

The ***GSE*** REPORT TM

Special Supplement

Fannie Mae and Freddie Mac: Lords of the Manor

September 2001

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Ask the public, “Do you support the use of lavish federal subsidies that sprinkle trivial benefits on just about everyone but provide extraordinary, concentrated benefits to wealthy investors who are canny enough to direct much of the flow into their own pockets, along with those who work for them?” The answer would be a resounding “No.” The public would argue that such a program flunks three separate common sense tests, and each test failure individually makes it fatally flawed:

First, federal aid should go just to those who deserve help and when it makes a difference in their lives.

Second, the Congress should efficiently control the cost to the taxpayers.

Third, investors and employees should not become wealthy just for carrying out Congress’ instructions.

Such a triply flawed arrangement exists now. It’s the indiscriminate disbursement of \$11 billion in federal subsidies to the shareholder owned corporations known as Fannie Mae and Freddie Mac. First, the portion of the \$11 billion that actually reaches the public helps the millionaire homeowner more than the middle class homeowner – although neither gets much help. Second, Congress doesn’t control the size of the subsidy, the companies do. Third, Wall Street investors and top executives are the Powerball winners in this subsidy lottery.

As bad as this state of affairs is, it may get worse. There is growing speculation that GSE shareholders and employees will get another pay raise by channeling additional subsidies exclusively to the wealthiest among us. The proposal is to relax loan size standards so that those who want to take out \$400,000+ -- approximately the top 6 percent of all earners -- will get federal help to do so! It’s unlikely such a flawed idea would withstand full public scrutiny, but it could slip into a large “Continuing Resolution” during a House-Senate Conference this fall while few in Congress notice and even fewer can block it. We hope our readers will do what they can to stop it if this threat to common sense surfaces.

Here are the facts about subsidies already going to Fannie Mae and Freddie Mac, the two largest government-sponsored enterprises (GSEs), before relaxed standards help out those with \$130,000+ incomes:

- **Federal subsidies to Fannie Mae and Freddie Mac are growing by the billions;**
- **Investors are pocketing almost \$4 billion of Fannie/Freddie federal subsidies every year;**
- **Low-income borrowers are seeing only pennies of savings from these subsidies; and**
- **Senior executives at both companies are cashing in with eye-popping compensation packages.**

Who's Pushing This Idea

The Congressional Budget Office (CBO) estimates that the portion of the \$11 billion subsidy passed onto homeowners gives them a savings of just under 25 basis points, or one-quarter of one percent, on the mortgage interest rate they pay.¹ For most of the country, the conforming loan limit is \$275,000. In the areas of the U.S. where the GSE conforming loan limit is \$412,500 – Hawaii, Alaska, Guam, and the Virgin Islands – the one-quarter of one-percent subsidy is available to families who earn three to four times the national median income to buy homes costing half a million dollars and more. They need an annual income of at least \$130,000 just to qualify for the top conforming mortgage, and they often earn much more.

The GSEs, along with the Realtors, want wealthy homeowners in states like California, New York, and Connecticut to get a 25 basis point interest rate break by adding these states and others to the list of areas that qualify for the higher \$412,500 conforming loan limit. A representative of the California Association of Realtors believes that the higher loan limit would extend the GSE subsidy to 85,500 California families whose loans are now too large to qualify.² Even in the most expensive areas, the \$412,500 limit exceeds the middle of the market – by almost double:

¹ The Congressional Budget Office (CBO), "Interest Rate Differentials Between Jumbo and Conforming Mortgages, 1995-2000," pg. 19

² *Wall Street Journal*, "Hawaii Mortgage Discounts Draw Envy as States Lobby for Similar Loan Terms," June 11, 2001.

