

# The **GSE** REPORT™

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## ***Major Events***

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to expand FHA’s responsibility in managing troubled loans

Bush administration hopes to limit the scope of the housing stimulus package

Presidential candidates enter the fray

### Senate approves housing stimulus bill

- By a vote of 84 to 12, the Senate approved the Foreclosure Prevention Act, a “modest” package of tax breaks and other provisions aimed at easing the nation’s mortgage crisis. Emboldened by the Republican votes for the measure, Democratic lawmakers in both chambers pressed for passage of more aggressive legislation to help more than a million homeowners at risk of foreclosure. The Bush administration and other Republicans are skeptical of the Democrats’ broader proposal, which they argue would put more taxpayer dollars at risk to bail out irresponsible borrowers. However, Democrats argue that bolder action is needed to stem the tide of foreclosures, which is driving the nation toward a recession. “This bill is called the Foreclosure Prevention Act. Quite candidly, what we’ve done here doesn’t quite live up to the title,” said Senate Banking Committee Chairman Christopher J. Dodd (D-CT). “We’ve got more work to do. ...We’re not done, yet.” Senate majority leader Harry Reid (D-NV) said that chamber’s vote is “just the beginning of a process [which] will continue in the House of Representatives.” Lawmakers hope that House Financial Services Committee chairman Barney Frank will be successful in passing legislation that would allow the FHA insure up to \$300 million of refinanced mortgages for up to 1.5 million homeowners. Reid added, “I hope when the process is complete, we will have a strengthened bipartisan bill that will do even more to help families, communities, and our economy.”
- Neither House leaders nor the White House approve of all of the provisions of the Senate measure, which jump-starts legislation to modernize the FHA by permitting the agency to insure homes worth up to \$550,000. The measure also provides \$4 billion for cities to buy vacant foreclosed properties, \$150 million for community groups to offer foreclosure counseling, \$30 million for legal service attorneys to help

borrowers, and \$10 billion in new tax-exempt bonding authority for state and local agencies to refinance troubled mortgages – all provisions supported by the House. The bill also provides a \$7,000 tax credit for buyers of foreclosed homes [for a total cost of \$1.5 billion through 2009] and provide homeowners who do not itemize their deductions a \$500 or \$1,000 property-tax deduction. Amendments to the measure also extended certain energy tax credits [\$6 billion in tax credits for “clean” energy producers and users] and provided specific tax relief for Gulf Coast homeowners who received grants for recovery from the 2005 hurricanes [\$1.1 billion]. However, the bill’s most expensive provision—a tax break for companies, including home builders, allowing companies who lose money in 2008 and 2009 to apply those losses to taxes paid back as far as 2004 for refunds, potentially costing the federal government more than \$12 billion over five years. Consumer groups and some economists have criticized the provision as a corporate giveaway that has no place in legislation claiming to help homeowners. Chairman Frank noted that the bulk of the Senate’s tax breaks are aimed at the homebuilders and providing incentives for buyers of foreclosed properties—provisions that he has little interest in. Frank said his proposals are designed to restore some liquidity to the secondary market and help “underwater” homeowners. The Senate bill, which would cost about \$16 billion over 5 years [with no offsets], is unlikely to be enacted in its current form.

- Approval of the Senate bill breaks a logjam over housing in the chamber, which had been deadlocked over a Democratic proposal to allow bankruptcy judges to modify the mortgage terms of a homeowner’s primary residents. *Politico.com* reported, “[Senator Richard] Shelby [R-AL] is one of the most powerful lawmakers working the housing issue. As the ranking Republican on Dodd’s Senate Banking, Housing and Urban Affairs Committee, Shelby has taken on a role similar to a legislative traffic cop, largely controlling what gets out of the Senate and onto the president’s desk. Known among lobbyists as a particularly wily negotiator, Shelby can outmatch Dodd’s more compromising style. ‘He’s almost perfect when it comes to conference-style negotiation,” said one mortgage industry lobbyist. ‘He always wins.’ ...Shelby was the GOP hatchet man in negotiations with Dodd to draft a compromise housing bill. Shelby blocked a proposal to allow bankruptcy judges to restructure mortgages. And he slowed progress on another plan, first proposed by Dodd and Representative Barney Frank (D-MA), to refinance mortgages for millions of homeowners at risk of defaulting. ‘I was insistent that it not be in the package, because I said we need to hold hearings on it,’ Shelby said on CNBC. ‘I’m not big on that package. ...There is a line that we should not cross,’ he said last week during a Senate floor speech on the compromise housing bill. ‘That line is represented by a taxpayer-funded bailout of investors or homeowners.’ ...Shelby’s hard line against bailouts, lobbyists say, exasperates everyone from Wall Street bankers to consumer advocates.”
- Many Republicans called the Senate bill an important, positive step in assisting distressed homeowners. Senator Mel Martinez (R-FL) said, “While this measure is a good start in stabilizing the current crisis, there is more to be done for the long term.” Some opponents denounced the bill. Senator Jim DeMint (R-SC) said, “This bill needlessly spends billions of dollars to bail out lenders, makes our tax code even

more complex and will do little to nothing to stimulate our economy. In fact, this bill could have the perverse effect of increasing the number of foreclosures and reduce home values for American families nationwide.” Senate Budget Committee ranking member Judd Gregg (R-N.H.) said, “Unfortunately, the bill does more harm than good by creating billions in debt for ineffective programs like Community Development Block Grants and special interest handouts that do little to address our economic woes. In fact, the biggest item in the bill is an \$18 billion giveaway for the home building industry at the expense of the American taxpayer. Rewarding this industry with a tax break for overbuilding and speculation will not solve our current housing problems and puts taxpayers on the hook for poor business decisions.” Gregg argued that the bill puts “billions in debt ... onto the back of our children” and will ultimately do little to stimulate the economy. Senator Jim Bunning (R-KY) said, “This is an unusually bad bill and I have opposed it from the start. It is a jumble of disjointed ideas unable to solve the crisis at hand.” (*Wall Street Journal*, Michael R. Crittenden, 04/11/08; *CQ Today*, Benton Ives, 04/10/08; *Bureau of National Affairs*, Brett Ferguson, 04/11/08; *New York Times*, David M. Herszenhorn, 04/11/08; *Washington Post*, Lori Montgomery, 04/11/08; *Politico.com*, Lisa Lerer, 04/10/08)

“An election year turkey”

- In an April 8<sup>th</sup> report, the Center for Budget and Policy Priorities said that 60% of the bill’s costs “will do little or nothing to help either the homeowners or hard-hit communities that, in one case, will actually worsen the problems facing local governments.” The group added, “As the House develops its own version of the housing legislation, it should drop the Senate’s ineffectual tax provisions and replace them with measures that advance the bill’s core objectives.” (*Bureau of National Affairs*, Brett Ferguson, 04/09/08)
- In an April 4<sup>th</sup> column in the *Washington Post*, Steven Pearlstein wrote, “The effect of the [tax break for home builders and other companies] provision would essentially allow home builders to get back some or all of the taxes they paid during the years of record profits. No doubt that will be much appreciated by home builders and their shareholders, and maybe even their creditors. But because it won’t lower prices or stimulate demand, it will do nothing to stimulate housing sales or production or create a single construction job. But it’s even worse than that. This provision doesn’t just apply to home builders—it’s a boon to every company that is losing money now but made huge profits in the preceding four years. And that could include any number of banks, investment banks, mortgage bankers and hedge funds. All this will do little to solve the housing crisis, but it may help to alleviate the campaign funding crisis created when these same tax provisions were jettisoned from the economic stimulus bill. The angry and ham-handed response from Brian Catalde, the president of the National Association of Home Builders, was to very publicly announce the indefinite cutoff of all contributions to federal candidates. Were those same provisions to be enacted now, it would be a stunning acknowledgement by members of Congress of the direct connection between political money and legislative outcomes.” (*Washington Post*, Steven Pearlstein, 04/04/08)

- In an April 7 editorial, the *Washington Post* wrote, “We’re realists. We know that legislation can involve a certain amount of moral and intellectual corner-cutting. But is it too much to ask that a bill called the ‘Foreclosure Prevention Act of 2008’ not contain a provision that might, at the margin, encourage home foreclosures? Apparently so, because the bipartisan Senate housing relief package includes just such a measure. We refer to a \$7,000 tax credit (payable over two years) to anyone who purchases a foreclosed home within a year of the proposal’s enactment. Supposedly, this would help clear the nation’s swollen inventory of repossessed properties, thus propping up home prices more generally. Here’s the catch. For lenders as well as borrowers, foreclosure is an expensive hassle. If at all possible, most banks would rather avoid repossessing a house, which they must then try to resell. But, by making it cheaper to buy a foreclosed house than a comparable unforeclosed property, the tax credit makes it more feasible to sell one. The cost and hassle—for the lender—of foreclosure go down, and the benefits go up. Other things being equal, lenders would be that much more likely to foreclose—rather than to help homeowners stay in their houses on modified terms.”
- “At a time when the Bush administration’s voluntary mortgage workout program is struggling to show results, this is no time to be introducing perverse incentives, even marginal ones. Indeed, the \$1.6 billion tax credit works at cross-purposes with the Senate bill’s \$100 million in foreclosure-avoidance counseling money.”
- “Perhaps the only provision that’s more objectionable is the bill’s \$6 billion tax break for money-losing home builders—who threatened not to give any more campaign money when they got shut out of the economic stimulus bill in February. The bill is studded with economically questionable sops to this or that segment of the populace: It would allow 28.3 million homeowners who do not itemize deductions (often because they’re seniors who have paid off their homes and have no mortgage interest to declare) to write off property taxes of up to \$500 for single filers and \$1,000 for couples. This might be a nice add-on to the coming stimulus checks but hardly progressive—and hardly a cure for what ails the housing market. The bill lets states sell \$10 billion in tax-free municipal bonds to subsidize mortgage refinancing for ‘underwater’ subprime borrowers. But this method of supporting home buying has proven notoriously inefficient.”
- “The Senate bill is not a total loss: It contains a needed tweaking of Federal Housing Administration loan insurance, which would permit the FHA to insure bigger mortgages in return for slightly larger down payments from eligible home buyers. There is also talk of simplifying federal loan disclosure forms, so that borrowers can better understand what they are signing up for. But, on the whole, the legislation looks like an election-year turkey, stuffed and cooked to order for lobbyists.”  
(*Washington Post*, 04/07/08)
- In an April 7<sup>th</sup> editorial, the *Wall Street Journal* wrote, “...To put it bluntly, [the Community Development Block Grants or CDBG] may be the worst-run program in

Washington. So why are Senators making it a centerpiece of this week's housing splurge? Because just about every dollar of the \$4 billion will not remain at HUD, but will instead be routed to state and local governments, which can then share the wealth with 'nonprofit' (i.e., politically favored) organizations. And while state and local pols will get the money ASAP—within 90 days of the bill's enactment into law—there is less urgency to address the housing crisis once these recipients cash the checks. They don't have to buy the foreclosed properties for another 18 months."

