainly doom Fannie Mae and Freddie Mac, so don’t be surprised if we, the taxpayers, have to bail out poor Fannie and Freddie—to the tune of more than \$1 trillion.”
- “Why more than \$1 trillion? If Goldman Sachs is correct in its recent projections that home prices in California are going to drop 35 to 40 percent, the state’s losses

alone would top \$2 trillion, because California has a disproportionate number of jumbo loans. The irony here is that the collapse in housing prices could make Fannie insolvent even without raising the loan limit. Increasing Fannie's limit is like going on a spending spree with your credit cards because you know you are going to file for bankruptcy in a few months. Only here the taxpayer is left holding the bag. Our children will pay interest on this debt in perpetuity. It is our debt. It is inescapable."

- "In the coming months, Fannie and Freddie will buy up mortgages based on old, fraudulent appraisals and on loans with bogus inflated incomes. Unfortunately, many of these loans will still default. But that's just the start. ...With zero new regulation, the same bad actors that caused this crisis can once again inflate property appraisals and begin a new cycle of fraud..."
- "Contrary to popular myth, Fannie holds a lot of subprime debt, option ARM debt and other dodgy securities. Fannie and Freddie owned or guaranteed almost 45 percent of all mortgages in America last year. *BusinessWeek* noted in 2007 that Fannie and Freddie have 'moved more prominently into low-documentation loans, which require little or no proof of the borrower's income.' Expansion of Fannie and Freddie's reckless lending is exactly what Congress wants because it's plausibly deniable. Teary-eyed lawmakers can take to the airwaves a year from now and declare: 'We had no idea Fannie could go under, but we can't cut and run now. We have to bail out Fannie and Freddie for the good of America! It's going to be a tough slog, but you're getting used to those, no?' Those same lawmakers won't mention the fact that they get paid far more by real estate lobbyists than they do from our Treasury."
- "I've spoken with borrowers who stopped making mortgage payments seven or more months ago. None has received a default notice. Defaults may be much higher than banks are letting on. The data lags are growing suspiciously long. Nobody knows what's going on. Seven months without making a single payment! Will Fannie guarantee those loans because they aren't in formal default yet? Nobody wants to know, because if they know, they might be called to testify next year. That's why lawmakers want to raise the limits now and ask questions later."
- "This shortsighted plan poses a terrible risk to every American taxpayer... And even if you live in high-priced San Francisco, Los Angeles or New York—and stand to benefit from the increased loan limit—this is a horrible fraud on you, too, because raising the limit to \$730,000 risks a systemic crisis that will cost far more than any temporary rebate check."
- "In support of the economic stimulus bill, Bush will have to face 'working American families' and explain that some of their tax money is going to be spent guaranteeing \$730,000 mortgages on \$1 million homes. It's like some sort of upside-down communism where the poor pay the rich welfare. Why should taxes from families earning \$48,000 a year be used to support expensive mortgages in New York, Los Angeles and San Francisco? Welfare for the hungry and homeless is evil, but

welfare for million-dollar homeowners facing a tough refi ...well, that's called 'helping the economy.' ...I guess Congress' hope is that median-income families will be too busy using their rebates to buy much-needed groceries to notice that the rich folk are getting away with a new scam."

- "Several months ago, economist Nouriel Roubini of New York University's Stern School of Business suggested that the housing market has been effectively nationalized. At first it seemed crazy, but now it's fairly obvious. In August alone, Fannie and Freddie increased their loan portfolios by \$62 billion, and the Federal Home Loan Bank by \$110 billion. That total of \$172 billion would come to just over \$2 trillion annually - not much less than the entire federal budget. Everyone seeking a loan, securitizing a mortgage, and buying or selling a mortgage security will now be dealing, in one way or another, with the U.S. government. This type of intervention is very expensive and will eat everything in its path, including Social Security. If we're going to have a government-financed intervention, it should be to make sure that Social Security benefits go to those who paid for them, that the poor are fed and housed, or that the army of uninsured receive health benefits. If, as they say, we don't have enough money for those important things, then I think we don't have enough money to bail out banks and bond investors."
- "Don't let me down, my fellow Americans. Let's vote out anyone who dares to vote for this scam." (*The San Francisco Chronicle*, Sean Olender, 01/03/08)

Ohio Attorney General sues Freddie Mac for hiding its exposure to subprime mortgages
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- Ohio Attorney General Marc Dann has filed a class action lawsuit on behalf of injured shareholders in the Ohio Public Retirement System (OPRS) and others against Freddie Mac alleging that the company hid its vulnerability to securities collateralized by subprime mortgages. "Freddie Mac has secretly and intentionally participated in one of the largest housing investment deceptions of modern U.S. economic times," said Dann, in the 71-page complaint filed in the U.S. District Court for the Northern District of Ohio on January 18th. "As a result of Defendants' violations of federal securities laws, Plaintiff and the other members of the Class have been damaged by purchasing Freddie Mac common stock at artificially inflated prices during the Class Period and by suffering losses when the price of Freddie Mac common stock declined after the revelations of the fraud at the Company," said the suit, which was brought by Dann on behalf of all purchasers of Freddie Mac common stock between August 1, 2006, through November 23, 2007. The Attorney General claims that Freddie Mac and members of senior management disguised the true value of its stock by issuing public statements that denied its exposure mortgage-backed securities collateralized by subprime mortgages. The suit also claims that Freddie Mac failed to establish and maintain key risk management measures which would have minimized the company's losses. In a statement, Dann said the suit sends "a loud and clear message to Wall Street that this type of fraud and manipulation will not be tolerated by the people who live on the Main Streets that are being devastated by what Freddie Mac has done."

The suit holds Freddie Mac's directors "personally responsible for their recklessness and secrecy about Freddie Mac's investments and resulting losses in the subprime housing industry." (*Bureau of National Affairs*, R. Christian Bruce, 01/24/08; *LegalNewsline.com*, Rob Luke, 01/29/08)

Fannie Mae and Freddie Mac

Senate Banking Committee demands that more be done to help subprime borrowers:

Undersecretary Steel tells the panel that the rate of subprime modifications more than tripled during the fourth quarter

FDIC Chairman Bair urges servicers to be proactive in restructuring the 1.7 million of (other) nontraditional mortgages that reset in 2009

Chairman Dodd proposes a \$20 billion bailout for subprime mortgages

Undersecretary Steel tells the panel that the rate of subprime modifications more than tripled during the fourth quarter

- In his January 31st testimony before the Senate Banking Committee, Undersecretary for Domestic Finance for the Department of Treasury Robert Steel advised the committee on the mortgage industry's efforts to work distressed subprime borrowers to avoid foreclosure. Through the industry's formation of the HOPE NOW Alliance, the industry has mailed 483,000 letters to delinquent homeowners, who had previously avoided contact, and achieved a response rate to date of over 16%. Since August, the Alliance has operated a HOPE hotline to answer borrowers questions and assist them in their efforts restructure their mortgages. Since August, phone calls to the hotline have increased 540% to 4,000 calls a day from subprime borrowers. During the second half of 2007, the mortgage industry has helped 370,000 homeowners with subprime loans through modifications or new payment plans, and 120,000 of those homeowners received modifications. During the fourth quarter, the rate of modifications of subprime mortgages tripled and the pace is expected to pick up even more this year. Steel estimated that approximately 66% of the 1.8 million resetting mortgages would be adjusted in some fashion through modifications and refinancings. (*U.S. Treasury Department Office of Public Affairs Press Release*, 01/31/08; *American Banker*, Stacy Kaper and Joe Adler)
- Senate Banking Committee Chairman Chris Dodd (D-CT) and other members of the panel questioned if the HOPE NOW Alliance is moving fast enough to have a

significant impact of the number of foreclosures which are likely to occur this year, as rates reset. According to Alliance figures, Dodd pointed out, about one-third of those who had been helped received long-term loan modifications, and about two-thirds got short-term repayment plans, which he said actually increase costs to the borrower. “And 25 to 30 percent have re-entered a default situation,” said Dodd. “It seems to me that we’re fiddling around here” While Steel acknowledged that it has taken time to set up HOPE NOW, he insisted “we’re committed to measures where [the Alliance] will be giving us the results with a one-month lag, beginning in February/March and we’ll be able to measure success.” FDIC chairman Shelia Bair told the committee that the Alliance members have been working in good faith on developing rescue plans for borrowers, but were hampered during the early days by accounting issues. “I also think there was more investor push-back than some servicers initially anticipated,” Bair said. “And I think one of the advantages of the protocols that have been developed is to provide somewhat of an insulation against certain security holders wanting to sue because they feel they would be better off with a foreclosed loan than with a modified loan.” Bair added that she believes “the investor liability issue has been overstated.”