Average Loan Amounts in High-Cost U.S. Residential Markets

State	Metropolitan Statistical Area	Median Loan Amount – 1999	Median Loan Adjusted for 2000 Appreciation	Adjusted Median, % of Loan Limit
California	San Francisco	\$279,000	\$372,186	90.2%
California	San Jose	\$240,000	\$267,384	64.8%
Connecticut	Stamford-Norwalk	\$240,000	\$271,896	65.9%
California	Santa Cruz – Watsonville	\$213,000	\$237,303	57.5%
California	Orange County	\$184,000	\$208,306	50.5%
California	Oakland	\$183,000	\$244,122	59.2%
Hawaii	Honolulu	\$179,000	\$194,197	47.1%
California	Ventura	\$174,000	\$197,120	47.8%
New York	New York	\$174,000	\$197,120	47.8%
California	Salinas	\$173,000	\$192,739	46.7%

Source: 1999 HMDA data collected and analyzed by SMR Research Corporation 2000 regional appreciation estimated derived from National Association of Realtors data

Watch What They Do, Not What They Say

In 1996, Congress learned that two corporate giants, Fannie Mae and Freddie Mac, were receiving \$6 billion in annual subsidies as GSEs. Almost \$2 billion of these subsidies were flowing to private investors who owned the companies’ stocks, making these two stocks among the very best performers on Wall Street.³ Three months ago, the CBO reported to Congress that, in just five short years, the subsidy to Fannie Mae and Freddie Mac has jumped to \$11 billion, with \$3.9 billion, or 37 percent, being directed to private shareholders.⁴ According to the companies’ 2000 annual reports, there were approximately 28,400 shareholders of record at the end of the year. On average, these shareholders received a \$137,000 subsidy – an amount close to the median value of a home sold in the U.S.⁵ **Federal subsidies are giving GSE shareholders the equivalent of a free home every year, while the average mortgage borrower receives less than a \$1 a day.**

With total assets of \$675 billion, Fannie Mae is the third largest financial institution in the U.S. The *Wall Street Journal* described Fannie Mae succinctly in a July 5 article: “While the company, using the slogan ‘our business is the American Dream,’ often talks like Habitat for Humanity, it is a shareholder-owned corporation whose highly profitable operations more closely resemble a Citigroup or a J.P. Morgan Chase.” Freddie Mac is the fifth largest financial firm, having \$459 billion in total assets.

³ CBO, “Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac,” (May 1996)

⁴ CBO, “Federal Subsidies and the Housing GSEs,” (May 2001)

⁵ The National Association of Realtors reported that the median value of a home sold in the U.S. at the middle of 2000 was \$138,000 (NAR website, August 19, 2001)

Who Really Benefits Most from Fannie Mae and Freddie Mac Subsidies?

Stakeholder	Average Annual Benefit	Average Daily Benefit
GSE Senior Executive	\$10,199,662	\$27,944.28
GSE Shareholder	\$137,000	\$394.52
GSE Employee	\$123,000	\$336.99
Median Mortgage Borrower	\$268	\$0.73
Very Low Income Family*	\$150	\$0.41

* 50% of Median Household Income (or \$20,200)

The average GSE Senior Executive earns more *in a day* than the Very Low Income Family receives in a year – and the Executive receives 68,000 times the benefit from federal government support!

Aggressive growth and generous subsidies are the fuel that drove Fannie Mae and Freddie Mac to record profitability during the last decade. The \$3.9 billion of federal subsidies the Congressional Budget Office says the shareholders and executives pocketed in 2000 accounted for more than half of their earnings! As the Gershwin song goes, “Nice work if you can get it.”

Fannie Mae and Freddie Mac Financial Statistics, 1990-2000 (\$ Millions)

	Fannie Mae				Freddie Mac			
	Earnings	Assets	Debt	Equity	Earnings	Assets	Debt	Equity
2000	4,448	675,072	642,682	20,838	2,546	459,297	426,899	14,837
1999	3,912	575,167	547,619	17,629	2,223	386,684	360,711	11,525
1998	3,418	485,014	460,291	15,453	1,700	321,421	287,396	10,835
1997	3,056	391,673	369,774	13,793	1,395	194,597	172,842	7,521
1996	2,725	351,041	331,270	12,773	1,243	173,866	156,981	6,731
1995	2,144	316,550	299,174	10,959	1,091	137,181	119,961	5,863
1994	2,132	272,508	257,230	9,541	983	106,199	93,279	5,162
1993	1,873	216,979	201,112	8,052	786	83,880	49,993	4,437
1992	1,623	180,978	166,300	6,774	622	59,502	29,631	3,570
1991	1,363	147,072	133,937	5,547	555	46,880	30,262	2,566
1990	1,173	133,113	123,403	3,941	414	40,579	30,941	2,136
% Growth 1990-2000	279.2%	407.1%	420.8%	428.7%	515.2%	1031.9%	1279.7%	594.6%

