

# The GSE REPORT™

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## *Major Events*

Federal Reserve commits to purchase \$600 billion in debt and MBS issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks

- In an effort to unfreeze credit for homebuyers, consumers and small businesses, the Federal Reserve announced on November 25<sup>th</sup> it will purchase up to \$100 billion in debt issued by Fannie Mae, Freddie Mac and the FHLB System and \$500 billion of mortgage-backed securities issued by Fannie, Freddie, and Ginnie Mae. On a weekly basis, the Fed plans to make regular purchases of the GSEs' corporate debt in an effort to lower the cost of mortgages for consumers. Initially, the central bank plans to focus on fixed-rate, non-callable senior debt. The Fed's purchases will extend over the "next several quarters" with weekly purchases being contingent on market conditions, according to the New York Federal Reserve Bank.
- In addition, the Fed announced the creation of the \$200 billion Term Asset-Backed Securities Loan Facility (TALF) to support consumer and small business loans. "This action is being taken to reduce the cost and increase the availability of credit for the purchase of houses, which in turn should support housing markets and foster improved conditions in financial markets more generally," said the Fed. Officials said the Fed may hold the GSE debt and securities until they mature or sell them with plans to be determined at a later date.
- During a press conference, Treasury Secretary Henry Paulson said that Fed's \$200 billion investment in asset-backed securities program is just "the starting point." Paulson added, "The economy is turning down pretty dramatically. It's very important that lending continue to be available." Treasury is allocating \$20 billion of TARP funds to provide the Fed credit protection for the credit facility. According to Treasury's press release, the facility may expand over time and cover assets, such as commercial and private residential mortgage-backed debt.
- In a November 25<sup>th</sup> statement, Federal Housing Finance Agency director James B. Lockhart said, "The Federal Reserve Board's announcement that it will purchase debt of the Federal Home Loan Banks, Fannie Mae and Freddie Mac as well as the mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae is a very positive step. This \$600 billion program should be a major boost to the mortgage and housing markets. By providing more liquidity to the market FHFA expects these actions to help reduce the large interest rate spreads between mortgages and Treasuries, resulting in lower mortgage rates over time, assisting homeowners and home purchasers."
- During an interview on Bloomberg Television, former St. Louis Fed chairman William Poole said, "They're trying to put funds into the system, trying to unfreeze these markets. Clearly, the Fed and the Treasury are beginning to take a large amount

of credit risk.” Asset buying by the Fed represents step three in the government’s efforts to fix the financial system and curb a year-long recession, said George Goncalves, chief Treasury and agency strategist for Morgan Stanley. He added, “Moving to actually purchasing assets and not just funding them—this ... is the quantum leap that will work off the liquidity programs in place.”

- “Prior to Fed’s announcement, we were worried that there is a significant uncertainty regarding overseas investor demand for agency bonds,” wrote Bank of America analysts in a research note. “This is not a big issue now as the Fed’s purchase activity should more than offset any potential selling of agency MBS by overseas investors.” By December 5<sup>th</sup>, the spreads on Fannie Mae two-year corporate debt and two year Treasuries was 1.16%—a decline of 66 basis points from a record 1.82% on November 20<sup>th</sup>.
- Federal Reserve Chairman Ben S. Bernanke said it is “encouraging” that the plan he announced on November 25<sup>th</sup> to purchase GSE debt and MBS had already spurred a drop in mortgage rates by December 1<sup>st</sup>. Fed purchases of agency securities may “influence the yields on these securities, thus helping to spur aggregate demand,” Bernanke added. The Fed’s November 25<sup>th</sup> announcement brought back mortgage-debt buyers in force that day, triggering a fall in the spread between mortgages and Treasuries from 2.09% to 1.86%, the largest single drop since Fannie and Freddie were placed into conservatorship. (*Wall Street Journal*, Michael Aneiro, 12/26/08; *Federal Housing Finance Agency Press Release*, 11/25/08; *HousingWire*, Paul Jackson, 11/25/08; *Bloomberg News*, Jody Shenn, 12/05/08; *Bloomberg News*, Dawn Kopecki, 12/03/08; *Bloomberg News*, Scott Lanman and Dawn Kopecki, 11/25/08)
- Separately, the Federal Reserve is considering issuing its own debt for the first time, a move that could provide the central bank additional flexibility as it attempts to stabilize financial markets that are in disarray. According to people familiar with the matter, Fed officials have approached Congress about the concept, which might include issuing bills or some other form of debt. At the core of deliberations is the Federal Reserve’s balance sheet, which has expanded more than 120% from less than \$900 billion to more than \$2 trillion since August. (*Wall Street Journal*, Jon Hilsenrath and Damian Paletta, 12/10/08)

Treasury considers plan to lower mortgage rates
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- The Treasury Department is considering a plan to revitalize the mortgage market that would push down mortgage rates for home loans, according to sources familiar with discussions. The plan, which is being developed, would temporarily use Fannie Mae and Freddie Mac to encourage banks to make loans with rates as low as 4.5%—a full percentage point below prevailing rates for 30 year fixed rate mortgages. Under the plan, Treasury would offer to purchase the newly issued mortgage-backed securities that finance newly issued loans for home purchases, which are guaranteed by Fannie Mae, Freddie Mac, or the FHA. Borrowers would be required to document their

income to demonstrate that the mortgage payment is affordable. These mortgages would be funded by Treasury debt yielding 3%, suggesting that the government could make a profit by purchasing the 4.5% mortgage-backed securities. Treasury believes this plan could potentially halt the slide in home prices by enabling borrowers to afford larger mortgages, thereby increasing demand for housing and ultimately supporting higher home prices. The plan remains in the discussion phase and may not be finalized before the Bush administration's term ends in January. Treasury officials suggested that the mortgage rate reduction plan is "fluid" and still being finalized.

- President-elect Barack Obama's economic team is expressing an interest in Treasury's proposal to stimulate home buying through the issuance of new mortgage-backed securities aimed at driving down mortgage rates. Incoming White House economic chief Lawrence White has asked for details on the proposal from Columbia Business School Dean Glenn Hubbard and Columbia real estate professor Christopher Mayer, who designed the program. Mayer has also briefed the Federal Reserve Bank of New York staff, where he serves as visiting scholar. "This proposal is all about putting out the fire," said Mayer. "There is nothing else on the table that even has the possibility of preventing a large, further decline in house prices." Obama's interest in the program is important for the program to proceed, because Treasury doesn't want to start projects that would be abandoned after January.
- Separately, Blackrock CEO Laurence Fink has proposed to the Obama administration that Treasury buy mortgage assets to increase demand for housing and stabilize the credit markets. Specifically, he has proposed that Treasury buy new mortgages issued by Fannie and Freddie with rates ranging from 4% to 4.5%. Also, Fink has recommended a government program which would allow homeowners to assume current mortgages rather than take out new loans. "Our view is that the crux of the crisis is housing and we need to stabilize housing to stabilize the economy," said Fink.
- According to *Fox News*, "The plan could be announced [the week of December 15<sup>th</sup>], as part of any Bush Administration request to Congress to allow the Treasury to tap the \$350 billion, second tranche of funding in the \$700 billion economic stabilization plan Congress approved in October. Under the legislation, the administration must detail for Congress what it plans to do with the funding. Of the first \$350 billion released in the plan, all but \$15 billion remains unspent or uncommitted by Treasury."
- Over the past month, the National Association of Realtors and National Association of Home Builders have been pushing for government-subsidized interest rates to the 4.5% level. According to NAR research, an interest rate deduction of just one percentage point could result in as many as 840,000 additional home sales, which would further reduce the inventory of homes by as much as 20%. "The buy-down program would complement the loss mitigation elements of TARP and provide an incentive to buy homes, which will reduce the housing inventory. This in turn will

stabilize home values, lessen foreclosure pressure, boost home sales activity and breathe new life into our nation's economy," said NAR president Charles McMillan. "We implore the Treasury, the Federal Reserve, the incoming Obama administration and Congress to get together and use all available resources, including the Troubled Assets Recovery Program, to quickly put a [mortgage] rate buy-down in place. This will really assist American families facing difficult economic times in the coming holiday season."

- "Lower mortgage rates will allow households to fortify their balance sheets, and we will likely see consumer spending come back a little quicker than it would otherwise," said Wachovia senior economist Mark Vitner. "It's not going to be an instant panacea for what ails the economy."
- An underlying problem with the plan relates to the funding the MBS. "If the plan relies on investors buying 3% Treasuries to fund 4.5%, one has to ask how still additional Treasury supply is going to attract still more buyers of 3% Treasuries," said FTN Financial analyst Jim Vogel. "Demand is not infinite, particularly when risk begins to stabilize." Nicholas Strand, head of Barclay's agency mortgage bond strategy, said between 20% and 25% of mortgage loan originations in the U.S. are currently underwater and wouldn't qualify for GSE refinancing, which would require borrowers to maintain a minimum of 3% equity in their homes. "So this would help, but only helps agency borrowers," said Strand. "I don't see how this would help other non-agency borrowers who essentially can't even get a mortgage at this point."
- In a December 4<sup>th</sup> speech, Treasury Secretary Henry Paulson said, "The most important thing we can do to mitigate foreclosures and progress through the housing correction is to reduce the cost of mortgage finance, so more families can afford to buy a home and so homeowners can refinance into more affordable mortgages." (*Fox Business News*, 12/03/08; *Bloomberg News*, Robert Schmidt and Craig Torres, 12/12/08; *National Association of Realtors Press Release*, 12/09/08; *Bloomberg News*, Sree Vidya Bhaktavatsalam, 12/11/08; *HousingWire*, Paul Jackson, 12/04/08; *Washington Post*, David Cho, Zachary A. Goldfarb, and Dina ElBoghdady, 12/04/08; *Wall Street Journal*, Deborah Solomon and Damian Paletta, 12/04/08; *National Association of Realtors Press Release*, 12/15/08)

*Congress investigates the failure of Fannie and Freddie:*

The buck *doesn't* stop here, say the GSEs' executives

What do we do with Fannie and Freddie now?

The buck doesn't stop here, say the GSEs' executives

- During a hearing on the failure of Fannie Mae and Freddie Mac, the companies' former executives told the House Oversight and Government Reform Committee that it was a struggle for to meet the GSEs' dual mandates of making a profit for shareholders and promoting affordable housing as its public mission. As Congress pressured the companies to finance low income borrowers, the regulator did little—or nothing—to curb their increasing exposure to riskier mortgages, the executives argued. Freddie Mac CEO Richard Syron said he faced enormous pressure in balancing the company's affordable housing goals and the demands of private shareholders. "We had to balance between the needs of safety and soundness, the needs of our mission, and the needs also to be relevant in the perspective of our shareholders because we were like any other private-held company," said Syron. "I checked a number of times and we had no ability to treat our shareholders differently than anyone else did." Franklin Raines, Fannie's former chairman and CEO, said, "It is remarkable that during the period that Fannie Mae substantially increased its exposure to credit risk, its regulator made no visible effort to enforce any limits. The regulator limited its intervention to the size of the on-balance sheet mortgage portfolio and the attendant interest rate risk. Indeed, right up until the time Fannie Mae was placed into conservatorship, the director of OFHEO maintained that the company was well capitalized to withstand the losses it would face."
- Former Fannie Mae CEO Daniel Mudd told the panel that the takeover of his company wasn't necessary and a "more modest" form of government action would have been adequate to keep its business sound. "While I deeply respect the myriad challenges facing the Treasury Department and the regulator, I did not believe that conservatorship was the best solution for Fannie Mae," said Mudd. Instead, he argued a "more modest government support" could have been used to raise private capital, "basically something more like the program many banks are eligible for now."
- Fannie and Freddie engaged in "an orgy of junk mortgage development," which turned the enterprises into vast repositories of subprime and risky nonprime mortgages—despite repeated warnings years ago from internal risk officers, according to internal documents. Edward J. Pinto, Fannie Mae's former chief credit officer, told the panel, "There are many more subprime and alt-A mortgages outstanding today than many people suppose, because half of all these loans are held or securitized by Fannie and Freddie and yet are carried in many databases as prime loans." The GSEs' push into risky mortgages from 2005 to 2007 has resulted in

Fannie and Freddie now guaranteeing or holding 10.5 million of nonprime loans worth \$1.6 trillion, said Pinto. Today, the GSEs' own or insure one in three of all subprime loans and nearly two-thirds of all Alt-A loans, he added. According to Pinto, these loans now comprise 34% of Fannie's and Freddie's single family mortgage portfolios, which may ultimately lead them to 8 million foreclosures in coming years. Pinto's testimony shed new light on the role that Fannie and Freddie played in the housing crisis. As Arnold King, a former economist for Freddie Mac, told the panel, high-risk loans were "laundered" by Wall Street and returned to the banking system as AAA-rated securities for sale to investors, which obscured the loans' risk. In a December 8<sup>th</sup> interview with the *Washington Post*, Fannie's former chairman and CEO Franklin Raines said, "These [risky] loans were bad loans from the beginning. It was knowable these were bad loans. You have a world in which very smart people at Fannie Mae and elsewhere suspended belief."