- Senator Chuck Schumer (D-NY) said he’s been skeptical of the Alliance’s program. “I just think basically the administration’s sort of ideological allergy to getting the government involved leads to all of these voluntary solutions and instead of drawing a straight line to the heart of the problem, you sort of beat around the bush because of ideological problems,” said Schumer. While he has been a longtime GSE supporter, Schumer voiced concern about Fannie’s and Freddie’s reluctance to participate fully in the foreclosure problem. “I’m getting a little tired of [Fannie Mae and Freddie Mac],” Schumer said. “They are not just a private agency. When they say, ‘We can’t do this because it’s not as profitable as other things,’ or, ‘We can’t do this because our stock might go down;’ well if that’s their only criteria, then they shouldn’t have a government guarantee ... [t]hey ought to be stepping up to the plate in many more ways than they are.” (*Bloomberg News*, Michael McDonald, 02/01/08)

FDIC Chairman Bair urges servicers to be proactive with the 1.7 million of (other) nontraditional mortgages that reset in 2009

- In testimony before the Senate Banking Committee, FDIC chairman Shelia Bair warned the committee “available information shows that foreclosures continue to be at an unacceptably high level while true loan modifications are lagging.” She noted that over 1.7 million subprime mortgages are scheduled to reset through 2009, along with another wave of other nontraditional mortgages, such as interest-only and payment option loans, that will also reset starting in 2009 [which are not a part of the industry’s plan to restructure]. “Waiting to confront the next reset problem [for other nontraditional mortgages] will once again create the risk of falling behind a fast-moving trend,” said Bair. (*Dow Jones Newswires*, Tom Barkley, 01/31/08; *Wall Street Journal*, Damian Paletta, 02/01/08)

- In her prepared testimony, Bair said, "...Unfortunately, some borrowers pose even more difficult issues because their debt far exceeds the value of their homes. Servicers have always had to evaluate whether the best option in these cases is foreclosure or some other process, such as a short sale, that results in the loss of the home. There may be no alternative except foreclosure for loans that were made to speculators, under fraudulent circumstances, or to borrowers who have no reasonable ability to repay (even with restructuring). However, in today's market, servicers should carefully consider whether some writedowns of part of the principal balance to the value of the home or forgiveness of arrearages of principal and interest are better options than foreclosure or even short sales in appropriate circumstances. Permitting borrowers with an ability to make reasonable payments to stay in their home would provide greater value to lenders and investors than forcing foreclosures that undercut the value of the property and harm the value of other properties in the neighborhood."
- "... Enactment of the Mortgage Forgiveness Debt Relief Act of 2007 provides an additional option for keeping borrowers in their home. This Act recognizes that cash strapped borrowers who are already facing financial difficulty cannot afford a potential tax liability that could hinder their ability to make their modified loan payments. It also provides greater assurance to lenders and servicers that borrowers will be able to perform after their loans are modified and decreasing the principal value will decrease the loan to value ratio, thereby potentially expanding the number of homeowners who could qualify for GSE refinancing. This will allow lenders and servicers to consider forgiving a portion of the principal balance owed to a level a borrower can realistically afford to repay, as long as it produces a net present value that is greater than the anticipated net recovery that would result from a foreclosure. This would require lenders and servicers to ascertain the existence and amount of any second mortgages, and obtain releases from these obligations to the extent appropriate. While this type of modification results in the recognition of a loss by the lender or servicer, it is virtually certain that the amount of the principal write-down will be less than the amount of loss sustained from foreclosure in today's market."
- "Permanently forgiving part of the principal amount can provide a better financial result for investors than foreclosure by creating long-term, sustainable solutions that will allow borrowers to stay in their homes. This approach also has the added benefit of limiting the overall adverse affect of declining property values on communities..."
- *CalculatedRisk* [blog] notes, "[Now Bair is] introducing a third scenario [for mortgage servicers]: simply reducing the principal balance of the loan to the market value of the property (or somewhat less than that) in order to keep the borrower right-side up or treading water, and thus to prevent default rather than cure it. If you are no longer trying to arrive at the highest payment the borrower can practically make, you are no longer producing calculations of loss that are mostly likely to be a better deal than [foreclosure]. This is where Bair is implicitly—but not explicitly—asking servicers to use something other than net present value of FC recovery based on current market prices and marketing time estimates of the subject loan. She is asking the servicer to use possible future FC recoveries based on the assumption that all

servicers will fail to forgive loan balances (i.e., that FC recoveries on other loans will be worse than they would have been if you foreclose this loan), and collectability estimates on the pared-down loan based on the assumption that all servicers will forgive loan balances (which will reduce FC inventory and stabilize prices, therefore leading to fewer future defaults). Moral hazard, meet tragedy of the commons.”

- “In the first case, you’re asking MBS investors to ‘take one for the team.’ I have no problem with that idea in theory, but as a practical matter I’d rather ask a cat to quit developing hairballs. The mathematics of ‘net present value to the trust’ means this trust, not somebody else’s trust and not some other loan. You can present this as self-interest: the less you FC, the more you are contributing to stable RE prices, but you will run into someone who realizes that if every other servicer of every other pool is forbearing, and therefore reducing REO inventory, I should go ahead and FC now while I can. Hence Bair brings in the perfectly respectable but, in the MBS context, rather alien concern about protecting communities. Of course some clever economist could calculate that ‘externality’ and add it to the NPV calculation for us, but there isn’t anything in these PSAs about that. And if you don’t think we can’t buy our own economists who will come up with a different number, you don’t know us very well. (Bair, I think, is used to dealing with federally chartered depositories and the GSEs, who can to a certain extent be bullied into ‘social responsibility’ because of their charters. But if all the lenders in question were owners of a federal charter, we probably wouldn’t be having this conversation.)”
- “Without the ‘externality’ adjustment, and without the assumption that we are aiming for the highest payment the borrower can afford short of the contractual payment, you simply have a situation in which loans are going to fail unless and until the servicer forgives sufficient principal to match the liquidation value of the property. (You can try to simply match the ‘fair market value’ of the property instead of the ‘REO liquidation value,’ but that assumes that FMV isn’t converging on liquidation value and that failure to match REO prices will stop defaults sufficiently.) There is therefore no obvious loss mitigation here, absent the assumption that this will arrest the slide in RE values. If you happen to believe that REO inventory isn’t the only downward pressure on prices, you risk having to pare these loans down every quarter until the bubble blows off. That builds enough ‘re-defaults’ into your modification analysis model that any given set of individual loan inputs come up ‘FC’ again.”
- “[Bair commented:] ‘This would require lenders and servicers to ascertain the existence and amount of any second mortgages, and obtain releases from these obligations to the extent appropriate.’ Or you could just assume a can-opener. It is really hard to believe that Bair can gallop over this one in one short sentence. All you gotta do is make sure the junior liens are willing to extinguish themselves first, and you’re golden.”
- “The reality is that the ‘magic number’ for the loans that are most likely to be facing trouble right now is 80% LTV on the first lien, and something up to 100% or beyond for one or more junior liens. So it is simply a fact that home value declines of 1-20%

mean all the hit goes to the junior lien. If you are trying to “arrest” price declines before they get worse than 20%, you are in a situation where you aren’t asking the first lien lender to forgive any principal to start with; you’re just asking the second lien lender to release its lien for a reduced or no payoff. Given how many of those junior liens are in bank portfolios, it doesn’t surprise me that Bair avoids coming right out and saying that banks will have to write off their junior liens before this plan gets any traction. But that’s what this means.”