Source: Office of Federal Housing Enterprise Oversight (OFHEO), 2001 Annual Report

GSE executives reward their peers. The *Washington Post* lists five Fannie Mae executives and three Freddie Mac executives among the Top 100 in the Washington, D.C. metropolitan area for 2000 total compensation, including salary, bonus, and stock options:

Compensation for Top Executives at Fannie Mae and Freddie Mac in 2000

Company	Position	Salary and Bonus	Total Compensation
Fannie Mae	Chairman and CEO	\$3,472,875	\$16,168,297
Fannie Mae	Vice Chair	\$1,484,779	\$8,329,424
Fannie Mae	Vice Chairman/COO	\$1,272,193	\$7,751,571
Fannie Mae	EVP & CFO	\$979,965	\$6,609,576
Fannie Mae	EVP/Housing & Community Development	\$979,965	\$4,056,084
Freddie Mac	SVP/Funding & Investments	\$816,083	\$20,031,715
Freddie Mac	Chairman/CEO	\$2,726,667	\$12,453,132
Freddie Mac	Vice Chairman/President	\$806,667	\$6,197,499
TOTAL			\$81,597,298

Source: *Washington Post*, July 19, 2001

Subsidies fund generous salary packages for 7,650 people working for these two GSEs. The average Fannie Mae employee earned \$123,000 in 2000⁶, a salary slightly lower than that earned by a Member of Congress; Freddie Mac employees are likely to receive equivalent compensation.

Low Income Families Do Not Get Special Treatment from the GSEs

While the government-subsidized shareholders reap billions in benefits, minority borrowers see less than their fair share. It's commonly believed that Fannie Mae and Freddie Mac divert some of their subsidy into affordable housing programs to benefit low-income families, but CBO did not document any such subsidy in its recent analysis. In fact, Dr. Richard Carnell, a senior Treasury official in the Clinton Administration, does not believe that the two GSEs engage in any affordable housing lending that does not meet their ambitious profit goals.⁷

⁶ Annual employee compensation can be found in Fannie Mae's 2000 Annual Report (p. 24). Information posted on Fannie Mae's website indicates that Fannie Mae employs 4,150 people (August 19, 2001)

⁷ In his testimony presented to the House Financial Services Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises, July 11, 2011, Dr. Carnell included the following comment: "Fannie and Freddie have provided no detailed disclosure of the profitability of their affordable housing programs. When the Treasury asked them for such information in 1996 for use in a congressionally mandated study, Fannie and Freddie responded very differently. Freddie replied that it 'purchases most single-family and multifamily mortgages in support of affordable housing goals through its standard

Low and moderate-income families get very little:

- In 1999, the GSEs bought 31 percent of the dollar volume of conventional conforming mortgage loan made to African-Americans and 39 percent of those made to Hispanics, while purchasing 47 percent of the mortgage made to whites.
- Homebuyers earning less than \$40,000 receive 5 percent of the subsidy.
- Hispanics make up 13 percent of the population, but only 4 percent of the subsidy goes to them.
- Neighborhoods having more than 75 percent minority resident receive 2 percent of the subsidy, while neighborhoods having less than 10 percent minority residents receive about 40 percent of the subsidy, or twenty times as much.⁸

Low and moderate-income families could make good use of the subsidy being passed out to GSE executives and shareholders. Let's use the 369,000 families who earn less than \$25,000/year, living in Memphis, Tennessee, as an example.⁹ The \$82 million compensation earned by eight top GSE executives in 2000 is enough money to send each of these families a check for \$221. The \$3.9 billion of annual subsidies handed to GSE shareholders is worth another \$10,600 each – putting those families well on their way to making a down payment on their own American Dream.