- Committee chairman Henry Waxman (D-CA) said that Fannie Mae's and Freddie executives ignored the "warnings of risks" related to their expansion into subprime and nontraditional mortgages and "their irresponsible decisions are now costing taxpayers billions of dollars." Waxman cited internal company documents that showed Fannie Mae CEO Daniel Mudd and Freddie Mac CEO Richard Syron ignored warnings about the growing risks the companies were taking in their expanded investment in nontraditional mortgage products. "These documents make clear that Fannie Mae and Freddie Mac knew what they were doing" said Waxman. "Their own risk managers raised warning after warning about the dangers of investing heavily in the subprime and alternative mortgage markets ...but these warnings were ignored."
- Representative Darrell Issa (R-CA) said, "All four of you [former GSE executives] seem to be in complete denial that Fannie and Freddie are in any way responsible for this [failure]. You're either standing behind the mandate of Congress or your mandate of your stockholders or perhaps the mandate of your bonus packages and you're telling us everyone's doing it." Issa acknowledged that Congress shares some of the blame for the failure of Fannie and Freddie, saying: "We have to recognize that what we've done with the GSE's hasn't worked. We in the Congress have to look in the mirror, because part of the blame is on our doorstep." Representative Lynn Westmoreland (R-GA), told the GSE executives: "I'm glad I came to the hearing today to learn that none of you had anything to do with Fannie Mae or Freddie Mac when it was going south. Your job as CEO was to rearrange the chairs on the deck of the Titanic and you didn't even know it was going down." Representative Stephen F. Lynch (D-MA) told the GSE executives: "[I]f you have accomplished anything here today, you have made conservatorship look very, very good."
- Mudd urged lawmakers to reconsider the structure of Fannie and Freddie, asking "whether the economy would be better served by fully private or fully public GSE. "I would advocate moving the GSEs out of No Man's Land," said Mudd. "Events have shown how difficult it is to balance financial, capital, market, housing, shareholder,

bondholder, homeowner, private and public interests in a crisis of these proportions.” Raines told the panel, “The GSE model is a far from perfect way to achieve the goal of using private capital to achieve the public purpose of homeownership and affordable rental housing. However, if the public policy goal remains the same, it will be hard to find a model that has more benefits and fewer demerits than the model that worked reasonably well for almost seven decades at Fannie Mae.” Raines and Syron defended the GSE model, arguing that it has served the housing market well. Syron said, “If you want to have long- term, fixed-rate mortgages, which the United States as an industrial country is pretty unique in having, you need to have some mechanism like the GSEs,” said Syron. “I think it is worth doing a very thorough commission or review of how these organizations are structured,” he told the committee. (*New York Times*, Lynnley Browning, 12/10/08; *CongressDaily*, Dan Friedman and Bill Swindell, 12/09/08; *Bureau of National Affairs*, Mike Ferullo, 12/10/08; *American Banker*, Steven Sloan, 12/10/08; *Bloomberg News*, Dawn Kopecki, 12/09/08; *American Banker*, Allison Bisbey Colter, 12/11/08)

- In a December 11<sup>th</sup> editorial, the *Wall Street Journal* wrote, “The two government-sponsored mortgage giants [Fannie Mae and Freddie Mac] have long maintained they were merely unwitting victims of a financial act of God. That is, while the rest of the market went crazy over subprime and ‘liar’ loans, Fan and Fred claimed to be the grownups of the mortgage market. There they were, the fable goes, quietly underwriting their 80% fixed-rate 30-year mortgages when—Ka-Pow!—they were blindsided by the greedy excesses of the subprime lenders who lacked their scruples.”
- “But previously undisclosed internal documents that are now in Mr. Waxman’s possession and that we’ve seen tell a different story. Memos and emails at the highest levels of Fannie and Freddie management in 2004 and 2005 paint a picture of two companies that saw their market share eroded by such products as option-ARMs and interest-only mortgages. The two companies were prepared to walk ever further out on the risk curve to maintain their market position. The companies understood the risks they were running. But squeezed between the need to meet affordable-housing goals set by HUD and the desire to sustain their growth and profits, they took the leap anyway. As a result, by the middle of this year, the two companies were responsible for some \$1.6 trillion worth of subprime credit of one form or another. The answer to Mr. Waxman’s question about their role in the crisis, in other words, is that they were central players, if not the central players, in the creation of the housing boom and the credit bust. ...The documents plainly show that people at both Fan and Fred clearly understood that these mortgages were risky, thought many homeowners didn’t understand them and that they were putting their business at risk by buying up Alt-A and subprime mortgage-backed securities...”
- “Mr. Waxman calls it a ‘myth’ that Fannie and Freddie were the originators of the crisis. That’s a red herring. Mr. Waxman’s documents prove beyond doubt that Fan and Fred turbocharged the housing mania with a taxpayer-backed, Congressionally protected business model that has cost America dearly.” (*Wall Street Journal*, 12/11/08)

- On the December 10<sup>th</sup> edition of Fox News' *Special Report with Brit Hume*, Mort Kondracke said, "...There is one thing missing [from today's hearing on Fannie and Freddie]—I agree that Henry Waxman was tough on these guys, but he was not tough on the enablers of this guy, namely, members of Congress of his own party—Barney Frank, Chris Dodd, the people who—and some Republicans—who resisted regulation, which the Bush administration, to its credit, wanted to put into effect on the GSEs. Freddie and Fannie spent something like \$11.5 million on lobbyists, 52 different lobbyists were hired and ordered to resist regulation, which the Bush administration was seeking. Now, I'd like to see another hearing where Barney Frank and Chris Dodd come in and explain themselves. Why did you resist this? One said 'if it ain't broke, don't fix it.' Well, I say we saw today that Fannie Mae and Freddie Mac were broke, broken, and it should have been fixed. *And Congress resisted fixing it.*" [Emphasis added.] (*Special Report with Brit Hume*, Mort Kondracke, 12/10/08)

#### What do we do with Fannie and Freddie now?

- The consensus among Republicans and Democrats is that the GSEs' current hybrid structure private ownership/public mission doesn't work and must be restructured—but how? House Financial Services Committee chairman Barney Frank (D-MA), who will have a key role in this debate, says he doesn't favor the status quo. In a recent interview with the *Wall Street Journal*, Frank said the GSEs' hybrid system "didn't work well" and there may be a case for separating their current functions into different entities, one to finance housing that is affordable for low- and moderate-income people and another to ensure adequate funding for the mortgage market in general.
- In the industry, a buzz is growing that the Federal Home Loan Banks might purchase the government-controlled Fannie Mae and Freddie Mac. While the concept is very early in its formation, the proposal calls for turning Fannie and Freddie into cooperatives owned by the lenders that sell the enterprises mortgages. These cooperatives would then securitize mortgages for sale to investors. Unlike Fannie and Freddie, the cooperatives wouldn't own large amounts of loans and MBS on their books. To make mortgage securities attractive for investors, Treasury would receive fees for agreeing "explicitly" to cover any losses on the MBS above a certain level. Treasury's explicit guarantee would replace the current system in which investors have assumed that the government would stand behind Fannie and Freddie through an "implied" guarantee. This approach would remove Fannie's and Freddie's responsibility for ensuring the mortgage market's liquidity through their purchase of mortgage-backed securities. Instead, Congress could set up government programs to achieve mortgage market liquidity, if necessary. If such a plan comes to fruition, the FHLB System would finally have something it has longed for—the ability to securitize mortgages. A source close to the FHLBs said, "Members need an avenue to securitize their mortgages. Unless we have a healthy secondary market, it's going to be hard for mortgages to be made in this country."

- A number of hurdles remain to such a cooperative structure, including the FHLBs being barred from holding publicly-traded stock. An unanswered question also remains as to the FHLB System's financial ability to Fannie and Freddie. Some observers say the purchase price could be a nonstarter for the FHLBs, since the Banks would have to tap its members for needed capital and the members are currently strapped for capital as it is. While some say the idea may be outlandish, observers note that the FHLB System owned Freddie Mac until February 1990. "This would be back to the future," said Alex Pollock, the former president of the FHLB-Chicago and fellow with the American Enterprise Institute. (*Wall Street Journal*, James R. Hagerly, 12/01/08; *American Banker*, Steven Sloan, 12/02/08)
- In a November 28<sup>th</sup> editorial, the *Washington Post* wrote, "It looks like Lawrence Summers will be the economic ideas man inside the Obama White House. As a former Treasury secretary and Harvard president, he is well qualified for his new post, which carries the formal title of director of the National Economic Council. And we have a suggestion for his first special task: devising a long-term solution to the mess at Fannie Mae and Freddie Mac."
- "When the Bush administration took over the two companies, ... it pledged that the move would make the mortgage market more liquid. This was true, in the sense that Fannie and Freddie—which own or back more than \$5 trillion in mortgages and which reported combined losses of \$54 billion in the third quarter—would probably be in even worse shape now if the government had not acted. However, the government's action created new uncertainties about the two firms, and those uncertainties are impeding housing's recovery. One market worry—the precise nature and strength of the government's guarantee—was partly resolved on Tuesday when the Federal Reserve announced that it would buy Fannie and Freddie's mortgage-backed securities and some of their debt. But the more fundamental question of Fannie and Freddie's future remains unresolved. Market wariness toward their debt reflects investor doubts as to whether they will remain government-sponsored enterprises, or GSEs, owned by private shareholders but with taxpayers on the hook for their losses—or whether they will be reformed."
- "Mr. Summers is the right person to lead a Fannie-Freddie rethink because he so clearly comprehends what went wrong. In a July 16 posting on the *Creative Capitalism* Web site, he provided this succinct postmortem: 'The illusion that the companies were doing virtuous work made it impossible to build a political case for serious regulation. ... When there were social failures the companies always blamed their need to perform for the shareholders. When there were business failures it was always the result of their social obligations. Government budget discipline was not appropriate because it was always emphasized that they were "private companies." But market discipline was nearly nonexistent given the general perception—now validated—that their debt was government backed. Little wonder with gains privatized and losses socialized that the enterprises have gambled their way into financial catastrophe.'"

- “In a *Post* op-ed on July 28, Mr. Summers suggested that after the current crisis has passed, the government could divide the firms’ functions into government and private components, the latter of which would be sold off in multiple pieces. The proceeds could be used to fund the low income housing support activity that was previously mandated to the GSEs.’ Whether or not that precise formula is best, Mr. Summers is clearly right that the hybrid public-private model no longer makes sense—a point that his future boss, President-elect Barack Obama has also embraced. Now all that’s left is for the new administration to place a high priority on fixing Fannie and Freddie, give Mr. Summers the assignment, and start working with Congress to make it happen. For a presidency that promises fundamental change, we cannot think of a more appropriate undertaking.” (*Washington Post*, 11/28/08)

## **TARP**

Government watchdogs criticize Treasury’s oversight of TARP
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- In separate testimony, the GAO and the TARP Congressional Oversight Panel (TARP COP) criticized the Treasury Department for doling out billions of dollars to banks without any means of ensuring that they comply with government restrictions or that federal funds were used to help increase the availability of credit to consumers. In its first report to Congress, the four-person Congressional Oversight Panel concluded that Treasury had “administered TARP without seeking to monitor the use of funds provided to specific financial institutions.” The panel added, “Treasury cannot simply trust the financial institutions will act in the desired ways; it must verify.”
- [The TARP COP got off to a rocky start with its sole Republican member, Representative Jeb Hensarling (R-TX), refusing to approve the panel’s report, saying he does not have the resources to adequately do his job. The other Republican member of the panel, Senator Judd Gregg (R-NH) has resigned and his replacement has not been named.]
- Acting comptroller general Gene Dodaro acknowledged that while the TARP program has been in place only a short time, his agency “found that it has yet to address a number of critical issues,” including compliance with executive compensation and dividend restrictions, and the broader issue of measuring the success of the program. “Until these issues are resolved, there is heightened risk that the interests of the government and taxpayers may not be adequately protected and that [Treasury] may not achieve its mission in an effective and efficient manner,” said Dodaro.
- In testimony before the House Financial Services Committee, Assistant Treasury Secretary Neel Kashkari defended his agency’s actions, saying Treasury has made “significant progress” toward stabilizing financial markets and is committed to a

transparent process. “But we don’t have the luxury of first building the operation, then designing our programs and then executing them,” Kashkari told the panel. “Given the severity of the financial crisis, we must build the Office of Financial Stability, design our programs, and execute them—all at the same time.”