- “Of course a junior lienholder may have no alternative to simply forgiving the entire debt and releasing its lien (since it would probably collect nothing in a foreclosure). But if the value decline isn’t ‘eating into’ the first lien yet, why is this a negotiation with the first lien lender? Borrowers should just be calling their junior lienholders asking to have their junior liens forgiven. If the first lien lender has to forgive principal too, then realistically price declines are greater than 20%. (A likely scenario is that the junior lienholder wants to be paid to go away, so the first lien lender is trying to ‘advance’ a couple thousand dollars to the second lien lender in order to get the second lien cleared. That ‘advance’ then gets ‘forgiven’ on the first lien loan, so the effect on a 80/20 deal is that the second lienholder wrote off 18% and the first lien holder wrote off 2% or something like that. If you can get the second lienholder to bother taking a couple grand to go away.)”
- “But at that point, we aren’t ‘staving off’ major RE market failure, we’re in it. We are certainly in it if we have to forgive all the junior liens and some portion of the senior liens. Either we’re far enough down that the end is possibly in sight, or we aren’t. At the end of it, Bair’s proposal is just a recognition that we have blown through all the ‘credit enhancement’ that first lien lenders thought they had. In order for there to be any ‘risk-based pricing’ on the resulting loans—which are all subprime, now—the Fed will have to keep cutting rates to zero, as far as I can tell. The best case scenario for first-lien lenders (banks or securities) is then a long lean period of years in which you have low-yielding fixed rate loans outstanding that won’t go anywhere until amortization (rather than appreciation) builds up some equity. Great. We’re all GSEs now.”
- “If you care to know what I think about this as policy, the answer is that I doubt it matters at this point. Really all Bair is saying is that servicers should modify down to the point where it’s no longer possible to go further without violating servicing contracts. Who actually disagrees with that? It is quite possible that it isn’t any better than doing nothing, but it’s possible that there are borrowers for whom it is, and I don’t see how it could be worse than doing nothing. So go ahead, everybody. As long as we all go first, there shouldn’t be any problems.”
- “However, if Bair thinks this plan will reduce stress on the FDIC, she’s crazier than I am by a long shot. When there is no longer ‘credit enhancement’ on these loans, Ms. Bair, you’re the credit enhancement.” (*Calculatedrisk.blogspot.com*, 02/01/08)

Chairman Dodd proposes a \$20 billion bailout for subprime mortgages

- During the January 31st hearing, Chairman Chris Dodd (D-CT) told the panel members that he is working to create a Home Ownership Preservation Corporation (HOPC), which would purchase mortgage securities that are backed by at-risk, subprime loans from lenders and investors. HOPC would give these parties a better price for the securities than they would receive through the foreclosure process. The government agency would then restructure the loans so that the borrowers could afford the new payments and remain in their homes. According to the testimony, the HOPC would require \$20 to \$25 million in seed money from the U.S. taxpayers and would then be self-funding thereafter. Dodd said there is support from both ends of the political spectrum for his proposal and pointed to the two of the witnesses who were testifying in support of this bailout—Michael Barr with the Center for American Progress and Alex Pollack, with American Enterprise Institute—as examples. Senator Jim Bunning (R-KY) expressed concern about the proposal, saying “Government meddling could make matters worse.” Senator Bob Corker (R-TN) said he was concerned about the “moral hazard” of rewarding borrowers’ risky behavior. Senator Chuck Schumer (D-NY) said that he supports the creation of this type of federal entity, but warned the timing of its creation is critical. “If you put something in place before the housing market has reached its bottom, it’s not going to do much good,” said Schumer. (*CNNMoney*, Les Christie, 01/31/08; *Bureau of National Affairs*, Richard Cowden, 02/01/08)

House Financial Services Committee Chairman Frank is exploring the creation of a temporary government program to purchase troubled subprime mortgages

- House Financial Services Committee Chairman Barney Frank (D-MA) said his staff is working with Senate Banking Committee Chairman Chris Dodd’s staff to develop a proposal that would enable the federal government to purchase troubled subprime mortgages at a steep discount. “[It would consist of] some kind of entity that could buy up the foreclosures and another that could buy up the properties,” said Frank. Specifically, Frank is exploring if Congress could provide funds to state housing agencies so that they could purchase distressed properties and assist displaced families in assuming affordable loans. (*National Journal’s CongressDaily*, Bill Swindell, 01/25/08)

Tensions are rising in New York AG’s lending probe

- The New York Attorney General is in a “tussle” with OFHEO over which regulator should be investigating allegations of appraisal and mortgage fraud, in connection with the AG’s subpoena of Fannie Mae and Freddie Mac. And friction is expected to increase, as a number of parties such as the Department of Justice and SEC, probe irregularities in the mortgage market. On November 7th, New York AG Andrew

Cuomo sent subpoenas to Fannie Mae and Freddie Mac and called for an independent examiner to review loans originated by Washington Mutual and purchased by the GSEs. On November 8, OFHEO director James B. Lockhart, III sent a letter to Cuomo, saying that “for the past several years, OFHEO had been working with the two firms as they continued to improve ... antifraud programs.” Lockhart added that he was “disappointed” that the AG didn’t seek to his agency’s cooperation. According to a person close to the investigation, Fannie Mae’s and Freddie Mac’s cooperation with the AG’s probe ceased. While representatives of Cuomo, Fannie Mae and Freddie Mac declined to comment on the matter, an OFHEO spokeswoman said that the agency “continues to work” with Cuomo’s office.

- On January 30th, Senator Chuck Schumer (D-NY) urged OFHEO to “in the strongest possible way” partner with Cuomo and “be a part of the solution not a part of a perpetuation of the problem.” Schumer added, “It is my understanding that Fannie Mae and Freddie Mac have agreed to comply with the ... subpoenas, but that your agency may be seeking to block the companies from complying with the requests.” The Senator said he believed that Fannie and Freddie attempted to enter into “productive discussions” with Cuomo’s office and were working toward “immediate positive conclusions but for OFHEO’s opposition.” (*Wall Street Journal*, Kara Scannell, 01/31/08)

H.R. 3906: A “tweak” to the bankruptcy law that provides a narrowly targeted solution for subprime borrowers

H.R. 3906: A “tweak” we don’t need

H.R. 3906: A “tweak” to the bankruptcy law that provides a narrowly targeted solution for subprime borrowers

- In a January 18th editorial in the *Los Angeles Times*, former HUD Secretary Jack Kemp wrote, “...Bankruptcy law is wildly off-kilter in how it treats homeownership. Under current law, courts can lower unreasonably high interest rates on secured loans, reschedule secured loan payments to make them more affordable and adjust the secured portion of loans down to the fair market value of the underlying property—all secured loans, that is, except those secured by the debtor’s home. This gaping loophole threatens the most vulnerable with the loss of their most valuable assets—their homes—and leaves untouched their largest liabilities—their mortgages. In the absence of modification, many of today’s loans will result in foreclosure. When servicers are unwilling or unable to voluntarily modify exploding, unsustainable home mortgage loans, Congress has a duty to consider involuntary modification in bankruptcy court, where the same relief is granted on all other secured loans. The proposed Emergency Home Ownership and Mortgage Equity Protection Act being considered by Congress would do just that. It is targeted at only sub-prime and

nontraditional mortgages and will be available for only seven years after it is enacted in order to mitigate against the next wave of exploding interest rate resets.”