- "Senator Richard Shelby (R-AL), mindful of the program's appalling history, was able to secure a partial rewrite of the bill last week. Any profits from the resale of homes bought in foreclosure must now be recycled back into buying other foreclosed properties. What remains unclear is exactly how much of the \$4 billion will stick to the various fingers touching these dollars along the way."
- "This CDBG fiasco is consistent with other provisions in this stinker of a bill. The main Republican contribution (thanks to Georgia's Johnny Isakson) is a \$7,000 tax credit for those buying homes out of foreclosure. This means that Americans who behaved responsibly and paid their mortgage but are now trying to sell their homes will have to cut their offering price by \$7,000 to compete with foreclosed properties nearby. Thus does the Senate contribute once again to tax fairness and personal responsibility. "There's also a new property tax deduction for non-itemizers, plus authority for states to issue another \$10 billion in tax-exempt bonds. The bonds will fund – of course – subprime mortgages. Having witnessed this disaster for investors, states will now run the experiment again, except with taxpayers eating the losses."
- "Previous government efforts to subsidize housing did nothing but encourage the real estate bubble. The best that can be said of the Senate's ideas is that they may be more feckless than destructive." (*Wall Street Journal*, 04/07/08)

#### The House is working on a "broader" version of housing relief

- The House is assembling its own broader alternative version of housing legislation, starting with a package of housing related tax breaks (H.R. 5720) passed by the Ways and Means Committee on April 9<sup>th</sup>. H.R. 5720 includes (1) a temporary increase of \$10 billion for tax-exempt mortgage revenue bonds available to state and local housing finance agencies for use in financing first-time home buyers, refinancing subprime mortgages, and financing rental housing developments; (2) a \$7,500 tax credit for first-time homebuyers [with a phase-out for single taxpayers with adjusted gross income of \$70,000 or \$110,000 in the case of joint filers], regardless of whether they have purchased a home in foreclosure, which would be repaid in equal installments over the next 15 years; (3) a standard deduction for state and local real property taxes of \$350 for single filers and \$700 for joint filers; (4) new authorization for the FHLBs to guarantee all tax-exempt bonds on a fully-collateralized basis, which sunsets on December 31, 2010; and (5) a temporary increase and simplification of the tax credit for low-income housing. The \$11.1 billion package is fully offset by provisions requiring (1) brokers to report the original purchase price and sales prices

of publicly-traded stocks and mutual funds [generating \$8.1 billion over 10 years]; (2) the delay by one year and limit to 10% of the implementation of a worldwide interest allocation; and (3) the modification of timing corporate estimated tax payments [\$3 billion generated by the second and third provisions].

- House Financial Services Committee chairman Frank is sponsoring legislation to allow the FHA to insure up to \$300 billion of refinanced mortgages, if lenders agree to cut the outstanding principal on the loan to reflect the lower value of the collateral property. At an April 9th committee hearing, the heads of the FDIC, OTS and OCC expressed support for the crux of chairman's proposal, which would allow the FHA to insure restructured loans, so long as the lenders had written down the principal. "Overall, the Frank FHA proposal includes many positive features and addresses many of the FDIC's fundamental principles," said FDIC chairwoman Sheila C. Bair. John Dugan, Comptroller of the Currency, agreed, calling the approach "prudent and appropriate." However, Bair added, there are concerns the risks inherent in Frank's plan, saying no one knows if FHA premiums will be able to cover the increased risk of FHA's expanded mission. "Losses that exceed the funds available in the reserve would have to be covered by taxpayers," she said—concerns that were also echoed by FHA Commissioner Brian Montgomery. "The FHA should not be forced legislatively to compromise its fundamental criteria at the future expense of the taxpayer," said Montgomery. "The FHA currently is self-sustaining. As you know, few government programs can claim the same. We do not want to cross that line, particularly at a time when we are most needed."
- During the hearing, lawmakers warned mortgage servicers that they will face tougher scrutiny and additional regulation if they don't voluntarily embrace proposals to address the housing crisis. Frank said, "I want to put the servicers on notice." "If we see a widespread refusal on the part of servicers to cooperate voluntarily in what we see as an important economic problem ... they can expect much tougher regulation in the future." Frank said lawmakers have heard anecdotes that mortgage servicers have been reluctant to rework terms of mortgages facing foreclosure, which could stifle efforts to slow the housing downturn. If it's true, lawmakers will have to act, said Frank. "The response will probably have to be more regulation than most people want to see," he added. "We can't abrogate contracts but going forward we can be much more restrictive." Representative Maxine Waters (D-CA) said too many lenders and servicers have engaged in "very limited, fake workouts" for borrowers. "Fair warning that while we have waited too long to really get tough on this issue, some of us are going to have to go beyond what would be considered reasonable," said Waters, citing legislation she has introduced that would ban foreclosures unless lenders and servicers made "reasonable" efforts to modify mortgages. Waters' bill outlines the kinds of activities which constitute "appropriate" loan modifications and provides borrowers the right to sue if lenders and servicers begin foreclosure proceedings without attempting loss mitigation.
- Frank has scheduled mark-up for the FHA Housing Stabilization & Homeownership Retention Act on April 23-24 with a possible floor consideration tentatively in early

May. Frank told reporters that he will likely roll his FHA legislation into a giant housing bill, which would include the House tax package, FHA modernization and GSE regulatory reform. (*CQ Today*, Benton Ives, 04/10/08; *Bureau of National Affairs*, Brett Ferguson, 04/11/08; *Bond Buyer*, Peter Schroeder, 04/10/08; *Washington Post*, Lori Montgomery and Dina ElBoghdady, 04/10/08; *CNNMoney.com*, Chris Isidore, 04/10/08; *States News Service*, 04/09/08; *American Banker*, Rob Blackwell, 04/03/08; *Dow Jones Newswires*, Michael R. Crittenden, 04/09/08)

Congress needs to “get real” in its plans to expand FHA’s responsibility in managing troubled loans

- In an April 10<sup>th</sup> Senate Appropriations’ subcommittee hearing, chairman Patty Murray (D-WA) and ranking member Kit Bond (R-MO) were cautious in analyzing the FHA’s ability to play a substantive role in rescuing the U.S. housing market. The Senators stressed that Congress must balance the desire to help struggling homeowners against long-standing issues within FHA, which includes antiquated 18 to 29 year old computer systems, which still rely on punch cards. Other problems include short staffing, inadequate underwriting, and the inability of the agency to work seamlessly with lenders, said Murray. She called on Congress to “get real” in its discussions about expanding the FHA’s responsibility in managing troubled loans. Brian Montgomery, assistant secretary for housing and FHA commissioner at HUD, warned lawmakers that while the agency has a “highly experienced” workforce, many staff members are nearing retirement. For example, FHA hired 376 new professional staffers in 2007, but ended the year seven fewer employees relative to the agency’s total employment at year-end 2006. (*Bureau of National Affairs*, Thecla Fabian, 04/11/08)
- Wharton emeritus finance professor Jack Guttentag warns that the FHA is not designed as a bailout agency. “The FHA’s core mission is predicated on it being a solvent operation, actuarially sound, charging an insurance premium large enough only to cover losses,” said Guttentag. “How [Congress] would reconcile that is not clear.” He predicted that attempts may be made to create a separate bailout agency within the FHA with different accountability. “But the devil is in the details,” Guttentag warned. “And the details have to do with exactly who is going to be helped, what the requirements are, what the nature of the assistance is going to be, and [a] myriad other factors that have to be worked out.” (*The Street.com, Knowledge@Wharton*, 04/08/08)

Bush administration hopes to limit the scope of the housing stimulus package

- On April 9<sup>th</sup>, the White House sent a letter to lawmakers, offering support for the FHA modernization provisions and additional mortgage revenue bonds. However, the administration voiced opposition to the tax credit for home buyers and grants to cities for purchase of foreclosed properties, saying the provisions would place responsible homeowners trying to sell their homes at a disadvantage and could further

depress home values. “We must not prolong necessary corrections in the housing market, bail out lenders, or subsidize irresponsible lending,” wrote Keith Hennessey, Assistant to the President for Economic Policy and Director, National Economic Council, and Karl Zinsmeister, Assistant to the President for Domestic Policy. “Nor should Congress pass legislation that further depresses the home values of these prudent homeowners. Government actions should instead focus on helping creditworthy borrowers with preventable foreclosures stay in their homes.” The White House also urged Congress to enact GSE reform, writing, “The Administration encourages the Congress to enact legislation to reform Fannie Mae and Freddie Mac by empowering a new regulator with the powers necessary to ensure they are adequately capitalized and focused on their statutory responsibilities. A powerful, independent regulator would be helpful during this period of mortgage-market difficulty to ensure the management of these enterprises does not put shareholder interests ahead of their important public mission.”

- Hoping to head off more aggressive legislation by Democrats, the Bush administration announced on April 9<sup>th</sup> its plan to help homeowners replace expensive adjustable rate mortgages with fix-rated loans insured by the FHA, which would help an additional 100,000 homeowners this year [increasing the number of FHA Secure loans from 400,000 to 500,000 by year-end]. The administration now supports the expansion of the FHA Secure program to allow borrowers who are as much as three months behind on their payments, have damaged credit histories, and owe more than their houses are worth to be eligible to refinance through the FHA Secure program. After months of being reluctant to pressure lenders to write-down the principal on troubled loans, the Bush administration announced that it is now willing to do just that, by requiring lenders to write-down the mortgage balance to within a loan-to-value range of 90% to 97%, depending on the risk profile of the borrower. The voluntary program would require the lender and borrower to agree to terms before the government would step in. The administration’s FHA refinancing plan is similar to Frank’s proposal, although more limited in scope and does not involve upfront taxpayer funding [as urged by Frank]—but instead would require FHA borrowers to foot the bill through premiums paid to FHA. Existing FHA underwriting standards still apply and the home must be owner-occupied to qualify for the program. The program is not available to speculators, high-risk borrowers, or owners of vacation homes. The expansion of the FHA Secure program takes effect through the issuance of a technical guidance to the nearly 2,000 approved lenders in the program, which will be mailed to lenders in mid-April. At a House Financial Services Committee hearing, HUD assistant secretary Brian Montgomery said that the administration is trying to find a balance between protecting homeowners who “played by the rules” without allowing banks to dump bad loans on taxpayers. “We must not federalize the housing market,” said Montgomery. “And we must not harm our economy through solutions that, however well intended, further erode the foundation of the nation’s housing market, hurt homeowners who are meeting their mortgage obligations, or prolong the correction.”