- With the number of lawmakers criticizing Treasury’s \$700 billion TARP, House Financial Services Chairman Barney Frank (D-MA) warned that significant deliberations would need to occur if Treasury decided to tap the second \$350 billion installment of TARP funding. Representative Maxine Waters (D-CA) pointedly told Kashkari: “Please don’t come here and ask for another penny, because if you do, I’m going to work 24 hours a day with the same people that I worked with to support [the program initially] to make sure that they do not support giving you another dime.” Ranking member Spencer Bachus (R-AL) said, “I wonder whether [Treasury Secretary Henry Paulson] or Mr. Kashkari, back when they were still working for Goldman Sachs, ever agreed to a deal in which billions of dollars changed hands based on a two-page application without asking what the money was going to be used for and whether it was going to be paid back.”
- While it is clear that TARP could be run better, Frank said his biggest concern remains Treasury’s inability to address the rising number of foreclosures in the country. Frank said, “The whole issue of foreclosure relief is the single greatest failure in public policy recently...The refusal so far to use the money for [foreclosure mitigation] has been a violation of the intent [of the legislation] and undermines the ability to get the votes from Congress in the future,” said Frank, referring to the second \$350 billion installment of TARP funding that Congress can vote to withhold. “I think it is likely at this point, absent a lot of work on foreclosures and other things that such a [funding disapproval] resolution could pass.” Frank added, “If there is a request of the second [\$350 billion], whether it comes early in January as a joint proposal from the two administrations or comes later, I would like to be in the position to defend the [money], to oppose efforts to cut it off. The extent to which I and the Speaker and a few others can get major legislation through entirely on our charm has run out, so we’re going to need some very hard answers.”
- Kashkari told the panel that Secretary Paulson has not made a determination as to whether Treasury will tap the second half of the TARP fund during the remainder of President Bush’s term in office. “If it were to be made, he would do it consulting with the [Obama] transition team and Congress,” said Kashkari. To date, some \$335 billion of the first TARP allotment has been spoken for, much of it dedicated to capital infusions for banks. He also told lawmakers that Treasury is currently working with the bank regulators to determine the best way to monitor the TARP infusions in financial institutions. “We intend to have a fully functioning TARP organization in place as the new administration takes office,” said Kashkari.
- President-elect Barack Obama expressed concern about the GAO report, saying that Treasury’s TARP lacks a comprehensive plan to ensure that its funds are used properly and has greater oversight and accountability. Obama said, “We’re seeing

some areas where we can be doing better, in making sure that this money is not going to CEO compensation, that it's protecting taxpayers, and that the taxpayers are going to get their money back; that it's effective in shoring up our financial markets.”  
(*Bureau of National Affairs*, R. Christian Bruce, 12/11/08; Maya Jackson Randall and Michael R. Crittenden, 12/09/08; *American Banker*, Stacy Kaper, 12/09/08; *CQ Today*, Benton Ives, 12/08/08; *HousingWire*, Diana Golobay, 12/04/08; *CQ Today*, Phil Mattingly, 12/10/08; *Wall Street Journal*, Michael R. Crittenden, 12/10/08; *CongressDaily*, Bill Swindell, 12/10/08; *Bureau of National Affairs*, 12/03/08)

#### Senate confirms the Special Inspector General for TARP

- On December 8, 2008, the Senate confirmed New York Prosecutor Neil Barofsky to serve as the Special Inspector General within Treasury, responsible for auditing TARP. (*Wall Street Journal*, Maya Jackson Randall, 12/09/08)

#### Treasury is working on way for mutual institutions and Subchapter S corps to participate in the Capital Purchase Plan

- On December 8<sup>th</sup>, Neel Kashkari, Treasury Department's interim secretary for financial stability, said the Treasury Department plan to allow taxpayer-funded capital injections for financial institutions organized as mutual organizations or Subchapter S corporations is moving slowly because of complex tax questions and other matters. “There are some real legal challenges associated with the way those institutions are structured,” said Kashkari. Treasury staffers are still trying to work their way through the legal difficulties and tax questions posed by the effort and it's uncertain when the issues will be resolved, he added. (*Bureau of National Affairs*, 12/09/08)

#### Treasury invests in Central Pacific Financial, an ailing Hawaii bank

- In a surprising move, the Treasury Department elected to inject \$135 million from its Capital Purchase Program into the ailing Central Pacific Financial, Hawaii's 4<sup>th</sup> largest bank with \$4 billion in deposits. CPF announced it had entered into a regulatory agreement, requiring the bank to limit dividends, subjecting the bank to government oversight, and requiring it to raise capital. At the same time, CPF announced Treasury's investment of \$135 billion in the bank. Banking analysts said Treasury's decision to spare CPF was surprising, particularly when contrasted by the agency's public rejection of National City of Cleveland, which was forced to sell itself to PNC Financial of Pittsburgh. “It has raised a lot of eyebrows,” said Brian Gardner, a Keefe, Bruyette & Woods analyst. “This clearly wasn't a bank that was too big to fail. After National City didn't get [CPP] money, why would you give it to” Central Pacific?” (*Washington Post*, Binyamin Appelbaum, 12/12/08)

## Treasury announces the Systemically Significant Failing Institutions Program

- The Treasury Department has released guidelines for its Systemically Significant Failing Institutions (SSFI) Program, which will be evaluated on a case-by-case basis pursuant to the Emergency Economic Stabilization Act of 2008. In this program, Treasury will consider (i) the extent to which the failure of an institution could threaten the viability of its creditors and counterparties because of their direct exposures to the institution; (ii) the number and size of financial institutions that are seen by investors or counterparties as similarly situated to the failing institution, or that would otherwise be likely to experience indirect negative effects from the failure of the institution; (iii) whether the institution is sufficiently important to the nation's financial and economic system that a disorderly failure would, with a high probability, cause certain major disruptions to the financial system; and/or (iv) the extent and probability of the institution's ability to access alternative sources of capital and liquidity. In making its determination, Treasury will consider information from a variety of sources, including recommendations from an institution's primary regulator, if applicable. Treasury may invest in any financial instrument of an institution, including debt, equity, or warrants, determined to be a troubled asset. Any institution participating in the SSFI Program will be required to provide the Treasury with warrants or alternative consideration, as it determines to be necessary. Institutions must also comply with the Treasury's limitations on executive compensation. Treasury also may impose additional corporate governance limitations, including restrictions on an institution's expenditures or bonus payments. (*InfoBytes*, Buckley Kolar, LLP, 12/05/08)

## Controversy over Notice on Use of Bank Loss Notices grows

- Three congressional watchdog groups waded into the fray surrounding the Treasury Department's guidance [Notice 2008-83] that lifted the limits on the use of losses by banks, following acquisitions. In a letter to senators dated November 30<sup>th</sup>, the Citizens for Tax Justice, the Coalition for Human Needs, and OMB Watch said Notice 2008-83 "essentially says banks can ignore specific provisions in the Internal Revenue Code that prevents tax shelters." They wrote, "There is something fundamentally wrong when aid for struggling families must survive a long and difficult legislative process while \$140 billion is spent to subsidize bank mergers through an agency action without congressional authorization... We are urging you to write legislation to reverse IRS Notice 2008-83." (*Bureau of National Affairs*, Alison Bennett, 11/28/08)
- Nine Democratic members of the House Ways and Means Committee have asked Treasury not to expand what they call a tax loophole for bank mergers, as set forth in Notice 2008-83. While the new rule applies only to banks, Democrats are concerned about the potential expansion of its scope, citing an industry proposal to allow foreign banks to take advantage of the provision. Representative Lloyd Doggett (D-TX), who

has introduced a bill on the issue, is spearheading the effort. Other members of the group include Representatives Pete Stark (D-CA), John Lewis (D-GA), Jim McDermott (D-WA), Chris Van Hollen (D-MD), Bill Pascrell Jr. (D-NJ), Shelley Berkley (D-NV), Earl Blumenauer (D-OR), and Mike Thompson (D-CA). (CQ *Today Midday Update*, 12/04/08)

The Service Employees International Union wants to organize bank workers

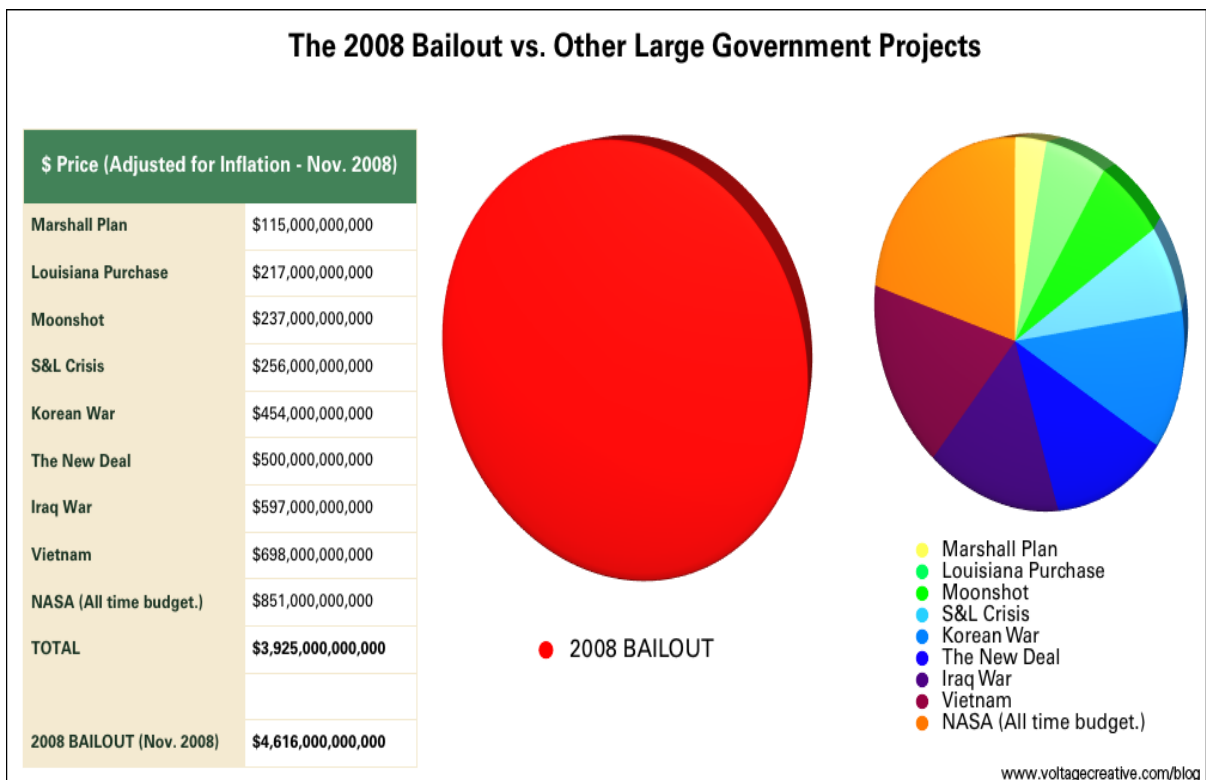
- As a result of the \$700 billion financial system bailout, the powerful Service Employees International Union has decided it wants to organize bank workers. In a November 13<sup>th</sup> email obtained exclusively by CNN, Inga Skippings, a member of SEIU's Private Equity Project, outlined initial discussions to organize bank workers "since the banking industry is now being infused with billions of taxpayer dollars." The e-mail was written to the director of the Washington office of the Association of Community Organizing for Reform Now (ACORN).
- Skippings continued, "Do you have ACORN members who work for banks or Freddie Mac/Fannie Mae? Is there anyway [sic] you could check? The banks we're most concerned about are: Fannie Mae, Freddie Mac, Chevy Chase/B.F.Saul, BB&T, SunTrust, Bank of America/Countrywide, Wachovia/Wells Fargo, PNC Bank/National City, Citigroup. Please let me know and if you have other suggestions, I'd love to hear them."
- SEIU is the fastest-growing trade union in North America, according to its own Web site, and its clout continues to grow. SEIU's \$85 million in political donations made it the single-largest contributor to either party in the 2008 elections, in which the union worked vigorously for the election of Barack Obama. (CNN.com, Drew Griffin and Kathleen Johnson, 12/08/08)

Keep the water pouring...

- In the December 12<sup>th</sup> issue of *Frontline Weekly Newsletter*, John Mauldin wrote, "...[I]f it looks like Bernanke and Paulson are making all their policy moves 'on the fly,' it is because that is exactly what they are doing. As would any person in their respective offices. There is no playbook with a set of standard policies and procedures that can be used in case of a credit crisis. They have to make up the plays as the game progresses, much as we did in pick-up football games as kids. 'John, go long and make a left cut at the trashcan. And try not to drop it this time.'"
- "There are very few real rules and laws, and Bernanke and Paulson have shown a willingness to ignore them if they seem to get in the way. This is a very pragmatic group that is trying to keep the economy from imploding. They only have a few theories and some loose analogies to what happened in Japan and maybe the US in

the 1930s as guidelines. But those times had such major significant differences that it is hard to make a direct inference as to what did and did not work. As Yogi Berra is alleged to have said, 'In theory, there is no difference between practice and theory. In practice, there is.' And when theories meet the rough hand of the market, they will be changed.”

- “We are getting to ready to run a grand experiment on many theories in the world of economics. Will Ben and Hank (soon to be Tim) get it precisely right? And what is precisely right? Does the avoidance of a second Great Depression mean success? Will anyone be grateful? ...Look at the previous Treasury secretaries under Bush. No disrespect to Mr. O’Neill or Mr. Snow, but would you really want someone with so little exposure to the capital markets in the current position? Compared to so many Treasury secretaries over the past 30 years, we are lucky to have Paulson at this time.”
- “In any event, Paulson is pouring water on the fire as fast as he can. I doubt that Tim Geithner will do any different. If Geithner has a play book for avoiding deflation and depressions, he has not shared it with anyone. They will still be making the plays up as they go along next year. I just hope they call the right plays...” (of *Frontline Weekly Newsletter*, John Mauldin, 12/12/08)
- The following table illustrates the cost of the bailout through the end of November, relative other large government projects, adjusted for inflation. ([www.voltagecreative.com/blog](http://www.voltagecreative.com/blog)).