- “The key is to avoid an overreaction that would have negative long-term effects on the housing market. Allowing certain distressed homeowners limited bankruptcy protection provides the greatest potential benefit with the least market disruption, and it will not cost the Treasury a dime. Moreover, a tweak to the bankruptcy code is a narrowly targeted solution. It is estimated that more than 600,000 homeowners could use bankruptcy protection to modify their loans and stay in their homes.”
- “Some argue that expanding bankruptcy relief for homeowners would encourage frivolous bankruptcy filings, but recent reforms have made filing a very onerous process. People who bought homes with the intent of flipping them two years down the road are not going to go through the aggravation, embarrassment and cost of bankruptcy.”
- “Why do we need to keep people in their homes? As HUD secretary, I saw firsthand that homeownership makes neighborhoods safer, encourages investment and raises our overall standard of living. People care more deeply about their neighborhoods if they have an ownership stake. Homeownership is not about left or right, conservative or liberal, Democrat or Republican. The House Judiciary Committee has passed a bipartisan compromise version of the bill, and the full House is expected to take it up next month. Both the House and Senate need to pass it—and soon.” (*Los Angeles Times*, Jack Kemp, 01/18/08)

H.R. 3906: A “tweak” we don’t need—and homeowners can’t afford

- In a January 29th commentary in the *Wall Street Journal*, former Representative Dick Armey (R-TX) wrote, “Politicians are always willing—if not quite qualified—to play the role of economic savior. And with fresh bad news about the economy coming out regularly, there are plenty of would-be saviors auditioning for the role. Some of their proposals are serious reforms. Others are Keynesian-inspired, more silly than harmful. But too many are dangerous ideas that would undermine recovery and do long-term harm to both homeowners and our general prosperity.”
- “One of the most dangerous proposals is now moving through the House of Representatives. The Emergency Home Ownership and Mortgage Equity Protection Act [H.R. 3906] was voted out of the Judiciary Committee recently. It takes aim at Chapter 13 bankruptcy proceedings to make it easier for buyers to rewrite the terms of their mortgage contracts in court. It would do this by changing how a debtor’s principal residence is treated in bankruptcy, allowing mortgage contracts to be modified by the courts.”
- “In short, if this bill becomes law a mortgage would no longer be a matter between a borrower and a lender, but instead, between a borrower, a lender and a judge. Rather

than interpreting private contracts, judges would suddenly be able to rewrite them. Current bankruptcy law has existed for more than 100 years, and was designed to promote homeownership by making mortgages secure from outside meddling. Strong contracts make for a vibrant mortgage industry. Weakening mortgage contracts would endanger the future of American homeownership by making it harder for homebuyers to obtain a loan. The bill's backers, of course, claim otherwise. Former Housing and Urban Development Secretary Jack Kemp, for instance, argues that this is merely a "tweak" to the law that would benefit subprime mortgage holders at risk of foreclosure. According to Mr. Kemp, 'when servicers are unwilling or unable to voluntarily modify exploding, unsustainable home mortgage loans, Congress has a duty to consider involuntary modification in bankruptcy court.' This type of modification is more commonly known in the industry as a 'cram down.'"

- "By introducing uncertainty into mortgage contracts, this rule change would make it harder and more expensive for buyers to get a mortgage. The Mortgage Bankers Association recently estimated that, if this reform becomes law, borrowers will have to start putting down 20% on a home to get a loan, which is much higher than today's standard. So in their efforts to cushion the fall of a few, advocates of this reform would raise costs on an untold number of future mortgage seekers."
- "Cram downs might not even provide security to those in risk of default. Changing the terms of a loan provides no assurance that the homeowner will not default at a later date. Moreover, recent research by the Federal Reserve Bank of Boston suggests that subprime borrowers are particularly susceptible to fluctuations in home prices. The end result of assistance may be to prolong the problems in the subprime market by extending the opportunity for borrowers to borrow to the point of default."
- "Only in Washington, where a billion dollars is treated as pocket change, could a change affecting millions of current and future homeowners, as well as the stability and success of the entire mortgage market, be referred to as 'a tweak.'"
- In recent congressional testimony on the economic stimulus package, [CBO] Director Peter Orszag noted that mortgages are treated differently than other property in bankruptcy, specifically to provide benefits to consumers: 'The rationale for the current differential treatment of residential mortgages is that exempting mortgage debt from reduction [in bankruptcy] would lower mortgage interest rates and encourage homeownership.' Mr. Orszag predicts that such a change in the bankruptcy laws will yield higher mortgage rates."
- "Not only does this upend more than 100 years of public policy promoting homeownership, it also raises important questions about the sanctity of contract. 'The definition of injustice is no other than the non performance of covenant,' wrote Thomas Hobbes in *Leviathan*. Yet now, it seems that some in Congress want to enshrine breach of contract into the law itself, ostensibly in service of assisting the nation's homeowners. Such a move would not serve homeowners in the least, but it would surely be an injustice." (*Wall Street Journal*, Dick Armey, 01/29/08)

- According to a new Freddie Mac/Roper survey, 57% of late-paying borrowers are unaware of foreclosure alternatives being offered by their lenders. However, that percentage was down from 61% in the first Freddie Mac/Roper survey in 2005. “Efforts to get borrowers to call lenders and counselors are starting to work,” said Ingrid Beckles, Freddie Mac’s vice president of servicing and asset management. “[But,] too many at-risk borrowers are still unaware their servicers routinely provide alternatives.” (*CNNMoney*, 01/31/08)
- Although President Bush has proposed to help one million subprime borrowers avoid foreclosure through the issuance of tax-exempt bonds, there is a problem. The states don’t want the credit risk for these loans any more than private lenders do. To date, state housing agencies that are already offering mortgage refinancing options have turned down so many applications that they haven’t had to raise funds. New York committed \$100 million to help subprime borrowers, but has approved only three of the 500 loans that they planned to issue. Massachusetts has extended four loans through its \$250 million program which was started in August, while Ohio has made just 36 loans out of the thousands promised by Governor Ted Stickland. Geoffrey Cooper, emerging markets director at a unit of MGIC Investment Co., estimates that more than 50% of subprime borrowers are being rejected by state programs because their homes have lost too much value or they’ve accumulated excessive debt. “These things are basically public relations gimmicks,” said Bruce Marks, CEO of Neighborhood Assistance Corp. of America. (*Bloomberg News*, Michael McDonald, 02/01/08)
- Servicers say that efforts to restructure mortgage for troubled homeowners is being hampered by Fannie Mae and Freddie Mac, because the GSEs have policies preventing them from agreeing to change mortgage terms for loans that have not yet become delinquent. Servicers, who would only talk about this issue with *American Banker*’s reporters on background for fear of upsetting the dominant buyers of their mortgages, said that Fannie, in particular, adheres to restrictive rules that reduce the number of loans that may be modified. Specifically, Fannie Mae will not agree to a loan modification that it has securitized until the loan has been delinquent for four months. “That’s a very arbitrary policy,” said Bert Ely, an Alexandria, VA consultant and frequent GSE critic. “There’s no reason they couldn’t do it much sooner. They do have a fair amount of latitude as to how dynamic they can be in managing their pools of securities.” (*American Banker*, Steven Sloan, 01/29/08)
- Mortgage companies eliminated 114,600 jobs in 2007—nearly a quarter of the industry’s workforce. (*National Mortgage News Daily Briefing*, 02/01/08)
- Fitch Ratings has revised the Rating Outlook to Negative from Stable for the U.S. Central Federal Credit Union (USC) due to its exposure to “the troubled mortgage market, particularly non-prime mortgage-backed securities.” According to Fitch, “...the [credit union’s] portfolio still has meaningful exposure to the non-prime

mortgage market and contains securities that could generate additional realized losses. Considering that USC operates with a high degree of leverage significant additional losses could materially impair the company's capital position, negatively affecting the company's ratings." According to its website, USC is the "credit union for corporate credit unions" with \$49.1 billion in assets, serving more than 8,400 credit unions across the country. (*Fitch Ratings Press Release, 01/25/08*)