- Treasury Secretary Henry Paulson has called a meeting of the Fannie Mae CEO Daniel Mudd, Freddie Mac chairman and CEO Richard Syron, Senators Christopher Dodd (D-CT) and Richard Shelby (R-AL), and Robert Steel, Treasury undersecretary for domestic finance, to hash out details of GSE regulatory reform legislation “to create a stronger regulator.” Freddie Mac spokesman Doug Duvall said, “We’re carrying through on our commitment to be a constructive part of the process and will work closely with the committee going forward.” Fannie Mae spokesman Brian Faith declined to comment on the meeting.
- On April 10<sup>th</sup>, Dodd told reporters that his committee should take up and pass GSE regulatory reform legislation over the next few weeks—adding that his is “quite confident that we can reach some accommodation on [the reform] and we should be able to get that bill done.” Dodd said that Fannie and Freddie need to take a more aggressive role given current market conditions. “The GSEs have a mission statement and they are called government-sponsored enterprises for a reason,” said Dodd. “In moments like this we expect them to help.” Dodd also urged the two companies to raise more capital so they can provide more liquidity to the strained mortgage market, so that they “can make a difference right now.” Dodd provided few details about what might be in the legislation, saying only that GSEs need a strong regulator. He also suggested the GSE legislation could be coupled with a broader housing package that could include reforms to the mortgage industry and other provisions designed to help homeowners at risk of foreclosure.
- The White House has signaled that President Bush is willing and able to negotiate with Democrats over a final version of housing legislation. Reid said that the President assured him that there is no veto threat against the Senate bill, even though the White House press secretary sharply criticized the measure earlier in the week. (*Correspondence to the Honorable Nancy Pelosi*, Keith Hennessey and Karl Zinsmeister, 04/09/08; *Wall Street Journal*, Michael R. Crittenden, 04/11/08; *New York Times*, David M. Herszenhorn, 04/11/08; *CQ Today*, Benton Ives, 04/08/08; *Los Angeles Times*, Maura Reynolds and Tiffany Hsu, 04/10/08; *American Banker*, Joe Adler, 04/11/08; *Wall Street Journal*, John D. McKinnon and Damian Paletta, 04/09/08; *Bloomberg News*, Dawn Kopecki, 04/09/08; *Bloomberg News*, Dawn Kopecki, 04/10/08; *Dow Jones Newswires*, Michael R. Crittenden, 04/11/08; *Reuters*, Patrick Rucker, 04/11/08)

#### Presidential candidates enter the fray

- In a sign of growing consensus that more government action is needed to address the housing crisis, Senator John McCain (R-AZ) announced his own plan, “the HOME plan,” which would help up to 400,000 owners of single-family homes refinance their mortgages into more stable, government-backed loans at a cost of between \$3 billion and \$10 billion. The plan would allow certain homeowners whose houses are worth less than their mortgage, apply for assistance. Speculators and investors wouldn’t be eligible for the program. If their lenders agree to write-off part of the borrower’s loan [to 90% of the appraised value of the collateral property], the FHA would agree to

guarantee the new loan. “We would combine the power of government and the private sector to find immediate solutions for deserving Americans,” said McCain. “[This plan] offers deserving American family or homeowner the opportunity to trade a burdensome mortgage for a manageable loan,” McCain added. He also called for a Justice Department task force on criminal wrongdoing among mortgage lenders, a move many senior Justice Department officials has resisted to date. McCain’s proposal represents a major shift from one he laid out two weeks earlier, in which he emphasized his opposition to any government bailout for people who made bad decisions. McCain endorsed the Senate housing stimulus bill, but criticized specific provisions providing tax breaks to home builders, money for cities to purchase foreclosed homes, and tax credits to encourage the purchase of foreclosed homes. “Tax breaks for builders, funds to purchase homes in foreclosure, and tax credits that are not targeted where the need is greatest do not constitute the federal help that is warranted,” said McCain.

- Separately, Senators Hillary Clinton (D-NY) and Barack Obama (D-IL) issued statements saying that the Senate bill did not go far enough to help struggling homeowners, who are in danger of losing their homes. Both candidates were also critical of McCain’s mortgage plan. Clinton ridiculed McCain’s speech, calling his latest proposals “half-measures.” Obama also dismissed McCain’s new approach. “Better late than never,” said Obama. “But don’t expect any real answers. Don’t expect to actually help struggling families. Because Senator McCain’s solution to the housing crisis seems a lot like the George Bush solution, which is to sit by, and hope it passes by, while families face foreclosure and watch their home prices decline.” (*New York Times*, David M. Herszenhorn, 04/11/08; *Wall Street Journal*, Laura Meckler and Elizabeth Holmes, 04/11/08; *Associated Press*, Libby Quaid, 04/11/08; *Washington Post*, Dan Balz, 04/11/08; *American Banker*, Joe Adler, 04/11/08)

## ***Fannie Mae and Freddie Mac***

Fannie Mae and Freddie Mac address the growing “walkaway” trend by borrowers

- Fannie Mae and Freddie Mac have a blunt warning for homeowners thinking about joining the growing “walkaway” trend, where homeowners stop making their mortgage payments and mail the lenders their keys. The message: “You will feel the pain.” On March 31st, Fannie Mae issued new guidelines for lenders aimed to address walkways and other foreclosure situations. In the future, Fannie will now prohibit a borrower from obtaining another mortgage from the GSE for a five year period, unless there is “documented extenuating circumstances” in which case the mortgage prohibition will be reduced to three years. After the five year prohibition, the borrower will be required to make at least a 10% down payment and have a minimum FICO credit score of 680. Under Freddie Mac’s current policies, homeowners who have lost their home to foreclosure will be prohibited from obtaining a new mortgage from the company for seven years. Freddie is now aggressively pursuing walkaway borrowers “to preserve our deficiency rights” where it is permitted by state law, said a senior official. (Washington Post, Ken Harney, 04/12/08)

Are Fannie and Freddie helping or hindering?

- In an April 9<sup>th</sup> column appearing on *Townhall.com*, Roger Schlessinger wrote, “Out of nowhere, or so it seemed, the United States of America developed a mortgage and credit crisis. It is now and will be forever known as the “Subprime Mortgage” crisis...Once the pain started in earnest the populous screamed, Congress heard and acted and the two GSE’s, ...Fannie Mae and Freddie Mac, took the challenge that they were given. Buy more mortgage loans at higher than conforming loan limits. They were given the area between \$417,000, the current conforming loan limit, and \$729,750 to work their magic with the new loans that now and forever more will be known as jumbo/conforming loans. Everything was in place to bring us out of the “Subprime Mortgage” crisis. This wouldn’t be a very interesting piece, however, if everything went right and the crisis was over. So I am here to report something went wrong! It began with a new set of criteria for conforming loans that appeared out of nowhere.”
- “The new rules weren’t here one day, but lo and behold, they came the next day. They would make things better for all that were hurting, yes? Not exactly. They actually would make things worse for those who were hurting. And so the story begins. There was a small reward for those who especially were in good shape and a large penalty for those who weren’t. If you have a 720 credit score or higher you of course are one of the great credit risks in this country. Add to that if you have a 60% loan to value while the real estate prices are falling then meeting both criteria, you are

rewarded and can perhaps get a lower interest rate on a 20 year, 30 year or 40 year amortized loan of up to an eighth of a point.”

- “On the other hand if you have a good credit score 660-679 and a reasonable loan to value in a falling real estate environment, 70%, you will be penalized a quarter of a point to as much as 5/8 of a point. Was this what Congress had in mind? Actually Congress was only interested in the new conforming/jumbos but had they been interested in the old conforming loans I do not think this is what they had in mind. Why did Fannie and Freddie do this?”
- “It is the same old answer you have heard many times before: because they could! Well I am sure you are thinking they were going to make this up in the conforming/jumbo loans, but once again I must say, not exactly. We heard rumors, and then more rumors and then out came the worse case scenario. The new loans for the new limits weren’t 3/8% to 1/2% higher than the old conforming rates they were 1.25% higher. Impossible you say! And I believe Fannie and Freddie heard your voices. They moved the new rates up to .75% (lower) to 1.500% higher. I think we shouldn’t have said impossible!”
- “Now back to reality. The result of the above is the buyer(s) simply can’t afford or won’t pay the higher rate and another house goes back on the market. What has happened is more than a travesty. For years there have been calls to divest the GSE status from these two mortgage giants and I for one didn’t feel it was a reasonable move. After all they are the largest purchasers of mortgage loans in this country. **But what they have done with a mandate from Congress is unconscionable. They not only have not helped fund new loans within the higher limits, they made things worse for the conforming borrower.** [Emphasis added.] What is the purpose of doing either or both of those? Pouring water on a drowning man only makes a good lyric for a song. It certainly doesn’t begin to turn around a bad situation.”
- “The nation’s lenders are losing their appetite for mortgage loans and it certainly doesn’t help to have the two giant GSEs leading the way. If you ever gave your children money to give to the poor and forlorn who need help and found that they spent it on themselves you would be very upset. That is exactly the way I feel about Fannie Mae and Freddie Mac. Something needs to be done such as writing your congressman or congresswoman and ask them to look into what is going on. After all, they gaveth and they should expect results, or just maybe they should take it away.
- “If you aren’t in the market for a new mortgage loan then all this seems like so much rhetoric. It isn’t. We have a serious problem stemming from the crisis caused by a multitude of bad loans and now being fueled by ever growing pessimism in the lending industry. There isn’t a simple solution to the overall problem. Congress has their ideas, the Administration has theirs. The Federal Reserve has acted on some of their bold ideas and yet it isn’t getting better. In fact it is going in the opposite direction. Loans that would have been approved in a day are being reviewed,

reworked and then denied. These are not stated income loans to people who really don't have a job or much money. These are loans to professionals with high credit scores, low loan to values and substantial reserves. The threat is if the best can't get approved what about the rest?" ([www.Townhall.com](http://www.Townhall.com), Roger Schlesinger, 04/09/08)

- According to two mortgage brokers interviewed by Maria Martiromo on *Closing Bell*, the higher loans limits for Fannie and Freddie haven't been a panacea for the jumbo market either. The brokers said, forget Fannie and Freddie –that FHA loans are the way to go for their customers. Mitchell Ohlbaum, president of Legend Mortgage in Los Angeles, CA, said that the only “plus” for Fannie Mae and Freddie Mac is the higher limit of up to \$729,500—but from there it's all “downhill.” Fannie and Freddie (1) perform manual underwriting rather than electronic underwriting of jumbos; (2) have lower debt-to-income ratios than traditional conforming loans; (3) offer only 30 and 15 year mortgage products; (4) offer no interest-only mortgage products; (5) do not allow payoffs of subordinate liens that were not purchased with money; and (6) offers higher pricing terms for the loans than expected. Instead, Ohlbaum said he is steering his customers to FHA loans with slightly better rates, higher loan-to-value ratios, lower FICO thresholds, and electronically generated loan underwriting. (*CNBC.com*, 04/10/08)
- Fannie Mae and Freddie Mac also are being criticized for designating declining markets, which is leading to unintended consequences, particularly for vulnerable minority and low- to moderate-income families. A survey conducted by the National Association of Hispanic Real Estate Professionals found that there is a growing concern that minorities will face even greater barriers to homeownership as a result of the declining market designation. NAHREP outgoing chair Felix DeHerrera said, “This study confirms that minorities are experiencing a much greater than anticipated hit from declining market policies. In effect, the consequence of these policies is a near complete suspension of financing resources to communities that need it most.” In the survey, 69% of respondents said that for every transaction they close, they turn away two to four customers that are unable to qualify for a mortgage under declining market guidelines. (*National Association of Hispanic Real Estate Professionals Press Release*, 04/01/08)

An “activist” government?
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- At an April 7<sup>th</sup> House Financial Services Committee hearing, FDIC chairwoman Sheila C. Bair told lawmakers, “We've got a real problem. And I think we need to have more activist approaches. And, I think it will be something that we need to be honest with the American people about. We do need more intervention. It will probably cost some money.” (*Wall Street Journal's Real Time Economic Blog*, 04/07/08)

Congress's objectives in the housing crisis must be determined  
before identifying viable policy options to address the crisis

- In an April 2008 report, the Congressional Budget Office analyzes the potential for federal intervention in the financial markets by encouraging and removing impediments to private mortgage restructuring or by providing federal financial support. According to the CBO report, policy options must be evaluated in the context of Congress's objective(s). CBO wrote, "If the objective is to assist homeowners in distress, some of the policies seem likely to succeed, at least to some degree. Many policies intended to help homeowners may produce significant benefits for lenders as well. Avoiding some unintended effects will be virtually impossible because it is difficult to distinguish among homeowners who were victims of their poor judgment or of predatory lenders, those who overstretched their finances for purchasing investment properties, and those who exploited poor underwriting standards."
- "If the objective is to avoid foreclosures and abandonment of properties, intervention might break a downward spiral in which foreclosures put houses on the market, pushing down house prices and producing more foreclosures. Although many analysts believe that house prices remain too high relative to people's incomes, such a spiral, without intervention, could reduce prices even below their long-run ratio to incomes and production costs."
- "If the objective is to arrest the decline in house prices, however, the policies are less likely to succeed. Perhaps the most important short-term influence on house prices is the elevated number of unoccupied houses for sale (the inventory overhang). That overhang is likely to remain until house prices fall enough to stimulate additional home sales. Put simply, none of the policies can (or presumably should) guarantee that house prices will stabilize in the near term. Furthermore, attempting to avoid (as opposed to attenuating) the market's necessary adjustments may not only be unrealistic, but even if it were to succeed, might ultimately serve only to delay the recovery of financial markets and impair the pace of economic activity."
- "Finally, if the objective is to stabilize the overall economy, the policies under discussion will probably have only a limited effect because most of them are likely to exert only a modest influence directly on the housing market. They might affect the economy indirectly, through their effects on consumer and investor confidence, though that is harder to predict."
- CBO director Peter R. Orszag concludes, "Direct federal provision or guaranteeing of credit to mortgage markets could help avoid foreclosures and ease the downward pressure on house prices, helping the market to adjust in an orderly manner. It would also shift part of the cost of mortgage losses from current lenders and investors to taxpayers. Most of the proposals under discussion involve modest federal subsidies and would probably affect several hundred thousand homeowners." CBO's full report is available at <http://www.cbo.gov/ftpdocs/90xx/doc9078/04-11->

Have we passed the point of no return for “clearing” markets?