## ***Proposed National Infrastructure Bank***

Governors call for the creation of a new GSE: the National Infrastructure Bank

- On December 3, the National Governors Association (NGA) urged President-elect Obama to establish a national infrastructure bank which could issue bonds to finance infrastructure projects as part of the Democrats stimulus package. “Your suggestion during the campaign for an infrastructure bank ...would be an important element for that recovery plan,” said NGA chairman and Pennsylvania Governor Ed Rendell (D). The governors hope that massive federal spending on infrastructure needs can help states overcome more than \$100 billion in budget gaps, which are forecast over the next two fiscal years. To date, the NGA has identified infrastructure projects worth \$136 billion, “that are ready to go.” In addition, the governors are asking that \$40 billion of the stimulus program be given to the states to fund Medicaid programs. The governors’ proposal mirrored a program promoted by Obama during the campaign, which called for the creation of a bank that could issue up to \$60 billion in tax-credit bonds that provide investors tax credits rather than interest payments. On August 1, 2007, Senate Banking Chairman Christopher Dodd and Senator Chuck Hagel (R-NE) introduced legislation to create an infrastructure bank with a mission of improving the nation’s infrastructure. The Senators unveiled the bill on the day that the Interstate 35W bridge in Minneapolis collapsed, killing 13 and injuring 145. The measure never got a floor vote.
- While not responding to Rendell’s proposal directly, President-elect Obama said that he looked forward to meeting with the NGA and underscored the importance of governors’ input on the economy. “The partnership we begin here must not—and will not—end here,” said Obama. “As president, I will not simply ask our nation’s governors to help implement our economic recovery plan. I will ask you to help design that plan.”
- During his December 6<sup>th</sup> radio address, Obama outlined his plans for a massive government investment program in technological and physical infrastructure needs as part of an economic stimulus bill that Congress will consider in January. Obama called for passage of the “single largest investment in our national infrastructure since the creation of the federal highway system in the 1950s,” but did not specify how much he wants to spend. He called for the stimulus bill to (1) make public buildings more energy efficient; (2) fund roads, bridges, and other parts of the country’s physical infrastructure; (3) repair and modernize schools; (4) provide broadband access to more parts of the country; and (5) ensure that all hospitals and doctor’s offices have access to patients electronic medical records. Obama said, “We need a big stimulus package that will jolt the economy back into shape and that is focused on the 2.5 million jobs that I intend to create during the first part of my administration. We have to put people back to work.”

- Obama has announced his economic team, which will work with Congress on the development of a stimulus package to jumpstart the national economy and create jobs. The key members of the administration's economic team include Timothy F. Geithner, the president of the Federal Reserve Bank of New York, to serve as Secretary of the Treasury; Peter R. Orszag, the director of CBO, to serve as director of OMB; Rob Nabors, staff director of the House Appropriations Committee, to serve as Orszag's deputy; Lawrence Summers, the former Secretary of the Treasury from 1999 to 2001, to serve as chairman of the National Economic Council; Christina D. Romer, an economics professor at the University of California at Berkeley, to chair the White House Council of Economic Advisors; Melody C. Barnes, a former chief counsel to Senator Edward Kennedy (D-MA), to chair the White House Domestic Policy Council; Paul Volker, a former chairman of the Federal Reserve, to chair the newly-formed Economic Recovery Advisory Board; and Austan Goolsbee, the University of Chicago economist, to serve as the board's staff director and chief economist. [In addition, Obama has named New York City Housing Commissioner Shaun Donovan to serve as HUD Secretary.]
- Obama plans to have the 111<sup>th</sup> Congress begin work on an aggressive economic recovery plan when they convene on January 6<sup>th</sup> with the goal of having the stimulus package ready around the time he takes office. According to the *Wall Street Journal*, Obama aides and advisers have set \$600 billion over two years as "a very low-end estimate" with the final number expected to be significantly higher, possibly between \$700 billion and \$1 trillion over two years. In addition to fiscal stimulus measures, the legislation may also include an extension of the increase in the conforming loan limits for Fannie Mae and Freddie Mac and insurance limits for FHA loans, which House Financial Services Committee Chairman Barney Frank (D-MA) is advocating.
- In an interview with Al Hunt of Bloomberg Television's "Political Capital with Al Hunt," House Speaker Nancy Pelosi (D-CA), said, "This week we had our most recent presentations from economists to tell us what—how robust such a package should be in order to have an impact on the economy, to turn the economy around. Economists told us that the package had to be strong enough, half a trillion, \$600 billion, somewhere near that." The stimulus package wouldn't be like "a 1930s public works project," but instead would have such modern components as broader access to quick Internet connections and greener forms of energy, she said. "The key number is 2.5 million jobs in the next few years that we want this package to stimulate. I hear people say, 'Oh, they want a 1930s public works project.' No. Certainly we will have public works projects in it, but it's about broadband for all Americans. It's about a smart, modern grid to be able to transmit the new, renewable energy – wind, solar, biofuels and the rest. It's about a very modern approach to building the infrastructure of America."
- House Financial Services chairman Barney Frank (D-MA) said he does not expect changes to the bankruptcy law to prevent foreclosures to be included in the economic recovery bill that Congress plans to pass in January. However, Frank warned

industry groups that Congress will pass a bankruptcy bill later in the year, if the level of loan modifications doesn't increase significantly. "If by February we have the same frustration. If we aren't able to have a better success rate at reducing foreclosures, then I believe political support for bankruptcy will increase," said Frank at an OTS housing forum. However, Senate Finance Whip Durbin said he would push a measure to provide bankruptcy judges additional power in restructuring mortgages for inclusion in the economic stimulus package in January. (*National Mortgage News*, 12/08/08; *Bureau of National Affairs*, Lorraine McCarthy, 12/03/08; *Congressional Daily*, Humberto Sanchez, 12/02/08; *Washington Post*, Ceci Connolly, 12/02/08; *CQ Weekly*, Benton Ives and Edward Epstein, 12/01/08; *Wall Street Journal Online*, Brad Hayes, 12/01/08; *Bureau of National Affairs*, 11/28/08; *CNNMoney*, Jeanne Sahadi, 12/10/08; *CQ Today Online News*, David Clarke, 12/06/08; *Wall Street Journal*, Jonathan Weisman and Deborah Solomon, 12/13/08; *CongressDaily*, 12/10/08)

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

The GSEs' focus is on providing affordability, liquidity and stability to the mortgage market

FHFA Director Lockhart urges servicers to adopt the GSEs'

"Redefaults" soar

Foreclosure follies

A litmus test for loan modifications?

The GSEs' focus is on providing affordability, liquidity and stability to the mortgage market

- Fannie Mae and Freddie Mac should focus on stabilizing the housing market and lowering mortgage costs, said Federal Housing Finance Agency director James B. Lockhart. "We're making sure that they look not only on profitability but they really focus on their mission," said Lockhart, whose agency placed the companies into conservatorship on September 6<sup>th</sup>. The FHFA has been working with the companies' new management to make sure they provide "affordability, liquidity and stability to the mortgage market," he added. "That's key, and we're doing that in conservatorship and will continue to do that."

- Lockhart said he's seeing "some progress" in mortgage affordability, after the Federal Reserve announced plans on November 25<sup>th</sup> to buy up to \$500 million of mortgage-backed bonds from Fannie, Freddie, and Ginnie Mae, along with \$100 billion of their unsecured debt. The average rate on a 30-year fixed rate loan dropped to 5.45% in the week ended December 5<sup>th</sup>, the lowest level since June 2005 according to the Mortgage Bankers Association.
- The FHFA is working with the Treasury and Federal Reserve on a program to drive rates even lower and is considering a "whole series of ways to get those rates down," said Lockhart. "Obviously there are a lot of things we're looking at, and certainly the Treasury is looking at how to get interest rates lower. The idea is over time, as we develop confidence in the system, we'll get those spreads down. In theory, if they return to a more normal market, interest rates could be less than 4 percent."  
(*Bloomberg News*, Dawn Kopecki, 12/08/08)

#### FHFA Director Lockhart urges servicers to adopt the GSEs' loan modification program

- Federal Housing Finance Director James B. Lockhart urged private lenders and servicers to aggressively modify troubled loans to help borrowers avoid foreclosure. "The cost of foreclosure, economically for investors, is extremely large," said Lockhart. "To stabilize this market, we're going to have to work much harder on that." The director has urged servicers to adopt Fannie Mae's and Freddie Mac's plan to modify loans that are delinquent 90 days or more. "I am convinced that private-label securities trustees and the servicers of the underlying loans can and should embrace the principles of and implement the streamlined modification program," wrote Lockhart in a November 24<sup>th</sup> letter to servicers. Under the GSEs' plan, interest rates may be reduced for as long as five years and loan terms may be extended to 40 years to help homeowners reduce their payments to about 38% of their pretax salaries.
- When the government announced the GSEs' loan modification plan, some GSE executives expressed concerns that the program would weaken their struggling companies. In a staff-wide message to employees, Fannie Mae's CEO Herbert M. Allison Jr., wrote, "As we take further steps to aid homeowners, some employees are asking about the potential cost to the company of modifying loans to help distressed borrowers. Our challenge is to keep families in their homes and support the mortgage markets." In the long-running conflict between the GSEs' profits and their public policy role, public policy is winning during the companies' conservatorship. As Allison said in a recent interview, "We're tilting toward the public mission of the company to safeguard homeowners."
- According to FHFA's Foreclosure Prevention Report, Fannie Mae and Freddie Mac completed 18,693 loss mitigation actions in August, which included 4,402 loan modifications, and completed 15,528 foreclosures. The GSEs' loss mitigation performance ratio for August was 53.5% and year-to-date was 54.7%.

- On December 8<sup>th</sup>, Fannie Mae announced it has shortened the time a servicer must wait to deem a loan eligible for modification. Specifically, Fannie introduced a new 2009 Single-Family Trust Agreement and servicer guidance, which provides servicers the flexibility of going forward to remove a loan from an MBS pool after the mortgage is one month delinquent for the purpose of modifying the loan. [Under current trust agreements, the loan must be 120 days delinquent before the loan can be removed.] For existing MBS pools, Fannie Mae has issued new guidance, directing the servicer to provide foreclosure assistance as soon as the borrower demonstrates the need for help, even if the borrower is current but may ultimately default. Fannie said it has rolled out a streamlined modification process similar to that used by IndyMac, in which borrowers agree to the modification and, after a successful trial period, the loan is permanently modified.
- Fannie Mae and Freddie Mac are working with renters of properties which have been foreclosed on, in an effort to help them stay in their homes. Fannie is finalizing a national policy that will allow tenants to remain in their homes even if their landlord goes into foreclosure. This new policy, which goes into effect on January 9th, is in response to growing pressure from legal aid groups, who have threatened to sue over recent evictions. Fannie said it will also ensure that its current holiday moratorium on new evictions is being followed for tenants until this new policy goes into effect.
- Although Fannie and Freddie had said they were suspending tenant evictions temporarily during the year-end holidays, New Haven Legal Assistance (NHLA) said Fannie Mae was proceeding with more than a dozen new eviction cases in Connecticut. NHLA threatened to sue Fannie, arguing that the evictions would violate legislation passed earlier in the year that required the GSEs "to permit bona fide tenants who are current on their rent to remain in their homes under the terms of their lease."
- A Freddie Mac spokesman said the company is "currently evaluating additional actions" with regard to protecting renters. Previously, company officials had said they were drafting policy which would allow the renter to remain in these properties under certain conditions. Tenants of two- to four-family properties that Freddie acquires through foreclosure can remain in the property, if their unit is inhabitable and up to code and if one unit is available to show. FHFA said it will work with Fannie and Freddie to ensure that policies are developed and carried out to protect tenants. (Bloomberg News, Dawn Kopecki, 12/08//08; HousingWire, Paul Jackson, 12/08/08; Bloomberg News, Dawn Kopecki, 11/25/08; Federal Housing Finance Agency Press Release, 11/25/08; Washington Post, Zachary A. Goldfarb, 12/08/08; Federal Housing Finance Agency Press Release, 11/24/08; American Banker, Allison Bisbey Colter and Harry Terris, 12/04/08; Federal Housing Finance Agency Press Release, 11/25/058; Bloomberg News, Dawn Kopecki, 12/10/08; *Wall Street Journal*, Kelly Evans, 12/15/08)

## Redefault rates soar

- More than half of loans modified in the first quarter of 2008 fell delinquent [again] within six months, said Comptroller of the Currency John C. Dugan at the OTS National Housing Forum. “After three months, nearly 36% of the borrowers had re-defaulted by being more than 30 days past due. After six months, the rate was nearly 53%, and after eight months, 58%. The data is similar for mortgages modified in the second quarter: the re-default rate after three months was 39 percent, and after six months, 51 percent.” Dugan characterized these results as “surprising” for regulators.
- “I do have concerns about allocating significant resources to loan modifications with such a high rate of re-default,” said OTS director John Reich. FDIC chairman Sheila Bair argued aid efforts to borrowers were falling short and that the “quality of the [modifications] are not what they should be.”
- According to *HousingWire*, “...[R]ecidivism rates are right where they historically have been, despite growing pressure to ‘do something’ about the growing number of foreclosures. ... Anyone with experience in this space expects roughly 50 percent recidivism on loan modifications, various sources in the servicing side of the business said, give or take some wiggle room with differences in vintage and product type. The fact that regulators were blindsided by these numbers seems likely to generate more cries for aggressive loan modifications, especially of the principal-forgiveness variety, from consumer groups and the government officials; but doing so entails huge moral hazard for lenders, and the very real risk that other borrowers currently performing on their notes will seek to default in order to lower their own mortgage balances.” (*Associated Press*, 12/08/08; *HousingWire*, Paul Jackson, 12/08/08; *Reuters*, 12/08/08; *Calculated Risk*, 12/08/08)

## Foreclosure follies

- In a December 10<sup>th</sup> editorial, the *Wall Street Journal* wrote, “On Monday [December 8<sup>th</sup>] we published a letter from the FDIC complaining about our recent editorial on the agency’s mortgage modification plan. Hours later, the Comptroller of the Currency released new data suggesting that the FDIC proposal may be as bad as we feared. The FDIC wants to pay loan servicers to restructure delinquent loans and then have taxpayers share the losses if the loans fail again after six months. The FDIC did not appreciate that we reported private data showing that more than 50% of modified loans go delinquent again. The agency suggested that 15% might be a better estimate.”
- “That estimate just got a lot harder to defend. Comptroller John Dugan released the default numbers on loans modified in the first two quarters of 2008, based on data from institutions servicing more than 60% of all first mortgages. ‘What makes these quarterly reports unique is that they are not merely surveys, but instead consist of

validated, loan level data,' said Mr. Dugan. 'We believe the reports include the most accurate and reliable data on mortgage performance that is available today.'"