For Luckier Homeowners, the GSE Subsidy Pays for Their Morning Cup of Coffee

The subsidies enjoyed by Fannie Mae and Freddie Mac were granted decades ago as part of their special GSE charters, along with a mission to assure the availability of mortgage loans to homeowners in all parts of the country. They have accomplished this mission, and passed on a small interest savings in the process.

mortgage purchase programs and under the same credit standards as its other mortgage purchases.’ One can reasonably infer that affordable housing goals did not impose significant costs on Freddie’s shareholders if ‘most affordable housing loans’ meet Freddie’s usual credit standards, then they presumably also provided something approximating a normal return. Fannie called the information proprietary and refused to provide it unless the Treasury signed a written agreement constraining the Treasury from making public use of the information, which would have defeated the purpose of obtaining the information. One can reasonably infer that Fannie withheld the information because it indicated that Fannie’s affordable housing programs were quite profitable.” (Reforming the Regulation of Fannie Mae and Freddie Mac, p. 13)

⁸ The data was compiled by SMR Research Corporation, Hackettstown, New Jersey, and is based on analysis of 1999 HMDA data provided to federal regulators.

⁹ Population income statistics provided by the 2000 Census data

All homeowners who close a GSE conforming loan, regardless of income, save about one-quarter of one percent on the interest rate they pay for their mortgage.

Therefore, a family with a \$47,000 annual income that qualifies for a \$150,000 mortgage receives a \$375 annual benefit. The often-derided Bush \$600 tax rebate is larger! Only families at 200% of the national median income, who can qualify for the largest loans at or near the national conforming loan limit, can look forward to an interest rate break from the GSEs that is greater than this year's tax rebate:

Estimated Income Qualifications for Conforming Mortgages

Mortgage Amount	Annual Subsidy	Daily Subsidy	Income Needed to Qualify for a Mortgage	Qualifying Income, as a % of National Median Income
\$50,000	\$125	\$0.34	\$15,769	39%
\$100,000	\$250	\$0.68	\$31,538	78%
\$150,000	\$375	\$1.03	\$47,307	117%
\$200,000	\$500	\$1.37	\$63,077	156%
\$250,000	\$625	\$1.71	\$78,846	195%
\$300,000	\$750	\$2.05	\$94,615	234%
\$350,000	\$875	\$2.40	\$110,384	273%
\$400,000	\$1,000	\$2.74	\$126,153	312%

Assumes a 7.25% interest rate, 30-year amortization; principal + interest does not exceed 25% of income. National median income in 2000 was \$40,000 (Census Bureau statistics).

As the table show, the daily subsidy increases with income. However, even the intended beneficiaries of a further program expansion, to cover \$400,000+ mortgages, would only save the cost of a cup of coffee or two a day. The median size of a single-family mortgage purchased by Freddie Mac in 2000 was \$107,250¹⁰, so this average borrower will have to settle for a small regular cup of java from their local carryout.

In 1999, the “average” family borrowing \$412,500 to buy a home had an income of \$169,261.¹¹ That level of income puts this borrower in the top 5 percent of U.S. household income.¹² This borrower’s monthly principal and interest payment of \$2,8143.97 represents 20 percent of his or her \$14,000 monthly income. The \$86 he or she saves in interest payments on his or her conforming mortgage represents about ½ of 1-percent of his or her monthly income.¹³

¹⁰ Freddie Mac website, “Key Corporate Statistics” (August 19, 2001)

¹¹ Calculations by SMR Research Corporation, Hackettstown, New Jersey, (average income for \$412,000 borrower)

¹² According to the U.S. Census Bureau, the lower limit of the 95th percentile household income in 1999 was \$142,021

¹³ Calculations by SMR Research Corporation, Hackettstown, New Jersey, (weekly income as a percentage of interest savings)