- In the April Investment Outlook, PIMCO’s Managing Director William H. Gross argued, “...[T]he private credit markets have forfeited their privileged right to operate relatively autonomously because of incompetence, excessive greed, and in minor instances, fraudulent activities. As a result, the deflating private market’s balance sheet is being re-nationalized in some cases with increased regulation, in others with outright guarantees and agency lending. Ultimately government programs which support private credit market assets may be required in order to prevent an asset deflation of significant proportions. Authorities must act quickly, with a shot of adrenalin straight to the heart of the problem: home prices. Since homes are the most highly levered and monetarily significant asset that American consumers own, if they decline much further they will drag the rest of the economy with them. Supporting home prices goes counter to the thinking of Republican orthodoxy. President Bush and Treasury Secretary Paulson argue that markets must ‘clear’ [i.e., the process of “getting there” via price adjustment] in order to avoid similar mistakes made by Japanese authorities in the 1990s. Yet we may have passed the point of no return for ‘clearing’ markets. Home price declines of 20% are in fact much more of a shock to the American economy than the popping of the Internet bubble and NASDAQ 5000, because the amount of homeowner leverage is so much greater. A 20% negative adjustment not only wipes out all ownership equity for millions of Americans, it turns their homes ‘upside down’ – incentivizing them to let their gardens grow weeds instead of lettuce. The decline needs to be stopped quickly in order to avert additional crises.” (PIMCO’s Investment Outlook, William H.Gross, April 2008)

Successful loan workouts “face long odds and steep costs”

- According to a new study from the National Low Income Housing Coalition (NLIHC), owning a home is more expensive than renting in 19 out of 20 metropolitan markets in the United States, based upon an analysis of “fair market rent” in these markets relative to the cost of a home mortgage, estimated at 75% of the median housing price in each market. The NLIHC study concludes, “To create effective policy to address the housing crisis unfolding as a result of the bursting of the housing bubble we must come face-to-face with the true dimensions of the problem. The simple analysis here provides a stark illustration that in the areas most affected by the steep increase in homeownership prices, homeownership will remain a costly and risky proposition for many households for some time to come. Policies that seek to help these homeowners remain in their homes as owners through subsidies and workouts will face long odds and steep costs. They also fail to help the significant proportion of renters experiencing eviction as a result of the current crisis. A preferable strategy is one that recognizes the rental market as part of the solution as

well as part of the problem, and seeks to provide households, particularly low income households, with affordable rental options.” (*The Cost of Maintaining Ownership in the Current Crisis*, Dean Baker, Danilo Pelletiere and Hye Jin Rho, April 2008)

To date, state mortgage relief programs are having “limited success”

- As the Senate completes its work on a \$15 billion mortgage relief bill which would authorize an additional \$10 billion of tax-exempt housing bonds to fund mortgage refinance programs, the on-going efforts of states to help troubled homeowners seems to be having “limited success.” To help stem foreclosures, nine states, including Ohio, Maryland, Illinois and New York, have started refinance programs for subprime borrowers. Unfortunately, these refinance programs are turning out to be far less effective than policymakers had hoped, in part because borrowers financial health is so poor that they can’t qualify. And, healthier borrowers are bypassing the states’ programs to refinance their mortgages through FHA, which has refinanced 145,000 loans over the past seven months. “Our experience, like the experience of other states, is that refinance programs have limited success,” says Philip Lentz, a senior vice president with the State of New York Mortgage Agency. “[The Senate bill] will allow us to be more flexible,” but it won’t make it possible to refinance borrowers whose loans are underwater. To date, Lentz’s agency has refinanced just three mortgages and has 17 loans in the pipeline, since it launched the “Keep the Dream” program aimed to help subprime borrowers keep their home in September.
- “It adds another tool for us,” said Clarence J. Snuggs, deputy secretary of the Maryland Department of Housing and Community Development. “But I don’t think refinancing is going to resolve the lion’s share [of mortgage problems]. Restructuring [loans] is going to the place where most people get relief.” Snuggs’ agency has closed 18 loans since it launched the “Lifeline” refinance program in June and has 17 loans in the pipeline. (*Wall Street Journal*, Ruth Simon, 04/05/08)

A reality check from “flyover country”

- On March 28<sup>th</sup>, James Freeman wrote in the *Wall Street Journal’s Political Diary*: “Rep. Tom Feeney, from Florida of all places, called us this week to slam House Financial Services Chairman Barney Frank’s draft mortgage bill. Although Mr. Feeney represents more than 70 miles of coastline in a state that is ground zero in the housing downturn, he calls a taxpayer-financed rescue a ‘terrible idea.’ During the Easter recess, Mr. Feeney has been strolling along Daytona Beach talking to voters. His findings are bracing. ‘My constituents for the most part have no sympathy for the lenders, and they are not terribly sympathetic with borrowers who made bad decisions,’ he says. In fact, relief for borrowers is not even at the top of the list of housing concerns. He hears more complaints about high property taxes based on bubble-era assessments. Mr. Feeney says his constituents realize that most of the pending plans to help strapped borrowers will benefit a relative few, while raising

costs for all borrowers. Mr. Feeney says of a specific plan to let bankruptcy judges knock down the loan amount due on a house: 'The percentage of people who will benefit is minuscule. The other 99.5% of Americans will pay for it.' Congressman Freeman represents the 24<sup>th</sup> Congressional district of Florida, which covers areas of Brevard, Orange, Seminole, and Volusia Counties and is home to the Daytona International Speedway, Kennedy Space Center, and The University of Central Florida." (*Wall Street Journal's Political Diary*, James Freeman, 03/28/08)

### Subprime and beyond

- On April 8<sup>th</sup>, the International Money Fund warned that despite "unprecedented" intervention by the central banks, the international financial markets are still under "considerable strain," compounded by a worrisome economic outlook, weakly capitalized financial institutions, and broad deleveraging, which is ongoing. The IMF estimates that losses and potential write downs from the subprime crisis at \$945 billion, including losses of \$565 billion on U.S. residential loans and securities; \$240 billion on commercial real estate securities; \$120 billion related to corporate loans; and \$20 billion on consumer loans. (*Bureau of National Affairs*, Diana I. Gregg, 04/09/08)
- In his April 2<sup>nd</sup> testimony before the Joint Economic Committee, Federal Reserve chairman Ben Bernanke told lawmakers that the economy is "slightly growing" at the moment, but "we think that there's a chance that in the first half [of 2008] as a whole, there might be a slight contraction." While the economy will benefit from the recently passed stimulus package and net exports should continue to boost economic activity in the near term, recent turbulence in the financial markets makes "uncertainty attending this forecast quite high and the risks remain to the downside," said Bernanke. (*Bureau of National Affairs*, Aaron Lorenzo, 04/03/08)
- In an April 10<sup>th</sup> speech in Richmond, VA, Federal Reserve chairman Ben Bernanke endorsed a set of new regulatory proposals designed by Treasury to rein in mortgage lenders, banks, investors, and credit rating agencies. "We do not have the luxury of waiting for markets to stabilize before we think about the future," said Bernanke. "Many of the necessary changes that have been identified, including increasing transparency, improving risk management and attaining better coordination among regulators could provide important support to the process of normalizing our financial markets." He added, "These recommendations should moderate the likelihood and severity of future financial shocks and enable market participants to better withstand shocks should they occur." (*TheStreet.com*, Nat Worden, 04/10/08)
- From July 2007 to February 2008, mortgage servicers have provided loan workouts that have enabled about 1.2 million homeowners to stay in their homes, according to a recent study by HOPE NOW. In January and February 2008, servicers provided approximately 309,700 prime and subprime loan workouts, including 196,200 repayment plans and 113,500 loan modifications. Loan modifications for 2008 have

been 48% of all subprime loan workouts, which is more than double the 2007 rate. “The industry is dedicated to minimizing foreclosures,” said Faith Schwartz, Executive Director of HOPE NOW. “While HOPE NOW is not the only answer to this issue, the alliance’s outreach efforts have had a significant impact on encouraging consumers to connect with their servicers. We are seeing real results.” (*HOPE NOW Press Release*, 04/10/08)

- The Treasury Department said that suspected mortgage fraud by borrowers, brokers and other participants soared 44% for the 12 months ending March 31, 2007, led by cash-out mortgage refinancings, home equity credit lines and stated-income (or low-documentation) loans. In 31% of the dishonest financial activities reported by financial institutions during this period, lenders suspected fraud before the loans even closed. California and Florida topped the list of state’s reporting the largest increase in mortgage Suspicious Activity Reports in 2006, with suspected loan fraud surging 71.3% in California, 53% in Florida, 51.5% in Michigan, 48.7% in Arizona, and 46.3% in New York. (*Bloomberg News*, Dawn Kopecki, 04/03/08)
- According to Fannie Mae’s 2007 annual report, mortgage delinquencies and defaults rose dramatically in the second half of 2007, particularly in major markets in Florida, Michigan, Indiana, Ohio, California, Nevada and Arizona. Together, these states generated more than half of Fannie Mae’s credit losses in 2007. Severe corrections are occurring in the real estate markets of Florida, Arizona, California and other “epi-centers of the pre-2007 speculation-driven housing boom,” which has made the national real estate market look “bleak.” In February 2008, the nation had over 10 months’ supply of unsold home with the inventory overhang much worse in the speculative markets of Las Vegas (25 months), Anaheim, CA (26 months), and Miami (49 months – with an 80 month supply of condominiums). (*Fannie Mae 2007 Annual Report*, 04/04/08)
- According to PMI Mortgage Insurance Co., the risk of housing price declines remains unevenly distributed across the United States and centered on the former bubble markets. Thirteen of the nation’s top 50 MSAs are now in PMI’s highest risk rank, representing a greater than 60% chance that home prices in these areas will be lower in two years. Risk remains largely concentrated in a number of MSAs in California, Florida, Las Vegas, NV, and Phoenix, AZ. According to PMI, the markets with the highest risk scores were Riverside/San Bernardino/Ontario, CA (93%), Las Vegas (91%), and Orlando (85%). (*HousingWire*, Paul Jackson, 04/10/08)
- In February, defaults on privately-insured mortgagors rose for the 14<sup>th</sup> straight month. According to MGIC, the number of insured borrowers falling more than 60 days late on payments rose 38% from a year earlier to 60,911, while the value of insured mortgages increased 51% to \$19.1 billion. (*Bloomberg News*, 04/01/08)
- It’s a sign of the times: rating agencies have slashed the ratings of four mortgage insurance companies and a title insurance firm. On April 8<sup>th</sup>, Standard & Poor’s slashed its ratings of MGIC Investment Corp., Old Republic International, PMI

Group Inc. and Radian Group Inc., and suggested that further cuts are possible. “The downgrades reflect weaker-than-expected results for the fourth quarter of 2007 and the continued deterioration in key variables that influence claims for mortgage insurance,” said S&P credit analyst James Brender. “The deterioration in the housing markets has also been worse than our expectations,” with house prices now expected to tumble 20% from their 2006 peak. S&P said the PMI companies’ operating results won’t meet its expectation for 2008 or 2009 and “current forecasts predict that most companies will not generate an underwriting profit until 2010.” The rating agency also warned that if these PMI companies were cut-off from doing business with the GSEs, the remaining insurers that qualify for the GSE-backed business may not have adequate capital to support the enterprises’ book of business.