- "...Of mortgages modified in the early part of this year, more than 35% had gone at least 60 days delinquent again after just six months, and a full 53% were 30 days delinquent or more. By eight months, this default rate had climbed to 58%. Second quarter modifications are on track to be nearly as ugly, with more than 50% of borrowers at least 30 days delinquent at the six-month mark. Come to think of it, these stinkers are going south so quickly that perhaps the FDIC's plan actually will protect taxpayers -- there won't be much left to insure after these toxic loans blow up in the first six months after modification."
- "Of course, that would mean that fewer foreclosures would be avoided, which is supposed to be the point of this exercise. For her part, FDIC Chairman Sheila Bair says that 'The OCC's data on redefaults raises more questions than answers because it fails to define, in any meaningful way, the modifications that have redefaulted.' In politics, when you don't like the data, merely wish it away."
- "She believes that her formula, which reduces interest rates initially but often creates larger obligations down the road, will yield fewer re-defaults than the industry average. Washington's housing bubble resulted in many loans going to borrowers who cannot or will not make their mortgage payments. Let's stop contriving ways for taxpayers to subsidize them." (*Wall Street Journal*, 12/10/08)

#### A litmus test for loan modifications?

- Greenwich Financial Services and QED LLC filed a class action lawsuit in New York State court on behalf of investors in 373 Countrywide mortgage-backed securities totaling \$150 billion, demanding that Countrywide Financial Corp. compensate holders of securities, which are collateralized by mortgages the terms of which the lender modifies. The complaint alleges that the Bank of America/Countrywide settlement with state attorneys general could result in the modification of nearly 400,000 Countrywide loans totaling \$80 billion and the reduction in payments to investors by \$8.4 billion. The plaintiffs argues that under the pooling and servicing agreements, Countrywide must purchase the loans out of the securitized pools at par with accrued interest before the loans can be modified. "The only way to modify the loan according to the contract is to purchase it," said Greenwich president William Frey. Countrywide has no contractual ability to modify the loans and keep them in the securitized trusts, he added.
- In an interview with *Financial Times*, Fey argued that the bank is unfairly passing on the cost of settlement to securities holders. While he does not oppose loan modifications for struggling borrowers, Fey emphasized the importance of protecting the investors' contractual rights in the face of enormous political pressure to modify mortgage loans. "Until they talk about protecting investors, desperately needed capital will not flow back to this market," said Fey.

- Legal experts believe the lawsuit will prove to be a strong litmus test for investors and for contractual rights in general. “It’s really amazing to think that Countrywide left this sort of ‘hanging chad’ in its PSAs,” a legal expert told *HousingWire*. “It’s really going to be interesting to see how this plays out.”
- More investors’ lawsuits are expected to be filed. “I think we are going to see enforcement and litigation activity both because there are some who believe mortgage servicers didn’t do enough to meet the needs of consumers and because others will take the view that they did too much at the expense of investors,” says Andrew Sandler, a partner with Skadden, Arps. Fey warned, “This [lawsuit] is an opening salvo.” (*New York Times*, Vikas Bajaj, 12/02/08; *Wall Street Journal*, Ruth Simon, 12/02/08; *Financial Times*, Saskia Scholtes, 12/02/08; *HousingWire*, Paul Jackson, 12/02/08)

Fannie and Freddie are expected to force over \$1 billion of mortgage buybacks

- Because of poor underwriting and mortgage fraud in mortgage originations in 2006 and 2007, Federal Housing Finance Agency director James Lockhart expects Fannie and Freddie to force buybacks in the range off \$1 billion to \$1.5 billion. Buybacks can put “some real discipline into the origination system,” said Lockhart. “If you know you are going to get the mortgage back, you may be a little more careful in the future.” (*National Mortgage News*, 12/11/08)

Treasury purchased \$23 billion of GSEs’ mortgage-backed securities in November

- In November, the Treasury Department purchased \$23.2 billion of Fannie Mae and Freddie Mac MBS, bringing the Treasury’s total MBS purchases to nearly \$50 billion since the companies were placed in conservatorship on September 7<sup>th</sup>. (*National Mortgage News*, 12/11/08)

Providing help for troubled homeowners is a top priority of the Obama administration

- During a December 7<sup>th</sup> interview on *Meet the Press*, President-elect Barack Obama said he was disappointed that more has not been done to abate foreclosures. Obama said, “...[W]e have said publicly and privately that we want to see a package that helps homeowners not just because it’s good for that particular homeowner, it’s good for the community. When you have foreclosures, property values decline and you get a downward spiral all across America. It’s also good for the financial system because keep in mind how this financial system became so precarious in the first place. You had a huge amount of debt, a huge amount of other people’s money that was being lent, and speculation was taking place on—based on these home mortgages. And if

we can strengthen those assets, then that will strengthen the financial system as a whole.”

- “So I think a moratorium on foreclosures remains an important tool, an important option. I think we also should be working to figure out how we can get banks and homeowners to renegotiate the terms of their mortgages so that they are sustainable. The vast majority of people who are at threat of foreclosure are still making monthly payments, they want to stay in their homes, they want to stay in their communities, but the strains are enormous. And if we can relieve some of that stress, long term it’s going to be better for the banks, it’s going to be certainly better for the community, it’s going to be better for our economy as a whole. This is going to be a top priority of my administration.” (*Meet the Press*, President-elect Barack Obama, 12/07/08)

### Subprime and beyond...

- A record 10% of U.S. homeowners fell behind on their mortgage payments or were in foreclosure during the third quarter, according to the Mortgage Bankers Association’s latest delinquency survey data. Single-family residential delinquencies soared to 6.99% during the third quarter, up 58 basis points from the second quarter and 140 basis points from a year ago. During the third quarter, 2.97% of single-family mortgages were in the process of foreclosure—up 22 basis points from the second quarter and 128 basis points from a year ago. The MBA expects to see 2.2 million foreclosures started by the end of 2008 and more to come in 2009. “Absent a recession, the 2009 number would likely have fallen by several hundred thousand,” said MBA chief economist Jay Brinkmann. “But the effect of job losses and general economic deterioration make the 2009 outlook worse, particularly if mortgage problems become more widespread.” (*Bloomberg News*, Kathleen Howley, 12/05/08; *HousingWire*, Paul Jackson, 12/05/08)
- Housing prices fell at a record pace during the third quarter. According to the S&P/Case-Shiller Home Price Index, home prices declined 16.6% from a year earlier, while the 10-City and 20-City Composites posted annual declines of 18.6% and 17.4%, respectively. (*Standard & Poor’s Press Release*, 11/25/08; *National Mortgage News*, Ted Cornwell, 12/03/08)
- According to Merrill Lynch economist David Rosenberg, the housing market is not close to bottoming out. In the *North American Economist*, Rosenberg wrote, “...New home sales dropped 5.3% in November to a 433k annualized rate—the worst since the 1982 recession. Even though sales are now down 69% from the July 2005 bubble peak of 1.39 million units, we believe builders have not been aggressive enough in curbing production because the most critical variable of all, the unsold inventory backlog, rose to 11.1 months’ supply from 10.9 in September. The reality is that even though single-family starts have dropped to 26-year lows of 531,000, they are still running 23% above the prevailing level of new home sales. The worst the inventory-sales ratio ever got in the early 1990s real estate meltdown was 9.4 months’ supply.

We are currently 18% above that level and almost 40% higher than the 8 months' supply we would need to see before calling an end to the housing deflation phase. ...Home prices are now down a remarkable 22% from the 2007 peaks. With the unsold inventory sitting at the third highest level of the past three decades and mortgage approvals for new home purchases falling to their lowest level in nine years, we believe the laws of supply and demand point to a further 15-20% decline from here..." (*John Mauldin's Outside the Box*, John Mauldin, 12/01/08)

- According to the Federal Reserve, U.S. households' net worth plunged by \$2.8 trillion in the third quarter decline and dropped a stunning \$7 trillion over the past 12 months. Adjusted for inflation, household net worth fell by 15.3% from its year-earlier level, exceeding the 10.9% plunge in the dot-com bust in 2001 and the 13.8% drop in the 1974 bear market, said Michael T. Darda, chief economist at MKM Partners. The drop in wealth triggered Americans to pay down debt, as household borrowing contracted at an annual rate of 0.8% during the third quarter, following an increase of 0.6 percent in the second quarter. (*Barron's*, Randall W. Forsyth, 12/15/08; Bureau of National Affairs, )
- In November, U.S. employers cut 533,000 jobs, sending the unemployment rate to a 15-year high of 6.7%. November marked the 11<sup>th</sup> consecutive month of job losses for a cumulative payroll decline of 1.9 million. (*Los Angeles Times*, E. Scott Reckard, 12/06/08; *Global Insight*, 12/05/08)
- Credit Suisse projects that 8.1 million homes—16% of all mortgages—will be in foreclosure in the next four years, up from the firm's estimate of 6.5 million in April. "At the time, most viewed our [original] forecast as being overly gloomy," wrote analyst Rod Dubistky in a research note. "However, based on the trends in delinquencies we were observing, the growing negative equity and our home price forecast, the forecast seemed reasonable." If unemployment levels reach 8%, Credit Suisse expects foreclosures to exceed 9 million foreclosures. (*HousingWire*, Diana Golobay, 12/10/08)
- Standard & Poor's has placed its credit ratings for Old Republic International Corp., PMI Group Inc., MGIC Investment Corp., Radian Group Inc., and Genworth Financial on watch for downgrade, citing steep deterioration in the employment and housing markets. S&P noted most of these companies will be downgraded and some will face a multi-notch cut. The review is set to be complete in Mid-March, but S&P said it could take action prior to that date if operating results were reported below the company's expectation. (*Dow Jones Newswires*, John Kell, 12/05/08)
- During the third quarter, the number of problem banks jumped 46% to 171 institutions with total assets of \$115.6 billion, marking the highest level since 1995. The FDIC's fund to cover bank failures was \$34.6 billion on September 30, a 23.5% decrease from the second quarter. FDIC has taken over 24 failed banks through December 12, 2008. During the third quarter, (insured) financial institutions experienced declining earnings, continued reserve growth which lagged behind

growth in delinquent loans, and rising commercial loan failures. The bank industry's profitability fell 94% to \$1.7 billion for the third quarter. The industry's return on assets fell to 0.5% versus 0.92% a year earlier. FDIC chairwoman Shelia Bair said, "Loan performance problems are spreading to a much wider range of lenders and categories of loans. While many large institutions are continuing to post losses due to weaknesses in their portfolios, we're now seeing losses spread to a growing number of smaller institutions." (*Bureau of National Affairs*, Thecla Fabian, 11/26/08; *Reuters*, 11/25/08; <http://www.fdic.gov/bank/individual/failed/banklist.html>; *American Banker*, Joe Adler, 11/26/08;)

- On December 1<sup>st</sup>, the National Bureau of Economic Research, the official body for dating the nation's recessionary cycles, said the U.S. has been in a recession since December 2007. According to the group, the peak of economic activity occurred in December 2007, marking "the end of the expansion that began in November 2001 and the beginning of the recession." (*HousingWire*, Kelly Curran, 12/01/08)
- China Investment Corp (CIC), the country's sovereign wealth fund, will no longer risk investing in western financial institutions because of concerns about their viability and a lack of consistency in their governments' policies, said Lou Jiwei, the fund's chairman. "Right now we don't have the courage to invest in financial institutions because we don't know what problems we will put ourselves into," said Jiwei. He compared the recent shifts in U.S. regulatory and government policy and efforts to rescue ailing banks with the "clearer policies" of some developing countries, in which CIC was still "actively" pursuing investment opportunities. "My confidence should come from government policies," said Jiwei. "But if they are changing every week, how can you expect that to make me confident?" (*Financial Times*, Raphael Minder, Geogg Dyer, and Jamil Anderlini, 12/04/08)
- In the *Frontline Weekly Newsletter*, John Mauldin wrote, "...The oil market is said to be in contango—...A condition in which distant delivery prices for futures exceed spot prices, often due to the costs of storing and insuring the underlying commodity... [On December 12<sup>th</sup>] West Texas Intermediate January oil futures prices were ...\$45.80. This rises to \$52.28 by just April. A few days ago, ...the spread between the first and fifth futures months had risen to \$8.06, the highest ever. When oil was at \$147, the spread was an average of \$3.25, or about 2.5%. You can buy January 09 crude futures at a stunning 34.5% lower than January 2010. ...[T]his tells us is that storage for oil is very tight. Oil producers are leasing very large ships to store excess oil, as they cannot find places to store it on land. Storing oil on ships is expensive, so that cost of storage gets figured into the price of oil a year out. The OPEC nations are not cutting back by any significant amount. Oil is backing up in the system. It is quite possible that oil could go a lot lower in the next few months as the world reels from a global recession, and that means the demand for energy will be down. Oil below \$30? Without production cuts that is certainly in the realm of possibility. ...Could oil fall below \$30? It could if producing countries do not start to cut back on production. But many of the larger producers need as much money as

they can to keep the lid on civil unrest.” (*Frontline Weekly Newsletter*, John Mauldin, 12/12/08)