- How would Fannie Mae be impacted by a potential "blow-up" of the private mortgage insurance industry, resulting from rising delinquencies and mounting losses? There are a number of looming questions about Fannie's exposure to private mortgage insurers. Some question if Fannie Mae is adequately reserved for possible losses, in the event that a PMI is unable to pay its claims? If a PMI takes a "massive hit," will Fannie be forced to buy fewer, high-LTV mortgages in the future? Market concerns have recently shifted from low FICO scores to high LTV values, in an environment where real estate values are deflating. In a recent report, analysts with Canadian Imperial Bank of Commerce concluded that the "highest losses will be driven by LTVs, not FICO scores." CIBC analyst Meredith Whitney wrote, "Today, as a higher percentage of people own homes and many of them have taken on 'too much house' or high LTV loans, things are different. Many previously considered 'prime' customers who took on 80+% LTVs are performing closer to sub-prime loans." Fannie Mae has \$227 billion of exposure to loans with LTV ratios exceeding 90%. Approximately 19% of the GSE's \$2.4 trillion single-family book of business has PMI or some other form of credit enhancement. In mid-January, Merrill Lynch wrote off \$2.6 billion of default protection from bond insurers that the banker believed was worthless. If Fannie Mae decided that portions of its mortgage insurance was impaired, then larger writedowns by the company may be looming. The GSE has just \$40 billion of capital to absorb these losses.
- As a result, some hedge funds managers have begun to take a more bearish stance on Fannie Mae. During a November investor conference call with Fannie's management, Nandu Narayanan, chief investment officer of Trident Investment Management, said, "It looks to us like a lot of the mortgage issuers will not survive if any kind of really bleak outcome comes to pass. To the extent that some of their risks may not be insurable by them if they're not in existence, it comes back on your books. So there's clearly a much more complicated interlinked relationship you have with a number of other providers, which are all possibly at risk in this situation." Fannie Mae's chief risk officer Enrico Dallavecchia, said the company believes that the mortgage insurance industry "will manage its capital position to meet the claims obligations that they have." He added, "I feel comfortable with the exposure that we have to the MI at this stage." (*TheStreet.com, Nicholas Yulico, 01/23/08*)
- During a speech at World Economic Forum Annual in Davos, Switzerland, Ray McDaniel, president of Moody's, admitted that the rating agencies models failed to predict future mortgage loan default rates, based on past patterns of loss, because they did not reflect shifts in household behavior. "In the past, if a household in America experienced financial problems it tended to go delinquent on its credit cards, but kept

on paying its mortgage,” says Malcolm Knight, head of the Bank for International Settlements. “Now what seems to be happening is that people who have outstanding mortgages that are greater than the value of their home, or have negative amortization mortgages, keep paying off their credit card balances but hand in the keys to their house ... these reactions to financial stress are not taken into account in the credit scoring models that are used to value residential mortgage-backed securities.” (*Financial Times*, Krishna Guha and Gillian Tett, 01/31/08)

- Some local municipal officials are becoming concerned about “gambling” with their communities’ funds and may change their investment policies to limit the risk of loss. In Naples, FL, city councilman Bill Willkomm said he doesn’t want to gamble the community’s money way in what he considers high-risk funds. “I think this is a bad policy for us, at this time, to have our funds in Fannie Mae and Freddie Mac,” said Willkomm. The city has about \$12 million in Fannie Mae and Freddie Mac bonds, which, paired with the money frozen in the state-run investment fund, has left council members concerned with the state of the city’s finances. Ann Marie Ricardi, Naples’ finance director, has decided to suspend the city’s investments in Fannie Mae and Freddie Mac bonds until 2009 and “they have met all reporting commitments.” (*Naples Daily News*, Jenna Buzzacco, 01/22/08)

Federal Reserve Governor Kroszner’s reappointment on shaky ground

- Federal Reserve Governor Randall Kroszner, who has become a lightning rod for Democrats frustrated with the central bank and the White House approach to economic policy, faces a stumbling block in Senate Banking Committee Chairman Chris Dodd (D-CT), who has suggested he will block his nomination to a 14-year Fed term. Kroszner, who ran the Fed committees that formulate policy on bank regulation and consumer protection for the past two years, has been criticized for not acting more aggressively to forestall mortgage-lending practices. He also served point person on the Fed’s recent proposal to rein in mortgage practices, which Democrats have criticized the measure, belated and halfhearted. “Many people—myself included—wondered whether Mr. Kroszner...was a good choice for the job,” said Representative Carolyn Maloney (D-NY), who heads the House Financial Services Subcommittee on Financial Institutions. “I think our concerns have panned out.”
- Kroszner, who holds a Ph.D. in economics from Harvard University, taught for more than ten years at the University of Chicago’s Graduate School of Business before coming to Washington in 2001 as a member of President Bush’s Council of Economic Advisers. In March 2006, he joined the Fed to fill the remaining two years of an unexpired term left by a departing board member. Some former White House officials speak highly of Kroszner’s experience and commend his work during the current financial turmoil. In academic circles, he is also well-regarded as a creative and collegial thinker. “There’s nothing idiosyncratic about his economic views,” said Harvey Rosen, former chairman of the Council of Economic Advisers. “He’s an excellent mainstream economist—very sensible, a good listener.”

- Dodd is currently holding up the pending nominations of Kroszner and two others to serve as Federal Reserve Governors. As of January 31st, there were only five people on the Fed's seven-member board with four members serving current terms. Kroszner can remain on the Federal Reserve board until the Senate confirms another nominee. (*Dow Jones Newswires*, Damian Paletta, 01/31/08)

The lone Democrat on the SEC departed on January 31 st

- Annette L. Nazareth, the lone Democrat serving on the Securities and Exchange Commission, resigned effective January 31st “to pursue other professional opportunities. Nazareth’s departure means that the five-member commission will operate without any Democratic representation in the waning months of the Bush administration. Her resignation follows the agency’s departure of its senior Democrat, Roel C. Campos, who left the commission in September for a law partnership. In November, Majority Leader Harry Reid (D-NV) forwarded to the Bush administration the names of Elisse B. Walter, a long-time Washington, DC regulator currently at the Financial Industry Regulation Authority, and Luis A. Aguilar, an Atlanta, GA corporate lawyer to serve on the SEC. Both nominations, which are currently undergoing lengthy background checks, required approval from the White House and a vote of the full Senate. (*Washington Post*, Carrie Johnson, 01/22/08)

Fannie Mae

Fannie Mae's retained portfolio grows at an annualized 3.3% rate in December

- In December, Fannie Mae's retained portfolio rose by an annualized 3.3% in December to \$724.0 billion. During the month, the company issued \$64 billion of mortgage-backed securities, as its MBS and other guarantees rose at a compound annualized rate of 27.1%. Fannie Mae's conventional Single-Family Serious Delinquency rate rose seven basis points to 0.90% in November (the latest data available). At the end of November, the GSE's serious delinquencies was comprised of 0.49% of its non-credit enhanced conventional mortgage portfolio and 2.51% of its credit enhanced portfolio. During the month of December, Fannie Mae's effective duration gap averaged plus two-months, unchanged from November. (*Reuters*, Julie Haviv, 01/25/08; *Fannie Mae Monthly Volume Summary*, December 2007)

Fannie Mae CEO Mudd receives compensation totaling \$12.2 million in 2007

- Fannie Mae's total compensation to CEO Daniel Mudd totaled \$12.2 million for 2007, a 15% decrease from his 2006 compensation of \$14.4 million. Mudd received a salary of \$990,000, up from \$950,000 for 2006; a \$2.2 million bonus, down from his \$3.5 million bonus for last year; and a long-term incentive award of \$9 million, down from \$10 million.
- In *Fortune Magazine*, Colin Barr wrote, "Wednesday [January 30th] was a red letter day for Fannie Mae chief Daniel Mudd, if not for the mortgage company's beleaguered shareholders. Fannie shares fell 6% in trading Wednesday, and that was before Fannie put out a press release announcing Mudd's 2007 pay. He made \$990,000 last year in salary and took in a 'performance bonus' of \$2.2 million, along with a \$9 million long-term incentive grant. Altogether Mudd pulled down \$12.2 million, Fannie said - this in a year in which the company's stock dropped 30%. That sounds like a nice deal for Mudd, though Fannie might point out that his pay actually dropped by \$2.2 million from 2006 levels. That means his compensation took a smaller hit last year than did Fannie shareholders, but you can't have everything. At least he didn't get a big raise." (*Washington Post*, David S. Hilzenrath, 01/31/08; *Fannie Mae Press Release*, 01/30/07; *Fortune Magazine*, Colin Barr, 01/30/08)

Mudd: "It's a fool's errand to try to call the bottom [of the mortgage market]"

- In a January 29th speech at Citigroup's Financial Services Conference, Fannie Mae's CEO Daniel Mudd said that "while there are small signs of stability emerging [in the mortgage market], this remains a choppy, unpredictable market, and it is a fool's errand to try to call the bottom." Among the knowns and unknowns in the

marketplace, Mudd concluded that (1) home prices will likely post a larger than average percentage decline in 2008 versus 2007; (2) credit losses will be not be evenly distributed geographically with the Upper Midwest, Florida and California continuing to suffer; (3) mortgage origination markets will continue to consolidate and the surviving counterparties “will be much more creditworthy;” (4) the mortgage trading markets have reduced the available liquidity for a variety of mortgage products, which has had an indirect impact on fair value pricing; and (5) concern about funding in the mortgage sector is particularly pronounced outside the Agency-eligible sector. Mudd noted that it is uncertain what the effect of government and regulatory action will have on the mortgage market. “The proposed stimulus plan, particularly the focus on FHA and the GSE loan limit, plus the Hope NOW initiative, and the [Federal Reserve’s] rate cuts—I think directionally are positive,” said Mudd. “There are other proposals—related to forbearance and changes to existing agreements—that could have a negative market impact.”