- As a result of recent ratings downgrades, Freddie Mac had asked PMI Mortgage, Radian, MGIC and Triad Guaranty Insurance Corporation to prepare remediation plans to restore their AA- ratings within 90 days in order to maintain their Type I Insurer designation. Normally, mortgage insurers whose ratings fall below AA- must meet additional requirements to continue doing business with government-sponsored entities. However, Freddie Mac announced in February that it was suspending its requirements for additional capital and automatic operational restrictions, when it became clear that several insurers were in risk of rating downgrades. Freddie Mac said it is optimistic that the PMI companies will remain eligible to do business with the GSE. “We continue to have confidence that the mortgage insurers will be able to provide counterparty support,” said Freddie Mac’s spokesman Brad German. (*Dow Jones Newswires*, Kathy Shwiff and Andrew Edwards, 04/09/08; *Associated Press*, Adam Schreck, 04/08/08; *Associated Press*, 04/08/08; *Freddie Mac Press Release*, 04/02/08; *American Banker*, Alison Bisbey Colter, 04/10/08)
- On April 10<sup>th</sup>, Fitch Rating Agency downgraded and placed on negative watch a number of key ratings for First American Corporation, including the company’s core issuer default rating [down one notch to BBB, only two notches above a junk rating]. First American’s senior unsecured debt was downgraded to BBB-, while its title insurance business rating unit’s rating was dropped a notch to A-. Fitch said its downgrades were driven by “a significant deterioration in First American’s pro forma capital adequacy,” a decline of approximately \$320 million in FY2007. Fitch warned it may make additional downgrades in the future, unless First American pumps additional capital into its insurance subsidiaries. “Ratings may further deteriorate one to two notches below current ratings if the company does not increase capital to its title subsidiaries such that the RAC ratio increases to levels more comfortably above 100 percent,” said Fitch. (*HousingWire*, Paul Jackson, 04/10/08)
- Washington Mutual announced it will raise \$7 billion from the sale of equity securities to TPG Inc., a private equity firm. WaMu reportedly spurned a similar takeover offer from JPMorgan Chase. The Seattle-based thrift will issue 176 million common shares at \$8.75 (a 33% discount from the prior-day’s closing price—which is down 75% from last year’s high), raising \$1.5 billion and will issue \$5.5 billion of preferred stock, convertible into common at the same price. WaMu said it was

slashing its dividend rate for common stock by 14 cents to a penny per share, in an effort to shore up its capital base, and was closing its wholesale lending business and 186 stand-alone retail offices and eliminating 3,000 jobs during the first quarter. (*American Banker*, Alison Bisbey Colter, 04/10/08; *Fortune's Daily Briefing Blog*, 04/08/08)

- Wall Street analysts expect to see “lingering subprime pain” in the banking industry’s financial results for the first quarter, as losses mushroom from home equity, auto and credit card loans. Oppenheimer & Co. analyst Meredith Whitney said that bank earnings will likely plunge 84% in the first quarter and warned investors to brace for dividend cuts this year from Citi, Bank of America, Wells Fargo, and Wachovia. Analysts at Celent, the Boston-based financial research firm, estimated that the U.S. banking industry will lose 200,000 jobs over the next 12 to 18 months, as the ripple effects of the subprime crisis reverberate throughout the industry. (*Associated Press*, 04/01/08; *American Banker*, Kevin Dobbs and Paul Davis, 03/31/08)
- The Federal Reserve has unveiled an interactive map to help community groups and government agencies to identify foreclosure concentrations and to target aid to those areas. The map is available at [www.newyorkfed.org/mortgagemaps](http://www.newyorkfed.org/mortgagemaps). (*American Banker*, Steven Sloan, 04/02/08)

<p>Raising additional capital is key to OFHEO lowering the GSEs’ regulatory capital requirements</p>
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- In an April 8<sup>th</sup> interview with Reuters, OFHEO director James B. Lockhart, III said that the size and timing of capital raising efforts by Fannie Mae and Freddie Mac will determine if the companies’ capital requirements will be lowered further. Lockhart said, “The key thing will be their capital raise, and how much it is and when it is. That, to me, will decide what the next step should be [on lowering the capital surplus again].” Although the GSEs have not decided on the amounts of capital that they will raise, it should be an amount that makes an impact on the housing market, said Lockhart. “Certainly, we’re encouraging them not to do the minimum, but to try to have enough capital so they can really fulfill their mission.,” he added. (*Reuters*, Al Yoon and Lynn Adler, 04/08/08; *Housing Wire*, Paul Jackson, 04/09/08)
- *National Mortgage News* reports that OFHEO director Lockhart is the leading candidate to becoming the next Secretary of HUD, according to Washington sources. (*National Mortgage NewsDaily Briefing*, 04/10/08)

- In an April 11<sup>th</sup> article in the *American Banker*, Thomas H. Stanton wrote, "...It is time to require the GSEs to strengthen themselves. The Fed and the Treasury must act to dampen the current crisis. But they must impose a price: In return for protecting shareholders, policymakers should call on the GSEs to support prompt enactment of the regulatory reform legislation, along with stronger provisions that allow the regulator to impose significant capital requirements that take account of safety and soundness and systemic risk. Government needs to wield a big enough stick that even Freddie Mac does the right thing. Especially in a housing crisis, the GSE is a weak institution. As current congressional pressure to reduce capital shows, some policymakers see high leverage as a form of government subsidy to the GSEs, despite the increased risk to taxpayers."
- "GSEs are more highly leveraged than commercial banks; when a crisis hits, they have less capital to provide financial support. Another problem is hubris. This has afflicted many different institutions and especially GSEs. GSEs benefit from so many government-provided advantages that they tend to grow even when their management systems lack requisite skills. The ability to grow virtually automatically, at least in more normal times, breeds an overconfidence that has harmed virtually all the major GSEs. Former Sen. Warren Rudman, appointed by Fannie Mae's board to review the company's failed management and internal controls a few years ago, concluded that the GSE had developed a 'culture of arrogance.' Freddie Mac was not far behind."
- "The government should move quickly to create a strong regulatory framework for the GSEs and subject them to capital standards at least as stringent as those that apply to large commercial banks and similar institutions with the potential to cause systemic risk. Then it will be time to consider turning the GSEs either into wholly-owned government corporations (comparable to Ginnie Mae, but eligible to deal in specified types of conventional mortgages) or into completely private companies, without government sponsorship. The current combination of private ownership and government backing leads to privatization of profits and socialization of risk. The financial system cannot afford to concentrate so much risk in two huge financial institutions that, despite their public privileges, focus narrowly on serving their shareholders while the rest of us worry about what is best for the American public." (*American Banker*, Thomas Stanton, 04/11/08)
- Peter J. Wallison, an Arthur F. Burns Fellow in Financial Studies at American Enterprise Institute, also urges Congress to pass GSE reform. Wallison wrote, "...For more than a year, legislation adopted by the House of Representatives to reform and improve the regulation of Fannie Mae and Freddie Mac has languished in the Senate Banking Committee. Now that the financial markets are in turmoil and the subprime meltdown is causing serious losses for the two government-sponsored enterprises..., it is becoming clear that continued failure to act could turn a mortgage market problem into a disaster for taxpayers. Yet the Senate Banking Committee is still

unable to pass—or even take up—a perfectly adequate House bill. It is no wonder that public approval of Congress has fallen so low and that the presidential candidates of both parties are campaigning to bring change to Washington.” (*Financial Service Outlook*, Peter J. Wallison, March 2008)

Fannie and Freddie trying to outrun their problems, which are bigger than they are

- In an interview with *The Institutional Risk Analyst*, Josh Rosner, managing director at financial research firm Graham Fisher & Co., said, “GSEs like Fannie Mae and Freddie Mac are in no position frankly to do much to save themselves let alone save the market,” given the acceleration of the delinquencies and loss rates that is moving from subprime through Alt-A mortgages through the prime market. Rosner notes that Fannie Mae has come up with yet another “bright idea” of offering the “Home Saver Advance” mortgage, though which the GSE provides a \$15,000 unsecured loan to borrowers with negative equity. Rosner notes, “[W]hat they are really doing is paying that \$15,000 because it is cheaper than having to buy defaulted loans out of mortgage pools guaranteed by FNM and cover arrears. ... This is something worse than [a loan modification]. With a bank that modifies loan, someone has to take the loss when the loan re-defaults. Here, [Fannie] and [Freddie] are modifying but without the increased security of the underlying asset. They’re actually taking an unsecured exposure. And given that re-default rates on modified loans were north of 20% in good times, it will be interesting to see how bad it gets this time around. The GSEs are trying to outrun problems that are faster than they are.” (*The Institutional Risk Analyst*, 04/07/08)

Split views on Wall Street about the financial prospects of Fannie and Freddie

- In “dueling” reports, Goldman Sachs analysts are telling their clients that Fannie Mae and Freddie Mac shares will tumble to \$16 or less, while Lehman Brothers’ analysts predict the GSEs’ shares will soar to \$45 or more. The reports illustrate the divergence of views on Wall Street about the GSEs’ ability to weather credit losses from their single-family mortgage portfolios. Goldman analysts reiterated their “sell” recommendations for Fannie and Freddie, predicting that credit losses at the GSEs will “increase rapidly.” Fannie Mae will have \$15.2 billion in additional credit losses—on top of the \$4.1 billion that the company has already booked, said the analysts. And, Freddie Mac will have \$10.6 billion of additional credit losses to book, in addition to the \$3.7 billion in losses which has already been recognized.
- In sharp contrast, Lehman analysts Bruce Harting and Mark DeVries raised their recommendations for the two companies to “overweight” from “equal weight” and predicted that Fannie’s and Freddie’s stock will rise to \$46 and \$45 a share, respectively. “[Fannie and Freddie] have reached an important inflection point,” wrote Harting and DeVries. “The stocks should gradually outperform on steady

market share gains and high returns on new business, which is sustainable while credit costs escalate.”