- According to the Federal Reserve’s Beige Book, business conditions weakened across the U.S. in almost every industry in recent weeks, as private employers shed jobs at an accelerating rate and the nation’s service sector contracted. Consumer spending weakened almost across all sectors of the economy, particularly for vehicles. The Fed report noted decreased sales and spending, declining manufacturing activity, contracting credit, weakening labor markets, softening mining and energy production, and continued real estate troubles. Agricultural activity was mixed. Lower inflation was the bright spot in the report, with price pressures relaxing. (*Bureau of National Affairs*, Aaron Lorenzo, 12/04/08; *Washington Post*, Neil Irwin and Howard Schneider, 12/04/08)
- In a December 2<sup>nd</sup> article in the *Financial Times*, Nouriel Roubini wrote, “...The worst is not behind us: 2009 will be a painful year of a global recession, deflation and bankruptcies. Only very aggressive and coordinated policy actions will ensure the global economy recovers in 2010 rather than facing protracted stagnation and deflation.” (*Financial Times*, Nouriel Roubini, 12/02/08)

#### New agency needed to monitor fair housing enforcement?

- A new, independent fair-housing enforcement agency needs to be formed by the federal government, because of conflict of interest problems and a weak fair-housing enforcement track record at HUD, conclude former HUD Secretaries Henry Cisneros and Jack Kemp and the National Commission on Fair Housing in a new study. “HUD is in the awkward position of policing its own programs and its own partners for fair housing violations,” said Cisneros. “It depends on various entities to carry out its policy goals, and at the same time it is also responsible when acting as a fair-housing enforcer to investigate the very same entities for their housing discrimination. ...There’s a built-in conflict in the present structure.” Out of the 4 million fair-housing violations filed every year, HUD investigates only about 2,500 cases and filed charges in only 31, added Cisneros. The report, which was released on the 40<sup>th</sup> anniversary of the Fair Housing Act, was the result of public hearings in Chicago, Houston, Los Angeles, Boston, and Atlanta that drew input from hundreds of housing experts and residents. (*American Banker*, Cheyenne Hopkins, 12/10/08)

#### Capitol Hill rumblings

- The 2008 election results in the House are final and the Democrats increased their majority by 21 seats. In the 111<sup>th</sup> Congress, there will be 257 Democratic members and 178 Republican members. Election tallies show that 19 incumbents lost in the general election—14 Republicans and 5 Democrats, while 12 open seats switched

from Republican to Democrat. Republicans lost seats in 17 states, while Democrats lost seats in five states. (*BIPAC Election Insights*, 12/11/08)

- Representative Spencer Bachus (R-AL) survived a no confidence challenge, holding on to his leadership role as ranking member of the House Financial Services Committee. Bachus fended off a challenge by disgruntled Republicans over his role in the \$700 billion financial rescue program. (*CongressDaily Alert*, 12/10/08)
- Senator Mel Martinez (R-FL) had decided not to seek a second term, creating the second open seat of the 2010 for Republicans. [Senator Sam Brownback (R-KS) is expected to leave the chamber to run for governor.] Martinez, who served as HUD Secretary in the Bush administration, is a member of the Senate Banking Committee. (*WashingtonPost.com's Politics Blog*, Chris Cillizza, 12/02/08)

SEC approves new rules to regulate credit rating agencies
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- The SEC has approved and re-proposed a new set of rules regulating credit rating agencies, aimed at preventing conflicts of interest and increasing the NRSROs' accountability. Specifically, the new rules will forbid NRSROs from rating securities they helped structure; ban employees from accepting more than \$25 worth of gifts from companies issuing securities; and require the agencies to provide detailed information on both how they determine specific ratings and how those ratings hold up over time. SEC Chairman Cox said these new rules would "touch every aspect of the credit rating process—from conflicts of interest, to publication of ratings methodologies, to disclosure of ratings track records." These actions are part of a larger global effort regarding credit rating agencies, including recent congressional scrutiny of their role in the credit crisis, the G-20 leaders' declaration favoring enhanced regulation of credit rating agencies, and the European Commission's proposed legislation regarding credit rating agencies.
- The SEC delayed action on other controversial proposals. One of the proposals the Commission did not vote on would have eliminated rules requiring reliance on credit ratings, a proposal heavily opposed by Wall Street. Lawrence J. White, an economics professor at New York University, strongly supported passage of this rule, arguing it would have increased competition among credit rating agencies and reduced the dominance of Standard & Poor's, Moody's and Fitch. "The commissioners missed an opportunity to really reform how the rating systems work," said White. "The actions they took are not the way to fix this problem." The SEC also failed to take action on a controversial proposal to require NRSROs to furnish a report on structured finance products [which they rated], which describe the risk characteristics associated with a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction differed from those of any other type of obligor of debt security. It was not clear from the meeting whether or not this proposal is still under consideration. (*Washington Post*, Amit R. Paley, 12/04/08;

Mark-to-market accounting rules likely to remain

- SEC chairman Chris Cox said his agency has almost completed its study on mark-to-market accounting and preliminary findings point to the need for additional guidance in valuing mortgage-backed securities in inactive or illiquid markets. “The work we have already done suggests that the accounting standard setters could improve upon the existing security impairment models,” said Cox, in comments to the American Institution of Certified Public Accountants. “Investors have also clearly indicated a view that the current concept of mark-to-market accounting increases transparency of financial information provided to investors—but that in inactive or illiquid markets, additional guidance would be useful to promote reasonable application of the standards,” said Cox. SEC is slated to submit its mark-to-market study to Congress by January 2, as mandated by the Emergency Economic Stabilization Act.
- According to a source familiar with the study, the SEC will not suspend the mark-to-market accounting rules, but instead will discuss ways to refine the rule’s application. While the agency doesn’t plan to issue guidance itself, the study may recommend that the Financial Accounting Standards Board further study the matter with an eye toward applying the rules more consistently. The report is expected to note that “impairment models” to value assets could be re-examined with fresh eyes. The study may also recommend establishing best practices that could include guidance to help companies and auditors sort out valuations when markets for financial instruments have seized. The SEC may suggest that FASB issue guidance to auditors about what information to use when trying to value assets when they are distressed, how to define “distressed” and how to develop models to place values on distressed assets. (*Wall Street Journal*, Kara Scannell, 12/08/08; *National Mortgage News*, 12/09/08; *Bureau of National Affairs*, Malini Manickavasagam, 12/09/08)

## ***Fannie Mae***

Fannie Mae’s mortgage portfolio grew 28% in October

- Fannie Mae retained mortgage portfolio grew at a 28% annual rate in October to \$771.1 billion in an effort to ease constraints in the U.S. housing market and help struggling homeowners. During the month, Freddie’s total book of loans that it owns or guarantees increased at an annual rate of 3.5% to \$3.1 trillion. “These companies

aren't being run for profitability, they're being run to try to get mortgage rates as low as possible," said Paul Miller, an analyst with FBR Capital Markets in Arlington, Virginia.

- The quality of Fannie Mae's mortgage holdings continued to deteriorate in September with its serious delinquency rate for conventional single-family mortgages increasing 15 basis points to 1.72%, while its serious delinquency rate for multifamily mortgages remained unchanged at 0.16%. The company's effective duration gap for October was positive two months. (*Fannie Mae Monthly Volume Survey*, October 2008; *Bloomberg News*, Dawn Kopecki, 11/25/08)

#### Fannie Mae plans a reverse stock split

- According to a SEC filing, Fannie Mae has notified the NYSE that it intends to bring the share price of its common stock and the average share price of its common stock for 30 consecutive trading days above \$1.00 by no later than May 11, 2009. To achieve this goal, Fannie Mae said it would likely undertake a reverse split, subject to approval from the U.S. Department of Treasury, to bring its stock under the NYSE listing requirements. "Fannie Mae expects to determine the actual number of shares that will produce one share of common stock as a result of any reverse stock split based on both the market price of Fannie Mae's common stock prior to announcement of the split and additional input from FHFA and Treasury," said the company. (*HousingWire*, Paul Jackson, 12/01/08)

#### Fannie Mae names its third chief financial officer in three months

- Fannie Mae has named David M. Johnson as its new chief financial officer. He will receive an annual salary of \$625,000, plus a cash bonus and incentive plan. Before joining Fannie Mae, Johnson served as the chief financial officer for Hartford Financial Services and Cendant Corp. He also was an investment banker for Merrill Lynch for 12 years. "With his broad and deep financial services and capital markets experience, David will help lead Fannie Mae as we assist the market during this unprecedented correction and weather the challenges facing all financial companies today," said Fannie Mae CEO Herbert Allison. "Going forward, as the financial system and industry undergo significant change, David will also help to lead Fannie Mae's transition to the future."
- Fannie Mae's chief financial officer role has been in flux, since the company was placed in receivership in September and then CFO Stephen Swad was replaced by David Hisley, the company's senior vice president and controller. Johnson will succeed Hisley as CFO, while Hisley will serve as executive vice president and deputy chief financial officer, responsible for financial planning and analysis, business unit finance, accounting, financial controls, financial reporting, and income

tax functions. (*Atlanta Business Chronicle*, 11/26/08; *Associated Press*, 12/01/08; *Wall Street Journal*, Jay Miller, 11/25/08)

Fannie Mae's "Homesaver" advances totaled \$301 million as of September 30<sup>th</sup>

- According to a FHFA report, Fannie Mae's use of HomeSaver advances to "cure" delinquent loan in securitized pools peaked in June and July with 66% of the personal loans being made to nonprime borrowers. During the eight months ended September 30, Fannie Mae made more than 45,000 HomeSaver advances totaling \$301 million. The average size of these unsecured loans was \$6,700, said the company. (*National Mortgage News*, 12/03/08)

Fannie Mae records subpoenaed by a federal grand jury

- Records involving Fannie Mae have been subpoenaed by a federal grand jury as part of a criminal investigation into claims made in a \$7 billion civil lawsuit against the company. "I think much of the materials in our case are relevant to the criminal case," said Mark Lanier, the lawyer representing those who sued Fannie and whose records were sought. "This subpoena is the sweet spot in our lawsuit." The subpoenas dated, December 8, demand records from the Lanier Law Firm. In a November 10<sup>th</sup> SEC filing, Fannie Mae said it was "cooperating fully in a Department of Justice investigation." In 2004, the owners of government-insured low-income housing sued, claiming Fannie Mae illegally kept as much as \$7 billion earned on escrow accounts. Since almost all records in the case are sealed, the law firm couldn't turn them over to investigators without a subpoena, said Lanier. (*Bloomberg News*, Laurence Viele Davidson, 12/11/08)

Who *would* have known?

- In *Human Events*, Seton Motley wrote, "...[Tom] Brokaw's last stand as [Meet the Press] host served as the perfect lead-in to his final official MTP duty—introducing his permanent successor, longtime NBC and MSNBC White House reporter David Gregory. Beyond Gregory's extensive liberal pedigree, a major conflict of interest should prevent him from hosting MTP, given some of the most important issues currently facing our nation."
- "Gregory's wife is Beth Wilkinson. Wilkinson was until very recently the \$3 million per annum (in salary and bonuses) executive vice president of the failed home loan giant Fannie Mae. She resigned this past September 20th when the federal government took over operational control. How qualified was she for this rich gig? The *New York Times*, on June 16, 2006 reported her hire this way: 'Ms. Wilkinson, for example, knew nothing about the mortgage-backed securities at the core of Fannie

Mae's business.' These sorts of hirings from amongst the unqualified Connected Class played a huge role in the failures of Freddie Mac and Fannie Mae. No one in the media, however, noted Wilkinson's now-proven cluelessness when she departed, nor did they bother to mention her relationship to and with Gregory."

- "Gregory himself continuously fails to mention his wife's direct connection to the home mortgage crisis (and subsequent meltdown). He said nothing of it on August 10th when he appeared on his future show [MTP] specifically to discuss the Fannie Mae debacle. Keep all of this in mind every time you tune in on Sunday mornings to watch Gregory report on Fannie Mae and the ongoing economic damage it helped deliver..." (*Human Events*, Seton Motley, 12/09/08)

Raines says he's paid the price for Fannie's problems under his watch

- Former Fannie Mae chairman and CEO Franklin Raines said he personally has paid the price for the problems that occurred at Fannie Mae under his watch. During an interview with the *Washington Post*, Raines said he has lost about 40% percent of his aggregate \$90 billion of compensation from Fannie, which was in the form of stock options that had no value or had been forfeited. "If people think I made a lot—if you take 40 percent away—that is a lot," he said. Raines still receives a \$1.2 million annual pension from Fannie. [Raines sold his company granted stock in 1995—stock which today has lost 99% of its value.] He now manages his personal investments in health and financial services firms from his corner office at the Washington, DC-based firm, Revolution, where Raines serves as a board member. (*Washington Post*, Zachary A. Goldfarb, 12/08/08)

## ***Freddie Mac***

Freddie Mac's mortgage portfolio grows 44% in October

- Freddie Mac's retained mortgage portfolio grew 44% to \$763.7 billion in October—the first full month that the company operated under federal conservatorship. During the month, Freddie added \$26.8 billion in net new purchases of home loans and mortgage bonds, in sharp contrast to the \$61.4 billion reduction of its mortgage assets in August and September "as it struggled to remain independent," according to Jim Vogel, debt analyst for FNT Financial. "Freddie accelerated around corners last month to rebuild its balance sheet in a major catch-up move," added Vogel, in a research note. As the company ramped up its mortgage purchases in October, Freddie also increased its liquid investments by 55% to \$51.7 billion. Vogel noted, "They may want to keep a very liquid balance so any minor changes or shifts in

discount note funding doesn't affect their liquidity. They can just draw on their short-term liquidity.”