- Mudd said that while Fannie Mae has a relatively solid total credit book of middle-class homeowners with standard fixed rate loans with good credit and equity. Within that book, he said Fannie also has “riskier pockets” which the company is focused most intensely on today. At September 30, these pockets included:
 - (1) \$325 billion of Alt-A loans (13.4% of Fannie’s overall book with almost 40% of the Alta-As carrying credit enhancement), which carries a serious delinquency rate of 1.4% and “drove about 28% of Fannie Mae’s total credit losses through the third quarter;”
 - (2) \$194.8 billion of interest-only loans (8.0% of the portfolio), which contributed 11% of the GSEs’ credit losses;
 - (3) \$117.9 billion of affordable housing loans (4.9% of the portfolio—of which 37% of the loans had credit enhancement), which had a serious delinquency rate of about 4% and contributed about 20% of the company’s credit losses; and
 - (4) \$7.3 billion of subprime loans, which have a serious delinquency rate of 4.8% but small losses to date due to credit enhancement that covers 80% of the portfolio.

On September 30, Fannie Mae’s “riskier pockets” totaled 644.7 billion and accounted for approximately 26.6% of its \$2.427.7 billion total credit book.

- During the past year, Mudd noted that Fannie Mae has (1) become a current filer and will file its 2007 10K with the SEC by the end of February; (2) has doubled its single-family mortgage guaranty market share from 20% in early 2006 to 40%; (3) has shored up its capital to \$40 billion through a \$7 billion preferred stock offering and reduction of common stock dividends; and (4) has trimmed operating expenses by more than \$200 million, which has resulted in a “run rate of \$2 billion going into

2008.” Going into the new year, Mudd acknowledges that Fannie Mae faces “extraordinary credit challenges to manage through.” (*Remarks Prepared for Delivery by Daniel H. Mudd, 01/29/08; Bloomberg Television, Kathleen Hays and James Tyson, 01/29/08*)

Something else to lose sleep over

- In the *National Mortgage News Daily Briefing*, Paul Muolo wrote, “...In the fourth quarter of 2007 Fannie Mae bought \$203.3 billion in mortgages from its seller/servicers. Countrywide Financial Corp. originated \$59.9 billion in conventional mortgages in Q4, selling a majority of them (so we’re told, to Fannie) which means (if my math is correct) that Fannie depends on CFC for 30% of its business. Interesting. If you think that Fannie Mae CEO Daniel Mudd is not closely watching CFC’s sale to Bank of America, then think again...” (*National Mortgage News Daily Briefing: Weekend Edition, Paul Muolo, February 2-3, 2008*)

Fannie Mae alumni news

- Charlotte Haberaecker has been named the chief operating officer for Global Impact, a “not-for-profit organization dedicated to helping the poorest people on earth,” which represents more than 50 of the most respected U.S.-based international charities in giving campaigns across the nation. During her 15 years with Fannie Mae, Haberaecker served 12 years as vice president in the areas of eBusiness Solutions, Single-Family Business Strategy, and, most recently, Single-Family Operational Risk Management. (*CSRwire, 01/24/08*)

Freddie Mac

Freddie Mac's delinquency rate up 43% over its December 2006 level

- In a sign that mortgage loan credit quality is deteriorating [including prime mortgages], Freddie Mac reported a 0.60% delinquency rate for single-family mortgages (90 days or more delinquent) in November, up 43% over its December 2006 rate of 0.42%. Freddie Mac said that its 60 basis points delinquency rate is the highest the GSE has reported since February 2003. On November 30, Freddie Mac's credit enhanced portfolio had a delinquency rate of 1.55% and its non-credit enhanced portfolio's delinquency rate was 0.40%.
- Freddie Mac also said that its fair market value attributable to shareholders has "declined significantly" due to wider spreads on mortgages, but declined to quantify the values until it announces the company's year-end results on February 28. In a comparison of the GSEs' new and old disclosures, Credit Suisse analysts estimated that Freddie Mac's fair value of common equity fell \$11 to \$13 per share in November—down from about \$25 per share in the third quarter—which represents more than a 50% drop versus a year ago.
- In December, Freddie's retained mortgage portfolio rose at an annualized rate of 28.6% to \$718.1 billion [adjusted for a new trust for cash remittances on assets backing its MBS, the portfolio balance was \$720.8 billion]. Most of the company's purchases consisted of its own MBS, while it reduced its holdings of non-guaranteed securities. For the year-ended December 31, 2007, Freddie Mac's retained portfolio rose at a 2.4% annual rate. The GSE's duration gap averaged 0 months in December, unchanged from November. (*Freddie Mac Monthly Volume Summary*, December 2007; *Reuters*, 01/24/08)

Federal Home Loan Banks

Subprime crisis provides impetus to pass legislation allowing the FHLB System to provide credit enhancement for tax-exempt bonds

- Legislation to allow the FHLBs to provide credit enhancement to small tax-exempt bond issuers has the best chance of passage in years because of the tumult municipal bond insurers are facing due to the subprime mortgage crisis, say advocates. “Given the turmoil in the private bond insurance market, it is more important than ever that [the banks] be allowed to provide this service to municipalities,” said Representative Sander Levin (D-MI), the sponsor of legislation in the House. “Our cities are on the front lines of the current economic slowdown and this legislation will help relieve some of the pressure on their already strained budgets.”
- Advocates concede that the bill, which now has 40 co-sponsors in the House and 10 in the Senate, will not likely be passed by Congress as a stand-alone measure, but hope that it will clear Congress as part of the stimulus package. “It could be very attractive as something that’s part of the stimulus package,” said Charles A. Samuels, an attorney here at Mintz Levin Cohn Ferris Glovsky and Popeo PC, who has organized a coalition of state and local groups to support it. Levin said lawmakers are still looking for the “appropriate legislative vehicle” for the proposal. As introduced, the legislation would change the federal tax code and allow any of the 8,100 member institutions of the FHLB system to issue letters of credit, which could be used to insure small tax-exempt industrial development bond deals or transactions involving small nonprofit health care facilities, colleges, or universities. Sixteen national organizations support the proposal, including the National Association of Counties and the National League of Cities, as well as 75 state agencies and conduit issuers.
- The push to amend the federal tax code to allow bonds to be credit-enhanced by the banks comes after the IRS began auditing deals in which the banks had issued what it dubbed “illegal federal guarantees” on the bonds. Currently, only housing bonds can be backed by a federal guarantee and still retain their tax-exempt status. Although the FHLB system doesn’t have an estimate of the volume of bonds that could be enhanced by the banks, the CBO has estimated that \$6 million would be diverted from federal coffers if the FHLB members were allowed to provide letters of credit for tax-exempt deals.
- The insurance industry rejects the advocates argument that localities have been historically shut out of capital markets and argues that the market is already well-served by efficient private firms. The Association of Financial Guaranty Insurers (AFGI) said that the legislation would reduce the fiscal discipline that capital markets currently impose on issuers and would significantly limit the tax revenue currently paid to the federal, state and local governments. Further, AFGI argues that the legislation would create a double government tax subsidy: the bonds would retain

their tax-exempt status and would also be backed by a GSE. AFGI's executive director Bob Mackin, said, "It's bad tax policy." (*Bond Buyer*, Andrew Ackerman, 01/23/08)