- Kevin Cronin, head of investments at Putnam Investments, observed, “We’re in a situation that’s been unparalleled in history in terms of the size and order of magnitude. Reasonable people can disagree about whether we’re a third of the way through [the real estate correction], halfway through it, or 90 percent through it.” (*Bloomberg News*, Elizabeth Stanton and Dawn Kopecki, 04/08/08)

Housing GSEs are the third largest lobbying force in the U.S.
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- According to OpenSecrets.org, Freddie Mac ranked number 12 among the “top spenders” from 1998 through 2007 on lobbying Congress and federal agencies. Over the ten year period, Freddie Mac spent \$90.4 million on lobbying. The U.S. Chamber of Commerce led the pack—spending \$369.9 million on lobbying, followed by the American Medical Association (\$179.5 million), General Electric (\$163.0 million), the American Hospital Association (\$143.9 million), Pharmaceutical Research & Manufacturers of America (\$127.0 million), AARP (\$126.8 million), Edison Electric Institute (\$116.0 million), Business Roundtable (\$107.3 million), Northrop Grumman (\$106.6 million), the National Association of Realtors (\$101.0 million), Blue Cross/Blue Shield (\$93.3 million) and Freddie Mac (\$90.4 million). Over the ten year period, Fannie Mae failed to rank in the “top 20 spenders,” reporting “only” \$76.6 million on lobbying over the period. Together, the two housing GSEs spent \$167.0 million—making Fannie and Freddie the third largest lobbying force in the country. ([www.opensecret.org](http://www.opensecret.org), 04/08/08)

## *Fannie Mae*

A few interesting observations from Fannie Mae's 2007 Annual Report
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- Fannie Mae reported a \$2.1 billion loss for FY2007, the first full-year loss reported by the company in more than 20 years. During the year, Fannie cut more than \$400 million in administrative expenses, nearly twice the company's stated goal.
- In FY2007, Fannie Mae increased its provision for credit losses on their guaranty book of business by \$2.8 billion to \$3.2 billion. The company's loan loss reserves at year end totaled \$3.4 billion, representing 12 basis points of its guaranty book. In 2007, Fannie's credit losses were 5.3 basis points of its average guaranty book, an increase of 141% over its FY2006 credit losses (2.2 basis points).
- According to the company's annual report, "Fannie Mae's business with many of our institutional counterparties is heavily concentrated, which increases the risk that we could experience significant losses if one or more of our institutional counterparties defaults in its obligations to us or becomes insolvent." Ten single-family mortgage servicers serviced 74% of Fannie's single-family mortgage credit book of business on December 31, 2007. Countrywide Financial and its affiliates was Fannie Mae's largest servicer, servicing 23% of the GSE's single-family mortgage credit book of business at year end 2007. Also seven mortgage insurance companies provided over 99% of Fannie's total mortgage insurance coverage, totaling \$104.1 billion on December 31, 2007, while ten of the company's largest custodial depository institutions held 89% of its \$32.5 billion in deposits for scheduled MBS payments at year-end 2007.
- During 2007, Fannie's top five lender customers accounted for 56% of its single-family business volume. Countrywide was Fannie's top originator of single-family mortgage loan originations, accounting for 28% of the GSE's single-family business volume in 2007. In January 2008, Bank of America announced plans to acquire Countrywide; together the two institutions accounted for approximately 32% of Fannie Mae's single-family business volume in 2007.
- During FY2007. Fannie Mae grew its total mortgage credit book of business by 14% and its guarantee fee income by 19% [to \$5.1 billion], while single-family mortgage originations in the mortgage market declined 10%. Fannie's market share of new MBS issuances nearly doubled year-over-year.
- Fannie Mae's strategy for 2008 is "build and protect." CEO Daniel Mudd wrote, "...[I]n times of market disruption and panic, companies that protect against current risk while prudently building for the future tend to do well after the crisis passes. That is our strategy for 2008: protect and build. Underlying the strategy is a keen focus on capital—on ensuring we have the capital necessary to protect our business,

while investing that capital for long-term value creation.” Mudd also addressed the issue of prospects for raising additional: “Concurrent with [OFHEO’s] partial release of our regulatory capital surplus, we have begun the process of considering additional capital-raising options so that we can continue to serve our mission and take advantage of market opportunities—play offense and defense—through the downturn.”

- Mudd identified two lessons learned from the subprime boom and bust. First, Mudd wrote, “We still need ‘stretch’ lending [meaning innovative, affordable and sustainable mortgage credit for working families, even for those without perfect or traditional credit histories]. ...The mortgage and housing industry’s future, including Fannie Mae’s future, will depend on giving people a fair chance of owning a home.” Mudd added, “We need mortgage reforms.” The current lending process is too complicated, cumbersome and expensive to get a mortgage loan, he said. And, it’s far too easy for “rogue” lenders to prey on unsophisticated borrowers. “At the very least, mortgage terms, risks and costs should be simplified and more clearly spelled out—and predatory lenders cast out,” wrote Mudd. “It is a key priority for Fannie Mae to work with the industry to strengthen the process.”
- As of December 31, 2007, two shareholders reported beneficial ownership of Fannie Mae’s common shares: Capital Research Global Investors (owning 117.5 million shares or 12% of the company) and Capital World Investors (110.8 million shares or 11.3%).
- For FY2007, the top five paid Fannie Mae executives included CEO Daniel Mudd (\$12.2 million), EVP and chief business officer Robert Levin (\$8.5 million), EVP and chief operating officer Michael Williams (\$6.6 million), EVP and CFO Stephen Swad (\$4.8 million), and EVP of Capital Markets Peter Niculescu (\$4.1 million).
- On May 20<sup>th</sup>, Fannie Mae will hold its Annual Meeting of Shareholders in New Orleans, LA, which will provide its shareholders an opportunity to see first hand the progress the city has made in its hurricane recovery efforts and determine how much still needs to be done in that region. In the aftermath of the 2005 hurricanes, the company committed \$40 billion in housing and redevelopment in the Gulf Coast region. (*Fannie Mae 2007 Annual Report*, 04/04/08)

<p>Fannie Mae extends forbearances for troubled borrowers and addresses streamlining short sales</p>
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- Effective April 11<sup>th</sup>, Fannie Mae is increasing the maximum forbearance term to six months for loans in its mortgage-backed securities pools, up from its previous limit of four months. Giving homeowners greater leeway also will help Fannie Mae limit the costly process of purchasing delinquent loans out of MBS it guarantees. According to Jason Allnut, a vice president for credit loss management in Fannie Mae’s Dallas office, Fannie Mae is balancing the need to “keep people in their homes ...with having

to pull loans out of trust. This is one of those changes that helps us in both ways.” He added, “Fannie Mae is trying to give the servicers as many tools as possible to help homeowners. [But] if a servicer does not gather the financial information, then some plans will just delay the inevitable [foreclosure process and increased costs for investors].” (*Housing Wire*, Paul Jackson, 03/31/08; *Reuters*, Al Yoon, 04/01/08)

- In the next few months, Fannie Mae also plans to roll out a new program, designed to encourage the short sales of delinquent borrowers’ homes. Allnut said Fannie is exploring ways to persuade servicers and REO brokers to do short sales while streamlining the process. “We want to incentivize the borrower with a program of pre-approved short sales,” said Allnut. “[And,] Fannie is telling servicers not to cut broker commissions.” Previously, brokers had complained that servicers typically cut their commissions on short sales relative to the 4% to 5% fee on foreclosure sales. By doing that, they kill the process, said Eli Tene, president of I Short Sale Inc. (*American Banker*, Kate Berry, 04/09/08)

Fannie Mae adjusts the dividend rate for its Series F and Series P preferred stock
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- On March 31<sup>st</sup>, Fannie Mae adjusted the dividend rate for its Series F and Series P non-cumulative preferred stock in accordance with the terms of the issues. (*Fannie Mae Press Release*, 03/31/08)

## ***Freddie Mac***

### Freddie and Fannie support more than 70% of the mortgages being made today

- In a March 19<sup>th</sup> speech to the Northeast Regional MBA Conference, Paul Mullings, Freddie Mac's SVP of Single-Family Sourcing, said that his company is focused on enhancing the mortgage market's stability and providing liquidity during this period of market crisis. In 2007, Freddie Mac purchased more than \$470 billion in mortgages, as the company's single-family portfolio grew 2.5 times faster than the broader residential mortgage market.
- While Freddie Mac "absolutely must not change our commitment to affordable housing... how we fulfill that commitment absolutely must change," said Mullings. Freddie is maintaining its affordable focus by taking a more balanced approach between homeownership and rental housing. In 2007, Freddie helped lenders make the right loans and kept \$45 billion in qualified loans out of the subprime market, said Mullings. The company also set a new record in multifamily business volume in 2007 in which virtually all of the volume supported families of modest financial means. "We want to support all these families—as well as those now pursuing home ownership—in finding the right kind of housing for them," concluded Mullings. (*Prepared Remarks for Paul Mullings, 03/19/08*)

### Freddie Mac to expand its disclosure on its PC securities

- Freddie Mac announced that it expects to provide nine new loan-level disclosures and expand two existing disclosures on its single-family fixed rate and adjustable-rate Participation Certificate securities. In June 2008, Freddie expects to provide these new disclosures for all newly issued PC securities and for PC securities issued on or after December 1, 2005. Beginning no later than August 2008, Freddie Mac expects to expand its Third Party Origination disclosure on all newly issued PC securities. (*Freddie Mac Press Release, 04/09/08*)

### Freddie Mac alumni news

- Dwight Fettig, formerly a top lobbyist for Freddie Mac, has joined Arnold & Porter as a senior legislative and policy adviser. Before joining Freddie Mac in 2003, Fettig worked for Senator Tim Johnson (D-ND) for 15 years, as legislative director during Johnson's service in the House and later the Senate. (*The Hill, 04/01/08; [http://www.jag.org/dwight\\_fettig.htm](http://www.jag.org/dwight_fettig.htm)*)

Freddie Mac Foundation awards \$800,000 grant  
to the National Alliance to End Homelessness

- Freddie Mac announced an \$800,000 grant to the National Alliance to End Homelessness to provide training and technical assistance to Washington, D.C. area service providers and public sector agencies in order to permanently house 1,500 families. The grant will enable the National Alliance to help nonprofit organizations and public sector agencies in the D.C. metro area to implement their ten year plans to end homelessness and adopt Housing First initiatives for homeless families. (*CSRwire*, 04/10/08)

## ***Federal Home Loan Banks***

Merger negotiations between the FHLB-Chicago and FHLB-Dallas are terminated

- On April 7<sup>th</sup>, the FHLB-Chicago and FHLB-Dallas terminated their merger negotiations, following seven months of discussions over ways to combine the two Banks. The FHLB-Chicago declined to comment on the failed deal, which seemed to be on track until very recently. Terry Smith, president of the FHLB-Dallas, said, “Both sides worked very, very hard. At the end of the day, we just couldn’t get there.”
- The Chicago Bank also announced that its president, Mike Thomas, has resigned, effective April 11<sup>th</sup>, and a search committee of the board has been charged to find a successor in the next six weeks. Matthew Feldman, currently the Bank’s Executive Vice President has been named interim president until a successor can be named. Thomas, who was hired by the board in 2004 to turn the Chicago Bank around following accounting mistakes and growing losses from its Mortgage Partnership Finance Program, reached a mutual agreement with the board of directors to terminate his employment. Thomas will receive a severance payment of \$1.13 million, roughly half the total he could have received under the terms of his employment contract. The Bank also agreed to pay Thomas’ legal fees related to negotiations on his separation agreement. [In 2007, Thomas received approximately \$1.3 million in compensation.]
- The breakdown of the Banks’ merger negotiations leaves the future of the Chicago Bank uncertain. According to the FHLB-Chicago’s March 19<sup>th</sup> annual report, a failure to consummate a merger with the Dallas Bank could lead to a restructure of its balance sheet that “may have significant short-term adverse effects.” The Chicago Bank predicted that it will report a loss for the first quarter and “for some time” and does not expect to pay a dividend to shareholders for at least this year. Deferred

losses on derivatives has been the “primary factor” driving the Bank’s losses, which management expects will be higher due to “hedging costs in current periods as we adjust our hedging strategy to maintain a more neutral exposure to interest rate changes.” In a letter to members, David Kuhl, the FHLB-Chicago’s board chairman, said that the Bank will now focus on developing a new capital plan within 90 days that outlines how it could operate on a stand-alone basis.