- As investors shied away from long-term agency debt, Freddie Mac shifted dramatically to the use of short-term debt to fund its operations, issuing \$58 billion in October. The company used roughly half its debt proceeds to purchase mortgages and the balance to increase its liquid investments.
- During October, the quality of Freddie Mac's mortgage portfolio continued to deteriorate with its single-family delinquency rate increasing 12 basis points to 1.34%. The company's duration gap averaged zero months for October. (*Freddie Mac Monthly Volume Summary*, October 2008; *Bloomberg News*, Dawn Kopecki, 11/24/08; *Washington Post*, Zachary A. Goldfarb, 11/25/08)

#### Freddie Mac plans to remain on NYSE

- Freddie Mac announced that it plans to boost its per-share price above \$1 per share for 30 consecutive days by May 18, 2009, in order to remain listed on the NYSE. Freddie is currently working with its conservator, the Federal Housing Finance Agency, to determine what steps it can take to preserve its listing on the exchange. The company advised the NYSE that, if necessary, it may undertake a reverse stock split to cure the deficiency by the May deadline. (*Washington Business Journal*, Tierney Plumb, 12/02/08)

#### Freddie Mac plans to lower the up-front fees on loans exceeding \$417,000

- In 2009, Freddie Mac will eliminate or lower the up-front fees it charges lenders for fixed-rate homebuyer loans and no-cash-out refinancings with balances above \$417,000. The company also will lower the fees for some other large loans by 25 basis points, to 50 basis points. A Freddie Mac spokesman called the fee reductions “the most sweeping” since the GSE was put into conservatorship September 6<sup>th</sup>.
- In November, Freddie and Fannie Mae canceled plans to double the 25-basis-point “adverse market” fees that were instituted in March to reflect deteriorating conditions. “Now that they're both in conservatorship, I think they are starting to look at some of the fee changes that have been put into place, which could have the undesirable effect of limiting affordability to some degree,” Keith Gumbinger, a vice president at the research firm HSH Associates. “Anything that's adding to the expense or burden of obtaining a home loan right now is really not welcome.”
- During the third quarter, Freddie Mac originated \$207 million of “super conforming” mortgage loans with balances up to \$729,750 in high-cost markets—a designation established in stimulus legislation enacted in February and set to expire at yearend.

[A housing law enacted in July caps the conforming loan limit at \$625,500 in high costs markets for 2009]. In a filing with the SEC, Freddie said competition, particularly from the FHA, had hindered its purchase of super conforming loans to date. (*American Banker*, Harry Terris, 11/25/08)

#### Alumni news

- Eugene McQuade, Merrill Lynch's vice chairman and president of U.S. banking operations, will have his second "short" stay with Bank of America, announcing his plans to leave the Bank next spring after its acquisition of Merrill is completed. Previously, McQuade joined BofA in 2004 after the bank bought FleetBoston Financial Corp, but announced his departure within two months of coming on board. McQuade joined Merrill in May, after serving as Freddie Mac's president and COO from 2004 until 2007. (*Charlotte Observer*, Rick Tothacker, 11/26/08)
- In a December 4<sup>th</sup> business profile of the incoming White House chief of staff Rahm Emanuel, the *New York Times* reporter Michael Luo failed to mention in his 1,700 word article that Emanuel served on the Freddie Mac board of directors from 2000 to 2001, when the company was mired in political contribution and accounting scandals during this period. Similarly, the *New York Times* reporter turned a "blind eye" to the \$260,000 of director fees that Emanuel received from Freddie Mac and the \$51,750 of campaign donations he received from Fannie Mae and Freddie Mac. (*Business & Media Institute*, Matt Philbin, 12/04/08)

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

#### FHLB System's assets grows 13% to \$1.429 trillion during the third quarter

- The Federal Home Loan Bank System's assets grew 12.3% during the third quarter to \$1.429 trillion on September 30, 2008. Advances rose 15.6% to \$1.012 trillion, representing 70.8% of total assets. Members' mortgage assets, totaling \$87.9 billion, were down 4.0% from yearend 2007. Consolidated obligations of the FHLB System increased 12.2% to \$1.323 trillion on September 30, while the system's total capital increased 6.5% to \$51.7 billion. The FHLB System's combined net income totaled \$506 million for the third quarter, down 30.9% from the same period last year. The drop in net income was attributable to a \$252 million write-off/reserves on receivables due from Lehman Brothers, which filed bankruptcy on October 3<sup>rd</sup>. (*FHLBanks Office of Finance Press Release*, 12/04/08)

- In a December 10<sup>th</sup> commentary in the *American Banker*, Diane Casey-Landry, chief operating officer of the American Bankers Association wrote, “While federal officials move to implement programs to thaw the credit markets, they should not overlook a vital tool already serving the U.S. banking system: the Federal Home Loan Banks. Credit is the lifeblood of the economy, and the Home Loan banks facilitate a large portion of our financial system’s credit needs, rapidly converting a range of loan collateral into affordable funding, so that more than 8,000 banks can extend credit in their communities. This privately capitalized, cooperative system of 12 Home Loan banks was first to respond to the credit crisis. They executed their mission remarkably well, while nearly all other sources of short and mid-term liquidity dried up. Because of prudent management, the banks had limited exposure to subprime loans and thus were prepared to respond.”
- “...In recent years the Home Loan banks have remained a financially strong and consistently reliable source of funding for most of America’s lenders that, because of size or scale, cannot regularly access capital markets and have limited options for meeting loan demand when core deposits are unavailable or too costly. The vast majority of Home Loan bank members are community banks. Some of our nation’s largest commercial banks are members, too. All use Home Loan bank advances to meet the needs of their businesses and communities. The Home Loan banks are a successful cooperative, where large and small members are provided fair and equitable treatment and receive commensurate benefits from their capital investment.
- “More recently, as the Treasury Department has formulated responses to the credit crisis, the Home Loan banks have served as critical on-call sources of liquidity as borrowers have tapped into contingent funding plans. Without the banks, the recent liquidity crisis would have worsened rapidly. Because of its extraordinary responsiveness, outstanding advances have exceeded \$1 trillion, making the system a liquidity source second only to the Federal Reserve. This performance was possible because the banks remained focused on their core mission and had the capital structure and strong credit and collateral requirements to meet critical demands safely and soundly.”
- “Given these benefits, how can the Home Loan banks evolve to meet the challenges of the current crisis? As the banks’ managers and policymakers consider ways to leverage the unique benefits of their government charter wisely, it would be helpful to keep two notions in mind. First, policymakers need to recognize and support the Home Loan banks’ critical mission. The banks consistently operate effectively and with purpose while remaining profitable, well managed institutions whose cooperative structure fosters conservative, prudent operations. This business structure, created by Congress in 1932, has weathered today’s difficult economic climate while other models have foundered.”

- “Second, the Home Loan banks work because they serve small and large lenders and help to foster a diverse and dynamic banking system. The banks provide funding options for a rich mix of lenders, which compete against each other to serve consumers and the communities where they live. This flexibility will be especially critical as the Home Loan banks give members the ability to manage funding more flexibly and confidently and put those funds to work in their communities.”
- “Policymakers must recognize that the Home Loan banks are a long-term, essential part of the financial services industry that does not require new actions or appropriations. In light of recent events, their utility and importance cannot be underestimated. As a consistent and reliable source of funding, the Home Loan banks are—and must remain—a central part of the U.S. banking system.” (*American Banker*, Diane Casey-Landry, 12/10/08)

FHLB-Boston halts redemption of excess shares to preserve capital
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- Facing losses on its private-label mortgage securities, the FHLB-Boston has stopped redeeming excess stock held by its members. “This action will help preserve the bank’s capital,” wrote Michael Jessee, the Bank’s president and CEO in a Dec. 8 letter to members. “While the bank has always had the discretion to approve or deny excess stock repurchase requests on a case-by-case basis, the moratorium will ensure that all members, large and small, receive fair and consistent treatment.” The Bank holds approximately \$213.6 million of excess stock, which is subject to the moratorium.
- In the letter to members, Jessee addressed the losses the bank could face in its private-label MBS holdings. He wrote, “Given the continuing uncertainty in the credit markets, substantial downturns in real estate values, and increasing weakness in the U.S. economy, if loan credit performance of the bank’s private-label MBS portfolio deteriorates beyond forecasted assumptions, in the future it may be determined that certain private-label securities in the portfolio would require an impairment charge.”
- During the third quarter, four FHLBs recorded other-than-temporary impairment losses in their private-label mortgage holdings including, the FHLB-Atlanta (\$87.3 million), the FHLB-Seattle (\$49.8 million), the FHLB-Chicago (\$9 million), and the FHLB-San Francisco (\$25.5 million). (*American Banker*, Steven Sloan, 12/08/08)

## ***Ginnie Mae***

### FHA insurance fund falls 39%

- On September 30<sup>th</sup>, FHA's insurance fund totaled an estimated \$12.9 billion, a 39% drop from \$21.2 billion a year ago, according to the agency's audit performed by Integrated Financial Engineering. The agency's \$12.9 billion fund represents 3% of the mortgages insured by FHA, above the 2% ratio required by law, but below the 6.4% ratio at the same time last year. "The 2 percent threshold is barely maintained," concluded the auditors. FHA spokesman Stephen O'Halloran said that the insurance fund "remains on solid ground. Guy Cecala, publisher of *Inside Mortgage Finance*, said, "That's a significant drop, and it's occurring at a time when the fund is insuring a lot more mortgages. You can easily say it's reason for concern." Howard Glaser, a former HUD official, cautioned, "If we don't have the capacity to monitor system risk in FHA, then we're in real trouble."
- The number of FHA-insured loans increased 225% during the nine months ended September 30, as loan originations swelled to \$176 billion. Observers—inside FHA and outside the agency—have voiced concerns about its ability to handle the expanded mortgage originations and higher risk profiles of these loans. Brian Chappelle, who oversaw FHA's loan production in the mid-1980s, said the agency's audit was "better" than he had expected. "Considering the historic collapse of the housing market, the fact that independent, outside auditors say FHA is actuarially sound today and will remain so in the next seven years, I think is a significant achievement," said Chappelle. (*Wall Street Journal*, James R. Hagerty, 12/02/08; *Washington Post*, Dina ElBoghdady, 12/03/08; *New York Times*, Barry Meier, 12/10/08)

### Ginnie Mae issuances through November tripled to \$246 billion

- For the first 11 months of 2008, Ginnie Mae's issuances more than tripled from the same period last year to \$246 billion. In November, the agency issued \$27 billion, surpassing for the second consecutive month that of Fannie Mae and Freddie Mac. "Ginnie Mae has consistently provided liquidity to the market and it is no surprise that our November MBS issuances were strong," said Joseph Murin, president of Ginnie Mae. "It is further proof that Ginnie Mae is continuing to thrive and provide stability." (*National Mortgage News*, 12/10/08; *HousingWire*, Diana Golobay, 12/10/08)

## *Farm Credit System / Farmer Mac*

Reform of the financial services industry in the 111th Congress will likely include the Farm Credit System

- In the November issue of *Farm Credit Watch*, Bert Ely wrote, “[The November] election outcome will have a huge impact on the FCS and its regulator, the Farm Credit Administration (FCA), as the Obama Administration and the new Congress tackle the worst financial crisis since the Great Depression. While specific reform proposals are still quite sketchy, fundamental reform of the financial services industry and the regulation of financial service providers will be at the top of next year’s legislative agenda. It would be naive for either the FCS or the FCA to think that they will be left out of these reform initiatives, especially given the FCS’s increasing emphasis on lending to large agri-businesses, such as Pilgrim’s Pride, Kroger, Cracker Barrel, and Jack in the Box. Evidence of that lending: As of September 30, 2008, the FCS had eight credit exposures (including unfunded commitments) falling between \$563 million and the FCS’s self-imposed lending limit of \$750 million.”
- “All five GSEs—Fannie Mae, Freddie Mac, the Federal Home Loan Banks (FHLBs), Farmer Mac, and not least, the FCS—will be swept up in this broader reform debate because of the significant role they play in supplying credit or guaranteeing credit risk within the U.S. economy and the severe financial problems Fannie, Freddie, and Farmer Mac have experienced in recent months. The FCS is fooling itself if it thinks it can hide in the corn stubble, especially since its failed attempt to expand its off-farm lending powers through its HORIZONS initiative drew the attention of the Senate Banking and the House Financial Services Committees. Growing credit problems within the FCS, specifically lending on ethanol plants and the FCS’s nearly \$700 million credit-risk exposure to Pilgrim’s Pride ... will draw even more attention to the FCS. Congress should merge the FCA into the new Federal Housing Finance Agency, which now regulates Fannie, Freddie, and the FHLBs, so that one regulator oversees all GSEs. That merger would greatly reduce the unhealthy influence the FCS now has over the FCA. Congress should go further and begin to trim the FCS’s tax and credit subsidies, such as subjecting to federal income taxation the profits the FCS earns on its real estate lending.”
- “Even before Congress enacts fundamental reform, the FCA certainly can expect to operate in a changed political environment. Among other actions, President Obama will have the opportunity to nominate a Democrat to fill the FCA board seat now occupied by former FCA Chairman Nancy Pellett. However, given the many higher-priority items on the new President’s agenda, it could be many months before Pellett’s successor is nominated and confirmed. It will be interesting to see how well the present FCA chairman, Leland Strom (a Republican), and the other board member, Dallas Tonsager (a Democrat), read the political tea leaves. Savvy tea-leaf readers on the FCA board might decide to abandon the FCA’s proposal to expand