FHLB-San Francisco announces board appointments

- The FHLB-San Francisco's board of directors has selected James F. Burr to fill an open position on the board, effective January 22 for a term ending December 31, 2008. Burr is EVP and corporate treasurer of Wachovia Mortgage FSB, Las Vegas, NV. (*FHLB-San Francisco Press Release*, 01/22/08)

International Mortgage Market

Housing boom flourishes in Mexico, as U.S. market falters

- As the U.S. housing market falters, Mexico now boasts a growing housing sector which leads Latin America and is attracting big investors, such as the California Public Employees Retirement System [CalPERS], who are looking to escape the U.S. downturn. Spokesman Clark McKinley said CalPERS has already invested more than \$300 million in Mexican real estate funds, where they see "more bang for the buck." Mexico's building trend could generate millions in jobs and personal savings as a fresh supply of loans gives many the residents their first chance to own a house. Mexico's president Felipe Calderon has set a national goal of a million new mortgages a year by 2010. (*Associated Press*, 01/20/08)

Farm Credit System / Farmer Mac

The next bubble?

- According to Farm Credit Services of America, farm prices have risen more than 20% in Iowa (22.6% increase), Nebraska (19.6%), South Dakota (22.6%) and Wyoming (20.9%). According to FCSA's chief appraiser Kirk Manker, the institution tracks real estate values by making semi-annual farm appraisal of 68 farms and followed 7,500 sales of farmland in the four states. Manker credited the rise in property values to increasing yields of corn, soybeans and wheat, stimulated by relatively low interest rates, the low [exchange] value of the U.S. dollar which has boosted exports, and a boom in ethanol production, which has increased demand for corn.
- Iowa State University Extension economist Michael Duffy said that Iowa farmland set a record in 2007 for the fifth year in a row, in which land rose to an average of \$3,098 an acre—22% more than a year ago and the largest one year increase since 1976. According to the Federal Reserve Bank of Chicago's most recent survey of agricultural bankers, farmland prices rose 21% in Iowa, 17% in northern Indiana, and 10% in parts of Illinois, Wisconsin and Michigan during the year that ended Oct. 1.
- Murray Wise, with leading Midwestern farm real estate brokerage firm of Westchester Group Inc., said the Iowa farmland market "is hotter than most, but Illinois, Indiana and Ohio follow close behind." Wise said that today's higher prices for corn, soybeans and wheat has been caused by demand from biofuel producers and export customers. "This is a demand-driven market," he said. "It's only the second one in history." As a spillover from the housing downturn, Wise said that capital is shifting from mortgages into agriculture. "East Coast lenders are saying they want to go into agriculture," he said. "Capital wants a home in U.S. ag." (*Des Moines Register*, Jerry Perkins, 01/22/08)

Farm Bill Conference off to slow start

- In the January edition of *Farm Credit Watch*, Bert Ely wrote, "The congressional conference committee that will resolve differences between the House and Senate-passed Farm Bills has not yet been appointed although congressional staffers are working to resolve differences between the two bills. Key differences include the cost of the 2008 Farm Bill and limits on commodity payments to farmers. This conference committee represents the last chance the FCS has to get any HORIZONS provisions included in the 2008 Farm Bill because the FCS failed to get any of those provisions tacked onto either the House or the Senate versions of the Farm Bill. The conference committee has until March 15 to complete work on the 2008 Farm Bill, for that is the day the 2002 Farm Bill will expire."

- “The Chairman and top Republican of the Senate Banking Committee and the House Financial Services Committee, Senators Christopher Dodd (D-CT) and Richard Shelby (R-AL) and Representatives Barney Frank (D-MA) and Spencer Bachus (R-AL), sent a powerfully worded letter on January 15 to the ag committee leaders essentially telling them not to include any HORIZONS provisions in the final version of the 2008 Farm Bill, stating that ‘we write to express our jurisdictional concern regarding certain proposals by the [FCS] to expand its lending authority beyond its statutory mission of providing credit to the agricultural sector... The letter further stated that ‘some of the proposals that have emerged from the FCS as a result of the Horizons Project would, in our judgment, so substantially expand its current lending authority beyond the agriculture sector that they would exceed the respective jurisdiction’ of the two ag committees. Noting that neither version of the 2008 Farm Bill includes any HORIZONS provisions, the letter concluded ‘if you are pressed to consider [HORIZONS] proposals during conference, we urge you to consult [with our committees] prior to taking any such action.’ Hopefully, the Farm Bill conferees will take this warning to heart and let HORIZONS sink below the horizon once and for all. (*Bert Ely’s Farm Credit Watch*, January 2008)

<p>Farm Credit Council creates new staff position to help its members serve young, beginning and small farmers</p>
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- The Farm Credit Council [FCC] has hired Gary Matteson to fill a new staff position to focus additional resources on supporting the efforts of FCS institutions to serve young, beginning and small farmers and ranchers [YBS]. Most recently, Matteson was a small farmer operating a greenhouse business in Epsom, N.H., growing anemones for the wholesale cut flower market. In addition to having been an agricultural entrepreneur himself, Matteson has also served as vice chairman of First Pioneer Farm Credit and on the FCC’s board. In *Farm Credit Watch*, Bert Ely notes, “Given how weak its YBS lending has been, the FCS needs all the help Matteson can give it to boost that lending. [Matteson] could start by working with the FCA to eliminate the double and triple counting that vastly overstates the amount of the FCS’s YBS lending.” (*Farm Credit Council Press Release*, 01/16/08; *Bert Ely’s Farm Credit Watch*, January 2008)

Postal Service

USPS's mail volume is down 3% for the first quarter of fiscal year 2008

- According to the agency's preliminary financial results, the USPS's mail volume was down by 3% [1.7 billion pieces] for the first quarter of fiscal year 2008 [ending December 31st], reflecting the impact of the postal service's "rate shock" from its May 2007 rate increase and the rapidly declining economy. The decrease is "very, very troubling," said Glen Walker, the USPS's chief financial officer and EVP. During the first quarter, First-Class Mail volume dropped by 3.9% while Standard Mail volume decreased by 2.6%, said Walker, with only Periodicals increased in volume – at a rate of 1.2%. "As we look forward, we're hoping for the best, but we're preparing for the worst," he added.
- Walker said that the agency's revenues are up about 3.5% for the first quarter, largely because of the 2007 rate increase, and that net income for the first quarter is estimated to be \$672 million. "Despite the numbers, we're not planning to do anything dramatic other than work harder and make our system work," said Postmaster General Jack Potter. "Financially, we are struggling with revenue, but we're not unlike other businesses." The Postal Service plans to issue its financial results for the first quarter at the end of February. (*DMNews.com*, Ellen Keohane, 01/31/08)

The USPS Board of Governors approves big pay increases for the agency's top officers

- On *Federal News Radio*, Mike Causey reported "What's the best of all worlds? Well, if you gotta work, and you gotta work for the government, make sure you pick an agency that isn't constrained by pesky regulations that keep a lid on the value of pay and perks. Although many rank-and-file feds don't know it, employees at a number of agencies—especially those that regulate banks—march to a different drummer. That drummer, in most cases, pays better than regular federal agencies. Examples include the Federal Reserve, Comptroller of the Currency and the FDIC. But the biggest independent of all, and the one agency that touches nearly all our lives, is the U.S. Postal Service. And while the USPS is composed mainly of relatively low-paid clerks and letter carriers, its officer corps does fine..." (*Federal News Radio*, Mike Causey, 01/30/08)
- According to a January 3rd response to a Freedom of Information Request, Postmaster General John E. Potter and seven other senior officers of the USPS were granted large raises by the Board of Governors in May 2007 retroactive to January 5, 2007. Under Potter's salary increased nearly 39% to \$258,840, followed by deputy postmaster general and COO Patrick Donahoe's salary increase of 26% (to \$235,000); chief human resources officer and EVP Anthony Vegliante's increase of 22.8% (\$225,000), chief marketing officer and EVP Anita Bizzotto's increase of 22.8%

(\$225,000), general counsel and SVP Mary Anne Gibbons' increase of 20.9% (\$215,000), senior vice president of operations William Galligan's increase of 17.4% (\$215,000), CFO and EVP Harold G. Walker increase of 15.6% (\$215,000); and chief technology officer and VP Robert Otto's increase of 17.4% (\$205,000). Otto retired on October 1st and his successor has not been named.