- On December 31, 2007, the FHLB-Chicago held \$4.77 billion of mortgage securities issued by Wall Street or other private sector entities with nearly half the collateral properties for these securities located in California and Florida. In addition, the Bank held \$34.6 billion of individual home mortgages, representing 39% of total assets at year end. The Bank said that those loans are fixed-rate mortgages with only 0.32% of this portfolio delinquent 90 days or more on December 31<sup>st</sup>.
- On April 7<sup>th</sup>, five-year notes issued by the FHLBs yielded 68 basis points above the comparable Treasury note—up from 30 to 35 basis points a year ago but down from a more recent high of 100 basis points, said Jim Vogel, the head of fixed-income research at FTN Financial Capital Markets Corp. Although the FHLBs are jointly liable for each other’s bond obligations, the overall condition the FHLB System appears to be solid, Vogel added.
- It is unclear what impact the merger breakdown may have on the FHLB System and prospects for other mergers among the banks. “Mergers are always a possibility,” said Allan Mendelowitz, a Federal Housing Finance Board director. “This doesn’t mean there won’t be other mergers.” Vogel said, “I don’t think this means the end of potential mergers down the road, because you have these extraordinary circumstances. It’s tough to manage the Home Loan Bank system in normal times. When you add in turmoil among your members, it becomes a lot more difficult.” (*Bloomberg News*, Jody Shenn and Dawn Kopecki, 04/07/08; *American Banker*, Steven Sloan, 04/08/08; *Wall Street Journal*, James R. Hagerty and Damian Paletta, 04/08/08)
- Standard & Poor’s said it will review the FHLB-Chicago’s financial condition over the next 90 days to determine if a downgrade of the Bank’s credit rating is warranted. The downgrade could reduce the FHLB-Chicago’s rating to AA-plus, signaling the rating agency’s skepticism about the Bank’s plan to remain independent. “The development heightens our concerns regarding the strategic direction and financial condition of FHLB Chicago,” said the S&P. “As part of our CreditWatch review, we will consider FHLB Chicago’s need to name a new president and chart a new course...” The spokeswoman for the FHLB-Chicago said, “Today’s announcement [by S&P] does not impact our day-to-day operations. As we announced earlier in the week, we are focused on finalizing a financial and operational plan in the next 90 days that will improve profitability, maintain and enhance our *products and services*, and address any outstanding regulatory issues.” (*American Banker*, Steven Sloan, 04/11/08)

FHLB System's advances increase 36.6% to \$875 billion as of December 31<sup>st</sup>

- According to the FHLBanks Office of Finance, the FHLB System's assets increased 25.4% to \$1.274 trillion at yearend 2007, while the System's advances to members increased 36.6% to \$875 billion and its consolidated obligations increased to \$1.179 trillion. The System's growth is primarily due to the "extraordinary events affecting the credit markets, said the FHLBanks Office of Finance. Members' mortgage assets, totaling \$92 billion, were down 6.5% from the prior year end. The System's combined net income increased 8.2% to \$2.8 billion, compared to \$2.6 billion in FY2006. Total combined capital rose 19.1% to \$54 billion on December 31<sup>st</sup>. (FHLBanks Office of Finance Press Release, 03/31/08)

Representative Kanjorski introduces bill to allow the FHLBs to assist student lenders

- Representative Paul Kanjorski (D-PA) has introduced legislation to allow the FHLBs to assist student lenders, after the Federal Reserve declined to use its emergency powers to grant "lending to non-depositories," such as student loan lenders, access to a \$200 billion lending facility at the central bank. In a letter to Kanjorski, Federal Reserve chairman Ben Bernanke said extending loans such "non-bank" lenders would "raise serious public policy issues" because they, unlike the Wall Street investment banking firms, are not in situations which pose significant risk of a systemic financial crisis. In essence, Kanjorski's bill seeks to use the FHLBs as a means to provide liquidity to student lenders, in place of the central bank. The bill would allow the FHLB System to temporarily invest in student loan-related securities with the Banks' surplus funds, as well as accept student loans and securities collateralized by student loans as collateral. The bill would also allow the FHLBs to provide secured advances to its members to originate student loans and finance student loan-related securities. The provisions of this bill would expire after two years. (*The Bond Buyer*, Andrew Ackerman, 04/10/08)

The Federal Housing Finance Board approves a proposed rule authorizing the FHLBS to establish set-aside programs for refinancing subprime mortgages

- The Federal Housing Finance Board has approved a proposed rule to authorize the FHLBs to establish Affordable Housing Program (AHP) homeownership set-aside programs to help subprime borrowers refinance or restructure their mortgages. The proposed rule would provide the FHLBs the authority to use the AHP direct set-aside subsidy to refinance or restructure low- or moderate-income households' subprime or nontraditional mortgages held by Bank members or their affiliates. This new authority would expire on June 30, 2011.
- The requirements of the proposed rule are generally the same as those specifically authorized for the FHLB-San Francisco in Board Resolution No. 2008-01 on January

15, 2008. If the FHLBs were to use the maximum proposed refinancing set-aside authority in 2008, the Banks could provide almost \$75 million to assist some 7,500 households facing possible loss of their homes (assuming an average subsidy of \$10,000 per household). The Finance Board requests comments on a number of issues, including whether it is generally appropriate for the AHP to provide subsidies for refinancing or restructuring existing owner-occupied mortgage loans. The proposed rule will be published in the Federal Register and will be open for public comment for 60 days. (*Federal Housing Finance Board Press Release, 04/09/08*)

Christopher Curtis named general counsel for the Finance Board

- On April 14<sup>th</sup>, Christopher T. Curtis joined the Federal Housing Finance Board as General Counsel. Curtis has more than twenty years of financial services experience in the government and private sectors. Prior to joining the FHF, Curtis was Associate General Counsel at Capital One Financial Corporation. Previously, Curtis served as Senior Counsel in the Legal Division at the FDIC, as an attorney with the Federal Home Loan Bank Board, the Finance Board's predecessor agency, and in the financial services group of the law firm Covington & Burling. He is a graduate of Harvard University and received his JD, magna cum laude, from Harvard Law School in 1981. (*Federal Housing Finance Board Press Release, 04/11/08*)

FHLB-Atlanta announces a new board member, representing North Carolina members

- The FHLB-Atlanta announced the election of Donna Goodrich, SVP and Deposit Services Manager of BB&T Corporation, as a new board member, filling a vacant directorship in North Carolina. Previously, Goodrich served on the FHLB-Atlanta's board of directors from June 2004 to 2005. She will serve the remainder of a term ending December 31, 2008. (*FHLB-Atlanta Press Release, 04/04/08*)

FHLB-San Francisco announces projected dividend rate for the first quarter

- The FHLB-San Francisco announced that its projected dividend rate for the first quarter is 5.46%. The Bank intends to announce its first quarter operating results on or about May 15<sup>th</sup>, at which time it will finalize its dividend rate for the period. (*FHLB-San Francisco Press Release, 03/31/08*)

## ***Ginnie Mae***

Ginnie Mae's MBS issuance surges 94% in the first quarter

- According to *Inside Mortgage Finance*, Ginnie Mae's issuance of mortgage-backed securities rose 94% to \$35.7 billion for the first quarter, versus only \$18.4 billion one year earlier. As a result, Ginnie Mae's MBS market share reached 11%. (*HousingWire*, Paul Jackson, 04/09/08)

## ***International Mortgage Market***

Property market collapse has triggered fears that Spain will slide into the worst economic downturn in its modern history

- International banks have scrambled to sell their holdings of Spanish mortgage debt at 40% discounts, fearing that the country is sliding into the worst economic downturn in its modern history. Mike Echavarren, director of the property consultancy Irea, warned that Spain's housing market is far weaker than the official statistics suggest and said real estate values could fall 20% to 25%. "All kinds of ploys have been used to disguise the true extent of the price falls, which we think are 5% to 7% already. Buyers have totally abandoned the market. We've had a wave of negative sales as people pull out of commitments already made," said Echavarren. "We have a very worrying situation. The developers simply cannot refinance their debts. We need to cut interest rates by 2%, which is obviously not going to happen." He warned that the 2008 crash could be sharper than the property crisis in the early 1990s. Standard & Poor's issued a recent report, saying that Spain risks a "major collapse" in construction, following a 40% decline in building permits from its peak in the construction cycle in 2006 in which 740,000 units were built—more than in Germany and Britain combined. Following the adoption of the Euro, Spain's interest rates were halved almost overnight, which fueled an explosive credit boom in the country and drove the expansion of the real estate market. Since late 2005, mortgage rates, priced off the three-month Euribo, have nearly doubled, triggering sharp downturning the housing market. The Bank of Spain is forecasting a rise in unemployment to 9.8% in 2009, up from 8.0% and 8.6% in the third and fourth quarters of 2007, respectively. Last year, Spain had a budget surplus of a 2% of GDP, which provides the government room to craft a stimulus program to soften the impact of the recession. Lawmakers are currently crafting a \$20 billion Euro spending stimulus on high speed railways and other mega-projects to cushion the country's economic downturn. (*Telegraph* [UK], Ambrose Evans-Pritchard, 04/04/08; *Reuters*, Jason Webb, 04/03/08)

- Jean-Michel Six, Standard & Poor’s chief economist for Europe, said, “Europe’s housing markets are overwhelmingly turning down. And in those countries where the housing bubbles have been expanding for longer, we believe the corrections could be severe and painful. Particularly at risk are the U.K. housing market, where the financial crisis is exacerbating issues of affordability and general economic gloom, and the Spanish housing market, which is coming to terms with a largess of new homes.” A combination of a sharp deterioration in affordability, scarce funding, and the economic slowdown are poised to cause a major slowdown in the U.K. real estate market. After years of double digit growth, S&P now forecasts that on average U.K. home prices will be flat or slightly negative with a modest increase of 4% in 2009. (*Business Credit Management*, 04/02/08)