FCS lending through the ill-fated ‘Investments in Rural America’ proposed rule. However, in the recent past, both FCA and the Farm Credit Council, the FCS trade association, have demonstrated tremendously poor political judgment. Only time will tell what comes next from them.” (*Farm Credit Watch*, Bert Ely, November 2008)

Ethanol industry’s triple whammy:  
falling oil prices, credit crunch, and volatile cost of corn

- The struggling U.S. ethanol industry faces severe challenges with falling prices for its product, severe constraints on credit availability, and volatile costs for corn. In early November, VeraSun, one of the largest U.S. ethanol producers, filed for bankruptcy protection after its bets on the price of corn turned out to be wrong and costly. Several other small producers filed for bankruptcy in 2008, and construction plans for several Midwestern ethanol plants have been postponed or shelved.
- Shares for the handful of publicly-owned ethanol companies have slumped this year, with Aventine Renewable Energy and Pacific Ethanol losing more than 80% of their value since the beginning of the year. Although producers hope that rising government mandates for the use of ethanol will keep the ethanol industry afloat, ethanol analysts expect more companies to fail, followed by a wave of consolidation to sweep the ethanol industry after the credit crisis eases. Ian Horowitz, an analyst with Soleil Securities, said he is worried about BioFuel Energy, a Denver-based ethanol maker that is low on cash and has lost \$46 million on commodity-price hedges. BioFuel Energy’s shares have fallen to \$0.57 from a high of \$7.75 in January.
- In the November issue of *Farm Credit Watch*, Bert Ely noted that the ethanol industry is a major credit-risk exposure for the Farm Credit System. According to FCS’s third quarter information statement, the System had a total credit exposure to “a large ethanol producer and its wholly-owned subsidiaries [VeraSun] which filed for bankruptcy protection” of “greater than \$250 million but less than \$563 million.” On September 30, the FCS’s credit exposure to biofuels—primarily ethanol—was \$4.26 billion, which included \$2.96 billion of outstanding loans. (*Michigan Farm News*, Paul W. Jackson, 11/30/08; *Farm Credit Watch*, Bert Ely, November 2008; *International Herald Tribune*, Kate Galbraith, 11/05/08)

## ***Postal Service***

### Postmaster General earns \$857,459 for FY2008

- Although the Postmaster General's pay is capped by law at \$263,575, PG Jack Potter earned \$857,459 during FY2008 through "deferred" performance bonus and other compensation which more than tripled his salary. At a time when postal supervisors and postmasters are being asked to forgo their performance based salary increases, the USPS paid Potter a performance bonus of \$135,041. Potter's accumulated deferred compensation balance (which totals \$593,6480 earns a generous rate of 5% on the deferred payment balance. The agency's 10K disclosure of Potter's compensation of \$857,459 is based on actual compensation received, plus the increase in the value of PG's deferred compensation balance and pension.
- In addition to the deferred compensation, Potter will also be the beneficiary of a supplemental retirement fund worth \$1,350,318, above and beyond the CSRS pension that he is entitled. In addition, Potter is also entitled to a monthly severance pay, "which when added to his CSRS benefits and Postal Service pension benefit, will equal 1/12th of his annual salary at the date of the termination of his Postal Service employment" for a period of one year. Had Potter terminated his employment with the USPS as of September 30, 2008, the annual value of this benefit would have been \$71,732, according to the agency's 10K. In the event of termination, the USPS would continue paying the full cost of the PG's FEHB health insurance coverage for one year and provide him outplacement assistance for up to two years if requested. ([www.postalnewsblog.com](http://www.postalnewsblog.com), 11/27/08)

### Federal judge dismisses APWU lawsuit against Bush

- The U.S. District Court for the District of Columbia has dismissed an APWU lawsuit against President George W. Bush and Postmaster General John E. Potter, which sought to compel the appointment of a Postal Advisory Council. The court's Nov. 26 ruling concluded that the postal council, which was authorized by Congress in 1970 under the terms of the Postal Reorganization Act, was not specifically reauthorized by the Postal Accountability and Enhancement Act of 2006. (*APWU Web News Article #118-08*, 12/04/08)

### More uncertainties for the USPS

- The downward spiral of the print media companies continues, triggered largely by plummeting advertising revenues and the industry's highly leveraged balance sheets. On December 9<sup>th</sup>, the Tribune Co., which owns the *Chicago Tribune*, *Los Angeles Times*, *Baltimore Sun*, *Sun Sentinel* [South Florida], *Orlando Sentinel*, *Hartford*

*Courant, Morning Call and Daily Press*, filed for Chapter 11 bankruptcy protection from its creditors. A number of newspapers are on the auction block, including E.W. Scripps' [Denver] *Rocky Mountain News* and the McClatchy Company's *Miami Herald*, one of its largest and most-respected newspapers. And, the parent company for *The New York Times* is attempting to borrow more than \$200 million against its headquarters building in an effort to meet cash flow demands.

- Elsewhere, print magazines and newspapers are offering early retirements and laying-off staff, as a means of coping with falling advertising revenue and falling circulation. During the six months ended September 30<sup>th</sup>, circulation for the 507 daily U.S. newspapers fell 4.64% [compared to the same period last year]. Ad revenues fell 18.1% in the third quarter, marking the sixth quarter of monthly decline. To date, 15,422 newspaper employees have been terminated or taken buyouts. Some publications, such as the 100 year old *Christian Science Monitor* and *PC Magazine*, are ending their print editions and publishing only on the Internet—and more publications are expected to follow. For example, Cablevision, which recently laid off 100 employees at *Newsday*, is pursuing an ambitious digital strategy to reinvent the newspaper's coverage and distribution model. "Our goal is to do something nobody else is doing, which is turn around [a print product]," said Tom Rutledge, Cablevision's chief operating officer. "We have the ability to *replace direct mail* with targeted advertising, with technology that's just being deployed." [Emphasis added.]
- Alan Robinson, president of the Direct Communications Group, said, "One of the problems in the past few years is that some print media companies were bought with lots of debt and an assumption that advertising would not disappear. However, a combination of the recession and a switch to the electronic media have overwhelmed these print media companies and they are now at the brink of bankruptcy. As the mailing industry does not have as public a profile as newspapers and magazines, not much is known about the financial health of the major players that produce the mail. If they are in as much financial trouble as the newspaper and magazine industries then it may be a long time before the Postal Service returns to delivering the volumes of advertising and periodicals that it did before the recession began." (*Chicago Tribune*, Michael Oneal and Phil Rosenthal, 12/09/08; <http://www.postcom.org/>, 12/08/08; *Advertising Age*, Andrew Hampp, 12/08/08; *Agence France-Presse*, Chris Lefow, 12/13/08)

It "ain't" easy being green
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- More than 92% of the fuel used by the Postal Service's 112,000 alternative fuel fleet continues to be fueled by standard gasoline, because the vehicles are being used in locations in which alternative fuel is not available. The latest generation of alternative vehicles have compounded the USPS's problems, because they come with larger engines than the ones they replaced, resulting in increased gasoline consumption and higher emissions. During the last fiscal year, the Postal Service

estimates that their 37,000 newer alternative-fuel delivery vans consumed an additional 1.5 million gallons of gasoline because of their larger engines. Wayne Corey, vehicle operations manager with the USPS, said, “I call it the ‘Field of Dreams’ plan. If you buy them, they will come. It hasn’t happened.” (*Washington Post*, Kimberly Kindy and Dan Keating, 11/23/08)

We’d *all* love to have a spam filter for junk mail

- According to *ABC News*: “...When a federal court in Raleigh, N.C., sentenced [Apex postman Steve] Padgett on November 18 to three years of probation, a \$3,000 fine, and 500 hours of community service for delaying and destroying mail, the judge nearly commended him. Locals thanked him and some out-of-towners went online to beg him to take over their routes. ‘He was our spam filter,’ says Tom Glembocki of Apex. That outpouring suggests that Americans are eager to junk junk mail, which would explain the efforts now under way to create the equivalent of the five-year-old ‘Do Not Call Registry’ for the 100 billion pieces of printed ads jammed into mailboxes each year. (*ABC News*, Patrik Jonsson, 12/06/08)

## TVA

Cost estimates soar for TVA’s planned construction of two nuclear reactors at Bellefonte

- The cost for TVA to complete construction of two nuclear reactors at its Bellefonte site in Alabama could cost as much as \$17.5 billion, more than double the utility’s estimate last year, according to the agency’s recent filing with the Nuclear Regulatory Commission. TVA estimated that the project will cost between \$9.9 billion to \$17.5 billion, including financing costs. TVA spokesman Terry Johnson said the cost to construct a new nuclear unit was cost \$4 billion to \$5 billion each, excluding interest expense. He argued that building new nuclear reactors remains financially promising, since “the options that are available out there for base load [energy generation] are rather few.” Critics argue that the higher cost estimates and the uncertainty of real cost raise legitimate questions about whether nuclear power is affordable and the best energy route for ratepayers, who bear the burden of paying off TVA’s excessive debt. (*The Tennessean*, Anne Paine, 12/09/08)

TVA issues an RFP for renewable energy

- TVA has issued a request for proposals to buy up to 2,000 megawatts of renewable energy capacity—a level equivalent to that produced by two nuclear reactors—by 2011. The utility wants to purchase up to 1,000 megawatts of renewable energy for

delivery by June 1, 2009; 1,500 megawatts by June 1, 2010; and 2,000 megawatts by June 1, 2011. The agency is targeting individual companies capable of producing at least 1 megawatt of renewable clean energy, which are willing to sign a power supply contract from 1 to 20 years. TVA spokesman John Moulton said, “We know that there are producers, individuals or entities, out there that would be able to respond. We just want to put this request out and find out what kind of market there is.” (*Associated Press*, 12/03/08)

TVA expects to make modest rate reductions in 2009

- Kimberly Scheibe Greene, TVA’s chief financial officer, said, “We expect there will be slight rate decreases in January, February and March. Given what I know today, I’m hopeful rates will continue to moderate somewhat.” (*Bristol Herald Courier*, Earl Neikirk, 11/26/08)

As rates skyrocket, TVA execs “live high on the hog”

- At a time when the utility is charging record prices for electricity, a dozen of TVA’s top executives and board members are paid more than \$11 million a year during FY2007. According to the utility’s compensation disclosures, TVA’s top 11 executives and two former executives [who left during FY2007] received about \$11 million in salaries, incentives and deferred compensation and the nine member, part-time board was paid an aggregate \$371,800. Over the past five years, the rate charged for electricity by the agency has increased 30%, driven largely by escalating costs for energy production. [In January, the utility plans to implement a 4% reduction in its energy surcharge to reflect recent declines in energy costs.]
- Recently, the TVA board of directors approved a \$200,000 annual raise for its CEO Tom Kilgore, which has drawn some criticism. “Just because someone else is making a ridiculous or unjustified salary does not mean that a public service agency like TVA should follow suit,” wrote Representative John Duncan (R-TN) in a letter to board chairman Bill Sansom. “TVA does not need to pay excessive salaries or bonuses to attract well-qualified people to fill its top-level positions.”
- David Williams, vice president of policy for Citizens Against Government Waste, said, “We see this disconnect with corporate executives or quasi-governmental executives—that they are clueless to see what is happening in the real world. Everyone else is tightening their belts. There is this great divide that taxpayers have with their government and elected officials. We’re also now seeing the same divide between people and the executives of these large companies.” (*Bristol Herald Courier*, David McGee, 12/07/08)

TVA year-end bonuses will be 30% lower than the \$48.9 million awarded in 2007

- With TVA's costs higher and power plant output lower than what was budgeted, TVA's year-end bonuses will be "about 30 percent less than last year," according to the utility's president, Tom Kilgore. On average, a TVA employee's bonus will fall from the \$3,915 received in 2007 to below \$3,000 per worker under the utility's fiscal 2008 incentive plan. "We missed one of our main goals [for power plant performance] and that will reduce what we pay," said Kilgore. "Our plants are performing pretty well, but they are old. We're in a process of refurbishing many of our plants to get back to top quartile performance [among comparable U.S. utilities]."
- During the first eight weeks of the FY2009, TVA electricity sales, adjusted for the weather, are down 4% because of the economic slowdown, said Kilgore. If the decline continues, TVA will have to trim at least \$170 million from its current budget to meet the utility's operating goals. "As the slower economy reduces our revenues, we must offset that loss by proportionately reducing our internal expenses, primarily our non-fuel operating and maintenance costs and any capital expenditures that can be postponed," said Kilgore. (*Chattanooga Times Free Press*, Dave Flessner, 12/15/08)

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