The Getting and Giving of Subsidy

While mortgage borrowers may save one or two dollars a day, investors have become rich. Shareholders and senior executives with stock options are the real winners when the GSEs grow and expand the use of their special benefits. Subsidy-infused profitability has made Fannie Mae and Freddie Mac into Wall Street superstars. Over the past ten years, Fannie Mae and Freddie Mac's stock provided an average annual return of 28.3 percent and 34.8 percent, respectively, compared to 17.5 percent for the S&P 500.¹⁴ Last year, when the S&P 500 posted a negative 10 percent return, Fannie Mae stock yielded nearly 39 percent.¹⁵ Noted consumer advocate, Ralph Nader, explains how the subsidy has been diverted from the GSE mission: "A lot of Fannie and Freddie's profits come from their links with the federal government which they retained after become a 'private' shareholder corporation. These ties to the government have given the GSEs great benefits in the marketplace.... The GSEs defend this largesse with the claim that the subsidy is passed on to homebuyers. CBO's studies debunk that claim. CBO says at least a third of the subsidy is pocketed by private shareholders, the corporations' executives and lobbyists."¹⁶

The government gave subsidies to Fannie Mae and Freddie Mac without any requirements that they develop any special programs for low- to moderate-income individuals. Affordable housing requirements were added in 1992, but meeting these goals does not mean that the GSEs have made low- to moderate-income families a focus of their business. A long list of government studies published in recent years all indicate otherwise (see attached appendix). These studies have shown time and again that Fannie Mae and Freddie Mac are doing less to reach out to underserved low- to moderate-income markets than banks and thrifts do.

Subsidy-backed GSE growth into new, expensive markets catering to high income buyers is a clear winner families in the top 5 percent income bracket and a bonanza for shareholders and GSE executives who pocket 37 percent of the profitability generated by such government-sponsored GSE expansions. Why should the federal government allow its resources to be used to help minimally those who can help themselves?

No Subsidy is Free to Everybody

In a letter to Congressman Richard Baker (R-LA) dated May 19, 2000, Federal Reserve Chairman Alan Greenspan declared that the GSEs derive powerful economic benefits from government support: "They clearly benefit from government sponsorship – particularly from their ability to borrow funds at a lower cost than comparably situated private sector borrowers. This benefit has been studied by many, including the

¹⁴ Data provided by L.E.K. Associates, published in the *Wall Street Journal*, February 26, 2001

¹⁵ Fannie Mae 2000 Annual Report, p. 7

¹⁶ Testimony given by Ralph Nader before the House Banking Subcommittee on Capital Markets, Securities, and Government Sponsored Enterprises, June 15, 2000.

Congressional Budget Office, the General Accounting Office, and the Department of the Treasury, and all have concluded that the benefits of GSE status are substantial.”

The GSEs have argued that these privileges do not cost the taxpayer anything. Dan Crippen, Director of the CBO, has found otherwise, observing: “[GSE] subsidies exist in the form of tax and regulatory advantages as well as lower borrowing rates and higher guarantee fees resulting from the perceived government guarantee and other legal preferences. Those subsidies represent costs to the economy and the public, and they are highly valued by their recipients.”¹⁷

It’s not often that Alan Greenspan, the *Wall Street Journal*, the Congressional Budget Office, a Treasury Department official from the Clinton Administration, and Ralph Nader agree. Apparently, lopsided subsidies to financial behemoths can bring them together.

Attempts to expand the conforming loan limit will only make the rich richer.

¹⁷ Letter from Dr. Crippen to Franklin Raines, Chairman and CEO, Fannie Mae, June 21, 2001

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Appendix

A Selection of Government Studies Analyzing the GSEs' Lackluster Affordable Housing Record

1. ***HUD's Housing Finance Working Paper Series on GSEs:***

Full Link: <http://www.huduser.org/publications/hsgfin/workpaper.html>

Table of Contents:

HF-001, The GSEs' Funding of Affordable Loans, by *Harold L. Bunce and Randall M. Scheessele*, December 1996.