## ***Farm Credit System / Farmer Mac***

Forward momentum on the 2008 Farm Bill
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- On April 10, House and Senate conferees met briefly to begin hammering out a final version of the Farm Bill, a day after a new bipartisan deal backed by House leaders cleared the way for that chamber to name its conferees. Negotiations are scheduled to resume this week. Although significant differences remain with the Senate version of the bill, lawmakers said agreement on a final package that could pass both chambers was near. “The promised land is in sight,” said Saxby Chambliss (R-GA), the ranking member on the Senate Agriculture Committee.
- Under the House agreement, new spending on agriculture programs would be limited to \$6 billion beyond the bill’s \$280 billion budgetary baseline. By a vote of 400-11, the House instructed conferees to oppose higher taxes to fund new farm bill spending. According to a committee aide, the savings might be generated by a credit card compliance provision, which would require credit card issuers to report to the IRS payments made to merchants to ensure that businesses are reporting all their income.
- Progress on the Farm Bill has been stymied by disputes between House and Senate tax writers about offsets for as much as \$10 billion in extra spending, which includes a controversial \$4 billion disaster fund sought by key senators that is opposed by some House members, who argue that the funds should be used for conservation and nutrition. Sen. Kent Conrad (D-ND), who supports the disaster fund, said Senate conferees will reject the House’s \$6 billion limit on new spending. Instead, they will propose to spend \$10 billion beyond the baseline, which will be financed in part with new customs and users’ fees. (*CQ Today Midday Update*, 04/10/08)

The “rise of the demon ethanol and other biofuels” have contributed  
to an international food crisis

- In the April 7<sup>th</sup> *New York Times*, Paul Krugman writes that an international food crisis is well underway, which has already “led to food riots around the world.” Krugman says that a combination of long-term trends (the population growth of emerging markets which has triggered increasing demand for oil and high crude prices), bad luck (bad weather—particularly droughts), and bad government policy. Krugman writes, “Where the effects of bad policy are clearest, however, is in the rise of demon ethanol and other biofuels. The subsidized conversion of crops into fuel was supposed to promote energy independence and help limit global warming. But this promise was, as *Time* magazine bluntly put it, a ‘scam.’ This is especially true of corn ethanol: even on optimistic estimates, producing a gallon of ethanol from corn uses most of the energy the gallon contains. But it turns out that even seemingly ‘good’ biofuel policies, like Brazil’s use of ethanol from sugar cane, accelerate the pace of climate change by promoting deforestation. And meanwhile, land used to grow biofuel feedstock is land not available to grow food, so subsidies to biofuels are a major factor in the food crisis. You might put it this way: people are starving in Africa so that American politicians can court votes in farm states. Oh, and in case you’re wondering: all the remaining presidential contenders are terrible on this issue.” (*New York Times*, Paul Krugman, 04/07/08)

Mission creep?

- On April 10<sup>th</sup>, the Farm Credit Administration issue a final rule amending the criteria that processing and marketing operations must meet to qualify for Farm Credit System (FCS) financing under titles I and II of the Farm Credit Act of 1971, as amended. Under the new rule, FCA has added three additional criteria for determining what legal entities, owned 50% or less by eligible borrowers, are eligible for financing as a processing or marketing credit need of an eligible borrower directly related to the borrower’s production operation, where (1) eligible borrowers regularly produce some throughput and exercise majority voting control over the legal entity or constitute a majority of the board of directors (or similar governing body) and exercise control over the operations of the entity; (2) eligible borrowers evidence a strong level of commitment by owning a significant equity stake (at least 25%), providing a substantial amount of throughput (20% or more), and maintaining representation on the board of directors (or similar governing body); and (3) the legal entity is a direct extension or outgrowth of an eligible borrower’s production operation (e.g., a family farming operation where there are different ownership structures, but strong interrelationships between the production and processing or marketing operations). Under the third criteria, eligible borrowers must also meet additional criteria concerning the entity’s creation, business needs, functional integration, and throughput requirements. The new rule requires each FCS institution making processing or marketing loans to comply with new reporting requirements

and to adopt specific new policies and procedures for these lending programs. (*FCA Fact Sheet*, 04/10/08)

#### Recent notational votes by FCA's board of directors

- On March 20th, the FCA board of directors voted to extend the comment period for the advance notice of public rulemaking in which the public was asked to comment on possible regulatory changes to the capital rules for FCS institutions. The comment period, originally scheduled to end on March 31, is now scheduled to close on December 31, 2008.
- On March 27th, the Board authorized CoBank to temporarily include in core surplus a portion of its allocated equities subject to certain limits and conditions. And on April 4th, the Board determined the regulatory capital treatment of up to \$1 billion of subordinated debt that CoBank proposed to issue to qualified institutional buyers or accredited investors. (*FCA Press Release*, 04/10/08)

## ***Postal Service***

#### Postal Regulatory Commission approves the USPS's competitive price increase

- The Postal Regulatory Commission has authorized the Postal Service's planned price increase for its competitive products, which include Priority Mail (3.1% increase), Express Mail (4%), parcel select (5.7%), and parcel return service (2%). The price increase is scheduled to go in effect on May 12<sup>th</sup>. (*DMNews.com*, Ellen Keohane, 04/11/08)

#### Direct mail is a key component in the USPS's business model

- Direct mail revenues accounts for approximately 33% of Postal Service's revenue, largely supporting the agency's six day-a-week mail service to 146 million locations. A number of state legislatures are considering passage of "do not mail" bills, modeled after "do not call" legislation passed by Congress, which would wreak havoc on the USPS and its financial solvency. In an April 1<sup>st</sup> speech before the National Association of Postal Supervisors, Senator Susan Collins (R-ME), ranking member of the Senate Homeland Security and Governmental Affairs Committee which oversees the USPS, said, "Direct mail is in no way comparable to the unsolicited and invasive telephone calls that are curbed by the Do Not Call registry. Direct mail imposes no

burden on the public, it causes no interruptions, and I, for one, look forward to the Bed, Bath & Beyond coupons I get in the mail. A Do Not Mail registry would attempt to solve a problem that does not exist and would have devastating consequences for every home, community, and business that relies upon our Postal Service. I commend the postal community for joining with the Direct Marketing Association and other business groups to form the Mail Moves America Coalition to educate consumers and states on how a Do Not Mail registry could be detrimental to them. You may be sure that if this issue comes before the Senate you will find no stronger advocate than me for your interests.” (*Multi-channel Merchant*, Craig Blake, 03/31/08; *Postcom.org*, 04/04/08)

#### GAO criticizes the USPS for a \$13,500 steak dinner

- In an audit of government credit card use, the GAO singled-out a \$13,500 tab run-up by the Postal Service in 2006 at a Ruth’s Chris steakhouse in Orlando, FL. GAO noted that no expense was spared for drinks (\$3,000), shrimp cocktails (\$500), mini-crab cakes (\$900), along with 81 entrees ordered from the menu. “The better question is probably what they didn’t order,” said GAO investigator Gregory Kutz, who cited this meal as part of an overarching audit into the abuse of government credit cards. The Postal Service’s response? USPS officials said it is unfair to compare the dinner with other abuses cited in the GAO report. **“This is not taxpayer money. What we spend is what we make. The Postal Service is funded solely by our products and services,” said USPS spokesman Gerry McKiernan.** [Emphasis added.] Which includes stamps, responded Kutz. “For the most part, my stamps helped pay for the dinner,” he said. “Every time you lick a stamp, think about Ruth’s Chris.” (*Orlando Sentinel*, Mark K. Matthews, 04/10/08)

#### APWU endorses Obama for President

- The American Postal Workers Union, the country’s largest postal workers union with 300,000 members and retirees, has endorsed Senator Barack Obama (D-IL) for president. “Senator Obama’s message is one of hope and change,” said APWU president William Burrus. “We believe he will be a president who will strongly represent the interests of working Americans.” (*AFP*, 04/09/08)

## TVA

### Nuclear Regulatory Commission holds public hearing on NuStart's application to build two nuclear reactors

- On April 4<sup>th</sup>, the Nuclear Regulatory Commission held a public hearing on the environmental concerns regarding an application for construction of two new nuclear units in Scottsboro, AL, filed by NuStart, a consortium of nuclear utilities including TVA. The consortium wants to build two new reactors next to TVA's unfinished Bellefonte site, which has two operating nuclear units. In 1988, TVA halted construction on a third nuclear reactor after spending \$4.2 billion on the facility, because of the utility's rising debt and falling demand for energy at the time. Jack Bailey, TVA's vice president of nuclear generation, told the NRC that nuclear power is the best means for meeting growing demand for power and other "green" options, such as wind and solar energy aren't practical yet. Bailey said that construction is scheduled to begin 2012 on the first unit and 2013 on the second unit.
- Environmentalists expressed their concerns about the construction of the new facilities, arguing that nuclear power is "high risk" technology which might endanger the environment. Don Safer, chairman of the Tennessee Environmental Council, said "There's no safe dose of radiation," arguing that the proposed plant would not be able to control routine releases of low levels of radiation into the environment. "Nuclear power is not the solution," Safer said. "It's the height of human arrogance to leave that kind of legacy."
- The NRC will accept written comments about the NuStart application through April 25<sup>th</sup> and will release a summary the public statements on August 19<sup>th</sup>. (*Associated Press*, 04/04/08)

### TVA announces plan to buy bankrupt gas plant

- TVA announced it plans to purchase a three-unit, 810-megawatt combined-cycle combustion turbine facility in Southaven, MI from Southaven Power, LLC, a subsidiary of Cogentrix Energy LLC, which is operating under federal protection in U.S. Bankruptcy Court. TVA will pay Southaven \$461.3 million for the facility, along with a \$5 million fee in connection with the termination of an operation and maintenance agreement by a Southaven affiliate. TVA President Tom Kilgore said the \$465.3 million that the utility will pay for the facility is well below what it would cost to build such a plant. The plant, which is the fifth such gas-fired plant TVA has bought or built in the past two years, will help the utility meet power peaks for less than buying the power from other utilities or independent power producers, agency officials said. "This is a great outcome for TVA and its customers, and it is a natural

fit with the goals of our strategic plan,” said TVA Chief Operating Officer Bill McCollum. (*Chattanooga Times Free Press*, Dave Flessner, 04/03/08)

TVA prepares to spend up to \$1 billion on energy conservation and efficiency programs

- TVA is preparing to spend as much as \$1 billion over the next few years on energy conservation and efficiency programs, aimed to reduce the demand for power by as much as 1,400 megawatts by 2012—equal to the output of one nuclear power reactor and one gas turbine plant. “We are going to have to spend some money on that. It doesn’t come for free,” said TVA President and CEO Tom Kilgore. TVA’s 1,400 megawatt goal would only meet about 30% of the utility’s projected need for more power, which is expected to rise 1.7% a year – or 800 megawatts annually.
- David Reister, an Oak Ridge National Laboratory scientist active in the Sierra club, said, “We think that energy efficiency is the most important source of new energy.” He urged TVA’s directors to reduce the utility’s carbon footprint.
- TVA plans to hold a series of public meetings and confer with its 159 power distributors, before adopting the energy and conservation programs. The utility also plans to test special pricing programs with industrial and commercial customers this summer, which are designed to encourage reduced energy use during peak demand. Kilgore said TVA will roll out the first programs in 12 to 18 months. “The first thing we have to do is educate people a lot on what this means in economic terms that they will understand,” he said. “We really want to give them an incentive to get off our peak [6 a.m. to 8 a.m. in the winter and 4 p.m. to 8 p.m. in the summer]. That will save both of us money.” The utility would install new time sensitive meters to monitor use during peak hours, which will allow TVA to bill higher rates during peak hours. While customers may not pay any more than they do now, TVA will be spending a billion dollars for the new meters and education materials for these new programs. In May, TVA’s board of directors is expected to review and approve the proposed energy and conservation programs. (*WBIR* [Knoxville, TN], Stoney Sharp, 04/03/08; *Associated Press*, Duncan Mansfield, 04/03/08)

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