- Under the postal reform legislation passed by Congress in December, the Board of Governors was given the authority to increase the pay of up to 12 USPS officers up to an amount "not to exceed 120 percent of the vice president's total annual compensation." Vice President Dick Cheney currently receives a salary of \$215,700. Under the UPSP's new compensation structure, four of the agency's officers receive more compensation than Cheney. (*Alliance for Non-Profit Mailers*, Bill McAllister, 01/22/08)

USPS Board of Governors elects new chairman and vice chairman

- On January 30th, the USPS Board of Governors elected Alan C. Kessler as its new chairman and Carolyn Lewis Gallagher as its new vice chairman. Kessler, who was appointed to the board in 2000 by President Clinton, has served as vice chairman of the board since 2005. His term expires in December 2008. Kessler is a partner at the Philadelphia-based law firm Wolf, Block, Schorr and Solis-Cohen LLP, where he practices class action litigation, with experience in "securities, antitrust and toxic tort cases," according to the firm's website.
- Gallagher, an Austin, TX native, was first appointed to the board in 2004 by President Bush to a term ending December 2009. Gallagher is the former president and CEO of Texwood Furniture, an educational furniture manufacturer in Taylor, TX, which she owned from 1988 to 2000. President Bush appointed Gallagher to serve on the President's Commission on the United States Postal Service in 2003. (*DMNews.com*, Ellen Keohane, 01/30/08)

The Postal Service's IG identifies more than \$1.6 billion in savings opportunities and \$1.7 million in revenue opportunities during the last six months of FY2007

- According to the USPS's Office of the Inspector General' semi-annual report to Congress for April 1-September 30, 2007, the IG issued 206 audit reports and management advisories, which resulted in \$1.6 billion in savings opportunities and more than \$1.7 million in revenue opportunities. The IG's office also closed 4,426 cases and referred 2,408 cases to management for administrative action. The IG's investigators made 282 arrests, obtained 123 indictments through which more than \$13.2 million in fines, restitutions and recoveries were made to the Postal Service. (*Office of the Inspector General Semiannual Report to Congress, April 1-September 30, 2007*)

NALC and APWU bring lawsuit against the Postal Service's IG, challenging his practice of "surreptitiously" obtaining medical files of employees suspected of engaging in fraud

- The National Association of Letter Carriers and the Association of Postal Workers have filed a lawsuit against the Postal Service's Office of Inspector General, challenging the IG's practice of "surreptitiously" obtaining medical files of agency employees who may be fraudulently receiving workers' compensation benefits, abusing sick leave, or engaging in medical fraud. The unions filed the lawsuit in a Manhattan federal court on January 17th. Despite the IG's broad statutory authority to investigate "fraud, waste and misconduct" throughout USPS, the unions' lawsuit calls his actions an "unwarranted intrusion by government agencies into the privacy of their employees' medical information, an intrusion that exceeds the agencies' statutory authority and violates federal law, regulations, and the United States Constitution." In a message to members, NALC president Bill Young linked the IG's actions to recent news reports of "unauthorized surveillance, illegal searches, suspension of civil liberties, illegal beatings—all the way from wiretaps to water-boarding." The lawsuit has been assigned to federal district court judge Denny Chin, who was nominated to the bench by President Bill Clinton in 1994. (*www.Post-notes.blogspot.com*, 01/22/08).

USPS is the most popular government agency

- According to a new survey of American attitudes conducted by Roper Public Affairs & Media, the Postal Service is the most popular government agency with an 81% favorability rating, and FEMA is the least popular with a 42% favorability rating. "That's one agency [the USPS] that most Americans touch," said Kathy Sheehan, a vice president with Roper. "They have some type of interaction with the post office. It's a service where people see value, and in many cases a personal face." (*Federal Times*, Gregg Carlstrom, 01/28/08)

TVA

Senator Alexander hopes TVA board nominees will be confirmed by the Senate soon

- When TVA's board meets on February 15th, three of the nine directors are not likely to be in attendance due to the Senate's failure to confirm the three board nominees. Senator Lamar Alexander (R-TN) said that confirmation is stalled over partisan disputes over presidential appointments. The Senate's impasse is preventing former TVA directors Susan Richardson Williams, of Knoxville, TN, and Bishop William Graves, of Memphis, and Blairsville, GA banker Thomas Gilliland from joining the utility's board. In a conference call with reporters, Lamar said, "[TVA] is in a critical stage right now [and needs its full board]. Hopefully, we can get it done by mid-February."
- Alexander had expected the TVA appointments would be confirmed by the full Senate before Congress adjourned in December, but they were delayed at the last minute because of a dispute between the Republican White House and the Democratically-controlled Senate over the confirmation of presidential appointees elsewhere in government. "Everything was cleared right up until the last day in December, and Senator [Johnny] Isakson (R-GA), who is very interested because of the new appointee from Georgia, was up on the phone until midnight with [Senate Majority Leader Harry] Reid (D-NV) trying to get the TVA people separated," said Alexander. Sheridan Watson, Isakson's press secretary, said, "Getting Tom Gilliland confirmed by the Senate to serve on the TVA Board continues to be a high priority." (*Chattanooga Free Press*, Dave Flessner and Herman Wang, 01/26/08)

NRC agrees to review TVA Bellefonte application

- The Nuclear Regulatory Commission has agreed to consider a combined construction and operating license application for two reactors at TVA's Bellefonte site near Scottsboro, AL, submitted by TVA and its nine consortium partners at NuStart Energy Development LLC. Ashok Bhatnagar, TVA's senior vice president for nuclear generation development and construction, said, "We are pleased that the [NRC] has determined that the license application submitted for a new nuclear plant at Bellefonte is sufficient to begin the review process." Bill Borchardt, who heads the NRC's Office of New Reactors, said that his department's review of the reactor design will likely run through 2009 and its review for the Bellefonte site will "continue into 2011." Bhatnagar said, "The application is very thorough and was prepared and submitted on schedule." The NRC's decision to place the applications on its docket is the next step in the licensing process that will give TVA more certainty about the cost and schedule of the project and will help determine if building a new nuclear plant at Bellefonte is the best option to meet the growing energy needs of the Tennessee Valley," he added. (*Associated Press*, Duncan Mansfield, 01/22/08)

Appeals Court: North Carolina can proceed with its lawsuit against TVA

- A three judge panel of the U.S. Circuit Court of Appeals has rejected TVA's motion to dismiss a lawsuit filed by the state of North Carolina against the utility that demands the agency clean up its power plants and reduce air pollution. The Circuit Court's decision affirmed an earlier decision by a lower court to let the lawsuit go forward. In 2006, North Carolina sued the TVA, claiming that thousands of the state's residents suffered ill health from pollutants blowing from TVA's 11 coal-fired power plants in Alabama, Kentucky and Tennessee. The lawsuit also argues that North Carolina's environment and economy are harmed by TVA's emissions and pose a public nuisance. "Clean air is critical to our health and our economy," said N.C. Attorney General Roy Cooper. "This ruling clears the way for us to make TVA clean up its pollution that's dirtying our air and making North Carolinians sick."
- TVA officials argue that the agency is complying with federal air pollution laws and has spent almost \$5 billion in the past 30 years to reduce emissions, including \$1.2 billion on pollution controls at three plants in East Tennessee. TVA had asked the federal appeals court to dismiss the suit, arguing essentially that as a federal agency, the utility has immunity from nuisance lawsuits. "We're disappointed in the outcome," said TVA spokesman John Moulton. "We're analyzing the decision and considering what steps we would need to take." (*News and Observer* [Raleigh, NC], Wade Rawlins, 02/01/08)

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