<http://www.huduser.org/publications/pdf/gsewp.pdf>

HF-002, The Multifamily Secondary Mortgage Market: The Role of Government-Sponsored Enterprises, by *William Segal and Edward J. Szymanoski*, March 1997.

http://www.huduser.org/publications/pdf/mf_002wp.pdf

HF-003, Characteristics of Mortgages Purchased by Fannie Mae and Freddie Mac 1993-95, by *Paul B. Manchester, Sue George Neal, and Harold L. Bunce*, February 1998.

http://www.huduser.org/publications/pdf/wkgpapr_3.pdf

HF-004, The GSEs' Purchases of Single-Family Rental Property Mortgages, by *Theresa R. DiVenti*, March 1998.

http://www.huduser.org/publications/pdf/wp_004.pdf

HF-005, The GSEs' Funding of Affordable Loans: 1996 Update, by *Harold L. Bunce and Randall M. Scheessele*, July 1998.

<http://www.huduser.org/publications/pdf/gsewp96.pdf>

HF-006, Characteristics of Mortgages Purchased by Fannie Mae and Freddie Mac, 1996-97 Update, by *Paul B. Manchester*, August 1998.

http://www.huduser.org/publications/pdf/wkp_006.pdf

HF-007, HMDA Coverage of the Mortgage Market, by *Randall M. Scheessele*, July 1998.

http://www.huduser.org/publications/pdf/wkgpapr_7.pdf

HF-008, Do FHA Multifamily Mortgage Insurance Programs Provide Affordable Housing and Serve Underserved Areas? An Analysis of FHA's Fiscal Year 1997 Book of Business and Comparison with the GSEs, by *Edward J. Szymanoski and Susan J. Donahue*, October 1999.

http://www.huduser.org/publications/pdf/wp_008.pdf

HF-011, An Analysis of GSE Purchasing of Mortgages for African-American Borrowers and their Neighborhoods, by *Harold Bunce* December 2000.

<http://www.huduser.org/publications/pdf/workpapr11.pdf>

HF-012 The GSEs' Funding of Affordable Loans: A 1999 Update, by *Harold Bunce*, December 2000.

<http://www.huduser.org/publications/pdf/workpapr12.pdf>

2. *Cityscape: A Journal of Policy and Development*

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Full Link: <http://www.huduser.org/periodicals/cityscpe/vol5num3/current.html>

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The Effects of the GSEs, CRA, and Institutional Characteristics o Home Mortgage Lending to Underserved Markets:

by *Richard A. Williams, Eileen McConnell, and Reynold Nesiba*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch1.html>

The Twin Mandates Given to the GSEs: Which Works Best, Helping Low-Income Homebuyers or Helping Underserved Areas?

by *Kirk McClure*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch2.html>

Performance of the GSEs at the Metropolitan Level:

by *Patrick Boxall and Joshua B. Silver*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch3.html>

Fannie Mae and Freddie Mac in Nonmetropolitan Housing Markets: Does Space Matter?

by *Heather I. MacDonald*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch4.html>

Fannie Mae and Freddie Mac Mortgage Purchases in Low-Income and High-Income Minority Neighborhoods: 1994-96

by *James E. Pearce*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch5.html>

Mortgage Lending on the Pine Ridge Indian Reservation

by *Paul B. Manchester*

<http://www.huduser.org/periodicals/cityscpe/vol5num3/ch6.html>

3. ***Issue Brief: HUD's Affordable Housing Goals for Fannie and Freddie:***¹⁸
<http://www.huduser.org/publications/pdf/gse.pdf>
4. ***"Federal Housing Enterprises: HUD's Mission Oversight Needs to Be Strengthened,"*** U.S. General Accounting Office, GAO/GGD-98-173, Washington, D.C. July, 1998
<http://www.gao.gov/archive/1998/gg98173.pdf>

¹⁸ For a detailed analysis of HUD's final Affordable Housing regulation, see *The GSE Report Special Supplement: "Fannie Mae's and Freddie Mac's UnAffordable Housing Goals,"* June 2001. This study also compares the GSEs' affordable housing requirements to the requirements imposed on depository institutions under CRA, and makes recommendations to strengthen the rules governing Fannie Mae and Freddie Mac's affordable housing requirements.